

# Penalty sought

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*HMRC are seeking a penalty charge from a client where an amount of expenditure has been disallowed. The question of whether such expenditure is revenue or capital has been the subject of differing legal decisions*

I am dealing with an HMRC enquiry into a client where the department are seeking to disallow a relatively small amount of expenditure claimed as revenue on the grounds that it is capital.

My question does not arise from whether or not the expenses are deductible, as the House of Lords have come to different conclusions on similar facts in a number of cases.

My query is whether it is appropriate for HMRC to seek a penalty under these circumstances, as they have indicated that they wish to do, on the grounds that the taxpayer was negligent in preparing their tax return by not disallowing the aforementioned expenditure.

Have *Taxation* readers had any experience of HMRC's attitude to seeking penalties under circumstances where it is well-known that it is difficult to decide whether an expense is allowable, and has there been a change in HMRC's attitude to seeking penalties under such circumstances as compared to recent years?

*Query 17,398 - Perplexed*

## Reply by Hold Fast

The new penalty rules in FA 2007, Sch 24 apply where the inaccuracy is contained in (or the under-assessment relates to) a return or other document which is due to be filed on or after 1 April 2009, and the return or other document (or under-assessment) relates to a tax period beginning on or after 1 April 2008. However, I assume the question relates to the old rules.

HMRC do not make a distinction between adjustments that arise from an in-depth investigation and those that might be considered technical.

The department's *Enquiry Manual* says at EM5140:

'Exactly the same principles used in full enquiries apply to establishing culpability in aspect enquiries. Those principles cover the full range of aspect enquiries, from complex technical enquiries on large companies to simpler omissions from personal income tax self assessment returns. Though it might be more obvious that a taxpayer has acted fraudulently or negligently where business receipts are understated or a source of income or gains has been omitted from a return, you should still give consideration to culpability whenever you make an adjustment to the taxpayer's return leading to additional tax.'

This guidance tells inspectors that they should consider the subject of penalties in every case in which they obtain an adjustment so *Perplexed* may simply have received a letter from the Inspector asking 'why is this not culpable?' and when given a sensible answer they may go away.

Over the past few years, HMRC have tried to be more consistent on this point and increasingly penalties are mentioned in aspect enquiries.

The onus is on HMRC to show that the taxpayer was negligent and that is not straightforward. At Budget time, HMRC published *Working with Tax Agents: A Consultation Document*. At paragraph 3.9 it says:

'A taxpayer who goes to an ostensibly competent professional adviser, provides a full and accurate account of the facts, checks that advice to the limit of his or her ability and competence, and then follows the agent's advice (or signs the return prepared on that basis) has not been negligent.'

Did the client really know enough of the case law to reach a judgment on the expenditure? If not (and that will be 99.9% of clients) and Perplexed advised him the expenditure was allowable then no penalty is due.