[2017] UKFTT 549 (TC)

TC05994

Appeal number: TC/2016/05325

Penalty–capital gain on share sale not declared on return - deliberate inaccuracy? – No – inaccuracy careless – appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

DOROTHY LYTH **Appellant**

- and -

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

TRIBUNAL: JUDGE SWAMI RAGHAVAN
MOHAMMED FAROOQ

Sitting in public at Eastgate House, Cardiff, on 19 June 2017

Nathaniel Monk of Martyn F Arthur Ltd for the Appellant

Karen Powell, HMRC Officer instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. The appellant appeals against an inaccuracy penalty in the sum of £31,409.80 imposed by HMRC under Schedule 24 Finance Act 2007 in relation to the appellant's Self-Assessment tax return for 2010-11 on the grounds that it contained a deliberate inaccuracy. The appellant accepts there was an inaccuracy and that it was careless but strongly disputes HMRC's view that the inaccuracy was deliberate.

2. We heard evidence from Mr Steven Fryer, on behalf of HMRC. He was the HMRC compliance caseworker who dealt with the appellant in relation to the penalty. We also heard evidence from Mrs Dorothy Lyth, the appellant. Both witnesses provided written witness statements, were cross-examined by the opposing party and assisted the tribunal with its further questions. We found both Mr Fryer and Mrs Lyth to be honest witnesses. The findings of fact which we set out below are based on their evidence and the bundle of documents we had before us containing correspondence between the parties, notes of meetings and the medical records of Mrs Lyth.

Background Findings of Fact

3. There is no dispute Mrs Lyth's return for 2010-11 contained an inaccuracy. On 30 April 2010 Mrs Lyth disposed of shares in a private limited company for £811,368.74 and on 11 July 2010 for £96,154.66. The net gain was £907,523.40. The amount was not declared on the 2011 return. The key issue in this appeal relates to whether the inaccuracy was deliberate.

4. The appellant had become an owner of the shares in a private limited company through her role with an agricultural equipment dealer, Simba International Ltd. She had first joined them in 2000 and been brought in to put IT systems in place and to build up the finance team although in practice her role involved a lot of travel along with the chairman and major shareholder building relationships with customers. Although she was at the time a Fellow member of the Association of Chartered and Certified Accountants (an FCAA) her professional role had always been in industry and she had never advised or been involved with tax apart from her own personal returns. Mrs Lyth had filled out her own tax returns since 1996. Her affairs were straightforward, consisting mainly of PAYE income, and she was also used to recording the relevant benefits e.g. company car each year. She had been working since the age of 16 but had never had any investments.

5. Following the sale of the company to American venture capitalists she resigned her position in the spring/summer of 2011 and was diagnosed with depression. She had been under a great deal of stress during this period, she had two small children her father had passed away, her disabled uncle who her mother had been looking after also subsequently passed away at Christmas in 2012. She was not directly involved with the share sale negotiations but helped out with due diligence queries. The share sale was handled through a solicitor who had indicated at the time that there would be a capital gains liability but that entrepreneur's relief at 10% would be available.

6. Around the time of the share sale in spring/summer 2010 Mrs Lyth set aside money under her husband's name with a view to meeting the tax liability.

7. We had before us Mrs Lyth's full medical history stretching over many years. For present purposes it is sufficient to note that the medical notes indicated she had been diagnosed with depression around April 2011 and was signed off work for 3 weeks. She did not work after that period, was prescribed medication and she attended regular review meetings with a doctor. Her notes for 1 December 2011 indicated her moods had worsened, that she was under financial pressures and was struggling to motivate herself to start job hunting. It was suggested that certain medication dosage was increased. Her condition as at January 2012 was better but she had by no means recovered. The meeting notes of 5 March 2012 reported that she was doing much better, and that her low moods may have been seasonal. In her oral evidence Mrs Lyth told us of the struggle involved in coping with the ups and downs of living with depression, how those continued after the period in issue, and that sadly she still had not been able to fully recover. The medication helped and she had also received counselling. Dealing with HMRC and the current proceedings had only added to her stress and anxiety. As at the date of the hearing Mrs Lyth was not able to work at the level she used to and was no longer a member of any professional organisation.

8. In August 2011 following her departure Mrs Lyth filled out a P50 tax repayment form. On 3 November 2011 Mrs Lyth telephoned HMRC to seek a tax repayment (this was on the basis that as she had stopped working part way through a tax year the PAYE which had been deducted on the basis she would be working throughout the year was excessive.)

9. Mrs Lyth submitted her return on-line herself without having sought any advice, or contacting HMRC with any queries. She completed various items relating to PAYE amounts, expenses and benefits figures and interest amounts but did not disclose the capital gain on the shares. The evidence regarding Mrs Lyth's state of mind at the time she filed the return is a matter of contention and we cover this in the discussion section of our decision below.

10. Following the return there was no disclosure in relation to the capital gain until some years later, when in the course of an HMRC project looking into unlisted share disposals HMRC discovered, having examined the annual returns of the relevant company, that Mrs Lyth had disposed of shares in it in 2010. HMRC wrote to the appellant on 10 February 2015 advising her of its belief her 2010-11 return was inaccurate.

11. A meeting between the appellant and her husband and Mr Fryer and another HMRC colleague took place on 14 April 2015. Mrs Lyth attended on the understanding it would assist in resolving the outstanding issues.

12. At the meeting Mrs Lyth confirmed she had not taken any advice and had got on with filing the return herself. The meeting note recorded the following:

> "She has sat and tried to realise how she had got here today and hadn't been in a correct frame of mind at the time. She hadn't been sure where any CG should go. She'd never had CG before and had only ever paid tax under PAYE she had been through the motions when completing the return and didn't set out deliberately to miss off the CG. She believed that she had

completed the form and she had put the money to one side. She had not been working at the time the return was submitted and was not able to make sensible decisions. There had been a sense of relief when [HMRC] had contacted her."

13. When Mr Fryer had asked her why she did not do anything when there was no capital gains in the calculation Mrs Lyth had said she did not know and that "she wasn't the person she had been."

14. Mr Fryer formed the impression that Mrs Lyth knew that she had not put the capital gain onto her tax return and proceeded to issue the penalty which is now under appeal.

Penalty calculation and assessment

15. The penalty was calculated as £31,409.80 which was 35% of the additional liability of £89,742. (This represented the minimum of the relevant range which was 35% on the basis the disclosure was prompted). HMRC gave a full 100% reduction for quality of disclosure because during the course of the check Mrs Lyth provided in a timely way all the explanations, help and documents required by HMRC to identify the inaccuracy. Additionally Mrs Lyth helped HMRC understand how the inaccuracy occurred. HMRC considered all the relevant circumstances including the fact Mrs Lyth was suffering from stress and depression but concluded in the light of the facts that a special reduction was not warranted.

16. A notice of penalty assessment was issued to the appellant on 17 June 2015 in the above amount. Mrs Lyth appealed to HMRC in a letter dated 15 July 2015. HMRC gave its view of the matter on 22 July 2016 (it appears the significant period of delay in responding arose from the fact the letter was misdirected when it reached HMRC) and the appellant then requested a review on 9 August 2016. A review decision upholding the penalty was issued on 22 September 2016.The appeal against the penalty was notified to the tribunal on 5 October 2016.

17. A discovery assessment in relation to capital gains tax was also duly issued on 17 June 2015. By the time of the hearing HMRC had come to the view the calculation of the assessment was incorrect and that the figure should be lower (£88,934.34 instead of £89,742.30). Mrs Lyth had not however appealed against the assessment but was invited to make a late appeal against the assessment so the tribunal would have jurisdiction to determine the assessment in the lower figure. She gave due notice to HMRC in writing at the hearing. HMRC did not object the late appeal, and the tribunal treated her as having made an application for permission to appeal out of time to the tribunal which the tribunal then proceeded to grant, determining that taking account of the circumstances, it was in the interests of justice for the appeal against the assessment to be permitted to proceed out of time. The tribunal accordingly determined the 2010-11 capital gains tax assessment in the lower amount sought which was £88,934.34.

Law

18. The relevant provisions of Schedule 24 Finance Act 2007 under which the penalty under appeal was imposed are set out below.

19. Paragraph 1 provides:

> "(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,
>
> (3) Condition 2 is that the inaccuracy was careless (within the meaning of paragraph 3) or deliberate on P's part."

20. The appellant's self-assessment return filed under s8 TMA 1970 is one of the documents listed in the Table referred to in Paragraph 1(1)(a) above.

21. Paragraph 3 which is headed "Degrees of culpability" provides where relevant:

> "3—
>
> (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."

Parties' submissions

22. HMRC argue a deliberate inaccuracy occurs when a person gives HMRC a document that they know contains an inaccuracy. HMRC point to the following factors upon which they base their view that the error was inaccurate. Mrs Lyth had been a finance director for a number of years and was a Fellow member of the Association of Chartered Certified Accountants. It was difficult to believe that when she completed her return she did not know that a capital gain of such a magnitude and which would have required a significant payment (in respect of which she had set money aside) ought to be disclosed and that she could have thought her return was correct. Although the appellant maintained she was unable to function, she had in fact pulled together bank interest, company car cash equivalent, fuel, and private medical benefits and was able to submit the return two days before the deadline. Completing those items on the return was not straightforward and this showed she was able to think about her responsibilities and function to a certain extent. The appellant disagrees with HMRC and submits that while the inaccuracy was careless it was certainly not deliberate.

Discussion

23. As to the meaning of deliberate HMRC referred to various FTT decisions. From these it can been there are two broadly differing conceptions of the definition of

"deliberate". In *Auxilium Project Management v HMRC* [2016] UKFTT 249 (TC) the tribunal, noting that the legislation did not further define the word "deliberate", took the view (at [62]) that "a deliberate inaccuracy occurs when a taxpayer knowingly provides HMRC with a document that contains an error with the intention that HMRC should rely upon it as an accurate document". The tribunal emphasised this was a subjective test and that the question was not whether a reasonable taxpayer might have made the same error or even whether the taxpayer failed to take all reasonable steps to ensure that the return was accurate, "it is a question of knowledge and intention of the particular taxpayer at the time." In *Salim Miah v HMRC* [2016] UK FTT 644 (TC) put the meaning in a similar way (at [44]); something was "deliberate" if it had been "thought about". The penalty there (which concerned a sale which should have been reported on a VAT return was deliberate if the appellant "knew that the sale should been reported on…the…return but decided that it should not be". Similarly in *Bhagya Raj Subbrayan t/a Swiss Cottage Diet Clinic v HMRC* [2013] UKFTT 161 (TC) the tribunal, in finding the taxpayer's conduct there had been deliberate because "she must have known that the amount of taxable income shown on her return was less than her actual income…", used a test of knowledge of the inaccuracy.

24. However in *Anthony Clynes v HMRC* [2016] UKFTT 644 (TC) the tribunal considered (at [86]) that an inaccuracy "may also be held to be deliberate where it is found that the person consciously or intentionally chose not find out the correct position, in particular where the circumstances are such that the person knew that he should do so."

25. Although there are different conceptions of the test it is not necessary for the purposes of this decision to reach a view on which is correct because whichever test is applied (the test of knowledge, or the wider test suggested in *Clynes*), the requirement is not satisfied on the facts. As explained below we find, having considered the evidence, that Mrs Lyth was not as a matter of fact aware of the inaccuracy when she completed and then submitted the return. Nor was it the case that she consciously or intentionally chose not to find out the correct position.

26. Mrs Lyth explained in cross-examination that she had been aware of the need to get her tax return in on time and that she been very focussed on completing this task. She did this in the way she had done in previous years by gathering together the relevant forms and materials completing the relevant PAYE, benefit and interest figures.

27. At the hearing the answers Mrs Lyth gave in relation to her state of knowledge of the capital gain were somewhat inconsistent. When HMRC put it to her that when she submitted the 2010/11 return she knew it was inaccurate she agreed. Later when asked whether she had decided to leave the capital gains figure off she was clear she had made no such decision. She accepted she knew about the capital gain at the time the solicitors involved in the share sale had told her about entrepreneur's relief but as the time she completed the return she described herself as not caring and "going through the motions".

28. Having considered her evidence carefully and in the round with all the surrounding circumstances we conclude that although around the time of the share

sales in 2010 Mrs Lyth had been aware of the capital gain, and although she may have realised some time after submitting the return there was a capital gains issue which needed to be resolved, at the time she completed and submitted the return, the priority, as far as she was concerned, was to get the return submitted with the PAYE, other benefits and interest figures she was comfortable and familiar with completing. We accept the oral evidence that she gave before us upon further questioning that at the time she completed and submitted the return the issue of the capital gain was simply not in her mind at all and that to all intents and purposes she was acting very much on "auto-pilot". The answers which she gave which suggest the contrary, to our mind, indicate a confusion and merging on her part with what she knew at earlier points and later points and it is not safe to take those at face value.

29. In a similar vein the matters Mrs Lyth was reported as saying at the March 2015 meeting with HMRC must be viewed in their proper context where it was accepted the meeting was difficult and where Mrs Lyth at some points showed signs of distress such as crying. While the accuracy of the note is not in issue the reliability of Mrs Lyth's answers must be treated with appropriate caution. We are unable to give them the same weight as the evidence we received from her orally direct to us. Although in the meeting she stated she believed she had completed the form (by which we understood her to be indicating she thought she had dealt with the CGT issue on the form) this point was not borne out in her oral evidence where after further questioning from the tribunal it was clear to us that she had not thought at all about the CGT when she filed the return.

30. In any case some of the matters relied on from what was said at the meeting are not conclusive: When it was reported she felt a sense of relief this did not necessarily mean she appreciated at the time of filing the return that it was inaccurate but is also consistent with her realising the omission afterwards.

31. Regarding the fact she had set aside payment for the capital gains liability earlier we accept this suggests there was a point in time at which she was aware of CGT and would in the absence of other evidence point towards the view she was aware of the CGT issue later. But here there is countervailing evidence – her oral evidence was that at the time she was filing her return the capital gain was not in her mind and that she had filled in her return as best she could in the way she had done for previous years.

32. The point HMRC raise about her having the ability to fill out non-straightforward matters such as the benefits also does not assist. We accept Mrs Lyth's evidence that she was familiar with these parts of the return from completing them in previous years. They did not present a challenge to her. The fact she was able to fill out something she was familiar with and focussed on getting the return submitted is not inconsistent with her having difficulties recollecting that there was also a one-off CGT liability which she had set money aside some time previously.

33. Similarly the fact Mrs Lyth rang in to ask about a tax repayment in the early part of November 2011, while consistent with her having a level of ability to engage with some of her tax affairs, is not inconsistent with her lacking actual knowledge of the capital gain on the shares at the time of filing the return in January 2012. (It is also possible that rather than pointing against her version of events it supports the view

that having thought about the money earlier and put some aside she had not remembered it in that if Mrs Lyth had been aware she would be due to make a large payment to HMRC it seems unlikely to us she would have so readily sought a repayment from HMRC).

34. The argument Mrs Lyth had deliberately not reported the liability on the basis that she was planning to use the funds that had been set aside to meet her own expenses was not raised previously and out of fairness we did not allow it to be pursued. But even if we had done the argument struck us one which was purely speculative and one which lacked any foundation on the evidence.

35. As to Mrs Lyth's professional background as an FCAA while on the face of it, it is reasonable to expect that such a professional would be well aware of the need to deal with and report the capital gain on his or her return we remind ourselves we are concerned with Mrs Lyth's actual state of mind and any presumption that arises from her professional qualification may be displaced by evidence to the contrary. We were satisfied that Mrs Lyth's actual knowledge in relation to CGT generally was very basic and outside her day to day experience. It was not in issue that at one point in time she was aware that there would be a capital gains tax liability having set money aside but her actual professional knowledge did not mean that it was implausible that at the time of filing the return the capital gain was not something that had entered her mind.

36. As regards Mrs Lyth's mental health issues, although HMRC sought to suggest that these were not as severe as might appear due to Mrs Lyth's ability to make enquiries as to a tax repayment and to file and complete the on-line return the severity of mental health issues is not conclusive of the issue of actual knowledge but a factor to be taken into account when assessing her state of mind at the relevant time and also by way of background to other evidence as to what she said and did. The more severe the difficulties the more plausible it might be that a significant liability did not enter someone's mind but the absence of severity or the presence of a basic level of functioning and ability to do other matters does necessarily not point against someone lacking actual knowledge in relation to the capital gain. The background mental health issue, and stresses and anxiety the appellant faced, although not totally incapacitating, were at a level which meant her evidence, that the capital gain was not something she thought about, was in our view entirely plausible.

37. Taking into account all the above circumstances including Mrs Lyth's oral evidence before us at the tribunal hearing, what she was reported as saying afterwards, and her medical circumstances around the time of the filing date, we accept her evidence that the CGT liability was not something that was in her mind at all when she completed and filed the return. She did not file it with the knowledge the return was inaccurate because it omitted mention of the capital gain. Nor (if it is correct the relevant test is the wider one discussed above) did she choose consciously or intentionally to not find out the correct position knowing that she should do so. In the light of these findings HMRC have not discharged the burden on them to show the inaccuracy was deliberate.

Conclusion

38. HMRC's decision relating to the deliberate inaccuracy penalty cannot therefore be affirmed and to that extent Mrs Lyth's appeal against the penalty is allowed.

39. Under paragraph 17(2)(b) of Schedule 24 FA 2007 the tribunal is able to substitute for HMRC's decision another decision that HMRC had power to make. HMRC submit that if the inaccuracy was not deliberate then it was careless and we note that the appellant's stance from the outset was that she accepted the inaccuracy was careless. (That concession appears to have been properly made bearing in mind that in contrast to the penalty for deliberate inaccuracy where the test is subjective, the test for careless error is an objective one of whether the taxpayer failed to take reasonable care).

40. Under paragraph 4(2)(a) the standard amount for careless action is 30% of the potential lost revenue. We agree the disclosure was "prompted" under Paragraph 9(2)(b). HMRC had applied the minimum percentage for the deliberate inaccuracy error which was 35%. We see no reason to not also apply the minimum percentage for the careless inaccuracy penalty taking account of the appellant's good level of co-operation. Under paragraph 10(2)(b) the minimum percentage for prompted careless inaccuracy penalties is 15% and that is the percentage in which we determine the penalty here (there appearing to us be no basis for disturbing HMRC's view that special circumstances do not apply). The penalty (15% of £88,934.34 (the amended figure for the assessment as set out above at [17]) is therefore £13,340.15.

41. 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.

SWAMI RAGHAVAN
TRIBUNAL JUDGE

RELEASE DATE: 06 JULY 2017