Not necessarily careless!

Mark McLaughlin points out that a tax return inaccuracy is not necessarily careless simply because an error was made

Tax return errors are not uncommon. If a tax return contains an error, HMRC will consider whether a penalty should be charged. However, the fact that an error has arisen does not necessarily mean that a penalty is chargeable. The penalty regime for errors in tax returns etc. (FA 2007, Sch 24) effectively provides that no penalty arises if a tax return error has arisen despite reasonable care having been taken. Even if the error was careless (i.e. the taxpayer failed to take reasonable care) and a penalty is in point, that does not necessarily mean that the penalty will be due and payable. For example, a penalty can be suspended in some cases, possibly resulting in the penalty being cancelled in the future.

Burden of proof

The starting point in any dispute with HMRC over penalties for a careless tax return error is that the burden is generally on HMRC to prove carelessness by the taxpayer. There is an exception to this general rule under the 'agency' provisions (FA 2007, Sch 24, para 18), whereby a careless error by the taxpayer's agent is imputed to the taxpayer, unless HMRC (or the tribunal, on appeal) is satisfied that the taxpayer took reasonable care to avoid the error.

HMRC's position (in its Compliance Handbook Manual at CH81140) is that 'reasonable care' can best be defined as the behaviour of a prudent and reasonable person in the position of the person in question. The approach to penalties for carelessness and establishing reasonable care was described by the First-tier Tribunal (FTT) in Collis v Revenue and Customs [2011] UKFTT 588 (TC): "That penalty applies if the inaccuracy in the relevant document is due to a failure on the part of the taxpayer (or other person giving the document) to take reasonable care. We consider that the standard by which this falls to be judged is that of a prudent and reasonable taxpayer in the position of the taxpayer in question" (emphasis added). However, the onus of proof is on HMRC to show that reasonable care was not taken (i.e. such that tax return error was careless), the standard of proof being on the balance of probabilities. Taxpayers should resist any attempt by HMRC to require them to prove a negative (i.e. that their behaviour was not careless).

Reliance on an agent

As indicated, reliance on an agent can result in a penalty for a careless tax return error, unless the taxpayer can demonstrate reasonable care (although interestingly (and incorrectly), in H & H Contract Scaffolding Ltd v Revenue and Customs [2024]

UKFTT 151 (TC), HMRC sought to argue that reliance on an agent does not constitute a reasonable excuse; see below).

In AB Ltd v Revenue and Customs [2007] STC (SCD) 99, it was held that a taxpayer who takes proper and appropriate professional advice with a view to ensuring that his tax return is correct and acts in accordance with that advice (if it is not obviously wrong) would not have engaged in negligent conduct. Reliance on an agent (such as accepting and acting upon incorrect advice) has provided an exception from a penalty for careless behaviour in several cases (e.g. Hanson v Revenue and Customs [2012] UKFTT 314 (TC)).

HMRC states (at CH84540) that the 'benchmark' for a taxpayer to have taken reasonable care in relying on an agent contains the following steps:

- giving the adviser a full and accurate set of facts;
- checking the adviser's work or advice to the best of the taxpayer's ability and competence; and
- adopting it.

However, circumstances differ, and each case will need to be considered on its own particular facts and merits.

Where the taxpayer receives advice relating to certain avoidance arrangements, they will not be able to rely on that advice to demonstrate they have taken reasonable care to avoid an inaccuracy arising from their use of those arrangements in certain circumstances (FA 2007, Sch 24, paras 3A, 3B). Consequently, the tax return error will be presumed to be careless (if it was not deliberate), unless the taxpayer satisfies HMRC (or the tribunal) that they took reasonable care to avoid it.

Held in suspense?

If reasonable care has not been taken and a penalty for careless error would otherwise be chargeable, consideration should be given to whether the penalties can be suspended. HMRC has the power to suspend penalties in cases involving careless error (FA 2007, Sch 24, para 14), although not for deliberate errors.

Detailed commentary on the suspension provisions is beyond the scope of this article, but it is worth noting that HMRC officers are instructed to consider the suspension of every penalty for a careless error (CH83131). However, HMRC may only suspend a penalty if a condition can be set that would help the person to avoid becoming liable to a further penalty for a careless error in the future (FA 2007, Sch 24, para 14(3)).

There is a right of appeal if HMRC decides not to suspend a penalty, and against the conditions set by HMRC for the penalty to be suspended (FA 2007, Sch 24, para 15(3), (4)).

Flawed arguments

Care should be taken to prevent HMRC from seeking to impose penalties based on erroneous or doubtful arguments.

For example, in H & H Contract Scaffolding Ltd v Revenue and Customs [2024] UKFTT 151 (TC), an amended corporation tax return for the period ended 30 June 2019 was submitted for the appellant company (HHCS), which included an R&D tax credit and R&D enhanced expenditure claim. In May 2021, HMRC opened a check into the return to look at the R&D claim. HHCS's agent (LR) provided a copy of an 'R&D Compliance Report'.

Following further correspondence, HMRC issued a closure notice concluding that no R&D credits were due to HHCS because the activities described in the R&D compliance report did not meet the definitions of R&D for tax purposes. HHCS appealed after HMRC also issued a penalty on the basis that a careless error was made and refused to suspend the penalty.

The FTT disagreed with HMRC that if HHCS could not show that it qualified for the R&D claim made, HHCS would have been careless. It was inherent in the existence of the inaccuracy that the appellants would not be able to show that it qualified for the R&D claim. The existence of the inaccuracy did not answer whether the inaccuracy itself was careless.

Furthermore, the FTT pointed out that ordinarily it was for HMRC to prove a careless inaccuracy, not for the appellant to establish reasonable care. Even if it was wrong about HMRC's case, the FTT found that HHCS took reasonable care to avoid an inaccuracy. The FTT considered that HHCS had shown that it did what a prudent and reasonable taxpayer would do in the circumstances. HHCS's appeal was allowed; its inaccuracy was not a careless one.

HMRC criticised

The tribunal in H & H Contract Scaffolding Ltd was critical of HMRC, referring to HMRC's 'statement of reasons' (SOR) as a "confused document". The SOR stated: "The appellant submits that they cannot be expected to review the BEIS guidelines, however, [HMRC] contend that it is reasonable for them to show that they qualified for the claim made. The absence of this evidence amounts to careless behaviour by the appellant."

Based on HMRC's argument, it would seemingly follow that the mere existence of an inaccuracy would render a 'reasonable care' argument redundant. Fortunately, the FTT disagreed with HMRC on this point.

Conclusion

Some cases should never get as far as the tribunal. H & H Contract Scaffolding Ltd appears to be one such case. Practitioners acting for taxpayers in HMRC enquiry cases should ensure that the basic requirements for HMRC seeking a penalty for a careless error have been met before proceeding further, and if they have, to consider seeking suspension of penalties in appropriate circumstances.

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