

Please, sir...

...I want some more. **JOHN BRASSEY** believes that advisers should ask for penalties to be suspended more often.

Having battled for many months (and possibly years), with HMRC, negotiating hard, the enquiry has finally concluded. It was agreed that the client's behaviour was careless and that there had been an under-declaration. Tax was payable and late payment interest was due, as well as a penalty. The penalty has been mitigated as much as possible. All in all, a great result for the client. Well done.

But wait ... has something been forgotten?

Something is nagging at the back of your mind from a penalty seminar you went to ... suspended penalties.

Has FA 2007, Sch 24 para 14 been considered? Has the client been left exposed and should you, like Oliver, have asked for more?

A check of HMRC's *Compliance Handbook Manual* at CH83143 shows that we can relax. The under-declaration related to a one-off transaction so we can breathe easily and the department will not suspend the penalty. Case closed ... or is it?

The Eastman case

In August 2016, the First-tier Tribunal heard the case of *Eastman* (TC5276).

The appellant sought to challenge HMRC's fundamental principle that a penalty relating to a careless error, which will not be repeated due to the one-off nature of the transaction, cannot be suspended. The case was decided in favour of the taxpayer.

KEY POINTS

- Is FA 2007, Sch 24 para 14 always being considered in investigation cases?
- HMRC's guidance has been that a penalty will not be suspended if the under-declaration relates to a one-off transaction.
- In *Eastman*, the First-tier Tribunal held that a penalty could be suspended in a single under-declaration.
- Previously, HMRC's view had been upheld in the case of *A Fane*.
- An ongoing obligation to file after the failure to disclose should mean that FA 2007, Sch 24 para 14(3) may apply.
- Omitting to request a penalty suspension could be seen as negligent.



© Romulus/Warwick/Kobal/REX/Shutterstock

The case concerned the sale of a building that had been used in the business of Mr Eastman and his business partner (both shareholders and directors of the limited company). The company had been sold, following negotiations by Mr Eastman, during the previous year and the capital gains from this sale were returned.

After negotiations by Mr Eastman's business partner, the building was sold in the following tax year, but Mr Eastman failed to declare his portion of the capital gain. The accountant was consistent throughout and was aware of both transactions.

HMRC enquired into the return and initially sought to assess Mr Eastman on the basis of deliberate behaviour. However, it agreed, during the course of the enquiry, that the behaviour was careless and a penalty was charged on that basis. The accountant asked whether HMRC would suspend the penalty, but was told that because this related to a one-off transaction it was not eligible to be considered for suspension.

Although not the focus of this article, I believe it would make sense at this point to detail the criteria that HMRC uses to gauge whether a careless penalty can be considered for suspension. These are to:

- (1) identify the underlying cause of the careless inaccuracy;
- (2) identify any future careless inaccuracies that could stem from the behaviour in point 1; and
- (3) consider and agree specific suspension conditions.

More?

This was not the first time that HMRC's stance on whether a careless penalty could be suspended had been challenged. *A Fane* (TC1075) was the leading case here and the First-tier Tribunal agreed that HMRC was correct in its application of the legislation, stating:

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

So the department had its interpretation, this was backed up by the *Fane* judgment and it has been applied rigorously in the consideration of suspending penalties ever since. But was HMRC correct?

The *Eastman* case considered the identification of the underlying cause of the careless inaccuracy. Why and how did this arise? This appears to be fundamental in the application of Sch 24 para 14(3), which says:

‘HMRC may suspend all or part of a penalty only if compliance with a condition of suspension would help P to avoid becoming liable to further penalties under paragraph 1 for careless inaccuracy...’

In other words, an error has been identified that is due to the careless behaviour of the taxpayer. By assisting the taxpayer to correct their behaviour, through specific conditions, further under-declarations of tax, linked to careless conduct, can be avoided.

HMRC guidelines state a one-off error cannot be suspended. However, a one-off error is not, as per point 1 above, an underlying cause. Rather, the one-off error is the *result* of the underlying cause. Mr Eastman’s record-keeping was insufficient to allow him to accurately assess the accuracy of his tax return. If Mr Eastman had maintained a better system for recording capital transactions, he would have been able to review his tax return and ascertain whether it was deficient. By improving his record-keeping and changing his behaviour, he will ensure future ‘one-off’ events are caught.

In essence, any taxpayer who has an ongoing obligation to file after the failure to disclose and tax a ‘one-off’ event should automatically be in a position to improve their ongoing compliance process and thus fall squarely within para 14(3). All practitioners should be seeking to engage with HMRC on the application for suspension of penalties.

In my view, this is exactly how the penalty system and HMRC should work: an error is found and HMRC works with the taxpayer to ensure the chances of future under-declaration are minimised.

Taking matters one step further, by agreeing more suspended penalties and more suspension conditions, HMRC will ensure that previously errant taxpayers are implementing a more robust tax compliance process, which will ensure future one-off events are more likely to be taxed. This is the pinnacle which HMRC should be aiming for.

Significant ramifications

This case has two very significant ramifications that every tax practitioner should be aware of.

The first – and the most important from a self-preservation point of view – is that advisers should be asking HMRC to consider para 14(3) and suspend all careless penalties, whether they relate to a one-off event or not. That said, particular clients may not wish to be tied into suspension conditions, so it is advisable to consult them before discussing their position with HMRC. If the adviser does not ask for the penalty to be suspended, or does not even explore whether it could be suspended, they could be seen to be negligent in their professional duties.

The second important issue is that this case could cause HMRC to take the wrong approach in handling cases. This is something tax practitioners need to be aware of.

Any penalty system is designed to be a deterrent to ensure that the correct behaviour is observed; it is not meant to be a revenue collection mechanism. However, HMRC penalties do collect a significant amount of revenue for the government every year – in excess of £1bn. Consequently, there is a potential conflict in the approach adopted by the department.

Could an inspector, with the knowledge that careless behaviour will mean that the penalty is likely to be suspended, open an enquiry with the preconception that the behaviour is ‘deliberate’?

In 2012-13, there were 5,162 deliberate penalties. By 2014-15 this category had risen to 20,740 and in 2015-16 had risen further to 28,663. That is an increase of 38% year on year and a 450% increase in the space of four years.

One of the first cases, with regards to suspended penalties for ‘one off’ errors, that went against HMRC was *Testa* (TC2549), which was heard in 2013. Is the rising number of deliberate penalties a coincidence? Possibly, but there has been a sea change within HMRC on how it looks at penalties and this is evidenced by the statistics above and anecdotal experience.

This change of stance raises other significant issues. If the behaviour of the taxpayer was considered to be deliberate, various consequences follow:

- the minimum penalty is 35% (prompted);
- the assessing window is extended to 20 years;
- the taxpayer could be named and shamed on the published deliberate defaulters list; and
- they could be brought into the managing deliberate defaulters regime.

Consequences

These are significant consequences for the taxpayer indeed. So, to conclude, let us not be too ‘British’ about this. Once the settlement has been negotiated, and there is a culpable position brought about by the careless behaviour of the taxpayer, always consider asking the inspector for more by suspending the careless penalty.

It is possible that HMRC’s initial response will be ‘What?’ However, it is the adviser’s duty to consider all the options available to the client. Hopefully, unlike *Oliver Twist*, such a request will be considered by HMRC and this will allow processes and procedures to be put in place that will assist the client to ensure that future compliance is correct. Failure to raise this with HMRC may well result in a disgruntled ex-client. ■

John Brassey is a tax director at Lancaster Knox LLP specialising in HMRC enquiries, penalties and powers. He can be contacted on 0203 7575669 or email: johnbrassey@lancasterknox.com.

The views expressed are those of the author and not necessarily those of Lancaster Knox LLP. The author, and Lancaster Knox LLP, cannot be held liable for any action, or inaction, based on the contents of this article.