[2016] UKFTT 0527 (TC)

TC05276

Appeal number: TC/2016/00253

PENALTY – careless inaccuracy – FA 2007, Sch 24 – HMRC deciding not to suspend penalty – Sch 24, para 14 - whether HMRC's decision "flawed" – judicial review principles – Sch 24, para 17

FIRST-TIER TRIBUNAL
TAX CHAMBER

ERIC EASTMAN **Appellant**

- and -

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

TRIBUNAL: JUDGE ROGER BERNER
MR JOHN ROBINSON (Tribunal member)

Sitting in public at The Royal Courts of Justice, Strand, London WC2 on 20 July 2016

Mr D Sinclair, BKL Tax, for the Appellant

Ms L Long, HMRC presenting officer, for the Respondents

DECISION

1. On 7 October 2015, the appellant, Mr Eastman, was issued with a penalty assessment under Schedule 24 of the Finance Act 2007 ("FA 2007") in the sum of £21,547.04. That penalty was assessed with respect to an inaccuracy in Mr Eastman's self assessment return for the tax year 2012-13, amounting to the failure to return a capital gain on the disposal in that year of certain business premises, which HMRC said was due to a failure of Mr Eastman to take reasonable care.

2. This appeal is not against that penalty assessment as such. Mr Eastman accepts that he was careless, and that the penalty has been properly assessed. But he has appealed, under paragraph 15(3) of Schedule 24 FA 2007, against the decision of HMRC not to suspend the penalty.

The law

3. The power to suspend a penalty such as the one in question in this appeal is given to HMRC by FA 2007, Sch 24, para 14 which provides:

> "**Suspension**
>
> 14—
>
> (1) HMRC may suspend all or part of a penalty for a careless inaccuracy under paragraph 1 by notice in writing to P.
>
> (2) A notice must specify—
>
> (a) what part of the penalty is to be suspended,
>
> (b) a period of suspension not exceeding two years, and
>
> (c) conditions of suspension to be complied with by P.
>
> (3) HMRC may suspend all or part of a penalty only if compliance with a condition of suspension would help P to avoid becoming liable to further penalties under paragraph 1 for careless inaccuracy.
>
> (4) A condition of suspension may specify—
>
> (a) action to be taken, and
>
> (b) a period within which it must be taken.
>
> (5) On the expiry of the period of suspension—
>
> (a) if P satisfies HMRC that the conditions of suspension have been complied with, the suspended penalty or part is cancelled, and
>
> (b) otherwise, the suspended penalty or part becomes payable.
>
> (6) If, during the period of suspension of all or part of a penalty under paragraph 1, P becomes liable for another penalty under that paragraph, the suspended penalty or part becomes payable."

4. Paragraph 15(3) provides that a person may appeal against a decision of HMRC not to suspend a penalty payable by that person.

5. The jurisdiction of this Tribunal on such an appeal is set out at para 17(4). That provides:

> "(4) On an appeal under paragraph 15(3)—
>
> (a) the tribunal may order HMRC to suspend the penalty only if it thinks that HMRC's decision not to suspend was flawed, and
>
> (b) if the tribunal orders HMRC to suspend the penalty—
>
> (i) P may appeal against a provision of the notice of suspension, and
>
> (ii) the tribunal may order HMRC to amend the notice."

6. The starting point for the Tribunal's jurisdiction is thus the quality of HMRC's decision not to suspend the penalty. The requirement for a finding that HMRC's decision is flawed is explained by para 17(6):

> "(6) In sub-paragraph … (4)(a) … "flawed" means flawed when considered in the light of the principles applicable in proceedings for judicial review."

7. It is thus the case that the jurisdiction of the Tribunal is appellate and not supervisory, but the exercise of that appellate jurisdiction requires the application of principles of judicial review more commonly associated with a supervisory jurisdiction.

8. The principles applicable to judicial review impose a high threshold, but they nonetheless ensure that the exercise of HMRC's powers to decide whether or not a penalty should be suspended are exercised in a reasonable manner. To be flawed in a judicial review sense the decision must be one that no reasonable body could have come to (see *Associated Provincial Picture Houses Ltd v Wednesbury Corp* [1948] 1 KB 223, per Lord Greene MR at p 230). In the context of a statutory appeal such as this, the exercise of a supervisory jurisdiction has been explained in *John Dee Ltd v Customs and Excise Commissioners* [1995] STC 941 (a case concerning a statutory condition, namely whether it appeared to the commissioners requisite to require security as a condition of making taxable supplies) by Neill LJ (at p 952) in the following way:

> "In examining whether that statutory condition is satisfied the tribunal will, to adopt the language of Lord Lane, consider whether the commissioners had acted in a way in which no reasonable panel of commissioners could have acted or whether they had taken into account some irrelevant matter or had disregarded something to which they should have given weight. The tribunal may also have to consider whether the commissioners have erred on a point of law. I am quite satisfied, however, that the tribunal cannot exercise a fresh discretion on the lines indicated by Lord Diplock in *Hadmor* [*Hadmor Productions Ltd v Hamilton* [1983] 1 AC 191]. The protection of the revenue is not a responsibility of the tribunal or of a court."

9. It was also held in *John Dee* that where it was shown that a decision of the commissioners (that is, HMRC) was erroneous because of their failure to take

relevant material into account, a tribunal could nonetheless dismiss an appeal if the decision would inevitably have been the same had account been taken of the additional material. The same would apply to a case where HMRC had regard to something irrelevant. That possibility is envisaged by the tribunal's powers in such a case: para 17(4)(a) provides the tribunal with a discretion not to order HMRC to suspend a penalty even if it is determined that HMRC's decision is flawed.

10. The use of the word "may" in para 14(1) indicates clearly that the power conferred on HMRC to suspend a penalty requires the exercise by them of a discretion. It is for that reason that, although the Tribunal has an appellate jurisdiction, the statute has provided that its power on an appeal against a refusal to suspend requires the application of judicial review principles, as set out in the *Wednesbury* case and *John Dee*. Interestingly, however, the use of the same word in para 14(3) does not connote the exercise of a discretion; there, when used in conjunction with the word "only", the word "may" is intended to establish a condition that must be met before all or part of a penalty may be suspended. That condition, which is accordingly a threshold which must be crossed before a penalty is suspended, is that compliance with a condition of suspension would help the person liable to the penalty to avoid becoming liable to further penalties for careless inaccuracy. Whether that condition is satisfied is again, having regard to the nature of the Tribunal's jurisdiction, itself a matter for the decision of HMRC, subject to review by the Tribunal on judicial review principles.

11. The Tribunal cannot in that respect substitute its own decision. Its power under para 17(4), if it finds that HMRC's decision not to suspend the penalty was flawed, is to determine whether to order HMRC to suspend the penalty. It cannot suspend the penalty on its own account, nor at that stage direct any particular conditions to be attached. That again is a matter for the discretion of HMRC; on an appeal under para 15(4) against a decision of HMRC setting conditions of suspension of a penalty, and a corresponding appeal under para 17(4)(b), the powers of the Tribunal under para 17(5) to vary those conditions are also dependent on the Tribunal finding that HMRC's decision was flawed in the judicial review sense.

The facts

12. There was no material dispute on the facts, although Mr Eastman was cross-examined by Ms Long on the contents of his witness statement, and Mr Eastman provided some further helpful evidence in response to questions from the Tribunal. From this evidence, we find the following material facts.

13. Mr Eastman is a Fellow of the Royal Institute of Chartered Surveyors. Between 1986 and 2011 he worked in a business jointly-owned by himself and Mr Michael Peddar. The business was run through a company, Eastman Peddar Limited, which traded as Michael Peddar & Co.

14. That business was disposed of in September 2011, when the company was sold to CBRE. Mr Eastman was responsible for the negotiations for the sale, and following completion he advised Mr Peddar and the accountants, Liles Morris, of the

financial details. On that basis, capital gains tax was computed and paid by Mr Eastman and Mr Peddar for the tax year 2011-12.

15. The sale of the company did not include the business premises, which were owned jointly by Mr Eastman and Mr Peddar. That sale was organised by Mr Peddar, and it was completed in August 2012. Liles Morris calculated the CGT on that disposal at that time and advised that it was payable 17 months later.

16. However, the disposal of the business premises was not entered on Mr Eastman's tax return for 2012-13. The oversight arose because Mr Eastman's return was not prepared by Mr Morris of Liles Morris as had been the usual arrangement, but by another partner in the firm who had not previously completed Mr Eastman's returns. That partner had failed to check the file to discover the details of the sale and the CGT computation. Mr Eastman, who had in the past relied on Mr Peddar and Mr Morris to ensure he paid the correct tax did not spot the error, despite having checked the return.

17. On 20 January 2015 HMRC opened an enquiry into Mr Eastman's return under s 9A of the Taxes Management Act 1970 in order to check the CGT position on the disposal of the property. On 28 January 2015, Liles Morris responded, accepting that a mistake had been made. The additional tax was calculated by HMRC and notified to Mr Eastman on 5 February 2015. Mr Eastman paid the tax on 13 February 2015. Interest was subsequently calculated and paid.

18. The initial approach of HMRC, as notified to Mr Eastman by letter of 12 March 2015, was to consider the inaccuracy in the return to have been deliberate, and to calculate the penalty accordingly, with reduction for Mr Eastman's cooperation. However, following a meeting between Mr Eastman, his advisers and HMRC on 2 June 2015, HMRC wrote to Liles Morris on 11 June 2015 accepting that Mr Eastman's conduct was not deliberate, but stating that a penalty would be levied on the basis that the inaccuracy was due to Mr Eastman's failure to take reasonable care. That letter stated that the HMRC officer had considered suspending the proposed penalty, but advised that "no suspension conditions can be put in place".

19. Notice of intention to levy a penalty assessment in the sum of £21,547 was issued on 11 June 2015. It made clear that no part of the penalty was to be suspended. However, the letter invited Mr Eastman to provide further relevant information, including anything that might affect HMRC's view on suspending the penalty. The accompanying explanation in tabular form also stated that "We cannot suspend any of this penalty."

20. Liles Morris replied on 2 July 2015. They stated that it was accepted that there had been a careless mistake, and sought clarification of the matters considered by HMRC in deciding that no suspension conditions could be put in place. Liles Morris put forward a proposal that the penalty be suspended on condition that Mr Eastman maintain a weekly diary in which all financial events would be recorded. That diary would then be made available to Liles Morris to ensure correct preparation of the tax return and would also be available for Mr Eastman to check when he signs the return.

Liles Morris also suggested that it might be reasonable to have a condition for timely filing of the return, suggesting 31 October.

21. In their reply of 24 July 2015, HMRC stated that there were three stages in the decision process that have to be considered when suspending a penalty (or, more accurately, we infer, when deciding whether to suspend a penalty). The three stages were identified as follows:

> "1. Identify the underlying cause of the current careless inaccuracy. Omitted Capital Gain for the sale of Business Premises.
>
> 2. Identify any future careless inaccuracies that would result from the underlying cause identified at 1 above, if the underlying cause is not corrected.
>
> If we can't identify a future careless inaccuracy then we will not be able to suspend the penalty because we will not be able to identify specific suspension conditions that would help the person avoid further penalties for careless inaccuracy.
>
> 3. Consider and agree specific (SMART) suspension conditions.
>
> We must be 'reasonably certain' that the specific conditions would help the person to avoid a penalty for a careless inaccuracy in a future return. We need to think about what careless inaccuracies would be included in the person's future returns if the changes made by the specific suspension conditions are not implemented."

22. The letter went on to explain that the legislation requires HMRC to be able to identify any future careless inaccuracies that would result from the underlying cause if it is not corrected. It stated that HMRC had to establish whether the careless inaccuracy being penalised, namely the omission of the capital gain, would recur in future returns if the specific suspension conditions were not put in place. But the letter went on to say that where the careless inaccuracy being penalised would not recur, and suspension conditions have been proposed that could help avoid a different inaccuracy, it needs to be established how likely it is that the underlying cause of the inaccuracy being penalised would, if the conditions were not implemented, result in that different inaccuracy.

23. Having set out those principles, the letter concluded as follows:

> "Mr Eastman sold his business premises and omitted the capital gain on the sale of the premises from his 2013 return. Mr Eastman accepts that a penalty is due for a careless inaccuracy. Mr Eastman will continue to make self-assessment returns which will most likely include income such as pay and tax, benefits from the employer and interest. These are normal straight forward entries which we would expect any person to make an accurate return, the expectation would be the entries to be of an acceptable standard. (sic.)
>
> Mr Eastman no longer has any businesses/business premises that, if sold, would lead to a capital gain. As there is no longer any likelihood of a future capital gain, and there is no problem with the completion of future returns or record-keeping, there is no condition that could be set

> to avoid an inaccuracy arising in the future. So in my opinion we cannot suspend the penalty."

24. On 4 August 2015 Liles Morris replied. After referring to a number of tribunal cases and a report of the Office of Tax Simplification of November 2014 (which we shall return to when discussing the parties' submissions), Liles Morris pointed out to HMRC that Mr Eastman held property and shares on which there were likely to be future capital gains.

25. HMRC confirmed their view in a letter to Liles Morris dated 11 September 2015. They said:

> "Consideration has been given to the underlying cause of the error as it is prudent of me to ensure that if there has been a systematic failure, or weakness, that I set suspension conditions that would then help your client avoid making careless inaccuracies in the future. It is not necessary that capital disposals will continue in the future, only that any conditions set would help to correct the underlying issue that resulted in your client making the careless inaccuracy, which will help your client to avoid careless inaccuracies in the future.
>
> HMRC guidance at CH83143 terms 'a very straightforward mistake is not caused by a systemic problem …' Systematic meaning regular, methodical …' and goes on to say 'In that case you will not be able to set a condition that will help the person avoid that mistake in the future. This is because there is no underlying failure or weakness in record that can be corrected by a specific suspension condition."

26. Having set out the facts surrounding the making of the inaccurate return, HMRC concluded:

> "The underlying failure occurred due to your client forgetting about the disposal of the business premises and the failure within your practice. It is the cause of the inaccuracy we have to set conditions for, and in this instance we cannot do so as it was human error, which we cannot plan for.
>
> Given the reasons put forward I cannot see how there are suspension conditions that can be set to help your client avoid careless inaccuracies in the future."

27. The penalty assessment was issued on 7 October 2015. Following a review, HMRC confirmed the decision not to suspend the penalty. In their letter dated 16 December 2015 they reiterated a number of the points made earlier, and under the heading "What I have considered" referred to the Explanatory Notes to the Finance Bill 2007 as follows:

> "Suspended penalties will not be appropriate for one off inaccuracies in returns such as a capital gain or a one off transaction. They are more likely to be appropriate for accounting system or record keeping weaknesses, where the money that may have been spent on the penalty could be used to remedy the defective processes ensuring future returns are accurate."

The letter continued:

> "For it therefore to be possible to suspend a penalty it is necessary to be able to set at least one specific condition that if met would help a person avoid a further penalty for a careless inaccuracy. Suspension conditions must result in improvements which would prevent future inaccuracies from occurring. They must not simply repeat the statutory requirement to complete an accurate return. So it would be an improvement to any ongoing record keeping systems etc. that any penalty suspension condition would have to address. In turn the condition must also meet the SMART (Specific, Measurable, Achievable, Realistic & Time bound) criteria."

28. The review concluded:

> "The conditions outlined within the legislation cannot therefore be met and it seems that by taking more care at the time that you completed your return you may well have avoided making the inaccuracy. The inaccuracy itself could not be considered as having resulted from a weakness in any process or record keeping system that you had in place. In the circumstances I agree that suspension is not therefore applicable in this instance."

29. In evidence, and in particular in response to questions from the tribunal, Mr Eastman, who we found to be a palpably honest witness doing his best to assist the tribunal, accepted that in his 2012-13 return he had been able, from the records he had kept, to make an accurate return of his sources of income, namely employment income (tax on which was deducted at source under PAYE), and dividends and interest for which he had retained the usual tax vouchers and certificates of deduction of tax. He maintained a file into which he would place these documents as they were received and then submit everything to his accountant to enable him to prepare the return. The computation he had received from the accountant in relation to the sale of the business premises some 17 months prior to the latest time for making the return for 2012-13 had not been placed in the relevant file, and there had been nothing to remind him of that transaction.

30. Although Mr Eastman owns a number of shares, he told us, and we accept, that he is not a regular investor, the shares largely comprising those issued on various privatisations. He has made no disposals. Up to the present, the only CGT disposals with which he has been concerned are the sale of the company and the sale of the business premises. Since selling his former home, however, he now owns a few buy to let properties, and receives rental income. Those properties are managed by independent agents who provide him with monthly statements showing rent receipts and any expenses; he is able on request to obtain the underlying invoices for expenses. He also has a rental property in South Africa.

Discussion

31. The legislative scheme for enabling penalties for careless inaccuracy to be suspended gives HMRC a discretion in that regard. But in exercising that discretion

HMRC must not only act within the framework of the legislation but must act reasonably in reaching their decision. The jurisdiction of the tribunal is to review the exercise of that discretion according to the judicial review principles we have outlined above.

32. There is only one specific limitation on the exercise of HMRC's discretion. It is that, as para 14(3) provides, a penalty or part of a penalty can be suspended only if compliance with a condition of suspension would help the person liable to the penalty to avoid becoming liable to further penalties for careless inaccuracy.

33. It is necessary, in order that HMRC can operate fairly amongst all taxpayers, that guidance is issued to officers tasked with the exercise of a discretion such as that which applies to the question of the suspension of a penalty. But that guidance should go no further than is required to ensure consistency of approach. It should not fetter the discretion of an HMRC officer otherwise than is consistent with the legislative scheme itself. If it does, then any decision which is constrained in that way will be likely to be flawed in the sense provided for by para 17(6).

34. One example of HMRC's guidance that has been considered by the tribunal is that relating to "one-off events". In *Anthony Fane v Revenue and Customs Commissioners* [2011] UKFTT 210 (TC), the tribunal considered a refusal to suspend a penalty on the basis that there was no realistic expectation of the particular problems which had arisen in relation to the termination of Mr Fane's employment recurring, and that this had been a "one-off event", for which no suspensive conditions could be set.

35. The tribunal in *Fane* noted, at [60], that para 14(3) contained no restriction in respect of a "one-off event". It did, on the other hand, at [65], endorse HMRC's guidance to the effect that a one-off event would not normally be suitable for a suspended penalty, and at [66] it drew support for this view by reference to the Explanatory Notes which had accompanied the publication of the Finance Bill 2007. The relevant passage from those notes was, as we have described, referred to in this case in HMRC's review letter of 16 December 2015, and Ms Long relied upon it in her submissions to us.

36. That endorsement of HMRC's guidance in *Fane* has been doubted in other tribunal cases. Thus, for example, in *David Testa v Revenue and Customs Commissioners* [2013] UKFTT 151 (TC), the tribunal considered, at [25], that the general statement made by the tribunal in Fane at [65] should be treated with care, as it was in the context of a proposed suspensive condition that amounted to little more than a condition not to submit careless inaccuracies in future tax returns. And in *Philip Boughey v Revenue and Customs Commissioners* [2012] UKFTT 398 (TC), where HMRC had taken the view that it was not possible to set a SMART condition "to enable [the taxpayer] to show that [he was] able to correctly declare a redundancy payment", the tribunal held that the decision was flawed because it had proceeded on the basis that the condition must be specific to the careless inaccuracy.

37. In her speaking notes for the hearing, of which Ms Long kindly provided us with a copy, she submitted that HMRC did not agree with the reasoning in *Testa* and *Boughey*. The notes argued that the tribunals in those cases appeared "to have adopted a rigid interpretation of Para 14(3) of Schedule 24 and taken a view that this applies to becoming liable to any penalties whatsoever under Para 1 of Schedule 24." When asked by the Tribunal to explain this submission, Ms Long withdrew it. We consider she was right to do so. First, there is no basis for saying that the tribunals in those cases adopted a "rigid interpretation" of para 14(3); to the contrary the tribunals were making the valid observation that the statutory framework did not preclude suspension where the inaccuracy had arisen in relation to a one-off event. The tribunals were making the point that it would be unreasonable for HMRC to adopt too rigid an approach and thereby fetter their discretion. Secondly, it is not the case that the tribunals were opening the floodgates as the written submission seems to suggest. Indeed the tribunal in *Testa* expressed the contrary view, saying (at [31]) that the apparent underlying purpose of the legislation, referring in particular to para 14(3), is not simply to allow a taxpayer the opportunity of "a last chance" if he mends his ways (the tribunal drawing an analogy in this respect with suspended sentences in the criminal courts) but only to allow him that last chance if he takes some specific and observable action which is specifically designed to improve his compliance.

38. Mr Sinclair drew our attention to a report - *Tax penalties: final report* – published by the Office of Tax Simplification in November 2014 in which it had noted the tribunal cases and had, at para 3.9 of the report, remarked that there had been a change of approach by HMRC and that updated guidance stated that it is possible to suspend penalties in instances where there have been one-off errors so long as it is possible to set appropriate suspension provisions. The guidance quoted there is from CH405050: "A penalty cannot be suspended where it is not possible to set specific conditions because the same type of inaccuracy is unlikely to happen in the future."

39. We have to say that this emphasis on the type of the inaccuracy remains vulnerable to the criticism that it unreasonably fetters the discretion of HMRC. All that para 14(3) requires is that the conditions or conditions would help the taxpayer avoid further penalties for careless inaccuracy. There is no necessary link between the type of inaccuracy and the possibility of further penalty. We respectfully disagree with the tribunal in *Testa* to the extent that it was suggesting, at [32], that the use of the word "further" in para 14(3) implies a link between the type of inaccuracy for which the original penalty has been levied and the type of inaccuracy which might give rise to a future penalty. In our view, the word "further" does no more than describe another penalty for careless inaccuracy that might arise in the future.

40. Whilst the nature of the inaccuracy in respect of which the penalty has been levied is a relevant factor for HMRC to consider in the exercise of their discretion, we do not consider that it should constrain the nature of the inaccuracies available to be considered for the purpose of determining whether conditions may be imposed which will help avoid penalties for carelessness in those respects as well as those related to the original inaccuracy. Paragraph 14(3) does not differentiate between types of careless inaccuracy any more than the provisions imposing the penalty do.

41. In the same way that the penalty for careless inaccuracy seeks to deter careless behaviour and penalise it, para 14 recognises that the imposition of conditions may alter behaviour so as to avoid that behaviour being repeated. It is therefore necessary, in exercising a discretion, for the decision-maker to have regard to the underlying behaviour that has given rise to the penalty and to determine whether a condition may be imposed to affect or obviate that same behaviour in the future. That is not something that is confined to the nature of the original inaccuracy, including whether it arose as a consequence of a one-off event that is not expected to be repeated.

42. We do not consider that the Explanatory Notes to the Finance Bill 2007 are of assistance in this respect. In our judgment they do not reflect the statutory language that has been used. To the extent that those Notes are sought to be relied upon to restrict, beyond the language of para 14(3), the cases where discretion in favour of a suspended penalty may be exercised, we consider that they represent an unwarranted fetter on the exercise of that discretion. Every case must fall to be considered by reference to its own facts and circumstances.

43. In considering whether any appropriate conditions may be imposed, the acid test, in our view, is to ask what the taxpayer could reasonably have done differently that would have avoided the original inaccuracy. That, in different words, is a similar approach to that adopted most recently by the tribunal in *Paul Ronald Steady v Revenue and Customs Commissioners* [2016] UKFTT 0473 (TC) where it said, at [28], that it could be argued that the purpose of the suspension conditions is to bring the standard of compliance up to the level of a prudent taxpayer. Having ascertained what could have been done in that respect, the question is whether, educated by that answer, a condition may be imposed which would help avoid future careless inaccuracies. As a penalty would not differentiate between types of inaccuracy, the condition must encompass all risks of future careless inaccuracy that can reasonably be identified.

44. Thus, a condition that leaves open an identified risk would not be a suitable one to be imposed. That, we consider, is the true reason why, in an example given by the tribunal in *Testa* at [33], a penalty for a careless inaccuracy in relation to a Construction Industry Scheme return would not normally be capable of being suspended by reference to a condition in relation to improved PAYE record keeping processes. It is not because there needs to be a link between the nature of the original inaccuracy and the condition, but because a condition that fails to address deficiencies in the CIS accounting would not help avoid liability to penalties, and so could not satisfy para 14(3).

45. Before turning to apply those principles to the case of Mr Eastman, we should draw attention to the fact that the question of suspension is not necessarily a binary one; it is not a question of all or nothing. Paragraph 14 expressly envisages that part only of the penalty may be suspended. That, in our view, reflects the nature of the penalty which is at once a deterrent and punitive. The suspension of the penalty subject to a relevant condition or conditions may be seen as both an encouragement to alter behaviour so as to reduce the likelihood of further penalties for careless inaccuracy and as a deterrent against future carelessness within the specified period.

But the punitive effect of a penalty should not be disregarded in the exercise of HMRC's discretion, and it is open to HMRC reasonably to determine that the aim of suspension may be achieved by a partial suspension whilst preserving a punitive element of the penalty. We note, however, that it is HMRC's published policy to suspend the full amount of the penalty in all cases.

Was HMRC's decision in Mr Eastman's case flawed?

46. The basis for HMRC's decision not to suspend the penalty in Mr Eastman's case can be found in three letters from HMRC, those of 24 July 2015, 11 September 2015 and the review letter of 16 December 2015.

47. Turning first to the letter of 24 July 2015, this set out a three-stage approach. The first stage was to identify the underlying cause of the careless inaccuracy giving rise to the penalty. Were that to have been directed towards the behaviour giving rise to the inaccuracy, which we consider would be a natural way to ascertain the underlying cause in a behaviour-based penalty regime, we would have considered that a reasonable approach. But it is clear from the letter that the underlying cause was regarded as the omission of the capital gain on the business premises. It was the nature of the inaccuracy, rather than the reason for it, that was seen as the underlying cause.

48. That was not the approach of a reasonable decision-maker. It directly affected HMRC's consideration of the second stage, namely to identify future careless inaccuracies that would result from the underlying cause. By wrongly addressing the question of the underlying cause, HMRC unreasonably confined their examination of future risk to capital gains connected to a business or business premises. That is, we consider, evident from the conclusion set out in the letter of 24 July 2015, which was based on Mr Eastman no longer having a business or business premises subject to capital gains, and which discounted Mr Eastman's future obligations to make accurate returns as straightforward and unlikely to give rise to error without having regard to the relevant factor of the deficiencies in Mr Eastman's record-keeping that had led to his failure to spot the omission in his 2012-13 return.

49. The letter of 11 September 2015 also confines itself to too narrow a focus. Although it recognised that it was not necessary that capital disposals would continue (thus accepting that the underlying cause was something different from the particular taxable event that had given rise to the inaccuracy), it focused on systematic or systemic failure, contrasting that with a very straightforward mistake, or human error. In doing so, we consider that HMRC was again failing to exercise its discretion in the way a reasonable decision-maker would. Although it can readily be appreciated that a systemic failure may be particularly susceptible to conditions aimed at remedying such failure, the legislative scheme is not confined to such failures. If the inaccuracy has been brought about by human error, the proper question to be addressed is whether there is scope for the risk of human error in the future to be minimised. The enquiry should not stop with the identification of a human error; it should start with it.

50. The same criticism can be addressed to the letter of 16 December 2015. That review was not one that could have been made by a reasonable reviewer; it was unreasonable in its assertion that a penalty suspension condition would have to address an ongoing record-keeping system or something similar, and that because Mr Eastman could simply have taken more care the inaccuracy could not be considered as having resulted from a weakness in process or record-keeping system that Mr Eastman had in place. That failed to consider the relevant question whether there was anything Mr Eastman could have done that could reasonably be considered would have obviated the error, and whether the imposition of a condition requiring that to be done in the future would help avoid a repetition.

51. Furthermore, for the reasons we have explained, we do not consider that it was relevant for HMRC to have had regard to a general exclusion of suspension for penalties for one-off inaccuracies. That exclusion, although suggested in the Explanatory Note to the Finance Bill 2007 which was considered by HMRC on review, amounts in our view to a fetter on the exercise of HMRC's discretion, which is unwarranted by the language of para 14.

HMRC's submissions

52. Before us Ms Long made a number of submissions which we have considered. Most repeated the reasons given by HMRC for their decision in the letters we have reviewed above. But there are some further observations to make on certain of the submissions.

53. Ms Long referred us to Fane, and in particular to what the tribunal had said at [60] after noting that there was no restriction on the face of para 14(3) in respect of a one-off event:

> "Nonetheless, it is clear from the statutory context that a condition of suspension must be more than an obligation to avoid making further returns containing careless inaccuracies over the period of suspension (two years)."

We respectfully agree, although it takes HMRC's case no further. As the tribunal in *Testa* said, at [31], the condition must require there to be some specific and observable action. In similar vein, we agree with the tribunal in *Steady*, at [28], that what is required is a practical and measurable condition.

54. Ms Long also argued that it is not enough for the suspension conditions to help meet an existing statutory obligation to submit accurate returns. With respect to Ms Long, that appears to us to be precisely what a suspensive condition must do. It is the careless failure to make accurate returns that is the subject of the penalty that the suspensive condition must be designed to help avoid. That is the statutory requirement itself in para 14(3).

Conclusion

55. We conclude, on this basis, that the decision of HMRC not to suspend the penalty in Mr Eastman's case was flawed according to judicial review principles. It proceeded on a flawed basis as to the underlying cause of the careless inaccuracy and it unreasonably confined the scope of HMRC's discretion both as regards its consideration of future risk and its unduly narrow focus on systemic failure. In doing so it unreasonably fettered its discretion. Those failures are such that we are unable to conclude that, had HMRC exercised their discretion in a proper manner, the decision would inevitably have been the same.

56. Having considered the evidence for ourselves, we consider that it was a failure by Mr Eastman to keep a proper record for himself of the disposal of the business premises that led to him failing to spot the error which had undoubtedly first emanated from his accountants. Although he had a file for more mundane tax documents he did not have any means of double-checking the contents of that file. That is something that is capable of remedy for the future, and is properly something that can be dealt with by way of a suspensive condition. It does not matter that the disposal of the business premises was a one-off event or that Mr Eastman no longer has business assets. Nor would it necessarily be a bar to a suspensive condition if he had no other chargeable assets, so long as he had a continuing requirement to make self assessment returns and thus a risk of a penalty for careless inaccuracy. In fact, of course, he does continue to own chargeable assets on which capital gains may have to be accounted for.

Decision

57. For these reasons, we find that HMRC's decision not to suspend the penalty in this case was flawed in a judicial review sense.

58. In accordance with FA 2007, Sch 24, para 17(4), we order HMRC to suspend the penalty. That does not, it seems to us, mean that HMRC are obliged by our order, as a matter of statute, to suspend the whole of the penalty, although we appreciate that it is HMRC's policy to do so. The ability of a taxpayer, following an order of the tribunal that the penalty be suspended, to appeal by virtue of para 17(4)(b)(i) against any "provision" of the notice of suspension demonstrates that HMRC's consideration following such an order is not confined to the conditions of suspension (contrast para 17(5)), but could therefore include a partial suspension.

59. As the tribunals in a number of cases, including *Testa*, *Steady* and *Ian Hall v Revenue and Customs Commissioners* [2016] UKFTT 0412 (TC), at [45], have noted, it is not for the tribunal to define the appropriate conditions. That, as Mr Sinclair himself observed, is a matter for discussion between the parties and, to the extent agreement is not reached, determination by HMRC subject to the right of appeal we have described above. We would say only that we have formed the view that a condition that provides Mr Eastman with an effective means of double-checking that what is comprised in his tax file represents all relevant material for the purpose of ensuring that he makes an accurate return, and that is capable of uncovering any

deficiency before the return is filed, should be carefully considered as an appropriate condition for the purposes of para 14(3).

60. We allow Mr Eastman's appeal.

Application for permission to appeal

61. 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.

ROGER BERNER
TRIBUNAL JUDGE

RELEASE DATE: 27 JULY 2016