Whose penalty is it anyway?

Mark McLaughlin looks at penalties for tax returns errors and a specific provision which can affect an agent who prepares an inaccurate tax return on their client's behalf

The penalty regime for errors in tax returns etc. (FA 2007, Sch 24) is generally familiar territory for practitioners involved with representing their clients in HMRC enquiries and investigations.

Many of those practitioners will have prepared client tax returns and accounts under enquiry. Whilst the penalty regime is primarily geared towards errors by the person to whom the tax return relates, what if the error was caused by the person's agent?

'It wasn't me!'

The penalty regime for errors was extended (in FA 2008) to provide for penalties where an error in a taxpayer's document is attributable to another person (FA 2007, Sch 24, para 1A). This is sometimes referred to as the 'another person' penalty.

In the above example of a tax return error, the other person (i.e., the taxpayer's agent in this context) is liable to a penalty broadly if the error was attributable to the agent deliberately supplying false information (directly or indirectly) to, or withholding information from, the taxpayer with the intention of the return containing the inaccuracy.

Note the word 'deliberately' here; the agent would need to have known that the false information (or the withholding of information) would result in the taxpayer's return containing an error that leads to what the legislation refers to as a 'relevant inaccuracy' (i.e., an understated tax liability, or false or inflated loss or tax repayment claim). The onus will initially be on HMRC to demonstrate that this is the case (see HMRC's Compliance Handbook manual at CH81167).

Your penalty or mine…

If the taxpayer is faced with a penalty for an inaccurate tax return, they might (and often do) consider trying to blame their agent for the error, as a convenient escape from a penalty.

However, the taxpayer would still need to demonstrate that the tax return error arose despite them having taken reasonable care. Furthermore, in the context of the 'other person' penalty, as mentioned it would need to be shown that the agent deliberately caused the error. Of course, where the agent's professional ability is being questioned and there is a threat to the agent's professional reputation (not to mention the threat of being sued), the agent will be anxious to ensure that they are not held responsible for any errors, let alone deliberate ones.

In addition, tax practitioners need to be mindful that HMRC may consider imposing serious sanctions against those practitioners who fail to meet HMRC's standards of behaviour. For example, penalties of up to £50,000 can be charged if HMRC considers that an agent has been engaged in any dishonest behaviour (FA 2012, Sch 38).

In the context of the 'other person' penalty potentially affecting tax professionals, some comfort can perhaps be derived from HMRC's acknowledgment in its Compliance Handbook manual at CH84545: "It is extremely unlikely that a tax adviser would be liable to this kind of penalty". However, this statement from HMRC is in the context of a tax adviser who receives information from the taxpayer and gives advice based on that information. Indeed, it is quite difficult to see why an adviser would deliberately give incorrect tax advice. But what about errors in tax returns?

…or both?

Even if an agent can be blamed for the tax return error, it is possible for both the taxpayer and the agent to be separately liable to a penalty in respect of the same error (FA 2007, Sch 24, para 1A(3)), if the taxpayer has not taken reasonable care to avoid the error. The taxpayer would be liable under the general penalty rule that applies to taxpayers, and the agent would be liable to the 'other person' penalty as mentioned.

However, the aggregate penalties will not normally exceed 100% of the potential lost revenue (although a higher maximum than 100% can apply if the error involves an 'offshore matter' or an 'offshore transfer') (FA 2007, Sch 24, para 12(4), (5)).

'Missing' gift

The first (and to my knowledge, so far, the only) appeal against the 'other person' penalty was Hutchings v Revenue and Customs [2015] UKFTT 9 (TC). The 'other person' in that case was not an agent or tax adviser, but a family member. Nevertheless, this case should be noted as an example of the potentially wide-ranging scope of the 'other person' penalty.

In Hutchings, an individual ('RH') made a lifetime gift to his son ('CH'). The gift was of funds held in an offshore account and was made in or around March 2009. RH died in October 2009. CH was a residuary beneficiary of RH's estate. RH's executors wrote to various members of the deceased's family, including CH. Their letter asked the family members to disclose if they'd received any gifts from the deceased. CH didn't reply to the letter. The executors subsequently submitted an inheritance tax (IHT) return (form IHT400) to HMRC in relation to the deceased's death. The return did not refer to cash held by RH or the transfer of funds in that account to CH seven months before his death.

HMRC subsequently assessed CH to IHT on the basis that he had received a lifetime gift of the offshore funds. HMRC also issued a penalty under the 'other person' provision in respect of the error in the IHT return. The First-tier Tribunal dismissed CH's subsequent appeal. The tribunal held that the omission of the gift from the IHT400 was not the executors' fault. The tribunal also found that the money in question was intended by RH as a gift and that CH knew the money was a gift.

The tribunal held: firstly, that the inaccuracy on the IHT return was attributable to CH; secondly, that CH withheld information from the executors; thirdly, that the withholding of information was deliberate; and finally, that CH did not answer the executors' questions on gifts with the intention that the IHT return would not contain the information about the gift to him. The tribunal concluded that the conditions for the 'other person' penalty were met, and CH's appeal was dismissed.

As can be seen from the Hutchings case, the 'other person' penalty can apply not only where the other person provided incorrect information for a return, but also where information is deliberately withheld with the intention of the taxpayer's document containing an inaccuracy.

Valiant attempts

Finally, whether the 'other person' is an agent or someone else, taxpayers should always exercise due diligence and reasonable care when checking information from other persons. Otherwise, the taxpayer may be liable to a penalty instead of, or as well as, the other person.

Having said that, HMRC accepts (in its Compliance Handbook manual in CH81168, at Example 1) that the taxpayer will have taken reasonable care to avoid a tax return inaccuracy (and so will not be liable to a penalty in addition to the other person) if it was not possible for the taxpayer to independently check that the information given by the other person was correct.

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