[2016] UKFTT 0363 (TC)

TC05118

Appeal number: TC/2016/00362

INCOME TAX – penalties for careless inaccuracies in returns – whether disclosure "prompted" or "unprompted" – paragraph 9 schedule 24 Finance Act 2007

FIRST-TIER TRIBUNAL
TAX CHAMBER

DR WAGEEH MIKHAIL **Appellant**

- and -

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

TRIBUNAL: JUDGE ASHLEY GREENBANK
DAVID E WILLIAMS CTA (Fellow)

Sitting in public at Birmingham on 15 April 2016

Mr Simon Robinson, of Wall & Partners, for the Appellant

Miss Joanna Bartup, officer of HM Revenue & Customs for the Respondents

DECISION

Introduction

1. The Appellant, Dr Wageeh Mikhail, appeals against assessments to penalties raised by the Respondents, HMRC, in relation to inaccurate returns for the tax years ended 5 April 2012 (the "tax year 2011/12") and 5 April 2013 (the "tax year 2012/13") in the aggregate amount of £4,792.71.

2. The penalties have been raised on the basis that each of the returns contained a careless inaccuracy. It is not disputed that the returns contained an inaccuracy. In each case, the questions before the Tribunal are: (i) whether the inaccuracy was "careless" within the meaning in paragraph 3(2) of Schedule 24 to the Finance Act 2007; and (ii) if so, what is the appropriate amount of the penalty?

Evidence

3. HMRC produced a bundle of documents for the hearing. We accepted these documents in evidence.

Facts

4. We make the following findings of fact.

5. Dr Mikhail is a general practitioner. He is the sole practitioner in a busy practice in Nottinghamshire.

6. Dr Mikhail is a member of the NHS pension scheme. The scheme is a defined benefit scheme. The members of the scheme are subject to tax on the amount by which the growth in value of their pension benefits in any year exceeds the annual allowance. For the purpose of calculating this excess, any unused allowance in the previous three years can be carried forward and set against the growth in value in the relevant period. We have referred to this tax charge in this decision on the "annual allowance charge".

7. When completing their tax returns, members of the NHS pension scheme are not able to calculate the growth in value of pension benefits themselves as they do not readily possess the information to do so. They have to rely on the provision of information by NHS Pensions in order to complete their tax returns.

8. Dr Mikhail submitted his income tax return for the tax year 2011/12 on 28 January 2013. He recorded the contributions that he had made to the scheme in the box for payments made in respect of retirement annuity contracts in the amount of £53,068 and took this amount into account as a deductible amount in calculating his taxable income.

9. Dr Mikhail did not record in his tax return any amount in respect of the growth in his pension benefits in excess of the annual allowance. This would have been impossible for him to do accurately at the time because he had not been provided with

the relevant information by NHS Pensions. Indeed, he could not have known at the time if there was any annual allowance charge to report.

10. By a letter dated 6 November 2013, NHS Pensions provided Dr Mikhail with the information for his 2011/12 tax return. The letter informed Dr Mikhail of the annual allowance for that period (which was £50,000). It also showed the growth in the value of his pension benefits for the year to 31 March 2012 and the growth in the previous 3 years.

11. For the year to 31 March 2012, the growth in the value of his pension benefits (referred to as the "pension input amount") was £103,046.17. The letter informed Dr Mikhail that he must determine whether or not he would have to pay an annual allowance charge and that it was his responsibility for declaring that amount to HMRC and paying any tax due.

12. Dr Mikhail did not take any action following the receipt of this letter either to inform HMRC or to take professional advice.

13. Dr Mikhail submitted an income tax return for the tax year 2012/13 on 20 January 2014. It showed payments made in respect of retirement annuity contracts of £66,183 as a deductible amount in calculating his taxable income. Once again, Dr Mikhail did not record in his tax return any amount representing the growth in his pension benefits for that period and he did not declare an annual allowance charge.

14. As in relation to the tax year 2011/12, it would have been impossible for Dr Mikhail to include an accurate amount in respect of the annual allowance charge in his tax return for the tax year 2012/13 at the time in which it was due to be submitted. Once again, this was because he had not been provided with the relevant information by NHS Pensions by the time that his return was due.

15. By a letter dated 15 June 2014, NHS Pensions provided Dr Mikhail with the information for his 2012/13 tax return. The letter was not in the same form as the letter for the 2011/12 tax year. However, it provided similar information and similar guidance. For the year to 31 March 2013, the growth in the value of his pension benefits (the pension input amount) was £77,741.92.

16. Once again, Dr Mikhail did not pass the letter from NHS Pensions to his accountants and he did not ask HMRC for any advice in relation to the calculation of the annual allowance charge.

17. On 13 January 2015, HMRC opened an enquiry into Dr Mikhail's tax return for the tax year 2012/13. The enquiry was in relation to various matters including pension savings. In relation to pension savings, the questions that were asked by HMRC assumed that Dr Mikhail was a member of a defined contribution scheme. The letter from HMRC noted that the return for that period appeared to show that Dr Mikhail had made pension contributions for the tax year 2012/13 in excess of the permitted amount by an amount of £6,386 and asked for information relating to his contributions to the scheme.

18. All of the requested information was provided promptly by Wall & Partners, Dr Mikhail's accountants.

19. In a letter dated 9 March 2015, Mr Jonathan Caren of HMRC advised Dr Mikhail that he had made contributions to the NHS pension scheme in an amount which was in excess of the annual allowance and that he would be liable to an additional income tax liability as a result of having claimed deductions for contributions in excess of the permitted amount by an amount of £6,638.

20. On 8 April 2015, Wall & Partners responded to Mr Caren accepting the tax charge calculated by reference to the excess contributions.

21. On 14 April 2015, Wall & Partners wrote to HMRC. Wall & Partners identified that HMRC's calculation of the potential additional tax charge for the 2012/13 tax year in relation to pension savings was wrong. Wall & Partners pointed out that the NHS pension scheme was a defined benefit scheme and not a defined contribution scheme. The tax charge should have been calculated by reference to the growth in the value of the pension benefits of Dr Mikhail for that year and not by reference to Dr Mikhail's contributions. Wall & Partners said that they had asked Dr Mikhail to obtain statements from NHS Pensions for all periods from 2008.

22. NHS Pensions provided some information in relation to the historic position in a letter to HMRC dated 11 June 2015. Following receipt of that letter, in the letter dated 23 June 2015, HMRC informed Dr Mikhail and Wall & Partners that an enquiry would be opened in relation to the tax years from 2009/10 to 2013/14.

23. There followed exchanges of correspondence involving Mr Caren, NHS Pensions and Wall & Partners in which attempts were made to establish the correct amounts on which Dr Mikhail should have been charged to tax in the relevant tax years. We will not go into the detail of that correspondence. It is sufficient to record that the information provided by NHS Pensions was to say the least confusing. It continued to refer to contributions to the NHS scheme as if they were relevant to Dr Mikhail's tax liability and referred to those contributions as "employee contributions" and "employer contributions" even though Dr Mikhail is self-employed and so all the contributions were made by Dr Mikhail himself.

24. Furthermore, some of the correspondence from HMRC to Dr Mikhail and Wall & Partners portrayed a lack of understanding on the part of HMRC of the nature of the scheme and the calculation of the tax charge in relation to a defined benefit scheme as opposed to a defined contribution scheme, in relation to which Wall & Partners had to correct HMRC's understanding at various points.

25. On 14 September 2015, Mr Caren wrote to Dr Mikhail and Wall & Partners setting out the outcome of his enquiries. His letter set out the additional tax due for the tax year 2011/12 and the tax year 2012/13. The additional tax liability for the tax year 2011/12 was £20,855. The additional tax liability for the tax year 2012/13 was £11,096.40. The total additional liability for the two tax years was therefore £31,951.40. Mr Caren said that Dr Mikhail would also be required to pay interest of

£2,072.13 and that he intended to charge penalties in an aggregate amount of £4,792.71 (being £3,128.25 in respect of the tax year 2011/12 and £1,664.46 in respect of the tax year 2013/14) on the basis that the inaccuracy was a careless inaccuracy and the disclosure was "prompted". The penalty explanation attached to Mr Caren's letter also explained that Dr Mikhail had been allowed the maximum reduction for quality of disclosure. The penalty was therefore calculated as 15% of the potential lost revenue of £31,951.40.

26. Wall & Partners, on behalf of Dr Mikhail, accepted the calculation of the tax charge and the interest. However, they protested against the imposition of the penalty. There followed an exchange of correspondence between Mr Robinson of Wall & Partners and Mr Caren of HMRC in relation to the imposition of the penalties. We will not record the detail of that correspondence as it does not advance the case any further. However, we should say that some of the language used on both sides was unnecessary and fell short of the standards of professionalism that we would expect of both parties.

27. On 15 October 2015, Mr Caren issued a notice of assessment for the tax year ended 5 April 2012 to Dr Mikhail. On 16 October 2015, Mr Caren issued a closure notice for the tax year ended 5 April 2013 to Dr Mikhail. The amounts of tax and interest charged were the same as those referred to in his letter of 14 September 2015. In addition, Mr Caren issued penalty assessments to Dr Mikhail in relation to the two tax years. The penalty assessments were in the same amount as referred to in his letter of 14 September 2015.

28. Wall & Partners requested a statutory review of the decision to impose penalties. Following the review, HMRC confirmed the imposition of the penalties in a letter dated 18 December 2015.

29. By Notice of Appeal dated 14 January 2016, Dr Mikhail gave notice of his appeal to the Tribunal.

The parties' arguments

HMRC's arguments

30. Miss Bartup made the following points for HMRC.

31. In HMRC's view, Dr Mikhail's tax returns should be treated as containing a careless inaccuracy. His failure to include the annual allowance charge in his tax returns for the tax year 2011/12 and the tax year 2012/13 was not at the time he submitted the return, either careless or deliberate, but the inaccuracy was to be treated as careless within the meaning in paragraph 3(2) of Schedule 24 to the Finance Act 2007 because he had later discovered the inaccuracy and failed to take reasonable steps to inform HMRC of it.

32. HMRC accepted that Dr Mikhail could not have included the relevant amount in his tax returns. NHS Pensions had not provided the relevant information by the time

at which the returns had to be made. However, for the tax years in question, the information was provided by NHS Pensions before the period for the amendment of the return had expired. At that point, a reasonable and prudent tax payer would have either sought advice from a professional adviser or from HMRC.

33. In HMRC's view the disclosure of the liability was "prompted". HMRC had not been informed of the potential liability before the enquiry had commenced. On that basis, the amount of the penalty should be in the range of 15%-30% of the potential lost revenue, the amount of which was not in dispute. HMRC had allowed the maximum reduction in calculating the penalty as it was accepted that Dr Mikhail had cooperated fully with the enquiry. The penalty charged was therefore 15% of the potential lost revenue.

34. There were no "special circumstances" which would justify reducing the penalty pursuant to paragraph 11 of Schedule 24 FA 2007.

35. Furthermore, it was HMRC's view that the penalties could not be suspended in this case. In HMRC's view, the suspension of the penalty was only appropriate in circumstances where it was possible to impose a condition on the suspension that would avoid the commission of careless inaccuracies in the future. There was no such condition that could be imposed in this case. In this respect, Miss Bartup referred to the decision of the Tribunal in *Anthony Fane v HMRC* [2011] UKFTT 210 (TC).

Dr Mikhail's arguments

36. Mr Robinson made the following points on behalf of Dr Mikhail.

37. It was not possible for Dr Mikhail to submit an accurate tax return at the time of which the return was due. The information from NHS Pensions was late.

38. Even when the information was provided by NHS Pensions, it was very confusing. Following the retirement of colleagues, Dr Mikhail was the only GP principal in his community. He had offered a partnership to an assistant who had declined the additional responsibility. It was not surprising that Dr Mikhail, as a busy general practitioner, prioritized his work for his patients over his paperwork.

39. The original HMRC enquiry had focused on Dr Mikhail's pension contributions. That was an error on behalf of HMRC as to the nature of the NHS Pension scheme. That error was only discovered as a result of the intervention of Wall & Partners on behalf of Dr Mikhail. It was unfair and unjust to impose a penalty calculated by reference to a liability that would not have been uncovered but for that disclosure.

40. Mr Robinson accepted that this was not a case in which penalties could be suspended as it was unlikely that Dr Mikhail would be able to meet a condition that would enable him to file an accurate return on time as he could not guarantee having the relevant information from NHS Pensions in time to allow him to make an accurate return. Mr Robinson was concerned that, if NHS Pensions did not provide the relevant information promptly in the future, his client's future tax returns might

contain "guesstimates" of any pensions-related tax charge, which might themselves be regarded as careless by HMRC.

Discussion

Were the inaccuracies "careless"?

41. An inaccuracy is "careless" if "the inaccuracy is due to failure by [the taxpayer] to take reasonable care" (paragraph 3(1) Schedule 24 FA 2007).

42. There was an inaccuracy in the returns provided by Dr Mikhail for each of the tax years 2011/12 and 2012/13 in that they did not contain any reference to the annual allowance charge. Those were the only relevant inaccuracies in each case.

43. HMRC accept that those inaccuracies were not "careless". Dr Mikhail did not fail to take reasonable care when he submitted the returns. He could not have known the amount of the annual allowance charge at the time at which the tax returns were submitted.

44. An inaccuracy which was not "careless" at the time at which the relevant document was provided to HMRC can become a "careless" inaccuracy at a later time. Paragraph 3(2) Schedule 24 FA 2007 provides:

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

45. HMRC accept that the inaccuracies in Dr Mikhail's returns were not careless or deliberate when the returns were submitted to them. HMRC say, however, that the returns were careless within the meaning paragraph 3(2) of Schedule 24 FA 2007 because Dr Mikhail discovered the inaccuracies at a later time, namely when he received the letters from NHS Pensions, and he did not take reasonable steps to inform HMRC.

46. Dr Mikhail has not sought to argue that he did not become aware of the inaccuracies when he received the letters from NHS Pensions. Mr Robinson has simply argued that Dr Mikhail was a busy doctor and chose not to devote time to the administration of his tax affairs. That cannot be an answer to this point.

47. We agree with HMRC that the inaccuracies were "careless" within the meaning of paragraph 3(2) Schedule 24 Finance Act 2007.

Calculation of the penalties

48. Schedule 24 FA 2004 imposes penalties for inaccuracies in returns where the inaccuracy leads to an understatement of a liability to tax and the inaccuracy is either deliberate or careless.

49. Where a careless inaccuracy arises, Schedule 24 sets out the method for calculating the penalties that are due. The penalty due is to some extent dependent upon the behaviour of the taxpayer in making HMRC aware of the inaccuracy and in co-operating with HMRC's enquiries into it.

50. Schedule 24 provides for reductions in penalties where a person discloses an inaccuracy. A distinction is made between a disclosure which is "unprompted" and a disclosure which is "prompted".

51. Disclosure is "unprompted" if "made at a time when the person making it has no reason to believe that HMRC have discovered or are about to discover the inaccuracy" (paragraph 9(2)(a) Schedule 24 FA 2007). In all other cases, the disclosure is regarded as "prompted".

52. We were not referred to any authority on the meaning of "prompted" or "unprompted". The only relevant decision of which we are aware is the decision of the Tribunal in *United European Gastroenterology Federation v HMRC* [2013] UKFTT 292 (TC). In that case, the Tribunal rejected the submission that the relevant test – that the person making the disclosure had "no reason to believe" that HMRC were "about to discover" the inaccuracy – was a subjective one. In its decision, at [60], Judge Poole said this:

> "We reject Miss Bailey's submission that the "no reason to believe" test is a subjective one. Paragraph 9(2)(a) of Schedule 24 requires the question to be asked: "At the time the disclosure was made, did the person making it have no reason to believe that HMRC had discovered or were about to discover the inaccuracy?" The question is not whether the person actually held that belief. It is whether there is any reason for them to hold that belief. To answer that question, an objective examination of the facts is required, not an enquiry into a subjective state of mind."

53. As we have discussed above, the only relevant inaccuracies in Dr Mikhail's returns were the failures to include any reference to the annual allowance charge.

54. In relation to the tax year 2012/13, HMRC had opened an enquiry by the letter dated 13 January 2015. That enquiry extended to the matter of pensions savings. Although HMRC's enquiries, prior to the disclosure contained in Wall & Partners letter of 14 April 2015, focused incorrectly on the contributions that Dr Mikhail had made to his pension fund and not on the value of the fund, it could not be said that that there was no reason for Dr Mikhail or his advisers to believe that HMRC were about to discover the inaccuracy. For that reason, we agree with HMRC that the disclosure was "prompted".

55. We take a different view in relation to the tax year 2011/12. Prior to the disclosure by Wall & Partners on 14 April 2015, there was no enquiry into the return for the tax year 2011/12 or any of the earlier periods. Given HMRC's incorrect focus on the level of deductions claimed by Dr Mikhail for his contributions to the fund, HMRC had not discovered any inaccuracy in that return. Dr Mikhail and his advisers had no reason to believe that HMRC were about to discover that inaccuracy at the time at which the disclosure was made. Indeed, they had every reason to believe that HMRC was not going to discover it. It was only as a result of the intervention of Wall & Partners that the correct issue was identified, the enquiry opened and the correct (much higher) amount of tax was paid. For this reason, we take the view that the disclosure for the tax year 2011/12 was "unprompted".

56. For a careless inaccuracy where the disclosure is prompted, the applicable penalty range is between 15% and 30% of the potential lost revenue (paragraph 4 and paragraph 10 Schedule 24 FA 2007). For a careless inaccuracy where the disclosure is unprompted, the applicable penalty range is between 0% and 30% of the potential lost revenue (paragraph 4 and paragraph 10 Schedule 24 FA 2007).

57. HMRC were minded to allow Dr Mikhail the maximum reduction to the potential penalty. We adopt the same approach to each penalty.

58. On that basis:

(1) we reduce the penalty for the tax year 2011/12 to nil;

(2) we confirm the penalty for the tax year 2012/13 at £1,664.46.

Decision

59. We allow this appeal in part. We reduce the penalties to £1,664.46.

Rights of appeal

60. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

ASHLEY GREENBANK
TRIBUNAL JUDGE

RELEASE DATE: 24 MAY 2016