Careless tax

Management of taxes



01 September 2015

David Whiscombe reflects on careless behaviour in tax avoidance cases

Key Points

What is the issue?

Taxpayers taking part in tax avoidance schemes that fail may sometimes be at risk of penalties for careless behaviour

What does it mean to me?

Regarding their personal liability for the accuracy of their tax returns, the same obligations apply to taxpayers in avoidance cases as in any others

What can I take away?

When claiming tax reliefs in avoidance cases, taxpayers must satisfy themselves as far as possible that the scheme has been properly implemented and that no short cuts have been taken

Practitioners will be familiar with the concept of culpability principally in the context of HMRC enquiries into the accounts of a trading business. If, after an enquiry, it becomes apparent or it is conceded that profits have been understated, it must be asked whether this is attributable to any culpability on the part of the taxpayer – or, in some circumstances, of someone else – or to what is usually termed 'innocent error'. By this last, we mean error without culpability of any kind, although, confusingly, the First-tier Tribunal has asserted that 'the making of an innocent error, and negligent conduct, are not mutually exclusive' (see *Anderson (deceased) v HMRC* [2009] UKFTT (TC) (TC206)).

In the past, degrees of culpability ran from negligence through wilful default to fraud: nowadays the distinction is between 'carelessness' and 'deliberate failure'. The former is coterminous with the old 'negligence'. The latter probably encompasses both the old terms wilful default and fraud. However, no one ever seemed entirely clear where the boundaries of wilful default lay, which presumably was one reason for the change in the law.

In the past, and certainly in the writer's now long-distant experience as an inspector of taxes, culpability would seldom, if ever, be considered other than in the context of extractive irregularities. Where so-called 'technical' enquiries gave rise to adjustments, recovery would be of tax and any interest; but it would be exceptional for the question of penalties to be raised.

Increasingly, however, HMRC's approach seems to be that in any case in which any adjustment to a tax return is found, or conceded to be due, consideration must be given to whether any resulting understatement of tax may be regarded as attributable to any kind of culpability. This may affect the taxpayer in three ways:

- it may affect the ability of HMRC to make a ‘discovery’ under the provisions of TMA 1970 s 29;
- it may restrict HMRC’s power to collect tax because of the effect of culpability on time limits for assessment; and
- it may affect the amount liable to be demanded and the level of penalties.

If the adjustment results from an enquiry made under the normal procedures and started within the ‘enquiry window’, the first two of these considerations will not be in point, and culpability will affect penalties only.

Carelessness

There will be circumstances in which a taxpayer is at risk of penalties for careless behaviour, the basic rule being much the same in all cases. Carelessness may be regarded as coterminous with negligence. In the law of tort this is ‘the omission to do something which a prudent and reasonable man would do’ (*Baron Alderson in Blyth v Birmingham Waterworks Co* (1856 11 Exch 781)). In the context of taxation, the test has been similarly formulated in *Anderson* as ‘to consider what a reasonable taxpayer exercising reasonable diligence in the completion and submission of the return would have done’. This is reflected in FA 2007 Sch 24 para 3 which provides that an ‘inaccuracy in a document given by [a person] to HMRC is “careless” if the inaccuracy is due to the failure by [the person] to take reasonable care’.

When carelessness, or any other form of culpability, is alleged by HMRC, the onus lies on HMRC to prove it. In cases when carelessness is alleged, the question to be asked of HMRC is: what do you assert that the taxpayer failed to do that a reasonable taxpayer exercising reasonable diligence would have done? HMRC lost *Ryan Gardiner and related appeals v HMRC* [2014] UKFTT 421 (TC) because they failed to produce any evidence that supported an allegation of carelessness – or even, apparently, appreciate the need to present any.

When it comes to reliance on an agent, the legislation requires especially careful examination. FA 2007 Sch 24 para 18 makes a person liable for any careless inaccuracy in a document given to HMRC on that person’s behalf. This does not apply to anything done by any agent where the person satisfies HMRC that the taxpayer took reasonable care to avoid inaccuracy. The part-reversal of the burden of proof should be noted.

Hanson

As set out in *Hanson v HMRC* [2012] UKFTT 314 (TC) at para 21, what is reasonable care in any particular case will depend on the circumstances. In the view of the tribunal chairman in that case, these include 'the nature of the matters being dealt with in the return, the identity and experience of the agent, the experience of the taxpayer and the nature of the professional relationship between the taxpayer and the agent'. *Hanson* quotes with approval and at length HMRC's guidance at CH84540, including:

> 'A person cannot simply appoint an agent and deny responsibility for their tax affairs. The person still has a duty to take reasonable care, within their ability and competence, to make sure that what they are signing for is correct…'

The benchmark is a person who goes to an apparently competent professional adviser:

- gives the adviser a full and accurate set of facts;
- checks the adviser's work or advice to the best of their ability and competence; and
- adopts it.

The person will then have taken reasonable care to avoid inaccuracy on the part of themselves and their agent.

Litman

And so to *Litman v HMRC* [2014] UKFTT 089 (TC). This was the first (and so far only) case in which the First-tier Tribunal had to consider negligence in the context of a failed 'complex packaged avoidance scheme'. In giving its judgment, the tribunal made several observations. First, entering into such a scheme is not in itself a negligent act. Second, the taxpayers in Litman could not be expected to understand the legal and tax implications of the transactions entered into or the basis on which the efficacy of the scheme might be challenged by HMRC. Whether this will be so in all avoidance cases is a question of fact, but in the writer's view this will almost always be true. These were matters on which the taxpayers could and did properly rely on the advice and expertise of ostensibly competent professional advisers. In that respect, therefore, the case fell within the principles expounded in *Hanson*.

However, the question remained what enquiry should be made by a taxpayer in the case of a ‘packaged scheme’. The tribunal agreed that little or no enquiry into the technical and legal aspects was required. But that did not absolve the taxpayers of all responsibility for checking any aspect. The particular scheme in question depended on some loans having been made to the taxpayers and the proceeds of these having been later loaned to trusts.

HMRC had apparently challenged the scheme on the basis that it was a sham and the stated loans had not been made. The problem for the taxpayers in demonstrating reasonable care, was that, when signing their returns claiming the relief in question, they had no evidence (and, crucially, had requested no evidence) that the supposed loans had ever been made. As the First-tier Tribunal put it:

> ‘The taxpayers should not have claimed the capital losses on their tax returns without at least understanding that an actual transaction had been entered into, that some money had moved and that the transaction was not a sham.’

Few taxpayers entering into an avoidance scheme will understand its technical niceties. But what *Litman* tells us is that taxpayers are obliged at least to understand what they are claiming to have done and to satisfy themselves that they have done it. What that is will depend on the scheme in question. In *Litman*, it was to have borrowed £400,000 and re-lent it. In other cases, the scheme may require certain decisions to be made at meetings taking place on certain dates in certain places in a certain order.

Plainly, a taxpayer needs no special knowledge of tax to know whether they were present at a particular meeting at a particular time and place, who else was there or what was discussed. Signing minutes of meetings that never took place or which misrepresent reality is at best careless; if they were signed in the full knowledge that the meetings in question never took place, it is fraud.

Conclusion

A taxpayer is not expected to know the fine technical detail of every entry on their tax return. However, every taxpayer has an obligation, which cannot be delegated or assigned to an adviser, to be satisfied as far as possible that the factual basis on which a return is made is an accurate one. In this regard, the same requirements apply to taxpayers in avoidance cases as in others.

A taxpayer who ignores that obligation does so at their peril.