A deliberate Cliff hanger

Management of taxes



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Satvi Vepa asks whether the decision in Cliff v HMRC, which has broadened the meaning of ‘deliberate’ in the context of discovery assessments, need clarifying

Key Points

What is the issue?

In 2019, a number of cases directly addressed the meaning of deliberate in the context of discovery assessments and the imposition of penalties for errors. A

broader meaning of deliberate could have serious consequences for taxpayers, as it would give HMRC wide powers to raise discovery assessments and impose penalties.

What does it mean for me?

The Cliff decision outcome is that to be acting deliberately, a taxpayer does not need to have an intention to deceive or to bring about a loss of tax (as required for fraud) or even, in the case of inaccuracies, actual knowledge of the inaccuracy or an intention to be inaccurate.

What can I take away?

The Cliff decision casts doubt on whether the wider meaning of deliberate will be applied by HMRC to other areas of law, including FA 1998 Sch 18, which applies to companies filing corporation tax returns.

In 2019, we saw a number of cases directly addressing the culpability of taxpayers and, in particular, the meaning of deliberate in the context of discovery assessments (Taxes Management Act (TMA) 1970 ss 29(4) and 36) and the imposition of penalties for errors (Finance Act (FA) 2007 Sch 24).

A broader meaning of deliberate in the context of this legislation could have serious consequences for taxpayers, as it would give HMRC wide powers to raise discovery assessments, impose a higher percentage of non-suspendable penalties and extend the time limits available in which to raise such discovery assessments and impose such penalties.

The broader meaning may also affect the interpretation of the term in the context of other legislation, including the equivalent discovery assessment legislation for companies delivering corporation tax returns found at FA 1998 Sch 18 para 43, and the interpretation of certain clauses in contracts such as share purchase agreements and tax deeds. In addition, FA 2007 Sch 24 para 19 gives HMRC certain powers to recover penalties for deliberate inaccuracies from officers of the relevant tax paying company. Widening the meaning of deliberate could therefore also impact directors and secretaries of companies.

Degrees of culpability

HMRC mention degrees of culpability in their manuals at EM5101. In the context of direct taxes, these are:

- in the context of discovery assessments: fraudulent, deliberate, negligent or careless behaviour; and
- in the context of penalty assessments: fraudulent, deliberate, negligent, careless or non-deliberate behaviour.

Although careless has been defined in tax legislation as ‘a failure to take reasonable care’, thereby imposing an objective test of reasonableness, fraudulent and deliberate have not been so defined.

HMRC state that they consider fraud to include ‘falsification with an intention to deceive’, which supports the well-established view that the intention of the taxpayer to deceive, judged subjectively, is key to establishing fraud.

The meaning of deliberate, however, is less clear. It has always been the market view that the level of culpability associated with deliberate fell above the level of culpability associated with carelessness but was on the same level as that required for fraud. Prior to recent case law specifically addressing the meaning of the term, there were a few indicators in legislation and HMRC’s manuals which supported this interpretation. These are discussed below.

The meaning of deliberate: HMRC manuals and legislation

Although deliberate has not been defined in the tax legislation, its use in TMA 1970 s 36 (and FA 1998 Sch 18 para 43) and in FA 1998 Sch 24 suggests that it is synonymous with fraud. These sections previously used the term ‘fraudulent or negligent conduct’ but were replaced in 2008 and 2007 respectively with ‘deliberately or carelessly’. The explanatory notes to the changes in FA 2007 state that ‘these definitions of behaviour are designed to replace the current concepts of … fraudulent and negligent conduct’. Therefore, ‘deliberate’ replaces ‘fraudulent’, implying that in order to act deliberately, the taxpayer should have an intention to deceive.

However, HMRC’s Compliance Handbook at CH81150 states that an example of a deliberate inaccuracy includes ‘deliberately describing transactions inaccurately or in a way likely to mislead’. Under this definition, could a taxpayer deliberately describe a transaction in a specific way, honestly believing that description to be

accurate, where such description is in fact inaccurate or likely to mislead? The manuals lack clarity on whether, in addition to the deliberate act, the taxpayer needs to have either:

- an intention to deceive (as would be required for fraud); or
- actual knowledge of the inaccuracy or an intention to be inaccurate.

The latter may be distinguished from cases of fraud, but still would mean the level of culpability associated with deliberate behaviour would fall above that required for carelessness.

The meaning of deliberate: case law

Case law has interpreted deliberately with similar inconsistency.

In Cliff v HMRC [2019] UKFTT 564, the taxpayer was a self-employed tax adviser who claimed to offset losses derived from his activity of being a ‘dealer in thoroughbreds’ from his other income. The taxpayer had made a considered and conscious choice to use the phrase ‘dealer in thoroughbreds’, which he asserted was an accurate description of his activities. However, the description of his activities was considered to be inaccurate by HMRC, which claimed that the losses should not have been allowed against the other income. Consequently, HMRC claimed there was a loss of tax and that this had been brought about deliberately because of the taxpayer’s considered and conscious choice to use the phrase ‘dealer in thoroughbreds’.

The taxpayer argued that he had made the claims for losses in good faith and without any deceitful or illicit intention, which he considered was required in order for his actions to be deliberate. (It is worth pointing out that the FTT noted the lack of documentary evidence to support the description ‘dealer in thoroughbreds’ and also cited ITTOIA 2005 s 50, which states that animals kept for racing are not to be treated as trading stock.)

Despite the taxpayer claiming to have acted in good faith and without an illicit intention, the FTT found that he had acted deliberately for the purposes of raising a discovery assessment under TMA 1970 and imposing penalties under FA 2007 Sch 24. The FTT considered that its views were supported by the Court of Appeal’s comments in Tooth v HMRC [2019] EWCA 826, which dealt with discovery assessments under TMA 1970. This decision stated that it was not necessary to show that a taxpayer intended to bring about the loss of tax where a loss of tax is brought

about by a deliberate inaccuracy, as TMA 1970
s 118(7) deems the intention to exist.

The wording in s 118(7) is limited to discovery assessments, and so does not lend support to the decision in Cliff in respect of penalties (which are imposed under FA 2007). In fact, the FTT in Leach v HMRC [2019] UKFTT 352 (decided prior to Cliff) explicitly stated that this wider meaning of deliberate should not apply to the penalty regime set out in FA 2007 Sch 24. However, the FTT in Cliff did not consider Leach. Instead, it sought to rely on the decision in Clynes v HMRC [2016] UKFTT 369 which dealt with the penalty regime under FA 2007 Sch 24, and stated that deliberate involves an element of conscious or purposeful choice and that this choice does not have to be accompanied by an intention not to pay tax or be made in good faith, as a loss of tax can be brought about by a taxpayer making a purposeful but poor decision.

Therefore, the outcome of the Cliff decision is that in order to be acting deliberately, a taxpayer does not need to have an intention to deceive or to bring about a loss of tax (as would be required for fraud) or even, in the case of inaccuracies, actual knowledge of the inaccuracy or an intention to be inaccurate. This interpretation of deliberate imposes a lower standard of culpability than that required for carelessness. The CIOT has submitted a Budget representation for the meaning of deliberate to be clarified in legislation, and so it will be interesting to see whether or not this interpretation is adopted
going forwards.

Applying the wider interpretation of deliberate

The decisions in Tooth and Leach had provided some comfort that the wider meaning of deliberate would be limited to instances where wording substantially similar to that in TMA 1970 s 118(7) was present in the legislation being relied on by HMRC. However, the Cliff decision casts doubt on whether the wider meaning of deliberate will be applied by HMRC to other areas of law, including FA 1998 Sch 18, which applies to companies filing corporation tax returns and which does not contain wording substantially similar to that in s 118(7).

The decision may also have an effect in a transactional context. Usually, a seller provides tax indemnity and warranty protection to a purchaser. Such protection is subject to a number of limitations, which are usually disapplied where claims arise from a seller’s fraud. From a tax perspective, it has been considered reasonable for

a seller to lose its protections under this provision where HMRC can raise a discovery assessment within a 20 year period; and it was the market view that the meaning of deliberate was either equivalent to or lay close to the meaning of fraud so that essentially this was achieved. Given the wider interpretation of deliberate in Cliff, however, purchasers will need to think about whether they are happy for the disapplication of the seller limitations to only apply in cases of fraud or whether this provision should be widened.