TC02538

Appeal number: TC/2012/05356

INCOME TAX – Penalty – Inaccuracy in tax return leading to understatement of tax (FA 2007 Sch 24) – Whether inaccuracy was "careless" –Whether penalty should be suspended – Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

JULIE ASHTON **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE CHRISTOPHER STAKER
RICHARD THOMAS

Sitting in public in London on 10 December 2012

Ms J Patwari and Mr R Leach for the Appellant

Mr D Lewis for the Respondents

DECISION

Introduction

1. This is an appeal against a civil penalty of £1,712.25 imposed under paragraph 1 of Schedule 24 to the Finance Act 2007 ("Schedule 24") in respect of an understatement of liability to income tax in the Appellant's self-assessment tax return for the year ended 5 April 2010 in the amount of £11,415.06.

The relevant legislation

2. Paragraph 1 of Schedule 24 states in relevant part as follows:

> (1) A penalty is payable by a person (P) where–
>
> (a) P gives HMRC a document of a kind listed in the Table below, and
>
> (b) Conditions 1 and 2 are satisfied.
>
> (2) Condition 1 is that the document contains an inaccuracy which amounts to, or leads to–
>
> (a) an understatement of a liability to tax,
>
> (b) a false or inflated statement of a loss, or
>
> (c) a false or inflated claim to repayment of tax.
>
> (3) Condition 2 is that the inaccuracy was careless (within the meaning of paragraph 3) or deliberate on P's part.
>
> (4) Where a document contains more than one inaccuracy, a penalty is payable for each inaccuracy.

Tax	***Document***
Income tax or capital gains tax	Return under section 8 of TMA 1970 (personal return).
...	

3. Paragraph 3 of Schedule 24 provides for degrees of culpability as follows:

> (1) For the purposes of a penalty under paragraph 1, inaccuracy in a document given by P to HMRC is—
>
> (a) "careless" if the inaccuracy is due to failure by P to take reasonable care,
>
> (b) "deliberate but not concealed" if the inaccuracy is deliberate on P's part but P does not make arrangements to conceal it, and
>
> (c) "deliberate and concealed" if the inaccuracy is deliberate on P's part and P makes arrangements to conceal it (for example, by submitting false evidence in support of an inaccurate figure).

(2) An inaccuracy in a document given by P to HMRC, which was neither careless nor deliberate on P's part when the document was given, is to be treated as careless if P—

(a) discovered the inaccuracy at some later time, and

(b) did not take reasonable steps to inform HMRC.

4. Paragraph 4 sets out the penalty payable under paragraph 1. Paragraph 4(1)(a) provided at the material time that the penalty payable is, for careless action, 30% of the potential lost revenue. For deliberate but not concealed action, the penalty is 70% of the potential lost revenue, and for deliberate and concealed action, the penalty is 100% of the potential lost revenue.

5. Paragraph 5 defines "potential lost revenue" to mean "the additional amount due or payable in respect of tax as a result of correcting the inaccuracy or assessment".

6. Paragraph 10(1) provided at the material time that "Where a person who would otherwise be liable to a 30% penalty has made an unprompted disclosure, HMRC shall reduce the 30% penalty to a percentage (which may be 0%) which reflects the quality of the disclosure". Paragraph 10(2) provided that "Where a person who would otherwise be liable to a 30% penalty has made a prompted disclosure, HMRC shall reduce the 30% penalty to a percentage, not below 15%, which reflects the quality of the disclosure".

7. Paragraph 11 further provides that HMRC may reduce the penalty under paragraph 1 "If they think it right because of special circumstances". However, paragraph 11(2) provides that special circumstances do not include ability to pay.

8. Paragraph 14 also enables HMRC to suspend all or part of a penalty for a careless inaccuracy under paragraph 1, but "only if compliance with a condition of suspension would help P to avoid becoming liable to further penalties under paragraph 1 for careless inaccuracy".

9. Under paragraph 15, a person may appeal against a decision of HMRC that a penalty is payable, or as to the amount of a penalty payable, or a decision not to suspend a penalty payable, or a decision as to the conditions of suspension.

10. Paragraph 17 deals with the powers of the Tribunal in any such appeal.

The facts

11. Some time in January or February 2010, the Appellant ceased her previous employment with BP. On 31 January 2010, the Appellant's former employer issued a P45 showing pay of £79,378.92 and tax deductions of £23,368.26.

12. The Appellant states, and HMRC have not disputed, as follows. She now lives in Hong Kong. While employed with BP she was paid a salary, and was also a member of four share schemes, respectively called ShareMatch UK, Performance Share Plan, ShareSave UK, and Executive Share Option Scheme. Since she left BP, she has not

been part of any UK share schemes. She is not a tax adviser and has no particular knowledge of tax beyond what may be regarded as general knowledge.

13. After the P45 was issued, but still within the 2009-10 tax year, she received three further payments from BP (some of which were in shares rather than cash) totalling £57,591.43, from which her employer deducted 20% tax (£11,518.28) and National Insurance of £720.33.

14. A letter sent to the Appellant from her former employer dated 15 March 2010, relating to one of these additional payments, stated: *"In accordance with Inland Revenue guidelines additional payments have been taxed at Basic Rate (20%). In this case an amended P45 is not issued, but for your reference please keep this letter safe in case you should need this additional information to any tax returns for the year ending 5th April 2010."*

15. Another letter sent to the Appellant from her former employer dated 15 March 2010, relating another of these additional payments, stated: *"In accordance with Inland Revenue guidelines additional payments have been taxed at 20%. Any additional tax will be your responsibility. Please retain this letter, as the details may be required when completing your Year End Tax Return.*"

16. The Appellant's 2009-10 tax return declared the income contained in her P45, but omitted the three further payments after her P45 was issued. The omitted income, and the consequent understatement of tax, was discovered by HMRC after it opened an enquiry into her 2009-10 tax return. HMRC imposed a penalty of 15% for carelessness, which was the maximum reduction possible for a prompted disclosure.

The submissions of the parties

17. The submissions of the Appellant as stated in her grounds of appeal are as follows.

18. The Appellant accepts that this is the maximum mitigation possible, and that this is not a situation where suspension of the penalty is appropriate.

19. The burden is on HMRC to establish that the Appellant was careless, and not on the Appellant to establish that she was not careless (relying on *Jussila v. Finland* [GC], no. 73053/01, ECHR 2006 XIII). HMRC have not met this burden, and have misdirected themselves in law. There is no duty on a taxpayer to audit an employer's payslip or to engage an accountant to check whether the employer has made a mistake in the payslip. The PAYE system is designed to collect the correct amount of tax with no need for disclosure from the employee, and the employee is entitled to assume that this has occurred. There is no obligation on the employee to understand detailed tax provisions, and the Appellant was never put on notice that she should seek professional help. A taxpayer has not been careless merely because she has made a mistake. A return is not signed as being completely correct and free of error, but as being to the best of the taxpayer's knowledge and belief. The Tribunal is not bound by previous decisions of the First-tier Tribunal. The HMRC manual has no statutory

authority. Carelessness is not the same as negligence, but the Appellant has not been negligent in any event. "Reasonable excuse" means what it says, and HMRC has erroneously taken the view that it is confined to something unexpected or out of the ordinary (relying on *Budiadi v Revenue & Customs* [2011] UKFTT 233 (TC) at [6]; *Hicharms (UK) Ltd v Revenue & Customs* [2011] UKFTT 432 (TC); *B & J Shopfitting Services v Revenue & Customs* [2010] UKFTT 78 (TC)).

20. The Appellant has acted in the same way as someone who seriously intends to honour their tax liabilities and obligations. Neither the P60 nor tax return form draws the taxpayer's attention to the fact that a post-termination payment from an employer may not have had sufficient tax deducted. The law has been changed to deal with this very issue. HMRC accepts that the Appellant has been honest and cooperative. A simple mistake does not necessarily mean that there has been carelessness, and HMRC have not established that the Appellant has failed in her duty of care. A non-specialist taxpayer cannot be expected to know more than that income tax is payable on income and that income tax from source is collected under the PAYE scheme. The Appellant's tax liabilities had previously been fully collected under the PAYE scheme, and she was entitled to assume that this had occurred in this year also (reference was made to *Brady v Revenue & Customs* [2011] UKFTT 415 (TC) at [58]-[59]).

21. As to the first of the employers' letters dated 15 March 2010 (referred to in paragraph 14 above), the expression "BR Month 1" used in this letter would have no meaning to someone unfamiliar with tax. The letter makes no reference to the fact that 20% is not the correct amount of tax. The word "should" as used in this letter connotes that the employee may not need this information, and nowhere is it stated that the employee does need it. The letter did not make clear that it was in addition to the existing P45. It lacks credibility to suggest that an employee would understand from this letter that additional tax needed to be disclosed. The Appellant was not put on notice of her duty to disclose this additional payment, and therefore had no duty of care to do so. She had no need to enquire where the additional payment came from, as she knew this. What she could not be expected to know was that she was required to know that additional tax was required to be paid on these amounts, given that a PAYE system existed to collect the correct amounts of tax.

22. Even if the Appellant had checked the PAYE calculation, she would be entitled to assume that 20% was the correct amount of tax for this particular type of payment. There is no statutory authority for HMRC's proposition that a higher degree of care can be expected for large or complex matters. In any event, the matter was not particularly complex. There is no obligation on the Appellant to engage the services of an accountant, especially when she considered that the PAYE scheme had collected the correct amount of tax. It is entirely reasonable for a taxpayer to complete a tax return in the same way as on previous occasions. *Fane v Revenue & Customs* [2011] UKFTT 210 (TC) ("*Fane*") is not relevant, as the Appellant in the present case has not misread anything.

23. At the hearing, the following additional arguments were made on behalf of the Appellant.

24. The crux of the HMRC argument appears to be that the Appellant must have noticed additional payments in such a large amount being paid into her bank account. However, out of the net termination payment, only some £16,500 was paid into the Appellant's bank account, since some of the payments were in shares. If the Appellant's employment had not ceased, the shares would not have been subject to tax. The Appellant accepts that they were subject to tax, and this tax has now been paid, but the Appellant was not careless in not realising the fact at the time. HMRC are tax experts, yet they still have not grasped this fundamental point. A non-tax expert would be entitled to conclude that 20% was the correct amount of tax for the additional payments, given that some share schemes are advantaged for tax purposes.

25. Contrary to what was stated in the grounds of appeal, the Appellant now considers that this would be an appropriate case for suspension of the penalty, in view of the decision in *Boughey v Revenue & Customs* [2012] UKFTT 398 ("*Boughey*"). In that case, a penalty was suspended on the taxpayer's undertaking that his accounts would be prepared by a qualified accountant during the next two years. The Appellant proposes a similar condition in the present case. Despite living in Hong Kong, the Appellant may have to submit tax returns in the UK in the future. In fact, the Appellant's tax returns for the subsequent two years were prepared by a qualified accountant. The HMRC suggestion that a condition for suspension must be relevant to the original offence is not contained in the legislation.

26. The HMRC arguments are as follows.

27. The Appellant was careless in failing to report her income accurately on her return. "Carelessness" is a failure to take reasonable care. Reliance was placed on *Collis v Revenue & Customs* [2011] UKFTT 588 (TC) ("*Collis*") and *Blyth v The Company of Proprietors of The Birmingham Waterworks* [1856] EWHC Exch J65. The letters provided by the employer detailing the additional income should have been sufficient to alert a person taking reasonable care of the possibility that the P45 did not record all of the income together with the need to carry out some research or to seek guidance. The Appellant received payments of £136,970 from her employer yet completed a tax return showing gross payments of £79,378 from that employer. The final payslip under "totals to date" showed net payments of £97,905. No specific tax expertise was required to carry out such a basic cross-check or reconciliation exercise. A higher degree of care would be expected over large complex matters than simple straightforward ones. If the Appellant was unfamiliar with the encountered transactions, she should have taken steps to find out about the correct tax treatment, rather than simply complete her tax return in exactly the same manner as in the past. The Appellant took no steps to alert HMRC to the fact that she had received additional, unusual payments, or that the final payslip dated 22 March 2010 showed figures of gross earnings far in excess of her P45. Reliance was placed in *Cobb v Revenue & Customs* [2012] UKFTT 40 (TC) and *Verma v Revenue & Customs* [2011] UKFTT 737 (TC) ("*Verma*").

28. The HMRC review decision of 13 October 2011 concluded that suspension of the penalty would not be appropriate in this case, as the aim of the specific suspension condition is to help the person address the specific systemic failure or record keeping

weaknesses that led to the careless inaccuracy, and it was considered unlikely that there were specific conditions that could be set that would help the Appellant avoid a careless inaccuracy in the future. The review decision considered that the inaccuracy was not the result of any specific systemic failure or record keeping weakness, but simply a generic careless mistake. HMRC contend that the review decision was not flawed in this respect. Reliance was placed on *Fane*, which is inconsistent with *Boughey*. Paragraph 14 of Schedule 24 contains an element of discretion. As the penalty that relates primarily to a failure to declare share options, HMRC did not consider that it was appropriate to set specific or generic suspension conditions on something that it considers unlikely to be repeated within the 2 year suspension period. It was not a case of a system or procedural error which could be addressed by putting in place corrective measures. Reference was made to the HMRC Guidelines.

29. At the hearing, the following additional arguments were made on behalf of HMRC.

30. This was not the first time that the Appellant filled in a tax return. It may have been the first time that she received payments of this kind. Even if she was not told that she had to put these payments on her tax return, she was clearly told that she "may" have to put them on her tax return. Some of the cases relied upon by the Appellant deal with a "reasonable excuse" rather than a "careless" inaccuracy. *Boughey* was a paper case and did not deal with the issues in the same depth as *Fane*. Reliance was placed on *White v Revenue & Customs* [2012] UKFTT 364 (TC) at [49]-[50]. The power to suspend a penalty must be seen in the context of influencing future behaviour and it is not applicable as a general mitigation of penalty: *Collis* at [43].

31. On behalf of the Appellant, the following additional submissions were made in reply. The words "Please keep" in the March 2010 letters are in the same terms as a P60 sent to every employee, yet most employees do not need to file a tax return and pay the correct amount of tax through PAYE. If more than one interpretation is possible, the Appellant should be given the benefit of the more favourable interpretation. HMRC says that the Appellant should have asked if she was in any doubt at all, but she was in no doubt: she was entitled to presume that nothing had changed and that the correct amount of tax was being paid through PAYE. In previous years she had been a member of the share schemes, yet no tax liability arose in respect of these. She had completed tax returns before, but this was the first time that she received a payment of this kind.

The Tribunal's findings

32. For purposes of paragraph 1 of Schedule 24, there is no dispute that in the present case there was an inaccuracy which amounted to or led to an understatement of tax liability. What is in issue is whether that inaccuracy was "careless" within the meaning of that provision.

33. The Tribunal agrees that case law dealing with a "reasonable excuse" is of no direct relevance to the interpretation of the concept of a "careless" inaccuracy under

Schedule 24. The Tribunal also accepts that it is difficult to see the relevance of 19th century case law on the concept of "negligence".

34. Paragraph 3(1)(a) of Schedule 24 defines the concept of "careless" to mean in this context a "failure by P to take reasonable care". This definition necessarily implies that there is an obligation on taxpayers to take reasonable care. In *Collis* at [29], it was said that the "standard by which this falls to be judged is that of a prudent and reasonable taxpayer in the position of the taxpayer in question". This Tribunal agrees.

35. In the present case, it is argued that the Appellant was unaware of her obligation under tax law to return the additional payments and to pay tax on those additional payments. In effect, this is a plea of ignorance of the law. Consistently with what has been said above, the Tribunal considers that a prudent and reasonable taxpayer must at the very least be expected to take prudent and reasonable steps to ascertain what are his or her tax obligations. Only where a taxpayer has done so could it be said that the ignorance of the law is not due to a "failure to take reasonable care". The Tribunal does not accept the Appellant's argument, at paragraph 12 of her grounds of appeal, that "no other knowledge about tax is reasonably known by a non-specialist taxpayer" than that "income tax is payable on income" and that "income tax from earnings is collected at source under the PAYE scheme". Even if a taxpayer genuinely had no other knowledge than that, a prudent and reasonable taxpayer would take steps to obtain whatever other knowledge is needed in order to complete their return. Ways in which such knowledge can be obtained would include contacting an HMRC helpline. Of course, a taxpayer could also seek professional advice, if the taxpayer so chose.

36. The Tribunal would add that it seems open to argument that the standard of reasonable care assumes a taxpayer who is aware of his or her obligations under tax law. On that view, failure to comply with an obligation due to ignorance of the law could never be compatible with the duty of reasonable care. However, the Tribunal finds, for the reasons below, that it is unnecessary for purposes of the present case to determine whether or not this view is correct.

37. The Tribunal agrees with what was said in *Verma* at [13], that "An omission may be innocent, in the sense of not having been deliberate, but such an innocent omission may still be the result of a failure to take reasonable care". It is implicit in the wording of Schedule 24 that a careless inaccuracy will be innocent, since otherwise it would be characterised for purposes of paragraph 1 as a "deliberate" inaccuracy rather than a "careless" one.

38. A significant part of the Appellant's case is that she was entitled to assume that the correct amount of tax was being paid through PAYE, since the PAYE system exists for this purpose, and this had happened in previous years. The Appellant suggests that she was entitled to assume that nothing had changed from previous years. The Tribunal does not accept that argument. Quite apart from anything else, tax legislation is subject to amendment. For this reason alone, a prudent and reasonable taxpayer would not simply assume that the position in one tax year is identical to that in the previous tax year or years. If a taxpayer is not a professional tax adviser and has no more than a lay person's knowledge of tax matters, a prudent

and reasonable taxpayer would be aware of the need to make relevant enquiries, rather than to proceed on the basis of an assumption that nothing has changed.

39. However, in any event, the circumstances in the present case were not identical to those in previous years. The Appellant had ceased her employment with BP during the course of the tax year. There is no suggestion that in previous years, payments had been made to the Appellant by her employer during a tax year after a P45 had been issued (and indeed there could not be, since a P45 is only issued when an employment ceases). The Tribunal considers that the terms of the 15 March 2010 letter referred to in paragraph 14 above indicate reasonably clearly that the payments to which it relates were additional to those reflected in the P45. Furthermore, even if not all of the additional payments were in cash, the Appellant does not deny that at least some £16,500 was paid in cash. A prudent and reasonable taxpayer would have realised that the amount of cash paid to the Appellant by her employer was in excess of what was stated in the P45, and would have thereby been put on notice that some or all of the post-termination payments had not been included in the P45. Even if all of the tax liability had been met by PAYE deductions, which the Appellant says she erroneously thought to be the case, a prudent and reasonable taxpayer would have realised that it was still necessary to return all of the income in the tax return, and would have realised that the figures in the P45 were insufficient for this purpose. A prudent and reasonable taxpayer would have realised that she needed to do more than simply include in the tax return the information contained in the P45, and that it was necessary to include additional information relating to the post-termination payments. A prudent and reasonable taxpayer, realising that they had had insufficient understanding of tax law or of how and where to return these types of payment, would have sought assistance or advice.

40. The Tribunal does not have to express a conclusion on the view referred to in paragraph 36 above, since it is satisfied that on the specific facts of this particular case that the Appellant has not acted as a reasonable and prudent taxpayer, for the reasons given in paragraphs 35 and 38-39 above. On the evidence before it, the Tribunal has no hesitation in finding that the inaccuracy was careless, within the meaning of Schedule 24.

41. The Appellant has not sought to argue that in the present case there are circumstances that would justify a special reduction under paragraph 11 of Schedule 24. For completeness, the Tribunal adds that for similar reasons to those given above, it is not satisfied on the evidence before it that there are any such circumstances.

42. As to the Appellant's argument that the penalty should be suspended, it is noted at the outset that by virtue of paragraph 17(4) of Schedule 24, the Tribunal can only order HMRC to suspend the penalty if it thinks that HMRC's decision not to suspend the penalty was flawed. Paragraph 17(6) further provides that "flawed" in this context means "flawed when considered in the light of the principles applicable in proceedings for judicial review".

43. The Appellant argues that the HMRC guidance on suspension of penalties contains a requirement that is not in the legislation, and argues that the HMRC

guidance is itself not legislation. That may be true, but it is not to the point. Paragraph 11 of Schedule 24 makes it clear that the decision whether or not to suspend a penalty is a power that HMRC may choose to exercise or not in its discretion. It states that HMRC "may" exercise that power "if they think it right". It is consistent with "the principles applicable in proceedings for judicial review" for a public body to adopt guidance on how a discretion such as this is to be exercised. Such guidance does not purport to be legislation. Rather, it is intended to promote consistency in the way that the discretion is exercised, by different officials in different cases. The guidance in this particular case, to which the Tribunal has been referred, states expressly that "You must consider each case on its own facts and look at what weaknesses caused the inaccuracy to occur". The Tribunal is not satisfied that the Appellant has identified anything in the guidance that is flawed under "the principles applicable in proceedings for judicial review". The Tribunal is also not satisfied that the Appellant has established that there was in this case a decision under paragraph 11 that was inconsistent with the guidance, or which was otherwise flawed under "the principles applicable in proceedings for judicial review". In the absence of any identifiable flaw in an HMRC decision, the Tribunal cannot order HMRC to suspend the penalty.

44. The Tribunal therefore does not consider the issue of suspension further, and need not resolve what the parties appear to consider is an inconsistency in the cases of *Fane* and *Boughey*.

45. It follows that the appeal must be dismissed.

Conclusion

46. For the reasons above, the Tribunal dismisses the appeal.

47. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

DR CHRISTOPHER STAKER
TRIBUNAL JUDGE

RELEASE DATE: 12 February 2013