## Chapter 1 - Introduction

### 1.1 Political Background

On 21 September 2009 the Rt Hon Stephen Timms MP, then the Financial Secretary to the Treasury, gave a speech to HMRC and other fiscal bodies at a conference to look at the best practice for fiscal authorities based on experience around the world. In that speech he said:

> 'Every Budget and PBR we set out measures to improve efficiency and equity in the tax system'.

Mr Timms was criticising the tax advisory profession for helping clients avoid tax saying that the use of avoidance damages the economy and is responsible for the excessive complication now faced by all taxpayers. He added:

> 'This behaviour – the behaviour of a minority – is not in the wider interests of business. It leads us down a road to mutually assured complexity in the tax system. And it is corrosive to the business environment'.

For the future, he promised:

> 'The Pre-Budget Report will therefore set out a programme of work to strengthen the disclosure regime, making disclosure requirements broader, increasing the penalties for the non compliant, and giving HMRC more information on who are using the schemes. New powers to tilt the game back towards honest, hardworking taxpayers'.

The Coalition Government have continued to encourage HMRC to close the tax gap. Although HMRC have been in a process of shedding headcount numbers for some years, more money and more officers have been promised to increase yield and close the tax gap. They need to reduce it by £7bn.

The government document, 'Measuring Tax Gaps 2011', is available at
http://www.hmrc.gov.uk/stats/measuring-tax-gaps.htm

At 61 pages, it is an interesting (if far too long) read. Overall the total tax gap is estimated to be £35 billion in 2009-10. This equates to around 8 per cent of the estimated total tax liability for 2009-10.

**Tax Gaps for HMRC administered taxes – 2004-05 to 2009-10**

| Tax Point estimates (£ billion) | 2007-08 | 2008-09 | 2009-10 |
|---|---|---|---|
| Value Added Tax (VAT) | 11.6 | 14.6 | 11.4 |
| Excise duties and other indirect taxes | 4.3 | 4.3 | 3.8 |
| Income Tax, NIC, CGT | 13.9 | 13.9 | 14.5 |
| Corporation Tax | 4.7 | 5.0 | 4.8 |
| Other direct taxes | 1.6 | 0.9 | 0.6 |
| **Total tax gap** | **36** | **39** | **35** |

### 1.2 Personal View

In this introduction, it is appropriate that I make it clear that the views expressed within this paper and presentation are those of the author and are not necessarily representative of the views of my employer the Institute of Chartered Accountants of Scotland or the AAT. The paper has been written at the start of October 2011 and is designed to update practitioners for the changes which occurred in the Finance Act 2009 some of which come into force on 1 November 2011 like the new filing penalty found in Schedule 55, FA 2009 (see Chapter 3 for a summary). In addition, I hope to draw practitioners' attention in Chapter 4 to some recent tax cases and developments in the fiscal world including the serious criticism that HMRC have earned for its unacceptable practices in issuing penalty notices (P35 filing) that are delayed and for its incorrect interpretation of what constitutes a reasonable excuse.

### 1.3 Legislative Cut Off

In taxation the law can be changed by decisions of precedent in the Court of Appeal, Court of Session, House of Lords or the new Supreme Court. Consequently, it is important to realise that this paper has been written reflecting the legislation in force as at 26 September 2011. The author and AAT cannot be held responsible for persons acting or failing to act as a consequence of information contained within this paper.

### 1.4 HMRC are working smarter and using information from many sources to populate their database and help with risk assessment.

Mortgage lenders are set to team up with HMRC to share information on home loan applicants in a bid to combat fraud. The scheme will allow mortgage lenders to check applicants' income with

HMRC tax and employment returns when they suspect the borrower may be fraudulently exaggerating their earnings.

The number of criminal convictions for tax evasion has jumped by more than a third during the last year as part of a new crackdown by HMRC, according to law firm McGrigors. It said HMRC figures, obtained following a Freedom of Information request, showed there was a 38% increase in convictions for tax evasion, with 148 convictions secured in the year to 31 March 2011, compared with 107 the previous year. HMRC aims to obtain 1000 convictions in future years and that will act as a significant deterrent.

The increase follows a fresh crackdown on tax evasion announced last year as part of the spending review. The Treasury said it would aim to deliver a five-fold increase in criminal prosecutions for tax evasion backed by an additional £900m in funding for HMRC.

Practioners need to protect their professional reputation and to give serious thought to the future. In the summer of 2011, HMRC published a consultation document on Relationships between HMRC and the Tax Agent Profession. Consultation closed on 16 September 2011.

On offer is for trusted agents to obtain access to self serve certain HMRC back office functions. Self authorisation, self coding, updating client lists and allocation of client tax payments are some of the things on offer. Trusted agent status will help many agents. It should eliminate many of the errors and delays for which HMRC have been responsible but it raises new issues on security, authorisation and control.

How will HMRC assess an agent’s performance? It may not be right but client results will be parameters that are taken into account. Those that file late or pay late or even worse get things wrong will count against an agent. Any agent whose figures are outside the norm will face an escalating series of actions from HMRC. If the draft legislation proposed to deal with dishonest conduct is enacted in 2012, dishonest agents will face penalties, losing control over all their clients’ files and a naming and shaming regime. Short of that, HMRC might refuse to deal with an agent as they have tried to do with Christopher Lunn & Co and it is likely that there will be different tiers of access to the self service regime. Only the trusted agents will have access to the better levels of self service.

HMRC are also seeking and obtaining information from many diverse sources. More importantly, they are improving their databases and better able to link the information to the right taxpayer.

In this morning’s webinar I hope to cover:

- The penalty regime based on behavior (FA 2007)
- Access powers of HMRC (FA 2008) [Chapter 2]
- Demonstrating that reasonable care has been taken
- The defense of reasonable excuse
- HMRC Campaigns

- HMRC spectrum of interventions & enquiries and possible escalation
- Help from HMRC including toolkits and leaflets series CC FS1 -10
- How to mitigate penalties
- FTT decisions on penalties and reasonable excuse

## Chapter 2 : HMRC Information Powers

**Outline of HMRC New Information Powers**

I would like to thank HMRC and, in particular Mark Leech and Catherine Gregory who were the team leaders responsible for introducing the new compliance check project. With their help, we have been given access to the internal training material of HMRC and this course is derived from the training pack including tutors' notes and a copy of the DVD used by HMRC but adapted to consider the perspective from the profession's approach.

Prior to the enactment of Schedule 36, Finance Act 2008, the information powers available to the merged HMRC were quite diverse with different authorisation levels, different penalties and different appeal rights. VAT and PAYE had inspection powers but no rights of appeal but for direct tax including income tax, capital gains tax and corporation tax, HMRC had a combination of information powers which needed pre-authorisation and could really only be challenged by judicial review. An enquiry started with notification under a Section 9A notice for an individual or a paragraph 24, Schedule 18, Finance Act 1998 notice for a company. Most of the information powers were to be found in Sections 19A and Section 20 Taxes Management Act and paragraph 27, Schedule 18, Finance Act 1998. In the VAT Act, it was to be found in paragraph 7 of Schedule 11, VATA 1994 and for PAYE, Regulation 97 of the PAYE Regulations 2003.

Schedule 36 looks at the new powers which forms the topic of this first presentation. The internal HMRC training material makes it clear that the new powers are the biggest change to powers in 20 years. The hope is that the existence of these powers will reduce confrontation, encourage co-operation, improve relationships and make the process of checking returns more efficient. The hope is that the legal powers will seldom be exercised and so there is a strict process of authorisation.

The training material used by HMRC concerned Smallforms Ltd, a company owned by Mr & Mrs Grieves which makes quality children's clothing which is normally zero rated. The expectation would be that with zero rated outputs of children's clothing, Smallforms Ltd would be a repayment trader probably making monthly returns to improve its cash flow recovering any input tax on purchases. You should accept that the company is closely controlled by its two directors, has a staff of about 150, is involved in manufacturing, will have a turnover of between £10 million and £15 million, operates PAYE in respect of wages paid to workers and has a distribution policy paying dividends to the owner shareholders. The company return together with accounts and computations has been submitted for year ended 30 April

2009. The company has been selected for a joint CT/VAT visit with the appropriate notification under para 24 Sch18 FA1998 being issued. The company complied with this notice and made available to HMRC information, documents and business records that support the accounts and computations which were examined and HMRC asked to discuss some additional points with the director who agrees to see the officer without the accountant attending.

The officer has a standard information package (SIP) prepared. The company uses the services of an accountant to prepare its annual accounts which are not audited and the tax return CT600. The company is responsible for its own PAYE and VAT returns

The new powers to be found in Schedule 36, Finance Act 1998 align and modernise HMRC's access to records and information. HMRC is granted a power to inspect records required. In essence there is little change from the familiar powers available for VAT and PAYE inspections to statutory records but for direct tax this introduces a new power for officers to inspect the records at the place of the business. This power is to be found at paragraph 10 of Schedule 36 and enables an officer to enter business premises and inspect the premises, business assets that are on the premises and business documents that are on the premises if the inspection is reasonably required for the purpose of checking the taxpayer's position.

Paragraph 10(2) specifically excludes a power to enter or inspect premises used solely as a dwelling but for many small businesses there will be some business use of the proprietor's house even if it is only to write up the records. This is in the statute to respect privacy and ensure that the powers are human rights compliant respecting the right of privacy and the right to enjoyment of private assets contained within Article 8 of the European Convention on Human Rights and Article 1 of the 1st Protocol.

It is important to emphasise that the legislation uses the word 'inspect'. This allows an officer to observe but it would not allow an officer to take active action searching premises or opening and entering rooms to which they have not been invited. For the future, we can anticipate that HMRC will use this power to inspect business premises to check:

- The type of plant and equipment
- The stock of raw materials comparing this to the value in the accounts
- How goods are dealt with in the course of being manufactured
- Observe the type of services being performed
- Stocks of finished goods
- Deliveries; and of course
- Inspection of the business records

The conduct of carrying out inspections is prescribed at paragraph 12 and would normally involve prior arrangement with at least seven days notice. On rare occasions, an unannounced visit may occur and this requires to be authorised by an appropriate senior officer within HMRC or by an independent Tribunal. The Tribunal is a safeguard and it will only grant authority if it is satisfied that the inspection is justified.

Normally, a power to inspect does not include a power to remove, for example, documents. There is however a power to copy documents contained with paragraph 15 and paragraph 16 enables an officer to remove documents where it appears to the officer to be necessary to do so. When this occurs, it is reasonable for the taxpayer to request a receipt or a copy of the document being removed and the officer of HMRC must do this without charge.

**Example 1**

After serving a notice under Section 9A starting an enquiry, an officer visits the business premises which are in a garage adjacent to the owners' domestic property. All of the business is conducted from the garage but when reviewing the business records, the officer notes the exterior of the dwelling house and that there is a substantial extension. With this extension the house is more than double the size of any other properties within the neighbourhood. This raises suspicions for the officer that the house is much larger than expected given the relatively modest profits being made by the business. Can the officer ask to see round the house to confirm his perception that the taxpayers' means cannot explain the ownership and occupation of such a substantial detached residence?

**Answer**

*The officer would not be allowed to enter or inspect any part of the premises that are used solely as a dwelling. He could not ask to see inside the house as this is prevented by paragraph 10(2), Schedule 36, Finance Act 2008.*

One of the safeguards within these new powers is the prescription that unannounced visits and indeed applications to the Tribunal can only be authorised by a restricted group of authorised officers. These authorised officers must be independent from the casework being done and they are prohibited from self-authorisation. They must also be able to give reasons for their decision to authorise a visit and these may be challenged if a taxpayer appeals.

Within HMRC, the role of managers will be to ensure that officers have passed the appropriate training material and it is perfectly legitimate to ask an officer when they sat the training and exams and what mark they achieved (to pass needs 80% or more). Managers are also charged with encouraging new ways of working and a significant cultural change. Officers conducting enquiries are encouraged to consider the taxpayers perspective and to be more sensitive when intrusive questions are asked. The means test may still arise but HMRC officers should not start to ask such questions until they have reasonable grounds to suspect that the means available are inadequate to meet the expected private expenditure.

The new power to obtain information and document within Schedule 36 starts with paragraph 1 which enables an officer to issue a notice in writing requiring the taxpayer to provide information or a document which is reasonably required by the officer for the purposes of checking the taxpayer's tax position. This is not a right to interview or question the taxpayer but with a new information regime, it is an appropriate time to consider what policy should be adopted in relation to requests for meetings and interviews.

The Institute has always taken the view that individual cases require individual judgements and therefore there is no general guidance in dealing with such requests. A professional adviser must exercise their own judgement in deciding whether or not a client will interview well. In many instances, having an interview can enable speedy resolution of the uncertainties and concerns of HMRC enabling the case to be concluded quickly. In other instances, it is self evident from the knowledge of the client that the client would make a very poor witness and would perform badly at a meeting. Sometimes the client is of a nervous disposition and cannot cope with the meeting.

To clarify the matter beyond doubt, meetings are voluntary. However, if it is in the best interests of the client to have a meeting and clear matters up quickly, it is essential that some preparation for the meeting occurs. The officer seeking to meet with the client should provide a detailed agenda of the questions he intends to ask. Sometimes officers of HMRC provide a vague agenda and this should be rejected, explaining to the officer that if he intends to ask detailed questions it is only right that the client should be able to anticipate those questions and, where appropriate, research the answers in advance of the meeting. This is the most effective use of time.

If at a meeting the HMRC officer opens up areas of questioning on which there was no advanced warning, it is necessary to exercise judgement as to whether the meeting should be terminated, the line of questioning discontinued or the client encouraged to answer the questions being raised. It is bad practice for an officer to initiate a line of questioning on which there has been no prior warning and the officer deserves criticism for such misconduct.

In the past, one of the fears has been that HMRC officers go on fishing expeditions. The new information powers in Schedule 36 should prevent this occurring as the officer is only entitled to seek information or documents that are reasonably required for the purposes of checking the taxpayer's tax position. Like Balfour's elephant this is difficult to define or prescribe in advance but examples of unreasonable information might include:

- Requesting a detailed analysis of private expenditure when it is obvious that the available means are more than adequate and substantially greater than average income.
- Asking for private bank accounts or credit card statements when means are adequate and there is no suggestion that there is any business transactions conducted through these accounts.
- Asking for diaries when there is no suggestion of any deficiency in the sales record (even appointment diaries are not a record of sales but rather an intention to provide a service that may not necessarily have occurred).

All requests for information and documents must be relevant and proportionate to the identified risk in the return. Requesting information and documents would be unduly onerous if the burden of producing that information or document is disproportionately greater than the benefit to be obtained. This test is particularly apposite in consideration of the power to obtain information and documents from third parties which is to be found in paragraph 2 of Schedule 36, Finance Act 2008. There is of course a right to appeal a third party notice to be found at paragraph 30.

Remembering that an authorising officer will be of a senior grade and will be accountable for their decisions, it is useful to know the internal guidance. Authorisation should only occur if the casework officer actually needs to exercise the power. This means that other methods of answering the risk question need to have been exhausted. The caseworker would be expected to have:

- Communicated the question usually in writing, by phone or at a meeting and been refused or encountered significant delays
- Have a clear picture of the risk
- Have considered the cost burden on the taxpayer and have evidence to show that the question is reasonable and necessary to check the return (so asking for 6 years of bank statements without evidence is out of the question)
- Confirms that the intervention plan supports the question

We have considered the basic information powers to be found in paragraphs 1, 2 and 10 giving an officer the right to visit business premises, inspect the records and seek information and documents. But what happens if the taxpayer refuses to comply? The answer is to be found in paragraph 39 which imposes a standard penalty of £300. Then if the failure continues, there is a daily penalty regime of £60 for each subsequent day in which the failure or obstruction continues (paragraph 40).

These penalties are disapplied if the taxpayer has a reasonable excuse for failing to comply or obstructing the officer and the right of appeal lies to the first-Tier Tribunal (paragraph 45).

Offices of HMRC are now being encouraged to focus on risks where there is a substantial and reasonable ground for suspecting a loss of tax. There should also be greater openness and in enquiry cases advisers should not be reticent about asking HMRC to explain to them precisely the risks identified and what work needs to be done to resolve the risks. This should be a new and more constructive way of handling enquiry cases and officers of HMRC are being encouraged to consider professional advisers as potential allies. At all times, professional advisers need to remember that their primary duty is to act in the best interests of the client, respecting the professional obligation of care and confidentiality for that client. But seeking clarification from an officer of HMRC of the precise risks should enable the enquiry to be addressed efficiently and effectively.

The new legislation is accompanied by a new set of time limits which are summarised in the table below.

Schedule 39 introduces a new more uniform time limit for assessment and claims amending the TMA 1970 and VATA 1994. Error or mistake claims are reduced from six years to four years which is a restriction of taxpayers' rights. Ordinary time limit assessments which are dealt with under Section 34 will have a 4 year time limit and the time limit for fraudulent or negligent conduct in Section 36 retains the 20 year time limit. A table of the new time limits is summarised below.

## New Time Limits

| | Mistake or discovery | Failure to take reasonable care | Deliberate understatement |
|---|---|---|---|
| Income tax | 4 | 6 | 20 |
| Company tax | 4 | 6 | 20 |
| VAT | 4 | 4 | 20 |

*Income tax includes PAYE and CGT*

The retention of the 20 year backstop to counter fraud is recognised by most to be in the public interest. The certainty that a failure to take reasonable care will not be challenged beyond 6 years is also generally to be welcomed. In the current fiscal rules, I often see HMRC officers in the direct tax field who are overzealous and technically ignorant threatening settlements or seeking offers in early years where they could not raise an assessment. They argue they have discovered negligence and currently can go back 20 years. If they have discovered negligence then the threat of their abuse is real but in reality they have discovered a mistake but not negligence and the limit is 6 years.

'Negligence' is simply a failure to take the requisite amount of care and includes any error which is not rectified without unreasonable delay after discovery (TMA 1970, s. 97(1)). However, negligence does not include making a mistake in interpreting a piece of complex tax statute.

In an excellent article published in Taxation of 29 July 2004, Keith Gordon advised on the possibility of a tax adviser being held negligent after a judicial precedent has established that the view which was taken was incorrect he wrote:-

> "*Elkington v Holland* (1842) 9 M&W 659 held that a lawyer was not guilty of negligence when 'the utmost that can be said is, that he has misconstrued a doubtful act of Parliament'.

So, provided that the adviser reaches a tenable view of the law, his advice is not negligent even if the view turns out to be wrong *Bell v Strathairn & Blair* (1954) 104 LJ 618). "

The test imposed on HMRC to show negligence for an ordinary taxpayer would be much harder. So an honest taxpayer who has misinterpreted a piece of legislation is not negligent even though the return will be incorrect as a result.

HMRC can raise assessments for out of time periods where they have discovered that earlier returns are incorrect but this only possible where the officer has made a discovery. This course is not the venue to discuss what constitutes a discovery but for those seeking guidance there is clarification available on the decisions of Cenlon Finance Ltd v Ellwood and Scorer v Olin Energy Systems Ltd. A discovery assessment is only appropriate when a discovery leads to additional tax liability.

HMRC have been using the power to be found in Para 21(6) to seek information in out of date years when HMRC believe they have made a discovery. Following Langham v Veltema 2004, EWCA Civ 193, HMRC believed that the power of discovery was very wide. In reality, there is little doubt that s29(5) TMA 1970 does not give taxpayers the certainty which was intended. HMRC have recently lost some discovery cases.

In Dr Michael Charlton Mrs Barbara Corfield Mr John Corfield v Revenue & Customs [2011] UKFTT 467 concerned whether HMRC had made valid discovery assessments on the three Appellants, thereby denying artificial capital losses that the three Appellants had hoped to secure by participating in the tax year 2006/2007 in a marketed tax scheme promoted by Tenon Limited ("Tenon").

Sub-section 29(5) precludes a discovery assessment from being made unless it can be said, at the end of the one-year period in which HMRC can open enquiries in relation to a taxpayer's self-assessment return, or on the notification to the taxpayer that such enquiries have been completed, that an average HMRC officer "could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware [*that the taxpayer's return failed to assess income or capital gains that ought to have been assessed, or that the return claimed excessive reliefs*]".

Since 2004, most practitioners are aware that Langham v Veltema introduced a change in the law because the Court of Appeal gave a decision of legal precedent that illustrated that the certainty and protection an honest taxpayer who had made full disclosure was intended to get was not available. Instead of remedying the defect with corrective legislation HMRC brought forward SP1/06 as a practical solution.

The artificial scheme failed. It aimed to generate an artificial loss, each taxpayer purchased an existing life assurance policy for a considerable sum; then effected a very substantial partial surrender; and finally sold or surrendered the small balance of the policy. The Appellants' tax returns all revealed the large capital gains that had been made, and then set against those gains the losses of broadly similar amounts that they hoped would be available. In the "white spaces" in the tax returns, sufficient details of the insurance policy transactions were given for the tribunal instantly to reach the understanding of the scheme. The tax returns also revealed the particular scheme's Scheme Reference Number ("SRN"), namely 50448445, under those DOTAS rules.

By the time the returns were submitted, the decision of the Special Commissioners given by Sir Stephen Oliver QC was given. So the appellants knew that HMRC were challenging the scheme and the Special Commissioners had already ruled that it did not work. But such a decision is persuasive only. It is not precedent. See *Jason Drummond v. HMRC* [2007] STC (SCD) 682.

So HMRC waited until the decision of the Court of Appeal became available which confirmed the scheme failed before it raised discovery assessments. The task for the Tribunal was simply to decide, in principle, whether those discovery assessments were valid or not.

With self assessment a balance has to be struck between giving the taxpayer legal certainty and the right of the state to collect tax which has not been assessed. HMRC has roughly a one-year period in which to open enquiries in relation to self-assessment returns.

A discovery assessment is competent if the strict statutory conditions apply:

> *29(5) The second condition is that at the time when an officer of the Board-*
>
> *(a) ceased to be entitled to give notice of his intention to enquire into the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment; or*
>
> *(b) informed the taxpayer that he had completed his enquiries into that return,*
>
> *the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in subsection (1) above.*

Information is made available to HMRC *"if it is information the existence of which, and the relevance of which as regards the situation mentioned in subsection (1) above-*

> *(i) could reasonably be expected to be inferred by an officer of the Board from information falling within paragraphs (a) to (c) above; or*
> *(ii) are notified in writing by the taxpayer to an officer of the Board."*

At 139 paragraphs, this is a lengthy and complex judgement and worth a read. It can be found at: http://www.bailii.org/uk/cases/UKFTT/TC/2011/TC01317.html

The disclosure in each taxpayer's white space did not merely summarise the facts. Whilst it may not have given section numbers, it certainly explained why there had been a substantial capital loss, when there was only a small economic loss in respect of the policy. The disclosure may not have explained the full law in relation to chargeable events in respect of policies and the further calculations in the final year, reference was certainly made again to the legal explanation for the lack of income in the tax return, and the disclosure was not confined to summarising the facts.
Second hand Insurance policy schemes (SHIPS) were designed to realise capital losses, vastly in excess of real losses, in respect of insurance policies.

All three Appellants in this case submitted their Returns for the period 2006/07 in the Autumn of 2007, after Sir Stephen Oliver's decision had been released on 5 July 2007. During the enquiry window into those returns, which would close on 31 January 2009, the High Court affirmed Sir Stephen's decision on 23 July 2008. After the enquiry window had closed, the Court of Appeal did likewise on 25 June 2009, and leave to appeal to the Supreme Court was in due course refused.

The case has nothing whatever to do with the merits of the Appellants' scheme. The only relevant point is that the conditions that have to be satisfied before a valid discovery assessment can be made and sustained are designed to give taxpayers some "finality", or "deserved finality", when their returns have been entirely accurate, and the question that we must address is how those conditions should be interpreted in striking the right balance between taxpayers and HMRC.

HMRC has effectively conceded that it was only through various administrative slip-ups that no enquiries were in fact opened. It was significant that when the discovery assessment was made, no HMRC officer had actually obtained any further information from the Appellants, or indeed Tenon, in relation to the scheme undertaken by the Appellants, and that without any such further information or admissions about “insufficiencies”, HMRC had felt able to make the discovery assessments. These facts both indicated an absence of any “newness” justifying the discovery assessments (an argument in relation to sub-section 29(1) which we have already dismissed), but they also indicated that whatever the actual officer, Mr. Cree, did in making the discovery assessments could manifestly have been done during or at the end of the enquiry window.

No HMRC officer could have missed the point that the taxpayers had effected an avoidance scheme. On that information, the possibility of challenge cannot have escaped anybody’s attention.

*“In this case the taxpayer has disclosed, with perfect accuracy, the essential features of the scheme, such that we understood immediately precisely what was involved. The notional officer might have been slightly slower in reaching such a conclusion, but could not have doubted that a very artificial scheme had been implemented. Equally clearly that scheme had been disclosed to HMRC under the DOTAS rules. When the taxpayer has given information that reveals these facts, it would be extraordinary if the protection of subsection 29(5) was not to apply, when one remembers that:*

- *first, HMRC would have utterly failed to look at the return, and to open the enquiry that should obviously have been opened;*
- *and secondly, the notional officer deemed to be considering the disclosed information, could be treated as unable to access any information about the law, any guidance in text books and the Inspectors’ Manual, and precluded even from making the one glaringly obvious phone call that would have instantly revealed that HMRC had undermined the relevant schemes, and succeeded both before the Special Commissioner and the High Court in sustaining that challenge.”*

Having made a full disclosure, the taxpayers in this case are protected from the making of discovery assessments, by sub-section 29(5).

The good news on discovery continues in *The Executors of David Atkins deceased v Revenue & Customs [2011] UKFTT 468* which concerned whether HMRC should pay costs of the taxpayer after raising and then vacating discovery assessments.

The decision can be read at: http://www.bailii.org/uk/cases/UKFTT/TC/2011/TC01318.html

HMRC had withdrawn its discovery assessment for approximately £13,000, at a very late stage in the period before the Appeal was due to be heard. Costs were sought by the executors but could only be awarded if the tribunal judged HMRC had “acted unreasonably in bringing, defending or conducting the proceedings”.

The deceased, Mr. Atkins, had until his death been a Lloyd’s “name”. In accordance with the proper basis of accounting, and of producing his tax return for the final year prior to his death, his accountant revealed that the deceased had had a loss in respect of his Lloyd’s activity, albeit that £29,878.14 was held in a Special Reserve Account, presumably by the manager of the deceased’s syndicate, as a reserve to meet then anticipated claims.

It was clearly the accepted practice that amounts required to be held and reserved in the Special Reserve Account were deductible from what would otherwise have been the profits of particular years, albeit of course that if and when such reserves were later released, those releases would be subjected to tax. The release was treated as being received in the later year when it was actually received for the purposes of interest but it was taxed as if it was received in the last year prior to death..

The practical way promoted by HMRC to enable the correct results to be achieved was for the initial return for the last year prior to death to be dealt with in the ordinary way (with therefore deductions being given for amounts held in the Special Reserve Account), but for HMRC then invariably to "open an enquiry" into those returns, deliberately leaving that enquiry open until the ultimate fate of the amounts held in reserve had been resolved.

Before the enquiry window closed, on 24 April 2008, Mr. Stubbs the accountant sent HMRC a letter reminding them to open an enquiry. In March 2010 the whole of the Special Reserve Fund, together with accrued interest, was released to the Executors and this was almost immediately disclosed to HMRC. HMRC sought to make and sustain a discovery assessment, and considerable work was undertaken by Mr. Stubbs in preparing for the Appellants' appeal against that assessment.

The return itself was made in accordance with correct practice and in conformity with the HMRC Guidelines. The problem in this case results entirely from the way in which HMRC have failed to act in accordance with their own Guidelines in failing to open an enquiry into the relevant return.

Howard M Nowlan writes good judgements and this one is no exception. He awarded costs to the appellant. The reasons for this Decision are that:

- the initial failure to open an enquiry and to follow the procedures in HMRC's own Guidelines appears entirely to have been the fault of HMRC;
- the Appellants' return appears to have been made entirely correctly;
- HMRC has forced the Appellants to prepare for a tax appeal that has involved considerable costs;
- in the light of the point made in paragraph 20 above that appeal had no deserved merit, even if on the ridiculous ground mentioned in paragraph 18 above the sub-section (2) defence might have been disputed; and
- at no time, or even in their letter summarising the background to this case, have HMRC even alluded to the failure to open an enquiry into the return, and their failure to proceed in the only way considered workable in relation to the precise situation that has arisen in this case. HMRC have, in other words been very unforthcoming to either the Appellant or to me in admitting their fundamental errors, and they have not appeared at the hearing to advance any argument as to why this conclusion may be unfounded.

These days it is all too common for HMRC to be responsible for serious delays and as a result to be seeking information about earlier years. If a discovery assessment is competent, they have the power to obtain information from paragraph 21(6), Schedule 36 FA 2008 but that condition is critical.

Taxpayers are entitled to certainty if they have made an honest and complete return so the two decisions reviewed here are important and persuasive authority that discovery assessments are not available if HMRC has delayed using information of has made an administrative error.

In practice, discovery assessments enabled HMRC to go back up to 20 years but this was rarely exercised. Depending on the tax lost in each year, the Revenue would consider whether discovery assessments were appropriate. Only in the most serious cases would the Revenue, in practice, go beyond 6 years after the end of the relevant accounting period and as a matter of practice they would protect this position by raising protective assessments.

When re-opening earlier years, a pragmatic solution is often to extrapolate the figures which have been discovered in the period under enquiry but if the business has changed substantially this may be an inappropriate method.

HMRC are sincere in aiming to ensure that the new powers are used consistently and in a proportionate way that not only respects the individual's right of privacy and is human rights compliant. HMRC have no wish to see public confidence diminished or to see a lot of appeals against notices that are onerous or intrusive.

Before the formal powers are used, the caseworker is expected to consider other avenues like an informal approach which might include a voluntary meeting with the taxpayer. There should be flexibility on venue and time and some caseworkers may wish to be accompanied by more specialist HMRC staff like economists or accountants. The caseworker should prepare his case to present to an authorised officer who is not involved in the line management structure but will be more experienced and will check that the case worker has considered all other approaches before the formal powers are exercised.

The authorised officer's role is a safeguard designed to provide independent review, consistency, a review of caseworker evidence, consideration of alternative options, checking time limits and most importantly of all, verifying and being accountable that the proposed exercise of power is reasonable and proportionate to the identified risk.

This concept of proportionate is an interesting concept. A request for information could be unduly onerous if the burden of producing the information is disproportionately greater than the 'benefit' to be gained. This is enshrined in the statute for third party notices at para 30(1) Sch36 but it should be considered in all cases.

Authorisation is required when:

- Specific information notices
    - Third party information (para 2)
    - Taxpayer old documents (para 20)
    - Persons whose identity is unknown (para 5) [scheme users]
- Specific Inspections
    - Short notice visits (less than 7 days) (para 12(b))
    - Unannounced visits (para 12(b)
- Applications for tribunal (paras 3(2) and 13)
- Sensitive cases

- Penalties (non compliance para 40 and the penalties for incorrect returns)

Authorisation requires a clear trail of documentation.

**Case Study Example 1**

One morning you are sitting quietly in your office having worked industriously on client business for two hours and you are enjoying a coffee break. Suddenly the phone rings. It is Joe Bloggs, a publican client who explained that he was working in his pub before it opens at noon, dealing with deliveries and re-stocking the shelves, when there was a knock at the door. The knock was an officer of HMRC seeking to inspect Joe's pub but Joe thought that it might have been one of two interviewees as he was recruiting new staff and the potential new employees were expected at any minute. Joes explained he was standing at the front door and seeking your advice on what he should do given his concern that it would create a bad impression to the new employees if HMRC were conducting an inspection of his premises. The time is very inconvenient. What do you advise?

**Case Study Example 2**

Colin Joiner is a self employed carpenter and has worked in the construction industry sector for many years. Colin's annual net profit is around £30,000 and he drives a large double cab, flat bed pickup truck with a lockable rear area in which he keeps all his tools. Most of Colin's work is for House Builders Ltd, a well known public company. Colin operates from his domestic address but he uses an outhouse adjacent to his property as a workshop. Colin is a skilled craftsman but is virtually illiterate. All the books and records are maintained by Colin's wife and she is responsible for all correspondence and providing estimates and invoices for the sundry small jobs which Colin does on a regular basis including building kitchens and built-in cabinets to order. HMRC have requested a meeting with Colin and his wife and have provided an agenda that they intend to discuss:

1. Whether there is constructive payment of the wife's wage (there is).
2. Precisely what duties Mrs Joiner performs for the business.
3. What records are kept by whom and what estimates were necessary in the preparation of accounts.
4. The adequacy of the income available to the couple to meet their domestic needs.

Mrs Joiner is paid a wage of approximately £200 per week and because of her husband's illiteracy her role is essential. The couple recently bought their four-bedroom detached house for approximately £300,000 and were able to do so without a mortgage because Mrs Joiner inherited some two years ago, several million pounds on the death of her great aunt. You knew this because you would question where Colin obtained the money to buy his top of the range double cab pickup truck.

**Case study 3**

This is the first year that you have prepared accounts and the CT return for Medium sized company. You obtained the usual professional clearance from the previous accountants and were given access to their files, extracting relevant information.

The client's return was selected for enquiry and a list of detailed questions answered, all satisfactorily, with access being given to the business records for the year. The officer has now requested access to the computerised accounting system for the previous year. A back up disc is held by the previous accountant and has said he will consider issuing a notice under para 3 to obtain the information unless it is volunteered.

**Case Study 1**

*Joe is faced with whether or not it is reasonable to allow the officers access. His concern that it will create a bad impression to new perspective employees is apparently legitimate especially as he needs to interview these employees. In the circumstances you should advise Joe to establish whether or not the visit has been authorised by a Tribunal or by HMRC authorised officers. As the visit is not convenient, HMRC should be requested to rearrange a meeting and Joe may wish to demonstrate that he is not being obstructive by explaining his difficulty and why it would be difficult to allow the officers to inspect the premises in the circumstances of his needing to interview potential employees.*

*If the officers of HMRC press the point, it would be helpful to Joe to understand the consequences of obstructing the officers and refusing entry. There will be no consequence if the authorisation of the visit is within HMRC but HMRC could consider imposing a penalty but this would be appealable with Joe having a reasonable excuse.*

**Case Study 2**

*On the available information, HMRC has no justification for suspecting that means are limited yet the issue of Mrs Joiner's privacy must be respected. HMRC do not have a right to interview or have a meeting but in the circumstance of this case, one can see that HMRC will know that the property was acquired without a mortgage and this would look unusual in the light of the available income to the couple. The explanation is simply the inheritance Mrs Joiner received.*

*If Mr & Mrs Joiner are willing to have the meeting and address the items raised in the agenda, this may the most expedient way to conclude the case. However, in a case like this you need to judge what is the best way to proceed. The agenda questions can be answered by correspondence although HMRC may wish to verify that Mrs Joiner did in fact receive a substantial inheritance.*

**Case Study 3**

*The question to pose is whether the information is reasonably required to check the return. It is reasonable to ask the officer what risk has been identified and what tax is thought to be at risk. The scenario is deliberately vague on this and the casework officer should be asked to provide the additional information to show why the request is justified. If this is not forthcoming, a closure notice should be sought as all of the questions relating to the accounts under enquiry have been answered satisfactorily and a complaint to HMRC should be considered.*

**Conclusion**

The purpose of the new information powers is to allow HMRC officers to obtain the information that is reasonably required to answer the questions identified in the risk assessment. The existence of penalties, whether fixed, daily or tax geared, is not to raise revenue but to act as a deterrent. The objective is to is to obtain relevant information, including access to computer data (para114, FA2008) and to unblock obstruction.

A reasonable excuse would include:

- Loss of records through flood, fire , theft and similar events outside the t/p control
- Serious illness or bereavement
- Computer breakdown
- Loss of key personnel
- Unexpected cash crisis
- Unavoidable delays beyond the taxpayers control

Chapter 3

Penalty regime

Some years ago I remember reading a joke that Nothing is certain in life except death and taxes but at least death does not keep getting worse and worse. Prior to 2009, it would be extremely rare for a penalty to be imposed in respect of VAT or PAYE and in the direct tax regime penalties were often mitigated for disclosure (30%), co-operation (40%) and Size and Gravity (40%) down to very small sums indeed. Serious fraud cases were often settled for modest penalties.

Now we face new penalties, the latest of which is to be found in Schedule 55, FA 2009. File late and a penalty regime applies even if no tax is due. This regime stinks. In some cases it seems like a breach of the doctrine of proportionality. HMRC own figures disclose that it costs £6 to process a paper return. But someone filing a paper return on 1 November 2011 faces a £100 penalty even if no tax is due.

## 3.1 Late filing penalties

I am concerned about the lack of awareness that a new late filing penalty regime is going to start for paper returns from 1 November 2011. I worry about those clients who are in and out of self assessment and who are clients but last year they did not require to file but this year they received notification. As part of the HMRC cutbacks, a copy of the requirement to file notice is sent to the taxpayer but not to the agent.

The deadline for submitting individual, partnership and trust self-assessment paper returns is 31 October following the tax year to which they relate, and 31 January following the tax year to which they relate for online returns.

Penalties are imposed for non-compliance with various tax obligations. The big change is in Schedule 55, FA 2009 which imposes a filing penalty even where all the tax has been paid. Previously, the filing penalty was capped at the lower of £100 and the tax due.

I might paraphrase the legislative gobligook into a simple message:

If you miss the deadline, the longer you delay, the more you'll have to pay. So it's important to send your tax return to HMRC before the deadline. If something is delaying the finalisation of the return, like the partnership accounts, lodge the return using provisional or estimated figures and amend the figures once the final ones are available.

If the paper filing deadline is missed and it is possible to file electronically on time because of the later filing deadline, please do so. Don’t send a paper return in late if an electronic filing can be on time.

| Penalties for missing the tax return deadline | |
|---|---|
| **Length of delay** | **Penalty you will have to pay** |
| 1 day late | A fixed penalty of £100. This applies even if you have no tax to pay or have paid the tax you owe. It applies even if you have overpaid tax and are due a repayment |
| 3 months late | £10 for each following day - up to a 90 day maximum of £900. This is as well as the fixed penalty above. |
| 6 months late | £300 or 5% of the tax due, whichever is the higher. This is as well as the penalties above. |
| 12 months late | £300 or 5% of the tax due, whichever is the higher.<br>In serious cases you may be asked to pay up to 100% of the tax due instead.<br>These are as well as the penalties above. |

**Examples**

Mrs A's electronic tax return is due on 31 January 2012 but HMRC don't receive it until 5 August 2012.

It is over six months late so she will have to pay **all** of the following:

- £100 fixed penalty
- £900 penalty - this is £10 each day from 1 May to 29 July, when the maximum 90 day penalty is reached.
- £300 or 5 per cent of the tax due - whichever is the higher

So if Mrs A was due a repayment of £1300, she will get nothing back if she lodges the return on 5 August

Mr B was due to file a paper return on 31 October 2011. He is self employed in the construction industry sector but because tax is deducted at source by the contractors he receives a repayment every year when he eventually lodges his return. During the summer months, Mr B works long hours but chooses to winter in South Africa and Australia relying on the repayment he knows is due when he returns to the UK in the spring and submits his tax return. In 2012, if he lodges late, he is going to be disappointed by the repayment being a lot less than expected because penalties have used it.

Mr C is sometimes in self assessment and sometimes not. Tax is not his main priority because he works hard at a variety of jobs. Although he was not required to lodge a self assessment return for 2009/2010, he will be required to lodge a return for 2010/2011 but he usually leaves it to the last minute before letting his tax advisers know. This year he is due an inheritance from an estate so he delays contacting his accountant until he gets the information. He is in for a big shock if his delay led to a filing penalty because not only is that due but there may be a further penalty for late payment to be found in Schedule 56.

## 3.2 Penalties from Schedule 24, FA 2007

Schedule 24 introduced a range of penalties. Research had shown that the previous penalty regime used by the Inland Revenue was inconsistently applied and in many cases the level of penalty was low. In a review of cases, hindsight showed that experienced officers would have charged more penalties than were actually obtained in the settlement.

The previous regime relied on disclosure (up to 30%), co-operation (up to 40%) and size and gravity or seriousness (up to 40%). Reviews after settlement showed that there was inconsistency and a tendency for persuasive pleas and mitigation to succeed. Other regimes such as PAYE and VAT did not generally carry penalties except in the defined cases like serious or persistent misdeclaration for VAT. The new penalty regime therefore is a substantial increase in potential penalties where there is a prompted disclosure of errors in VAT, PAYE and compliance. The old penalty regime will continue to apply for returns filed before 1 April 2009.

From 1 April 2009 we have a new penalty regime. The good news about this penalty regime is that simple error will not be penalised. In essence when tax is complex a failure to interpret correctly a complex piece of legislation would not be penalised. A failure to take reasonable care accompanied by full voluntary disclosure on an unprompted basis will also result in a zero penalty.

We can anticipate that for the future the penalty regime which will apply to most cases will be a failure to take reasonable care which is discovered by HMRC either from risk assessment or following a visit. What is therefore important to understand is the subjective nature of the test of reasonable care. With this in mind, it is better to err on the side of caution than to adopt a cavalier approach.

### 3.3 Health reminder about possible prosecution in serious cases

The summary of the new penalty regime is below either as tables of new tax penalties or as a graphical presentation. This sets out what the stepped approach looks like and today we are going to concentrate on the green area in the graph (at page 28 ) dealing with a failure to take reasonable care. However, the training video used by HMRC does go into the more serious areas of deliberate understatement with a penalty range of 20 to 70% and deliberate understatement with concealment with a penalty range of 30 to 100%. What must be remembered at all times is in cases of serious fraud or conduct which is viewed as heinous, the department has a prosecution policy. In cases of doubt it is therefore recommended that consideration is given as to whether full disclosure will result in a settlement involving tax interest and penalties or whether there is the possibility of criminal prosecution.  In the latter case, expert advice should be obtained.

### 3.4 Outline of new regime

The underlying principle of the penalty regime to be found in Schedule 24, Finance Act 2007 is to forgive or reward good behaviour but to punish bad behaviour which HMRC discovers.  There are items of good news within the new penalty regime and these include:

- No penalties for mistakes in a complex area.
- No penalty for voluntary disclosure when a mistake arising from a failure to take reasonable care is disclosed voluntarily.
- Suspended penalties which encourage the taxpayer to rectify the issue that causes the error.
- No liability where an agent makes the error provided the taxpayer took reasonable care and checked the return.  Note however this may change with the agent suffering a penalty if legislation for dishonest conduct is enacted in FA 2012

### 3.5 Suspended penalties

Suspended penalties are a new innovation and are designed to encourage the taxpayer to rectify the issue that caused the error.  Thus, in the example within the DVD, poor bookkeeping might have given rise to an incorrect return.  If the taxpayer volunteered to employ a bookkeeper and therefore improve the bookkeeping this might be an occasion when HMRC would consider a suspended penalty to be reviewed over a two year period to check that compliance had improved.  But suspended penalties are only going to be available where there is the possibility of recurrence.  Therefore an error in a capital gains tax computation which is viewed as an isolated error will not be able to benefit from a suspended penalty whereas a weakness identified in a return such as failing to add back entertainment, could be capable of correction and therefore could be included within a suspended penalty regime.

When dealing with a return which has been found to be incorrect, it may be possible to request a suspended penalty where the underlying error arose from something that is recurrent and therefore the suspended penalty is an incentive to correct the behaviour or flaw that gave rise to the error in the return.  Suspended penalties will not be available where it is an isolated transaction, such as a capital gains tax on disposal, that gave rise to the error.

### 3.6 Comment on the level of penalty

Many of us reading the new penalty regime remember the introduction of penalties for VAT following the Keith Committee recommendations in the 1980's.  It took several years before the courts began to agree that the new penalty regime was too severe and one suspects that we will be faced with a similar process with this new regime.  The introduction of prompted errors giving rise to a 15% or more penalty when there has been a failure to take reasonable care is punitive and will mark a dramatic increase in the level of penalties being collected especially in VAT and PAYE. It is also important to remember that in the case of any settlement, mitigation is only achieved by helping HMRC and by telling them and giving them access to the information to enable them to check the return and the disclosures to correct the return.

**3.7 HMRC online learning packages and links**

For returns filed on or after 1 April 2009, the new penalty regime applies. It relates to income tax, capital gains tax, corporation tax, PAYE, NIC and VAT. HMRC has provided an online training facility for Penalties which is worth setting aside a little time to work through. It is at:-
http://www.hmrc.gov.uk/about/new-penalties/NPA/HTML/NPA_101.html

The sections within this online learning package are

- Introduction and overview (7 pages)
- Legislation and calculation (11 Pages)
- The penalty assessment process (5 pages)
- Further information. (1 page)

This e-learning package is also being rolled out to 28,000 HM Revenue and Customs (HMRC) staff.

The aim of this e-learning package is to help equip frontline staff, managers, **agents** and taxpayers with a general awareness of the new penalty regime. The further information includes a link to more detail about penalties at http://www.hmrc.gov.uk/about/new-penalties/index.htm

There is a very full Q&A page at http://www.hmrc.gov.uk/about/new-penalties/faqs.htm

These links save a rainforest or two in printing but are well worth setting aside some time to read. You could even, if you wish, participate in the test. Please see Appendix 1

The training DVD has been aimed at being realistic and each scenario in the DVD deals with a different type of behaviour and should be treated in isolation. HMRC reminds its officers that the majority "of its customers try to comply with their tax obligations".

**3.8 Reasonable care**

Defining 'reasonable care' is going to be difficult until we have more experience of the attitude being adopted by HMRC. A taxpayer who fails to keep proper records is likely to face the penalty of failure to take reasonable care. In the Compliance Handbook at 81142, HMRC gives some examples of what they believe is a failure to take reasonable care. They say that a tradesman who fails to keep adequate records would be charged with failing to take reasonable care. They say that a shopkeeper who replaces a van with an estate car and wrongly claims input tax on the car would indicate a lack of reasonable care.

In the DVD accepting a contract to supply petite clothing and wrongly thinking this was zero rated instead of standard rated for VAT would be at the very least a failure to take reasonable care. HMRC have made it clear that they expect a manufacturer or shopkeeper to seek advice on any new area of business that is different from the normal business.

A failure to identify and check what element of an advertising budget related to disallowable entertaining and hospitality would according to HMRC constitute a failure to take reasonable care. In these circumstances in the DVD the failure to separately identify and code the disallowable entertaining of prospective customers would be treated as a failure to take reasonable care. However the question that is left unanswered is whether this is corrected at the time the accounts are prepared or indeed at the time of the tax return preparation.

Similarly private expenditure such as a private phone bill or private hotel bill should be a matter on which PAYE and NIC would be deducted. If an officer of HMRC highlights that a treatment is incorrect and an employer subsequently fails to follow the advice given by the compliance officer, HMRC would be seeking a penalty for failing to take reasonable care because the advice of HMRC has been ignored.

In the Compliance Handbook at CH81142, example 5 is Fizz Ltd. On several consecutive VAT return periods, Fizz Ltd tells you after the end of the return period that the return was wrong and gives you correct figures. Fizz's systems are not adequate enough to produce correct figures for the return by the end of the return period and this repeated inaccuracy may be seen as at least a lack of reasonable care. Cut off errors might now be at risk of a penalty which is a very worrying development.

### 3.9 Protective measures

Returning to PAYE and benefits in kind, the compliance cost for your clients could be reduced by obtaining dispensations whenever these are possible in regard to as many reimbursed expenses as are possible. There should also be set in place in the client's organisation a method of checking and learning from any errors that are identified and a system to correct what is wrong.

Reasonable care will remain difficult to define until we have greater experience. Anyone entering a complex or unusual transaction should seek advice from their adviser or from HMRC especially if the transaction is material. The more significant the amount of the transaction the higher the standard of care is expected to show that reasonable care was taken. This is a matter of commonsense. A newsletter to clients advising them of the new penalty regime might be appropriate!

### 3.10 Examples of HMRC's opinion on reasonable care

HMRC accepts that the test of what is reasonable care is subjective. This does create a degree of uncertainty but one can appreciate that defining what is 'reasonable care' would have been beyond the skill of the UK's Parliamentary Draftsmen. HMRC have made it clear that there is no obligation to employ an agent in order to avoid penalties.

The HMRC Compliance Handbook says at paragraph CH81120:

> 'In HMRC's view it is reasonable to expect a person who encounters a transaction or other event with which they are not familiar to take care to find out about the correct tax treatment or to seek the appropriate advice'.

Later at CH8454 they say:

> 'A person who asks a lay colleague or someone they meet in the pub for advice is not taking reasonable care. The person has an obligation to choose an adviser who is trained and competent for the task in hand'.

In the DVD, Mr Grieves sought a valuation from a local surveyor. That person appears competent and therefore if that was the only isolated error in this case study there would be no penalty charged on Mr Grieves for the fact that the surveyor gave an inadequate and low assessment of the transfer value between connected persons.

It is of course unrealistic to expect the average taxpayer to be able to check the workings of a professional tax adviser in what is often a complex calculation. But what is expected is for the taxpayer to review the return for its completeness and accuracy, ensuring that all material items have been included.

### 3.11 Correcting mistakes

This raises the issue of finality and the new penalty regime contains a significant new development. The tax law with which we are all familiar required a return to be completed to the best of the taxpayers knowledge as being correct and complete. If this was correct at the time of filing, there was often a dilemma created when the taxpayer discovered later than an error had been made. Even more common was the situation caused when HMRC made an error.

Professional Conduct guidance is not mandatory but recommends that the error is corrected by making full voluntary disclosure to HMRC. But in the past, especially when HMRC was responsible for the error, there could be difficulty if the client declined permission to make the disclosure. The new legislation makes it clear that a failure to correct a discovered error (within 30 days of an inadequate assessment being issued) will be treated as careless. Penalties may also apply if an inaccuracy in a document or return is discovered after it has been sent to HMRC.

If an inaccuracy was neither careless or deliberate at the time the document/return was sent to HMRC, it will be treated as careless if the person

- discovered the inaccuracy at some later time, **and**
- did not take reasonable steps to inform HMRC.

The new penalty regime is about changing customer behaviour and encouraging better compliance in the future. Penalties for inaccuracies will impact across VAT, CIS, Income Tax, CT, CGT, PAYE and NICs with effect from 1 April 2009.

The legislation for error penalties applies to various returns across various taxes.

- Personal returns under section 8 of Taxes Management Act 1970.
- Trustees returns under section 8A of Taxes Management Act 1970.
- Returns, statements or declarations in connection with a claim for an allowance, deduction or relief.
- Accounts in connection with liability to tax.
- Partnership returns and statements, declarations and accounts in connection with a partnership return.
- PAYE returns.
- CIS returns for the purposes of regulations under section 70(1)(a) Finance Act 2004 in connection with deductions on account of tax.

- Corporation tax returns under paragraph 3 of Schedule 18 of the Finance Act 1998.
- Returns, statements or declarations in connection with a claim for an allowance, deduction or relief.
- Accounts in connection with liability to tax.

- VAT returns under regulations made under paragraph 2 of Schedule 11 of VAT Act 1994.
- Other returns, statements or declarations in connection with a claim. This includes documents submitted under voluntary disclosure arrangements contained in regulations 34 and 35 of the VAT Regulations 1995.

### 3.12 New penalties to be alert for:

Under the new penalty arrangements, there is no longer a guarantee of no penalty for a VAT voluntary disclosure, except mistakes despite taking reasonable care, although it is still possible to reduce a careless penalty to nil.

Correction of an error on a later return under the VAT voluntary disclosure scheme would not meet the definition of an unprompted disclosure of the error. A fuller disclosure would be required.

Penalties for inaccuracies also apply to any document likely to be relied upon by HMRC to determine a person's liability to tax or repayment due, for example, PAYE form P810, repayment claim R40 or a short SA103..

Documents can include information given to HMRC in an e-mail or letter, by fax or telephone call.

And, as a reminder, a failure to correct a mistake discovered after the return has been filed.

### 3.13 Penalty Conditions

The inaccurate document will need to satisfy **two** conditions before a penalty can be charged.

The first condition is that the inaccurate document either amounts or leads to

- an understatement of the person's liability to tax, or
- a false or inflated statement of a loss by the person (this is new), or
- a false or inflated claim to repayment of tax.

The second condition is that the inaccuracy was careless, deliberate or deliberate and concealed. There is no penalty where the taxpayer makes a mistake despite taking reasonable care.

If a document contains more than one inaccuracy, a penalty will be charged for each inaccuracy. Some documents may include more than one inaccuracy. The Potential lost Revenue (PLR) could be calculated individually for each inaccuracy, but penalty calculations may be simplified by grouping inaccuracies resulting from the same behaviour and treating them as a single inaccuracy.

In the HMRC training video, the first error is a failure to include dividends in the return but then the taxpayer, Mr Grieves, phones to make a disclosure. The second error is different and different behaviour led to the mistake(s). Experienced practitioners might think that the final error which is a fraudulent claim for Capital Allowances on non existent machines using false documents taints the earlier less serious errors which emerged but this is not the case and each of the errors will be considered separately and penalty loadings applied.

There are new rules for penalties where there are group relief, losses, repayments and delayed tax (accounting timing issues).

More detail on these can be found in the Compliance Handbook.

- Group Relief is Compliance Handbook 82280.
- Losses is Compliance Handbook 82300.
- Delayed Tax guidance is Compliance Handbook 82380.

#### 3.13 Penalty Summary

An **unprompted** disclosure is made at a time when the person making it has no reason to believe HMRC has discovered or is about to discover the inaccuracy or under-assessment.

Otherwise it is a **prompted** disclosure. For a prompted disclosure, each penalty can be reduced by up to half of the maximum penalty.

The table below shows the maximum and the minimum penalties for each type of inaccuracy.

| Type of disclosure | Penalty | Careless | Deliberate | Deliberate and concealed |
|---|---|---|---|---|
| **Unprompted** | Maximum penalty | 30% | 70% | 100% |
| | Minimum penalty | 0% | 20% | 30% |
| **Prompted** | Maximum penalty | 30% | 70% | 100% |
| | Minimum penalty | 15% | 35% | 50% |

**Table of new tax penalties** which apply to returns filed after 1 April 2009

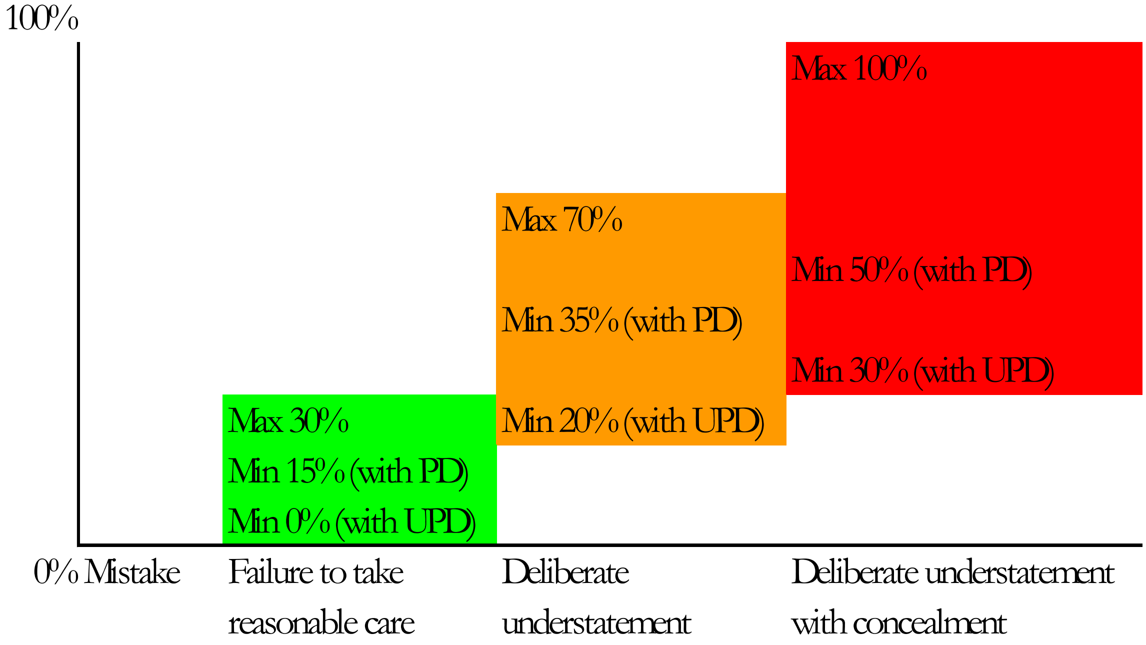
| | Prompted disclosure | Mistake despite reasonable care | Failure to take reasonable care | Deliberate understatement | Deliberate understatement with concealment |
|---|---|---|---|---|---|
| 1. | Max | 0% | 30% | 70% | 100% |
| 2. | Min: Prompted | 0% | 15% | 35% | 50% |
| 3. | Max reduction for prompted (1. – 2.) | 0% | 15% | 35% | 50% |

| | Unprompted disclosure | Mistake despite reasonable care | Failure to take reasonable care | Deliberate understatement | Deliberate understatement with concealment |
|---|---|---|---|---|---|
| 4. | Max | 0% | 30% | 70% | 100% |
| 5. | Min: Prompted | 0% | 0% | 20% | 30% |
| 6. | Max reduction for prompted (4. – 5.) | 0% | 30% | 50% | 70% |

The maximum reduction in penalties, from the starting point of the maximum (1. above), depends on whether the person made disclosure after prompting (3.) or not (6.). To summarise the position, if an error is discovered it makes sense to disclose it fully, helping HMRC by revealing the nature of the error, the quantity and getting it sorted as quickly as possible.

## The New Penalty Regime – what the stepped approach looks like

UPD = Unprompted voluntary disclosure; PD = Prompted (after HMRC challenge) disclosure



**3.15 Practical considerations:**

The old penalty regime continues to apply for returns filed before 1 April 2009. In a hypothetical case involving an enquiry into the return filed after 1 April 2009 which resulted in a settlement re-opening earlier years after a discovery and covering six years, the tax (and NIC) would be quantified for all years.

The old penalty regime would apply for the first five years of the settlement (and this could be really important if the settlement involves PAYE or VAT in any of these years) and the new regime would only apply for the last year of the enquiry.

**3.16 Mitigating the penalty after an error is identified**

The quality of the disclosure depends upon the person:

## Telling

Telling includes

- admitting the document(s) was inaccurate or that there was an under-assessment
- disclosing the inaccuracy(ies) in full, and
- explaining how and why it (they) arose.

## Helping

Helping includes

- giving reasonable help in quantifying the inaccuracy or under-assessment.

## Allowing access to records

Allowing access to records is where a person responds positively to requests for information and documents, and allows access to

- their business and other records, or
- other relevant documents.

### Conditions for the new Penalties

The first penalties shall be charged in respect of inaccuracies in returns or documents

- for return periods starting on or after 1 April 2008
- where the due date for filing is on or after 1 April 2009.

**Both conditions must apply in order for the inaccuracy to come under the new regime.**

Chapter 4

Recent developments in Penalties and Reasonable excuse

In Anthony Leachman t/a Whiteley and Leachman v Revenue & Customs [2011] UKFTT 261, Mr Leachman appealed against the £400 penalty imposed by HMRC for late filing of employer end of year returns (P35s). His argument was that, as a matter of fact, he believed that his accountant would file the P35 whilst his accountant believed that the appellant would personally attend to it. I'd describe this as being in a guddle.

This appeal raises two issues. The first is whether a mistake of fact can amount to a "reasonable excuse". The second is, if it can, whether on the facts of this case there is a reasonable excuse.

Geraint Jones QC, the judge ruled: " *If one person genuinely believes that another person is undertaking a particular task and that other person genuinely believes that the original person is undertaking that task, each is labouring under a mistake of fact. There is no good reason either in law or in logic, why such a mistake of fact should not amount to a reasonable excuse for a failure to file a particular document on time or to undertake some other task."*

What becomes really interesting is that he went on to observe that the European Court of Human Rights in Jusilla v Finland (73053/01) ECtHR (Grand Chamber) *….."decided that a penalty or supplement charged by the revenue authorities of a member country is in the nature of a criminal penalty and thus any proceedings in respect of it attract the provisions of article 6 ECHR (right to a fair trial). Thus, in my judgement, it is for HMRC to satisfy me, so that I can be sure, that there was no mistake of fact of the kind attested to by the appellant."*

Mr Leachman was successful in his appeal. He had a reasonable excuse for the failure to file. As the judge said:

*"It follows that in my judgement the appellant has established a reasonable excuse for the failure that has resulted in the penalties being levied by HMRC. I find that his state of mind was that the necessary P35 was being submitted by his agent and that he could rely upon the action of his agent to fulfil his filing obligation. I also find that that state of mind was held genuinely, but mistakenly. That situation is totally different to a situation where a taxpayer relies upon his agent do a particular act but the agent neglects to do it."*

The full decision can be read at:

http://www.bailii.org/uk/cases/UKFTT/TC/2011/TC01125.html

In previous years, many ICAS members have complained to me when their clients have incurred a penalty yet HMRC failed to advise that a penalty was accruing. There might be some comfort in another of Geraint Jones QC decisions. In N A Dudley Electrical Contractors Ltd v Revenue & Customs [2011] UKFTT 260 there is one simple ground of appeal, as set out in a letter of 16 October 2008 from the appellant's accountants, which is that no P35 was issued to the appellant by HMRC and so it could not return that which it had not received.

For the tax year ended 5 April 2007 the appellant's P35 was filed by its accountants using an on line filing facility. The appellant had not registered to undertake its own online filing. HMRC does not contend that the appellant had registered for or elected to undertake online filing. Instead, HMRC contends that because the P35 for the year ended 5 April 2007 was filed online, it was entitled to take it or to assume that the appellant would wish to use the online filing facility in those subsequent years during which it had a choice about whether to file on paper or online. HMRC says that because it made the assumption that the appellant would file subsequent returns online, it desisted from sending a paper return to the appellant in readiness for it to file it by the 19th May 2008. The default penalty has been levied as £400 for the period 20th May 2008 - 19th of September 2008 and a further £300 for the period 20th September 2008 - 5thDecember 2008.

I found the judgement to be a really interesting read. Geraint Jones QC said:

*"I should also make it clear that if the first penalty had stood, in the sum of £400, the second penalty, in the sum of £300, could not stand. That is because HMRC , well knowing that the P35 had not been filed on time, desisted from sending a first penalty notice to the appellant until 29 August 2008, being 19 days after the start of the period when a second penalty (£300) could be levied. That is not plain dealing. It might be the case that there is no obligation upon HMRC to issue a reminder but given that it has the statutory power and/or duty to issue a penalty notice, that should be done timeously and well before any second penalty period begins because, as a matter of common fairness and justice, that operates to put the defaulting party on notice that it is in default and gives that party a proper opportunity to remedy that default. In my judgement it is not open to HMRC to take advantage of its own default in sending a timeous default notice to a taxpayer. That would offend the common law principle of fairness and most right thinking members of the public would find it repugnant, especially on the part of a public body. In those circumstances, even if the initial £400 penalty had stood, the second penalty of £300 could not have stood."*

The Full decision can be found at:

http://www.bailii.org/uk/cases/UKFTT/TC/2011/TC01124.html

In Wald v R&C (TC01052) and American Doctor was paid £14,617 removal expenses by his employer but failed to include the excess over the £8,000 limit in his 2006/07 return. I may know about s271 and s 287 ITEPA 2003 but is it realistic to expect an American to know about and understand such complex legislation?

Now let me remind you of history. In the UK it used to be that when an employer re-imbursed removal expenses this was tax free. I understand that this is currently the position in USA. In 1993, the Inland Revenue conducted research which showed that the average amount being reimbursed to an employee by the employer on relocation for work purposes was £24,000 and even the cost for a civil servant was £16,000. So the limit was set at a level way below what had been researched as the commercial cost. It is not a benefit to face upheaval of home and family. Since it was introduced in 1993, the limit of £8,000 has never been increased (even though such an increase is long overdue). This is bad legislation which discourages workforce mobility.

David Wald's appeal was against a penalty determination dated 1 February 2010, imposing on the Appellant a penalty under s.95(1)(a) of the Taxes Management Act 1970 (the "TMA") "for negligently delivering to an officer of HMRC an incorrect return under Section 8 of that Act" for the year 2006/07. Mr. Wald was represented by Robin and Alastair Summers who had not advised on the return preparation but took the appeal on a pro bono basis because of HMRC's maladministration in imposing a penalty is so obvious to any reasonable person. HMRC were represented by Mr Maffia.

HMRC accept that the Appellant had not received a P11D from his employer Queen Mary University of London (QMUL) before he filed his 2006/07 tax return. The taxable portion of his relocation expenses (£6,617) was therefore omitted from his return. He made a mistake. The tax was £2,646.80. HMRC opened an enquiry which was quickly closed with Mr Wald accepting the additional tax was due and had to be paid. The appeal is about the 10% penalty or £264.68.

Mr Wald's argument was that he was not negligent. It was a case of innocent error. Immediately upon being informed of the error, he acted with utmost urgency to rectify the error and pay the correct amount of tax with interest. His expertise is in cardiac surgery, not tax affairs. It is unreasonable to expect him to know the rules of taxability of relocation expenses. The imposition of the penalty by HMRC lacks common sense and perspective and is an inappropriate use of public resources. I agree with that argument.

**DR CHRISTOPHER STAKER (Tribunal Judge) MR M M HOSSAIN (Tribunal Member)** got this decision hopelessly wrong. Their decision is an embarrassment to decent sensible people but they were faced with HMRC pursuing something that should never have been pursued. The tribunal decided, based on the balance of probability as a standard of proof, that HMRC had sufficient to contend that Mr. Wald had been negligent.

Paragraph 17 discloses that: "*It is not in dispute that in the relevant tax year, the Appellant received a payment of £14,617 in settlement of relocation removal expenses, and that this amount was not included in his tax return. The Tribunal considers that the amount was of sufficient significance that it would not readily be overlooked or forgotten."*

Cynically, I might suggest that hidden away in the 20 odd pages of the guidance notes that accompany a return it is quite clear.

*"When you move house any payments you receive from, or any goods or services provided to you by your employer are part of your taxable earnings. However, if you move house for your job and meet certain conditions, the first £8,000 of any help you receive is exempt from tax. ... [Y]our employer is required to tell us about the excess of any relocation expenses and benefits over the £8,000 limit. Your employer should give you details of the amount to include in your entry in box 1.22."*

Of course in this case the employer had not given him a P11D before he completed his return. He was an American citizen, required to complete his US return as well and in the US relocation expenses are not capped and they are not taxable.

The tribunal went on to find, at paragraph 21 that:

*"The Tribunal finds on a balance of probabilities that the failure to include the relocation expenses was due to negligence for which the Appellant was responsible, rather than a wholly innocent error."*

In theory under the old penalty regime, HMRC could charge a maximum of 100% of the tax lost. In this case HMRC allowed a20% reduction of the maximum penalty for prompt disclosure after being challenged, 40% for cooperation and 30% for the limited seriousness. Interestingly, the case discloses that there are sensible human beings in HMRC and two officers commented that no penalty should be sought. Unfortunately, the case working officer decided to proceed with a penalty of 10%.

Paragraph 25 records: *The Tribunal is not persuaded that the penalty imposed was excessive.*

That is such an unfair and unjust decision that HMRC should hang its head in shame for imposing the penalty. Of course the tribunal is only human and human beings do make mistakes. This was a bad judgement and a bad decision.

In Anthony Fane v Revenue & Customs [2011] UKFTT 210 (TC), the issue was whether a penalty on an isolated error could be suspended under paragraph 14 Schedule 24 Finance Act 2007.

Mr Fane was employed by BNP Paribas ("BNPP") as Head of the Debt Capital Markets Fixed Income Group until his employment was terminated in February 2009. In October 2008 Mr.Fane received a stock payment from BNPP. The income tax to be deducted under the PAYE system in that month was £40,302. This amount exceeded his gross salary in that month. BNPP therefore made an advance of £30,729.12 to cover this amount and his net pay was reduced to nil. This advance was later deducted from his termination payment paid on 5 March 2009. The Appellant thought that the £30,729.12 deduction made by his employer to cover his PAYE liability was an actual deduction of PAYE. Confused? Well Mr. Fane was.

His return was selected for enquiry because his return differed from the end of year return submitted by his former employer. The discrepancy was that the employment income, including the termination payment, disclosed on the Appellant's return amounted to £504,605.00 when compared with an amount of £498,306.08 on the employer's return. In other words he was reporting a tax exempt ex gratia payment as taxable. He was confused and in a guddle. The Appellant, on his return, showed the amount of tax deducted as £145,778.00 in contrast to the figure returned by the employer of £110,486.80. He had incorrectly assumed that the amount shown as a deduction in respect of the "Advance" on his payslip was a deduction of PAYE. This of course is the error which was viewed by HMRC as careless.

The Appellant believed that the net amount paid to him had tax already deducted from it in respect of the stock payment. Consequently in his income tax return he overstated the amount of tax deducted from his termination payment giving rise to an additional net tax liability of £30,771.

The penalty charged was £4,615.65 (15% x £30,771). This is the minimum for a prompted disclosure if there has been a failure to take reasonable care. Now let us pause for a moment. Mr. Fane has the trauma of losing his job. His payslips from his employer are lacking in clarity.

He was involved with a stressful legal dispute with BNPP concerning the termination of his employment.

He overdeclares some exempt income and he claims too much tax has been deducted but he is using figures provided by his employer. But the figure of tax is substantial and maybe demands to be checked? This was a case of the taxpayer making a mistake but HMRC viewed it more seriously.

The officer then considered whether suspension of the penalty was appropriate and referred to the HMRC Compliance Handbook CH 83130, CH 80 3150 and CH 83160. This makes it clear that conditions needed to be set that, if met, over a set period would help Mr Fane avoid an inaccuracy in his return arising due to similar circumstances as those occurring. But termination is not a recurrent event. It fails the conditions in the HMRC guidance and so suspension is not available.

In my earlier podcast of 6 June 2011, I criticised HMRC for seeking a penalty on Dr Wald, an American cardiac surgeon who received relocation expenses of more than the statutory limit of £8,000 and failed to include the excess. This case is reinforcing the principle that HMRC expect more of taxpayers than common sense suggests a lot of taxpayers are capable of delivering. HMRC’s position is that it was reasonable to expect a person, who was unsure, would take care to find out the correct position or would draw HMRC's attention to the relevant entries. The transactions were unusual and therefore care was needed to ensure that all transactions were fully understood and that the correct documentation was obtained.

The tribunal ruled at paragraph50 that when he misunderstood his payslip and mis-stated the amount of tax deducted he failed to exercise the standard of care expected of a reasonable person. The transactions were unusual, particularly the refund of the advance by his employer, and this should have alerted the Appellant to the need to pay special attention and if necessary seek advice from his adviser or from HMRC. He failed to do this. The error was entirely innocent. It was, however, careless.

They also ruled that HMRC's guidance indicating that a one-off error would not normally be suitable for a suspended penalty is understandable and, in their view, justified.

Mr Fane had a really bad day. This decision must be a warning to risk assess and take more care for anything unusual.

The big worry about penalty assessments is that a sensible commercial decision might be to accept the penalty even though HMRC are wrong to seek it.

There is an expectation that HMRC should behave in an honourable way and play fair. In HMD Response International v Revenue & Customs [2011] UKFTT 472, a small charity which has some employees should have filed an end of year return P35. Mr John Williams, a chartered accountant believed he had done so and the first that the charity knew of the failure was when it received a penalty notice in the sum of £400 on 27 September 2010.

Mr Williams appealed the penalty which had grown to £500, immediately filed the end of year return and wrote seeking a review of the penalty. Nothing happened for 6 months except HMRC sent HMRC sent a threatening letter to the appellant alleging, quite wrongly, that the appellant had been ignoring *"our(HMRC's) efforts to resolve the matter of your outstanding liability."* In the light of HMRC inertia, in the tribunal's judgement, it was quite wrong of HMRC to send a letter which threatened, in its second paragraph, to levy distraint by sending somebody to the appellant's premises to seize goods to be sold at public auction. Such high-handed threatening action was not justified. It smacks more of the conduct of a disreputable debt collector than of responsible conduct by an organ of the state.

The appellant's appeal is put on the basis that its P35 was sent to and filed with HMRC on 16 May 2010. HMRC denies that it was received. Alternatively, says the appellant, the fact that it, by its agent Mr Williams, honestly and genuinely believed that the P35 had been filed by the due date amounts to a reasonable excuse for the default thereafter (if default there was) at least until such time as it was put on notice that the honest and genuine belief was incorrect.

It is a common compliant that HMRC does not receive things which have been sent. They have a copy letter on file but no proof of postage. As sole practitioners, they lack the corroboration under Scottish law necessary for having evidence. But a tribunal can accept a statement and form its own judgment on the credibility of the witness. The question and complaint was whether they needed to send everything by recorded delivery and the answer is "no". As an observation though, HMRC seem to lose a great deal of correspondence. I believe HMRC monitor the post on hand and this indicates that performance standards are being met and broadly there are no serious arrears of post unanswered. Yet here is a reported decision confirming that HMRC took over 6 months to answer an appeal and in the meantime the debt collection activity continued inappropriately.

The European Court in the **Jussila v Finland (2009) STC 29** case has recognised that in certain circumstances a reversal of the burden of proof may be compatible with Article 6 ECHR, but did not go on to deal with the issue of whether a reversal of the burden of proof is compatible in a case involving penalties or surcharges. This is important because a penalty or surcharge can only be levied if there has been a relevant default. If it is for HMRC to prove that a penalty or surcharge is justified, then it follows that it must first prove the relevant default, which is the trigger for any such penalty or surcharge to be levied.

It is for HMRC to prove that a penalty is due. That involves HMRC proving, on the balance of probabilities, that the required end of year filing did not take place by 19 May 2010. In the tribunal's judgment HMRC has produced no, or insufficient, evidence to that effect and, for that reason alone, this appeal must succeed.

So far as the State and its several manifestations are concerned (HMRC being one such manifestation), there is a common law duty of fairness. In R v S. S. Home Department [2003] EWCA Civ 364 at paragraph 69 the Court of Appeal expounded the principle as related to the decision making process under scrutiny in that appeal. In S. S. Home Department v Thakur [2011] UKUT 151 the Upper Tribunal, in paragraph 12 of its Decision, also recognised that principle, again in the context of a decision making process.

Geraint Jones QC stated at Paragraph 18:

*"Thus, in our judgement, the appellant is entitled to rely upon the common law duty of a public body to act fairly not just in its decision-making process but also in administering its statutory powers. We are in no doubt that such a body does not act fairly when it deliberately desists from sending a penalty notice, for four months or more, knowing that the effect will be to impose a minimum penalty of £500 upon somebody whose sin may amount to no more than oversight or forgetfulness."*

The words "reasonable excuse" "*must be given their ordinary and natural meaning. If Parliament had intended to say that an appellant must prove some exceptional circumstance, it could and should have said so. It did not choose to say so. Instead, it used the expression "reasonable excuse" which HMRC has quite wrongly sought to elevate to something more onerous than the test specified by Parliament. The fact that section 118 Taxes Management Act 1970 (the definition section) does not contain a statutory definition of "reasonable excuse" is sufficient to indicate that those words or that expression must be given the plain and ordinary meaning that they bear in everyday usage. That meaning cannot be said to extend to demanding that an appellant demonstrates that there were exceptional circumstances or some exceptional event beyond its control before a "reasonable excuse" can be established."*

This question of the burden of proof is important. This is not to require HMRC to prove a negative. It would probably be sufficient for HMRC, by a responsible officer, to provide a statement explaining precisely how its online filing system works (or is supposed to work) and stating that the witness has examined the relevant appellant's account to check whether any relevant on line filing took place; and then giving the result of that check. If the evidence is to the effect that no such online filing took place or is recorded as having taken place, it is at that stage that an evidential burden would shift to the appellant.

This decision, though persuasive only, is worth a read. It is critical of HMRC's procedures for issuing penalties and the failure to give early notification.

http://www.bailii.org/uk/cases/UKFTT/TC/2011/TC01322.html

The R v S. S. Home Department [2003] EWCA Civ 364 decision can be read at:
http://www.bailii.org/ew/cases/EWCA/Civ/2003/364.html

In Consult Solutions v Revenue & Customs [2011] UKFTT 429, the company had paid the tax but its attempt to file the PAYE end of year return was unsuccessful. The issue was whether it had a reasonable excuse for the failure to submit an employer's annual return (P35 and therefore the filing penalty of £500 sought by HMRC should not apply.

The company had only been trading for eight months, and this was the first time that it had been required to file an end of year return on line. It logged onto its account and believed it had filed on 17 May 2010. HMRC waited 4 months before issuing the penalty notice. The Appellant was advised by HMRC that its on line return failed because of a systems or internet error. The Appellant pointed out that it had paid over the necessary tax one week prior to the filing date.

HMRC argued that the company should have known that the submission of its return on the 17 May 2010 was unsuccessful because it did not receive an electronic message confirming receipt. The company had met its obligations to collect and return the requisite tax, and submitted a new return in good time after discovering that the return on 17 May 2010 had not been received by HMRC. It acted as a reasonable person should.

The Tribunal, having regard to all the circumstances, was satisfied that the Appellant has established a reasonable excuse for its failure to submit in time an employer's annual return (P35) for the tax year ending 5 April 2010.

http://www.bailii.org/uk/cases/UKFTT/TC/2011/TC01282.html

This is only one of a long line of filing penalty cases which the HMRC has lost. Why do they keep taking these appeals when the Tribunal has ruled, repeatedly, that the HMRC policy of delaying the penalty notice is wrong and that HMRC have been interpreting 'reasonable excuse' wrongly and need to apply common sense and the everyday meaning to the words? You may recollect that last week's podcast (29 August 2011) summarised the HMD case and made it quite clear that HMRC were not entitled to a penalty when they failed to notify the taxpayer that penalties had started to accrue.

In Buxton Rugby Union Football Club v Revenue & Customs [2011] UKFTT 428, Anne Redston QC at the FTT decided that the rugby club had a reasonable excuse for its failure to file employer (P35) end of year returns over a 3 period. The Club is a small local rugby club with one part-time paid staff member, the barman. Most of the work, including the filing of tax returns and the making of tax payments, is carried out by volunteers.

The Club Treasurer, had filed the 2004-05 return online but found it complex. He decided to revert to paper filing for 2005-06. However, because the Club had used online filing for 2004-05, HMRC did not issue a paper form for 2005-06. The Club missed the filing deadline of 20 May 2006. The total tax and NICs for the year was £565.18. Almost two years later, HMRC advised the Club that it had missed the filing deadline and charged it a penalty of £900.

The judge considered that HMRC's formulation of the "reasonable excuse" defence is too narrow and reflects neither the normal and natural meaning of the term (per *Dudley*), nor the earlier *dicta* of this Tribunal. In the second year, the P35 was posted two days after the due date and so received by HMRC one or more days later. HMRC would thus have been empowered to issue a penalty of £100. In fact they have levied a penalty of £400 followed by a further penalty of £100. The penalty is thus clearly incorrect. In what I might describe as natural justice the judge was unable to say that £100 would be the "correct amount" of penalty to impose on a 2006-07 P35 which was late by only a few days, and as a result she had not replaced the £400 penalty with one for £100. Instead, she simply set aside the incorrect £400 and £100 penalties.

She accepted the Treasurer's evidence that he filed the third year and vacated the penalty.

http://www.bailii.org/uk/cases/UKFTT/TC/2011/TC01281.html

I think HMRC have earned some criticism for employer end of year penalty notices (late filing penalty P35). Several judges at the First Tier Tribunal (FTT) have ruled that HMRC need to notify errant taxpayers if they become liable to a penalty.

This is another of those cases that illustrate that HMRC's attitude to penalty imposition is overly aggressive. The company's (DWS) business is the supply and maintenance of water coolers to customers' premises. The director and shareholder, Mrs Newell was ill, suffering from stress. The company had changed its name from Direct Water Solutions Ltd to DWS Environmental Ltd on 7 November 2008. On 5 August 2009 the Appellant moved premises and informed HMRC of their change of address. The company was late with its VAT. HMRC did not activate the change of name or the change of address and sent the surcharge notices addressed to Direct Water Solutions Ltd and to the Appellant's old address. The company and its director were unaware of the problem until the bailiffs arrived as a result of the non payment of the surcharges.

None of the notices had been received. It appeared that the surcharge notices had been sent to their old address. HMRC must have had the correct address for the bailiffs to be able to visit.

Section 98 of VATA states

> Any notice, notification, requirement or demand to be served on, given to or made of any person for the purposes of this Act may be served, given or made by sending it by post in a letter addressed to that person or his VAT representative at the last or usual residence or place of business of that person or representative.

HMRC denied having received the notification of change of name and change of address but there was other evidence that showed the taxpayer had made repeated attempts to notify and update HMRC's records. All practitioners will have view on the credibility of HMRC not having received the notifications especially when so many practitioners have tales to tell of HMRC losing post, correspondence and returns, even files, with monotonous regularity.

The surcharge notices had not been validly served in accordance with VATA and so the default surcharge penalties were cancelled..

http://www.bailii.org/uk/cases/UKFTT/TC/2011/TC01339.html

**Reasonable Excuse P35 late in Writtle College Services Ltd v Revenue & Customs [2011] UKFTT 478**

Anne Redston QC was the judge at the FTT who heard the appeal against a £400 penalty imposed for late filing of the 2009/10 end of year return of payments due under Pay As You Earn (P35).

On 8 April 2010 the company completed their P35. It was submitted to HMRC but the company was not aware that, in order to make a successful submission, it was necessary to "untick" the "test submission" box.

HMRC acknowledged receipt. The company assumed that their P35 had been filed. By letter dated 27 September 2010, HMRC issued a penalty notification for not filing the P35. It charged the company a penalty of £100 per calendar month for the period from 20 May 2010 to 19 September 2010, a period of four months.

An excuse is likely to be reasonable where the taxpayer acts in the same way someone who seriously intends to honour their tax liabilities and obligations would act. Here, the company completed the online return in good time, and believed it had been successfully submitted.

HMRC's message could easily mislead taxpayers who had not noticed that they had to 'untick' a box in order successfully to file a return. The tribunal found the company had a reasonable excuse and the penalties were not due. The decision is short and worth a read.

http://www.bailii.org/uk/cases/UKFTT/TC/2011/TC01325.html

There have been too many cases recently in which HMRC have lost and been criticised because their interpretation of "reasonable excuse" has been overly harsh and unreasonable. The asymmetry of standards; HMRC make many mistakes but suffer no sanction yet expect perfection from taxpayers, is unsatisfactory. The string of cases they have lost on what is a reasonable excuse illustrate the deficiency of their internal review process. Culturally, as an organisation, HMRC are cynical and they see nothing wrong with their interpretation of "reasonable excuse". So they keep going to tribunal and losing cases in which, in my subjective opinion, they should have accepted a reasonable excuse when it was first made. It illustrates why an independent review is essential and why HMRC must never be judge and jury on any important issue.

## Chapter 5: **Conclusion**

In summary, an inaccuracy made by a person in a document or return may be

- an inaccuracy made despite the person taking reasonable care in which case **no penalty will be due**, or
- careless, or
- deliberate but not concealed, or
- deliberate and concealed.

Penalties for inaccuracies are designed to address the behaviour that led to the inaccuracy.

Penalties for deliberate inaccuracies are therefore higher than those for careless inaccuracies.

There are two deliberate categories within the legislation to reflect different degrees of seriousness. Higher penalties are charged where a person has taken active steps to cover up a deliberate inaccuracy.

According to HMRC, the regime aims to

- drive up and encourage voluntary compliance
- encourage and influence positive customer behaviour. For example, the way a taxpayer maintains his/her books and records from 1 April 2008 could later impact upon their liability to a new type penalty if they make an error
- educate and support those who try to comply
- penalise those who deliberately evade tax.

In practice, this new penalty regime is intended to act as a deterrent. But there is little doubt that taxpayers who submit incorrect returns or incorrect documents will face higher penalties than they have in the past.

For employers and VAT registered traders, the new penalty regime will bite for mistakes that in the past would never have been penalized. Prompted errors arising from a failure to take reasonable care will start at 15%.

When errors do occur, it is therefore important to establish as clearly as possible why the error arose and to document any defence which might be used to mitigate the penalty. To summarise the position, if an error is discovered it makes sense to disclose it fully, helping HMRC by revealing the nature of the error, the quantity and getting it sorted as quickly as possible.

Tax Practice is getting harder and more challenging. A balance has to be found which respects taxpayers' rights of privacy with the powers that are necessarily required to check a return.

I hope that the webinar this morning has given you a better idea of where the pivot point lies. If something seems unfair, it is worth challenging HMRC's view on the matter.

**Appendix 1**

Test your knowledge of Schedule 24 FA 2007 Penalties using HMRC's test below

**Question 1**

Which of the following statements is true?

a) The first penalties shall be charged in respect of inaccuracies in returns or documents: for return periods starting on or after 1 April 2008; where the due date for filing is on or after 1 April 2009.

b) The first penalties shall be charged in respect of inaccuracies in returns or documents where the due date for filing is on or after 1 April 2009.

Please tick a box a) ☐ b) ☐

**Question 2**

Please complete the sentence.

The amount of penalty is based on the

| | | |
|---|---|---|
| a) | understated tax | |
| b) | Potential Lost Revenue (PLR) | |
| c) | potential lost yield | |
| d) | assessed tax | |

**Question 3** (multiple answer)

Which of the following outcomes is the new penalty regime aiming to achieve?

| | | |
|---|---|---|
| a) | Encourage and influence positive customer behaviours | |
| b) | Drive up and encourage voluntary compliance | |
| c) | Educate and support those who try to comply | |
| d) | Penalise those that deliberately don't comply | |
| e) | Increase penalty yield | |

### Question 4

What percentage of Potential Lost Revenue is the maximum where the inaccuracy in a document is made deliberately but without concealment?

| | | |
|---|---|---|
| **a)** | 0 | |
| **b)** | 30 | |
| **c)** | 70 | |
| **d)** | 100 | |

### Question 5

A disclosure is made by telling us about it, giving us help in quantifying the inaccuracy/under-assessment and allowing us to access the person's records.

Is the following statement **True** ☐ **or False?** ☐

A penalty may be reduced depending upon the quality of the person's disclosure of the inaccuracy.

### Question 6

Which of the following behavioural categories will not be liable to penalty?

| | | |
|---|---|---|
| **a)** | Careless | |
| **b)** | Deliberate and concealed | |
| **c)** | An inaccuracy made despite the person taking reasonable care | |
| **d)** | Deliberate but not concealed | |

**Question 7**

Is the following statement **True** ☐ **or False?** ☐

When calculating the Potential Lost Revenue National Insurance Contributions are excluded.

**Question 8** (multiple answer)

The new legislation introduced in Finance Act 2007, applicable from the 1 April 2009 applies to errors in returns and documents for which of the following taxes?

| | | |
|---|---|---|
| **a)** | VAT | |
| **b)** | Construction Industry Scheme | |
| **c)** | Income Tax | |
| **d)** | Capital Gains Tax | |
| **e)** | Excise Duties | |
| **f)** | National Insurance Contributions | |
| **g)** | Corporation Tax | |
| **h)** | PAYE | |

**Question 9**

Which of the following statements is true?

| | | |
|---|---|---|
| **a)** | Suspension of a penalty can only be considered for an inaccuracy made despite the person taking reasonable care. | |
| **b)** | Suspension of a penalty can only be considered for careless inaccuracy. | |

**Question 10**

Can a person appeal against the decision not to suspend a penalty?

Yes ☐ No ☐

You have reached the end of the knowledge test. Now compare your answers with those on the next few pages.

1. (a) 2. (b) 3. all of (a to d) exclude (e) 4. (c) 5. true

6. (c) 7. False 8. all except (e) 9.(b) 10 yes

Smallforms Ltd is a family company which manufacters and distributes quality children's clothing (generally zero rated for VAT). It employs 150 staff. Husband and wife David and Susan Grieves are the directors.

The CT 600 for YE 30/4/2009 together with accounts has been selected for a joint CT/VAT compliance check and a standard information package (SIP) prepared to assist the HMRC officer.

The records and documents have been reviewed by HMRC after being requested and an interview with Mr. David Grieves arranged.

**Scenario 1 : phone disclosure of £10,000 dividend omission**

**Scenario 2: Valuation of property transferred to Grieves (reasonable care if valuer used)**

**Scenario 3:Transposition error £75,000 or £70,500 (is there evidence of carelessness?)**

**Scanario 4: Business entertaining and private hotel bill**

**Scenario 5: VAT error on adult clothing (standard rated)**

**Paul Anderson new GP HMRC Officer doing VAT, PAYE & CT**

**It is for the HMRC caseworker to establish all the facts and decide whether or not a penalty is exigible. Each error should be considered separately. The behaviour that led to the error should be identified and at all stages it is important to document what evidence emerges and how it is explained.**