[2016] UKFTT 387 (TC)

TC05141

Appeal number: TC/2015/00534

INACCURACY PENALTY – whether claim careless – yes – whether inaccuracy discovered at later time – yes – whether failed to take reasonable steps – yes – no special circumstances - penalty at 15% upheld in principle

FIRST-TIER TRIBUNAL
TAX CHAMBER

DR DAVID ATKINSON **Appellant**

- and -

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

TRIBUNAL: JUDGE Barbara Mosedale

Sitting in public at the Royal Courts of Justice, the Strand, London on 31 May 2016

The appellant in person

Mrs J Bartup, HMRC officer, for the Respondents

DECISION IN PRINCIPLE

1. The background to this appeal is set out in my summary decision dated 20 November 2015 which followed a hearing on 13 October 2015 to consider HMRC's strike out application of Dr Atkinson's appeal against a closure notice issued in respect of his 11/12 tax return. This hearing was to consider the appellant's appeal against liability to a penalty for misdeclaration of £4,052.88 in respect of entries made on his 2011-12 tax return.

2. The appellant accepted that that return contained an error in that he claimed £30,000 of deductions to which he was not entitled; in the last hearing I found, in that I struck out his appeal on this on the basis it had no reasonable prospect of success, that he had also claimed entrepreneur's relief to which he was not entitled.

3. HMRC's case is that these two misdeclarations resulted in liability to a penalty under Schedule 24 of FA 2007 on the basis of carelessness. The appellant disputed the alleged carelessness; he also said that he disputed the calculation of the penalty. In particular, he considered that his tax liability was overcalculated because it failed to take into account a claim, he said, which could have been made for taper relief.

4. My ruling following the previous hearing was that although the appellant's appeal against the closure notice was struck out in so far as it was an appeal against the rejection of his claim to entrepreneurial relief; and that the entire appeal against the closure notice would be automatically struck out unless by 31 December 2015 he made a further claim for relief.

5. He did not do so, so the appeal against the closure notice was automatically struck out on 1 January 2016. He had 28 days in which to apply for reinstatement but he did not do so. The closure notice was therefore upheld in its entirety. His only route now to challenge it would be to apply for the appeal to be reinstated. He said he wished to do this: I said he should immediately email the Tribunal office in Birmingham to that effect setting out the grounds on which he wished to challenge the closure notice and the reasons why the application was not made much earlier. It was not right to ask Mrs Bartup to express a view of the matter here and now as she had had no warning of it.

6. Both parties agreed and I determined that nevertheless today's hearing should proceed. The appeal against the penalty was a discrete matter which could be determined in principle: I might decide to allow the appeal against the penalty and even if I did not, I could determine liability to the penalty in principle even if the quantum of the penalty might later be affected if the appeal against the closure notice was re-opened.

The legislation

7. The penalty legislation is contained in Schedule 24 of Finance Act 2007. For a penalty to apply the preconditions are:

(a) The appellant submitted a tax return which contained an understatement of his liability to tax and/or a false claim to a relief and/or a false claim to a loss

(b) The inaccuracy in the return must be due to the appellant's carelessness. HMRC did not allege the error was deliberate, the penalties for which were higher.

8. The appellant did not accept that he was careless.

9. The maximum level of the penalty for careless inaccuracy was 30% (paragraph 4 of Schedule 24) of the potential lost revenue but this could be reduced where the taxpayer 'disclosed' it (paragraph 9). There were different degrees of disclosure recognised by the legislation. The maximum reduction for *prompted* disclosure (paragraph 10) was to a penalty of 15%, but for *unprompted* it could be reduced to 0%. While HMRC considered the appellant had given full disclosure, they considered the disclosure to be prompted and therefore had reduced the penalty to 15%. The appellant did not accept his disclosure was prompted.

10. HMRC did not apply a further exceptional reduction on the grounds of 'special circumstances' (paragraph 11) nor did they suspend the penalty (paragraph 14). The appellant considered that the grounds he put forward to explain how the inaccuracies occurred amounted to special circumstances; he did not suggest the penalty should be suspended.

Was making the £30,000 claim careless?

11. The appellant's explanation of the background to the £30,000 deduction was not challenged and I find as follows. He was director of a company which wanted an overdraft facility with its bank. The bank required the director to guarantee the overdraft facility, so the appellant gave the guarantee. The company subsequently went into voluntary liquidation with a £30,000 overdraft which was not repaid to the bank. The bank called on the director's guarantee in September 2008 and the appellant accepted his liability. However, he did not have the funds to meet it and agreed to pay the bank at the rate of £20 a month. By the time of submitting his 11/12 tax return he had repaid some £1,000 of the debt.

12. As recorded in my previous decision, he sold his shares in tax year 11/12 and was therefore liable to declare the gain on his 11/12 tax return. His tax return showed the £30,000 as an 'improvement expense'. HMRC's position was that he was not entitled to do this expense as it was neither an improvement expense nor actually paid and that it was careless of him to think he was entitled to treat it as such.

13. The appellant's case was that he accepted he should not have claimed this deduction but that he did not consider his mistake in doing so was careless: he considered it reasonable to take the view he could claim for it and reasonable to wait and see if HMRC challenged it.

14. The appellant was right, in my view, to accept at the hearing that he should not have claimed a deduction for the £30,000. This is because it would not qualify as acquisition cost (s 38(1)(a) of the Taxation of Chargeable Gains Act 1992 ('TCGA')), disposal costs (s 38(1)(c) TCGA) nor does it qualify as enhancement value costs (s 38(1)(b) TCGA). To be such, it must have been expenditure incurred to enhance the value of an asset plus the enhanced value must be reflected in the asset at time of sale. Neither of these conditions was met. The expenditure was incurred when the guarantee was called in: the calling in of the guarantee did not at that point increase the value of the shares in the holding company. It follows that there was no enhanced value in the shares at the time of sale. Moreover, even ignoring that point, any enhanced value must have disappeared by the time the subsidiary went into liquidation and Dr Atkinson sold his shares in the holding company. In any event, his lack of entitlement to the relief was conceded by the appellant.

The law on carelessness

15. But was it careless of Dr Atkinson to make the claim for the relief in his return? There is no statutory definition of carelessness. It is the failure to take reasonable care. It is an objective test very similar to the one for negligence.

16. In the past, the Tribunal as often cited the test for negligence in *Blyth v Birmingham Waterwords Co* (1856) where it was said:

> '"Negligence is the omission to do something which a reasonable man, guided upon those considerations which ordinarily regulate the conduct of human affairs, would do, or doing something which a prudent and reasonable man would not do. The defendants might be liable for negligence, if, unintentionally, they omitted to do that which a prudent and reasonable person would have done, or did that which a person taking reasonable care would not have done."'

Reliance on that test was criticised in this Tribunal in the case of *Verma* [2011] UKFTT 737 (TC) on the basis *Blyth* was a nineteenth century case in a very different context and on a question of negligence rather than carelessness.

17. The Tribunal in *Verma* relied on the test applied in *Collis* [2011] UKFTT 588 (TC) which was whether the taxpayer acted as a:

> 'prudent and reasonable taxpayer in the position of the taxpayer in question' would have have acted.

18. In my view, the *Collis* test is a modern and more concise reformulation, specific to tax cases, of the same test used in *Blyth.* The test in *Blyth* is not wrong but the test as expressed in *Collis* is easier for appellants to understand and is to be preferred for that reason. It is also no coincidence that it is virtually the same test as for 'reasonable excuse' where that defence applies to a statutory test. The question is whether the taxpayer acted as a careful taxpayer, in the same factual position as the actual taxpayer, and mindful of his tax obligations, would have acted.

19. It is trite law that ignorance of the law is no excuse: if being ignorant of the law was an excuse then that would only encourage people to remain in ignorance of it, rather than try to acquaint themselves with it. Nevertheless, the reality is that ordinary taxpayers, however mindful of the need to complete a tax return carefully and correctly, will not know tax law in any great detail.

20. In my view, a taxpayer does not act carefully if, being largely in ignorance of the applicable law, he simply 'takes a view' and claims the relief or expense without taking any steps to verify his entitlement to it. In this case, Dr Atkinson said he could not remember if he read the notes accompanying the tax return. In my view, a taxpayer carefully completing his tax return, would have read them.

21. The notes said:

> *Improvement costs*
>
> *The cost to improve the value of an asset so long as that improvement is still reflected in the asset at the time of sale*

22. In my view, no careful taxpayer, reading that, could have considered that the calling in of the guarantee was an improvement cost: and certainly not one that was still reflected in the value of the shares of the holding company at the time of their sale. In particular, I was given no reason to suppose that the calling in of the guarantee had in 2008 any effect on the value of the holding company and certainly none that it affected its value in 2012. My conclusion is that claiming the £30,000 deduction in the face of this indication in the guidance notes, and without taking any other steps to verify entitlement to the deduction, was not the act of a prudent and careful taxpayer and Dr Atkinson was therefore careless in doing so.

23. Dr Atkinson's view is that his inability to afford tax advice counts in his favour: I consider that it does not prevent his actions being careless. A taxpayer in the same position as Dr Atkinson, in other words, a taxpayer similarly unable to afford tax advice, nevertheless would have read the notes to the tax return and would have read the note on improvement costs as it was specific to the claim being made, and would as a result not have made the claim.

24. Dr Atkinson's submission is that HMRC ought to accept that making the claim was not careless, because they accept that his making of the entrepreneur's relief was not careless (see §26 below). But I agree with HMRC that the two claims were factually different because, in so far as entrepreneur's relief was concerned, the appellant's accountant (on his instructions) had contacted HMRC to find out if he was entitled to the relief. No such advice was sought with respect to the claim that the calling in of the guarantee was an improvement expense: all Dr Atkinson had to go on was the notes to the tax return, and, as I have said, those indicated that he was not entitled to the claim. Acting carefully, he would not have made the claim, certainly not without querying it with HMRC or an adviser.

25. I find that he was careless in making the claim for the £30,000 deduction for improvement expenses.

Was making the entrepreneur's relief claim careless?

26. HMRC did not allege making the claim for entrepreneur's relief was itself careless; I understood their position was that, as Dr Atkinson had instructed his accountants to query the position with HMRC and they had written to HMRC on 21 December 2012 but not received a reply by the due date of filing of the appellant's tax return, it was not careless for the return to include the claim.

27. It was HMRC's case was that the appellant was caught by paragraph 3(2) of Schedule 24 which provides:

> (2) An inaccuracy in a document given by P to HMRC, which was neither careless nor deliberate on [the taxpayer's] part when the document was given, is to be treated as careless if [the taxpayer] –
>
> (a) discovered the inaccuracy at some later time, and
>
> (b) did not take reasonable steps to inform HMRC.

28. HMRC take this view because HMRC replied to the accountant's query on 30 January 2013 and stated in that reply that entrepreneur's relief was not available (for the reasons explained in my earlier decision, which were that he ceased to be a director more than three years before he sold the shares) and the appellant knew this in early February 2013. He knew this because by letter dated 5 February 2013 his accountants sent him a copy of HMRC's letter and advised him to amend his return to remove the claim.

29. The appellant's evidence was that at this point in time, despite the advice of HMRC and his accountant, he still considered that he was entitled to make the claim and wait for HMRC to challenge it. It was also clear from his evidence that by this time (early 2013) he had committed himself to using the money that would otherwise be paid in tax to start up a new business, and he knew that he could not afford to both start his new business and pay the tax, and this influenced his actions.

30. Dr Atkinson's case was that, as an entrepreneur who had sold his shares, he considered he was a person Parliament had intended to benefit from the relief and he also referred to the parliamentary materials mentioned in the previous hearing and decision. But in my view, by the time he got HMRC's opinion and his accountant's advice, he was not only knew that he did not qualify, he had been told why he did not qualify (which was that he had ceased to be a director before he sold the shares). Does that mean he fell within paragraph 3(2)(a) and had 'discovered' the inaccuracy?

31. <u>Discovery:</u> There is no definition of 'discovery' and neither party made submissions on this to me. In the absence of submissions, I do not intend to attempt a comprehensive definition. But it must connote an awareness of the inaccuracy, and I do consider that it encompasses the situation in this appeal. While up to February 2016, I accept that Dr Atkinson was of the opinion that he was the sort of person the relief was intended to benefit, in early February 2013 he became aware that HMRC did not share this view and he became aware that that was because he did not meet the requirement of being a director immediately before the shares were sold.

32. Even though I accept he personally remained of the view that he *ought* to benefit from the relief, indeed he remained of the view that the rules ought to be interpreted to give him the benefit of the relief, nevertheless I find in early February 2013 he discovered the inaccuracy because he was told the actual reason why he was not entitled to the relief. At that point, he actually knew of the inaccuracy, even though he chose not to recognise it.

33. Reasonable steps? I consider that a failure to take 'reasonable steps' is the same as 'carelessness' in that it is a failure to do what a prudent and careful taxpayer would have done in the same circumstances. I do not consider that a prudent and careful taxpayer would have disregarded his accountant's advice to amend his return in these circumstances. I consider Dr Atkinson's failure to do so was a failure to take reasonable steps. He was therefore 'careless' within paragraph 3(2)(1) in respect of his claim to entrepreneur's relief.

Was disclosure prompted?

34. Unprompted disclosure is defined in paragraph 9(2) as disclosure:

> "...made at a time when the person making it has no reason to believe that HMRC have discovered or are about to discover the inaccuracy...."

Otherwise the disclosure is defined as prompted.

35. HMRC corrected the appellant's tax return by way of closure notice following the opening of an enquiry. I consider that revealing the facts behind the disallowed claims to HMRC during the course of an enquiry, as happened in this case, is prompted disclosure because it is not disclosure at a time when the appellant had no reason to believe HMRC were about to discover the inaccuracy: clearly HMRC were likely to discover the inaccuracy during an enquiry.

36. Dr Atkinson's position, however, is that he informed HMRC of the position before the enquiry was opened in that his accountants had written to HMRC about it on his instructions in their letter of 21 December 2012. There was some dispute about whether the Tribunal had a copy of this letter. Dr Atkinson's position was that it was the letter in the bundle with a date of 13 August 2014: his inference was that when he asked his accountants for a copy of it during the enquiry, they printed out a copy with the current date on it rather than the date it was actually sent. Mrs Bartup did not take a view either way.

37. I think Dr Atkinson is right. The letter certainly reads as the letter to which HMRC's letter of 5 February 2013 was a reply. It made no sense if it was sent in 2014. It does not matter in any event: the letter asks if in the circumstances of the appellant's case he was entitled to entrepreneur's relief. The letter does *not* inform HMRC that Dr Atkinson intended to make such a claim in his 11/12 tax return. It was therefore not disclosure of the inaccuracy in the 11/12 return.

38. While it was possible that if, later, an HMRC had looked at the letter of 21 December 2012 together with the appellant's tax return of 30 January 2013, he may

have inferred both that (1) such a claim was made in the tax return and (2) should not have been, the taxpayer had not actually disclosed these facts. Disclosure should be explicit and not rely on HMRC putting together two documents and making inferences.

39. I find disclosure was prompted as disclosure only actually occurred during the enquiry.

Special circumstances?

40. As recorded in their decision of 13 October 2014, HMRC did not consider that there were any special circumstances in the appellant's case and did not apply a further reduction. I can only interfere with that decision if it was flawed in the public law sense.

41. As HMRC did not specify in their decision which circumstances they took into account, their decision may be technically flawed in that it contains no reasons. It also means I cannot ascertain whether they took into account something they should not have done or failed to take into account something which they should have taken into account.

42. But even if the decision was technically flawed, I would not interfere with it as I do not consider that there are any special circumstances justifying a further reduction in penalty.

43. Dr Atkinson relied on his particular circumstances as amounting to special circumstances. Those were:

> (a) He was an entrepreneur who was forced out of the company he helped create in a boardroom coup, and was forced to (successfully) litigate against his erstwhile directors in order to realise his investment; as this meant he ceased to be a director long before his sold his shares, he was unable to claim entrepreneur's relief although he would have been entitled to it had he sold his shares at the same time as he resigned as director;
>
> (b) His income had never been such that he was able to afford tax advice;
>
> (c) He had started up a new business in 2013 which had generated more in tax revenue for HMRC than at stake in his appeal; he had been unable to start up this new business until he received the money from the sale of his shares and would have remained unable to do so if he had paid the tax due on this sale.

44. So far as point (b) is concerned, an inability to afford professional advice is not a special circumstance. It is a common situation and clearly not intended by Parliament to excuse taxpayers from careless errors. If it were otherwise, only taxpayers who used agents to complete their tax returns could be liable to a penalty for a careless error. In any event, in this case, as I have already noted, the taxpayer

was not short of advice: the problem was his failure to follow it. Either he did not read or ignored the advice in the capital gains tax notes which accompanied the tax return with respect to the claim on the calling in of the guarantee, and he outright ignored HMRC's opinion that he was not entitled to entrepreneur's relief and did not take his accountant's advice to amend his tax return to exclude the claim. His inability to afford advice was neither the cause of the incorrect return nor did it justify a special reduction.

45. So far as point (c) is concerned, generation of further profit is not a good reason for failing to properly account for tax on earlier profits. Moreover, in using the money which should have been paid in tax, the appellant was using HMRC, whether or not he understood this at the time, as an unwilling lender of money. The fact that he put the money unwillingly loaned to him to good use is not a special circumstance justifying a reduction in penalty: the circumstances may be unusual but it would be against policy to reduce the penalty as it would encourage taxpayers to use HMRC as an unwitting lender of money.

46. So far as point (a) is concerned, it seems likely that had the appellant taken legal and tax advice at the time of the coup he may have been able to avoid ending up in the situation where his loss of directorship preceded his sale of the shares, thus resulting in his inability to claim entrepreneur's relief he would otherwise have been entitled to. But while those circumstances may be 'special' in the sense of unusual, they do not justify a reduction in penalty. The penalty was for the inaccuracy in the return, and the unfortunate end to his first business venture did not cause nor justify the inaccuracy in the return.

Suspension

47. HMRC's case was that they were unable to suspend the penalty as paragraph 14(3) stated that they could only do so where

> compliance with a condition of suspension would help [the taxpayer] to avoid becoming liable to further penalties...for careless inaccuracy

48. HMRC's decision letter records that they did not consider it appropriate to impose a criteria requiring Dr Atkinson to do as his accountant said following advice from HMRC.

49. Dr Atkinson did not claim that the penalty ought to be suspended and so I do not really need to consider this. In any event, I do not consider that HMRC's decision was flawed or if it was, that there any grounds to reach a different conclusion.

50. In particular, I agree with HMRC that Parliament did not intend a condition of suspension to be something as general as, say, requiring the taxpayer to be more careful in future. Conditions were intended to be more specific and relate to something in the control of the appellant which was likely to arise again, so that the appellant could instigate an improvement and such improvement was likely to result in compliance in the future where otherwise there would be non-compliance. It also

seems to me that suspension, which might result in the lifting of a penalty, was for the less serious end of careless penalties.

51. The specific facts leading to the inaccuracies in this case were unlikely to recur in the future so a specific condition (such as taking the joint advice of HMRC and his accountant) was not likely to lead to compliance in the future. In any event, I do not consider that this is an appropriate case for suspension as it is not at the less serious end of careless behaviour. The appellant's evidence was that he preferred to claim the relief, and wait for HMRC to challenge it, as that was the only way he could fund his next business venture, even though (I find) he knew HMRC considered he was not entitled to it and had no real reason to suppose HMRC's opinion was wrong. The penalty should not be suspended.

Overall conclusion

52. As this was a decision in principle, I do not determine the amount of the penalty. But in principle the penalty is confirmed at 15% of the potential lost tax revenue with respect to the incorrect claims for improvement costs and entrepreneur's relief in Dr Atkinson's 2011/12 tax return. The two claims were made carelessly, and while he is entitled to the full deduction of 15% on the grounds of cooperation for prompted disclosure, thus reducing the penalty to 15%, he is not entitled to a further reduction for special circumstances, nor should the penalty be suspended.

53. 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.

BARBARA MOSEDALE
TRIBUNAL JUDGE

RELEASE DATE: 3 JUNE 2016