[2016] UKFTT 0801 (TC)

TC05526

Appeal number: TC/2016/03648

PENALTY – failure to disclose employment income – penalty for careless inaccuracies under FA2007, Sch 24 - held careless – whether HMRC decision not to suspend penalty was flawed – held yes – appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

PATRICK MILLER **Appellant**

- and -

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

TRIBUNAL: JUDGE NIGEL POPPLEWELL

Sitting in public in Bristol on 2 November 2016

The Appellant did not appear and was not represented.

David Lewis, Officer of HM Revenue and Customs, for the Respondents

Introduction

1. This case concerns a penalty of £862.08 (the "penalty") visited on the appellant by the respondents (the respondents or "HMRC") under Schedule 24 to the Finance Act 2007 ("Schedule 24") in respect of the appellant's tax return for the period 2013 – 2014.

2. HMRC believe that the penalty reflects careless behaviour on the part of the appellant and have declined to suspend the penalty.

3. The appellant believes that he has behaved carefully. Although he has made no submissions on whether the penalty should be suspended, HMRC have dealt with this in their statement of case, and I have considered whether or not their decision not to suspend the penalty is flawed.

Appellant's absence

4. The appellant did not appear and was not represented.

5. The appellant was working abroad on the date of the hearing. In an email of 9 October 2016 he explained to the Tribunal Service that "*….having recently returned to a new job it has not been possible to secure another leave at such short notice. I'm therefore resigned for the hearing to continue in my absence, as I will not return to UK before 30 Dec 2016*".

6. Under Rule 33 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rule 2009, I am permitted to proceed with the hearing if I am satisfied that the appellant has been notified of the hearing and I consider that it is in the interest of justice to proceed with the hearing. Given the appellant's email, it was my view that he had been notified of the hearing and it was in the interest of justice to proceed with it.

Evidence and findings of fact

7. From the documents submitted to the tribunal I find the following facts:

   (1) HMRC opened an enquiry into the appellant's 2013-2014 self-assessment tax return on 2 October 2015.

   (2) The appellant responded to the opening letter via telephone on 12 October 2015 to determine why the enquiry had been opened and to discuss the error. He agreed to check the figures and respond in due course.

   (3) The appellant again telephoned HMRC on 30 October 2015. According to HMRC's record of the phone call, the appellant confirmed that he had failed to follow the guidance and a penalty would be due for failing to take reasonable care. At the hearing, Mr Lewis handed up some additional documents which in HMRC's view was the guidance referred to in this telephone conversation. It comprised pages TRG2 and TRG3 from the guidance notes for completing a self-assessment tax return. I find on the balance of probabilities that this was the guidance referred to in that telephone conversation.

(4) Following that telephone conversation, and the appellant's agreement to the error, his charge to income tax was amended to £17,861.20. An amount of £12,114.00 had already been paid by the appellant leaving an underpayment of £5,747.20.

(5) The appellant has discharged the underpayment.

(6) HMRC issued a closure notice on 15 January 2016 and a penalty assessment on 14 January 2016. The penalty notice confirmed that the appellant's behaviour was deemed careless and that consequently HMRC had imposed the penalty.

(7) The appellant appealed against the penalty assessment on 24 January 2016. He did this by way of a letter dated 24 January 2016 in which he stated "*I have lived outside the UK from Sept 2008 to Jan 2013 and have always completed the property section of the self-assessment form for my property. I continued to do so on joining Aerotek in 2013 and Loganair in 2014 not realising that the income details should have been included in the additional sections of the Self-Assessment form along with my pension details. This was because I truly believed that I was already paying the correct amount of tax on those accounts.*"

(8) HMRC issued a final decision on the matter on 18 March 2016 and invited the appellant to request a review.

(9) The appellant accepted HMRC's offer of a review in his letter of 26 March 2016. In that letter he states "*Having read the guidance on the Self-Assessment form, I misunderstood the requirements due to the fact that I had been a non-resident tax payer for a number of years and was only required to complete the property section of the form...*"

(10) An extension of the review period to 16 June 2016 was subsequently agreed.

(11) HMRC issued a review conclusion letter on 10 June 2016 (the "Review Letter") confirming that the enquiry officer's decision had been upheld.

(12) The appellant then appealed to this Tribunal on 5 July 2016.

Summary of the law

8. All references to paragraphs below, and elsewhere in this decision are, unless otherwise stated, reference to paragraphs in Schedule 24:

(1) The respondents may assess a taxpayer for a penalty if a tax return contains a careless inaccuracy (paragraphs 1 and 13).

(2) An inaccuracy is careless if it is due to failure by the taxpayer to take reasonable care (paragraph 3(1)).

(3) The penalty for a careless error is capped at 30% of the potential lost revenue (paragraph 4).

(4) This can be mitigated to zero if a taxpayer makes unprompted disclosure or to 15% for prompted disclosure (paragraphs 9 and 10).

(5) The respondents may reduce the penalty for special circumstances (paragraph 11) and may also suspend the penalty (paragraph 14).

(6) HMRC's discretion to suspend the penalty (or part of it) is subject to paragraph 14(3) "*only if compliance with the condition of suspension would help P to avoid becoming liable to further penalties under paragraph 1 for careless inaccuracy*".

(7) A taxpayer may appeal against a penalty assessment (paragraph 15).

(8) Paragraph 17 allows the Tribunal to order HMRC to suspend the penalty but, pursuant to paragraph 17(4)(a) "*only if it thinks that HMRC's decision not to suspend was flawed*".

Burden and standard of proof

9. HMRC accept that the burden of proof lies with them to show that the inaccuracy in the return and the resulting underpayment of tax was caused by the appellant's carelessness. However, the burden of proof is upon the appellant to establish that the penalty ought to have been suspended. In either case, the standard of proof is the balance of probabilities.

Case law

Reasonable care

10. There are a number of cases which have dealt with the interpretation of paragraph 3(1).

11. In particular this was considered in the case of *Hanson (JR Hanson v The Commissioners for HMRC* [2012] UKFTT 314 (TC))

12. In that case Judge Cannan said as follows:

> "In my view carelessness can be equated with "negligent conduct" in the context of discovery assessments under *section 29 Taxes Management Act 1970*. In that context, negligent conduct is to be judged by reference to the reasonable taxpayer. The test was described by Judge Berner in *Anderson (deceased) v Revenue and Customs Commissioners* [2009] UKFTT 206 at [22], cited with approval by the Upper Tribunal in *Colin Moore v Revenue and Customs Commissioners* [2011] UKUT 239 (TCC):
>
> > *"The test to be applied, in my view, is to consider what a reasonable taxpayer, exercising reasonable diligence in the completion and submission of the return would have done.""*

13. In the context of Schedule 24, Judge Cannan took the view that there was a subjective element in the test of reasonable care. "*What is reasonable care in any particular case will depend on all the circumstances".*

14. This view was endorsed in the case of Martin *(Catherine Grainne Martin v HMRC)* [2014] UKFTT 1021 (TC). Judge Redston recognised that the concept of taking reasonable care in the context of Schedule 24 penalties does import a subjective element since "*If failure to take reasonable care were to be an objective test, sch 24 would be much harsher than the TMA penalty provisions, because the objective test of negligence at TMA s.95 can be mitigated by the reasonable excuse provisions.....*".

15. Mr Lewis took the view that the relevant test is that set out at paragraph 29 in the decision in *Collis* (*David Collis v Commissioners for HMRC* [2011] UKFTT 588 (TC),)

> "*The penalty applies if the inaccuracy in the relevant document is due to a failure on the part of the taxpayer (or other person giving the document) to take reasonable care. We consider 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*".

16. The view taken by Judge Cannan in *Hanson*, Judge Redston in *Martin*, and Judge Berner in *Collis*, is consistent. I am content, therefore, to accept Mr Lewis' submission that the test I should adopt is that set out in *Collis* mentioned above.

Suspension

17. There have been a number of cases recently on suspension. HMRC, in the Review Letter, cite the case of *Barbara Hackett v HMRC* [2012] TC 01817.

18. However, the case which I have found most helpful in this area is *Eric Eastman v HMRC* [2016] UKFTT 0527, a decision by Judge Berner, from which I take the following principles:

    (1) In paragraph 17(6) “flawed” means flawed when considered in the light of the principles applicable in proceedings for judicial review.

    (2) The jurisdiction of the tribunal is appellate and not supervisory but the exercise of that appellate jurisdiction requires the application of principles of judicial review.

    (3) To be flawed in a judicial review sense the decision must be one that no reasonable body could have come to. The tribunal needs to consider whether HMRC have acted in a way in which no reasonable panel of Commissioners could have acted or whether they have taken into account some irrelevant matter or have disregarded something to which they should have given weight. The tribunal may also have to consider whether the Commissioners have erred on a point of law.

    (4) Even if the Commissioners' decision is erroneous because of their failure to take into account relevant material, the tribunal can nonetheless dismiss an appeal if the decision would inevitably have been the same had account been taken of the additional material. The same would apply to a case where HMRC has regard to something irrelevant.

(5) The tribunal cannot substitute its own decision for that taken by HMRC. Its power under paragraph 17(4), if it finds that HMRCs decision not to suspend the penalty is flawed, is to determine whether to order HMRC to suspend the penalty. It cannot suspend the penalty on its own account nor at that stage direct any particular conditions to be attached.

(6) There is only one specific limitation on the exercise of HMRC's discretion. It is that, as paragraph 14(3) provides, suspension can only be granted if compliance with a condition of suspension would help the person liable to the penalty to avoid becoming liable to further penalties for careless inaccuracy.

(7) In order to ensure that HMRC can operate fairly amongst all taxpayers, it is necessary for HMRC to issue guidance to officers who have to exercise a discretion (to ensure consistency of approach). But that guidance should not go further than is required to ensure such consistency. It should not fetter the discretion of an HMRC officer otherwise than is consistent with the legislative scheme itself.

(8) All that paragraph 14(3) requires is that the conditions would help the taxpayer avoid further penalties for careless inaccuracy. There is no necessary link between the type of inaccuracy and the possibility of further penalty.

(9) In exercising its discretion the decision maker must have regard to the underlying behaviour that has given rise to the penalty and to determine whether a condition may be imposed to affect or obviate that same behaviour in the future.

(10) In considering whether any inappropriate conditions may be imposed the acid test is to ask what the taxpayer could have reasonably done differently that would have avoided the original inaccuracy.

(11) Having decided what could have been done in that respect, the question is whether, educated by that answer, a condition may be imposed which will help avoid future careless inaccuracies.

(12) An argument that it is not enough for the suspensive conditions to help meet an existing statutory obligation is misconceived. That is precisely what a suspensive condition should do. The suspensive condition must be designed to help avoid future careless inaccuracies.

Discussion

Reasonable Excuse

19. The appellant’s reasons for not including his PAYE income in the relevant tax return appear be twofold. The first is because he "*truly believed that he was already paying the correct amount of tax on those accounts*" (his letter to HMRC dated 24 January 2016 reflecting (in my view) that, as reflected in his call with HMRC on 12 October 2015, he thought that as his PAYE income had been taxed at source, he did not need to put it on his return).

20. Secondly, as per his letter of 26 March 2016 to HMRC, "*Having read the guidance on the self-assessment form, I misunderstood that the requirement is due to the fact that I had been a non-resident taxpayer for a number of years and was only required to complete the property section of the form*".

21. The appellant accepts that he had read the guidance. As I have said at [7(3)] above, it is my view that this guidance included the pages TRG2 and TRG3 which Mr Lewis handed up at the Hearing.

22. Page TRG2 makes it clear (under the heading "Getting started"), that a taxpayer should collect his financial records for the year to 5 April 2014 such as "your forms P60, P11D or P45 Parts 1A and your 2013-14 and 2014-15 PAYE Coding Notices".

23. These financial records are employment records, thus suggesting to a reasonable taxpayer that employment income is something that should be included in a return.

24. This is then bolstered by the information on page TRG3 where a direction is made to “fill in the employment page if you … were employed in part-time, full-time or casual employment”. There is no immediate qualification to this.

25. However, later on under that section, TRG3 states that a taxpayer will not need to complete an employment page if he holds an office or employment but no liability to UK income tax arises on those earning because the taxpayer is resident or domiciled outside the UK.

26. It is therefore conceivable that, having read the guidance, the appellant (as he suggests in his letters), thought there was no need to complete the employment page because he was (and had been) a non-resident taxpayer for a number of years.

27. Mr Lewis fairly recognises this, but then points out that a taxpayer who is in two minds about whether they should complete an employment page should indicate in the “Any other information” box (box 19) why they have not included employment income in the return. It is Mr Lewis’s view that the appellant, if in two minds about the ostensibly conflicting directions on page TRG3 concerning completion of the employment page, should have identified his uncertainty in box 19. A reasonable taxpayer would have done that. The appellant has not done so.

28. Mr Lewis also suggests that a reasonable taxpayer would have also investigated the positon more deeply by accessing additional electronic information put out by HMRC. One such piece of information was identified at page 60 of the bundle. This guidance entitled “Tax on your UK income if you live abroad” clearly says that “You usually have to pay tax on your UK income even if you are not a UK resident … income includes things like … wages”.

29. Mr Lewis submits that failure to access this additional information shows that the appellant has failed to take reasonable care.

30. I think the position is finely balanced. The pages TRG2 and TRG3 are not as clear as they might be in respect of employment income for a non-UK resident taxpayer. However, they do refer to employment related forms and state that

employment income (generally) must be reported. I agree with Mr Lewis that if there is an ambiguity about reporting by a non-resident, then that can be resolved by a box 19 disclosure. Furthermore, I take the view that the more glaring the ambiguity, the greater the need for a reasonable taxpayer to conduct further research of readily available materials.

31. On balance, therefore, I consider that a reasonable and prudent taxpayer would have been aware that all employment income should have been included, and any uncertainty about the appellant's position as a non-resident should have been resolved by making such a box 19 disclosure. I have no doubt that the appellant made a genuine and honest mistake, but such a mistake can still be careless if it is not reasonably made.

32. I find, therefore, that the appellant has completed his tax return carelessly. He has not taken reasonable care in completing it.

Suspension

33. Although, as I have said earlier, the appellant did not raise this in his grounds of appeal, HMRC have considered it in the Review Letter. Given that the appellant is unrepresented I consider that it is appropriate for me to review HMRC's decision not to suspend.

34. Under the heading "No Suspension" in the Review Letter, HMRC "draw on" the *Hackett* case (see paragraph 17 above) and say the following:

"*Drawing from a first tier tribunal case Barbara Hackett v HMRC [2012] TC01817, the judge stated a suspension condition must be "something more than just a basic requirement that tax returns should be free from careless inaccuracies*."

There is an expectation all taxpayers will submit returns accurately, an assertion that next year's returns will be correct, without any specific change to process, amounts to mere conjecture. No additional steps, or suspension conditions, can guarantee the return will be correct. The suspension condition would not place any further obligations upon you other than your basic requirements.

The Hackett case was heard before the First Tier Tribunal, although not a binding precedent, it demonstrates the view of the tribunal when observing suspension of a penalty".

35. I agree that the *Hackett* case is not a binding precedent. But the above extract from it does not, in my view, reflect a correct exposition of the law. I say this for two reasons:

(1) Firstly, it is inconsistent with paragraph 14(3) which states

"*HMRC may suspend all or part of a penalty only if compliance with a condition of suspension would help P to avoid becoming liable to further penalties under paragraph 1 for careless inaccuracy".* (emphasis added)

(2) Secondly, because, as Judger Berner says in *Eastman* at [54].

"*Ms Long also argued that it is not enough for the suspension conditions to help meet an existing statutory obligation to submit accurate returns. With respect to Ms Long, that appears to us to be precisely what a suspensive condition must do. It is the careless failure to make accurate returns that is the subject of the penalty that the suspensive condition must be designed to help avoid. That is the statutory requirement itself in paragraph 14(3)*". (emphasis added)

36. In deciding whether the decision not to suspend is flawed, I must consider what HMRC took into account in coming to that decision. I then need to decide whether it is relevant or irrelevant. I must then consider whether they have failed to take into account something which is relevant.

37. In considering what is relevant or irrelevant, I must consider the doctrine of proportionality. In the context of direct taxes, this doctrine imposes a limit on the wide margin of appreciation which a state enjoys when choosing the means of enforcement and to ascertaining whether the consequences of enforcement are justified in the general interest for the purpose of achieving the object of the law in question.

38. In *Bank Mellat v HM Treasury (No.2)* [2013] UKSC39, Lord Sumption identifies a number of questions which need to be answered in deciding whether a measure is proportionate. One of these is whether a less intrusive measure could have been used.

39. In the context of penalties (and in my view, to any consideration of whether to suspend a penalty), a penalty (and a condition to suspend) may be treated as disproportionate if a less intrusive measure could have been used to achieve the objective. The objective in this case is that set out in paragraph 14(3); namely to help the taxpayer avoid further penalties for careless inaccuracies.

40. So, for example, a decision by HMRC to suspend a penalty on the condition that a taxpayer who has failed to submit a timely self-assessment tax return, seeks advice from a big four accounting firm, is likely to be a disproportionate condition.

41. HMRC should not be impugned for failure to consider whether such a disproportionate condition should be imposed. In judicial review speak, it would be an irrelevant consideration and need not be taken into account.

42. I reiterate here the acid test set out at paragraph [18(10)] above.

> "*The acid test..... is to ask what the taxpayer could reasonably have done differently that would have avoided the original inaccuracy*".

43. This is culled from *Eastman* at [42]. The word "*reasonably*" emphasised above, could be bolstered with "*and proportionately*".

44. Then, having decided what could have been done, the question is whether "*educated by that answer a condition may be imposed which will help avoid future careless inaccuracies*" (see *Eastman* at [42]).

45. In the case of the appellant, HMRC have taken the view that it is not possible to impose a condition which is:

(1) SMART (i.e. specific, measureable, achievable, realistic); and

(2) Which would place any additional obligation on the appellant compared to any other taxpayers completing their tax returns.

46. HMRC's view is that the underlying reason why the appellant was careless in completing his return was because that he failed to follow the self-assessment guidance. Mr Lewis submitted that the error arose because of the appellant's incorrect belief that employment income did not need to be included on his return.

47. The Review Letter went on to state that:

"*Now that you are aware of the need to report your income on your self assessment tax return, I would expect all future returns to avoid a similar inaccuracy*."

48. As Mr Lewis submitted:

"*The appellant is now fully aware that such income has to be included together with his future responsibility. HMRC can therefore not identify any future careless inaccuracies that would result from the same underlying cause*".

49. As I have mentioned at [35] above, my view is that HMRC have not adopted the correct legal test towards the application of paragraph 14(3). They have adopted the test in *Hackett* that a suspension condition must be "*something more than just a basic requirement that tax returns should be free from careless inaccuracies*".

50. For the reasons given above, I think this is incorrect in the light of *Eastman* and the correct test is the two-fold test set out therein; namely;

(1) Firstly, one must ask what the taxpayer could have reasonably [and proportionately] done differently that would have avoided the original inaccuracy; and

(2) Having decided what could have been done in that respect, whether, educated by that answer, a condition may be imposed which will help avoid future careless inaccuracies.

51. So HMRC have applied the wrong legal test.

52. If they had applied the correct test, they might have come to the conclusion that, as submitted before me by Mr Lewis, and as set out in the Review Letter, the appellant could (and should) have:

(1) Made a box 19 disclosure.

(2) Undertaken a more detailed research by reviewing HMRC's published materials.

(3) Contacted HMRC.

53. HMRC accept that the appellant is likely to have to complete further self-assessment tax returns. This is not a "one-off" case.

54. The evidence before HMRC at the time of the Review Letter is set out in [7] above. My view, is that one element of underlying behaviour that resulted in the failure to report the employment income and/or to make a box 19 disclosure was uncertainty about the appellant's filing obligation given his non-resident status.

55. Uncertainty about the basis on which to complete a tax return may well arise in the future (even if not in the context of non-residence status).

56. If HMRC had considered whether the matters set out at [52] above might be suitable conditions, I believe they might have concluded that are all SMART. They relate to the appellant. He can show whether he has met them, and he can reasonably and proportionately meet them. They are realistic.

57. By applying the test in *Hackett* and focusing on the general obligations of taxpayers to complete accurate returns, rather than on the appellant and what might be done to help him avoid a future careless inaccuracy, HMRC have applied the wrong legal test; as a result they have failed to take into account relevant information, and so have come to a decision that is flawed within the meaning of paragraph 17(6).

58. But even if HMRC have arrived at such a flawed decision, I can still dismiss the appeal if such decision would inevitably have been the same if HMRC had applied the correct test, and taken into account relevant information.

59. I do not think that this would have been the case. As I say, Mr Lewis has submitted in the context of carelessness that the appellant should have made a box 19 disclosure, conducted further research, and contacted HMRC. If the reviewing officer had, as in my view he should have, considered these suspensive conditions, I do not think he would have inevitably come to the same decision not to suspend.

Decision

60. For the reasons given above, I find that HMRC's decision not to suspend a penalty in this case was flawed in a judicial review sense.

61. In accordance with paragraph 17(4) I order HMRC to suspend the penalty.

62. I have no power to define the appropriate suspensive conditions. As set out in *Eastman* at [59] defining the appropriate conditions is a matter for discussion between the parties and, to the extent that agreement is not reached, to be determined by HMRC subject to the appellant's right to appeal under paragraph 17(4)(b)(i).

63. But I would hope that HMRC consider what I have said at [52] above when discussing conditions with the appellant.

64. It follows, therefore, that I allow the appeal to the extent of directing HMRC to suspend the penalty upon such conditions as shall be agreed with the appellant, or in default of agreement upon such conditions as HMRC shall impose (subject to the appellant's right of appeal against those conditions).

65. 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.

NIGEL POPPLEWELL

TRIBUNAL JUDGE

RELEASE DATE: 30 NOVEMBER 2016