[2019] UKFTT 42 (TC)

TC06938

Appeal number: TC/2017/07461
TC/2017/07463

INCOME TAX – Payment of redress for mis-sold interest rate hedging products – Penalty for failure to declare payment in tax return (FA 2007 Sch 24) – Special circumstances

FIRST-TIER TRIBUNAL
TAX CHAMBER

ANTHONY LOVELL **Appellants**
ELIZABETH LOVELL

- and -

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

TRIBUNAL: JUDGE CHRISTOPHER STAKER
MR ANDREW PERRIN

Sitting in public at Cardiff on 12 November 2018

The first Appellant in person, for both Appellants

Charles Bradley, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. Mr Lovell and Mrs Lovell (the "Appellants") each appeal against a penalty imposed under Schedule 24 of the Finance Act 2007 ("Schedule 24") for an inaccuracy in their 2013-14 tax returns. On 3 January 2018, the Tribunal directed that their appeals were to proceed together and be heard and determined by the same Tribunal.

2. Only Mr Lovell attended the hearing, where he gave evidence and made submissions on the joint behalf of both Appellants. In the decision below, the expression the "Appellant" when used in the singular refers to Mr Lovell.

Background

3. The Appellants are a married couple, who run a nursing home business in partnership. Years ago they took out an interest rate hedging product ("IRHP") with Barclays Bank in respect of a loan used to purchase a nursing home. It is common ground that over the following years, the IRHP premiums were appropriately deducted in the Appellants' tax returns as revenue expenses of their business.

4. On or about 16 December 2013, following the review by the Financial Conduct Authority ("FCA") described below, the Appellants received a redress payment from Barclays Bank concerning the mis-selling of this IRHP. Some general background to this FCA review and redress payments made by banks in respect of IRHPs is provided in *Gadhavi v Revenue & Customs* [2018] UKFTT 600 (TC) ("*Gadhavi*") [24]-[26]:

> [24] In 2012 the FCA identified failings in the way nine banks … had sold swaps and other interest rate hedging products. The banks agreed to carry out reviews of their sales of IRHPs to "unsophisticated customers" subject to the supervision of independent reviewers appointed under the Financial Services and Markets Act 2000 (FSMA). The reviews resulted in the banks agreeing to pay redress to large numbers of unsophisticated customers ...
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> [25] The FCA published their review into IRHPs on their website. The review set out who was entitled to redress, what redress might be available and how some elements of that redress were to be calculated.
>
> [26] The FCA review looked in some detail at how the banks were to determine the redress due. The underlying principle was that the bank should put the customer back in the position they would have been in had the mis-selling not occurred, including any consequential loss. The review then set out the different elements that might be comprised in the redress.

5. As set out in at *Gadhavi* [26], different elements of redress payments included "basic redress" (the difference between actual payments made on the IRHP and those

that the customer would have made if the breaches of relevant regulatory requirements had not occurred), interest (either 8% a year simple interest or interest costs actually incurred) and "consequential loss" (for instance, loss of profits over and above the interest paid on basic redress).

6. The December 2013 redress payment received by the Appellants, which was paid into an account held jointly by them, was not shown in their 2013-14 tax returns.

7. On 9 September 2016, HMRC wrote to them saying that HMRC had become aware that they had received the redress payment, and that HMRC proposed to raise an assessment under s 29 of the Taxes Management Act 1970 to bring into account the tax that should have been paid on it. The letter requested the Appellants to provide more information about the payment.

8. The Appellants' accountants responded in a letter dated 4 October 2016, stating amongst other matters as follows. The receipt of the redress payment was acknowledged. The redress payment was not accepted by the Appellants as a full settlement with Barclays Bank for all losses suffered by them as a result of the mis-selling of the IRHP, as it excluded any claim for consequential loss. The bank had also withheld interest, saying that this would be paid only on the Appellants accepting the bank's offer as a final settlement, which the Appellants refused to do believing this to be unreasonable. Barclays had also withheld tax. The Appellants were investigating ways to get what they believed to be fair compensation. A group action against the bank was contemplated, which was running in parallel to a complaint made to the FCA. The Appellants acknowledged that tax was due but considered that the moneys received to that point were merely a payment on account, and that the tax would be due once the redress was finalised, and once the full amount of the compensation was known.

9. There followed further exchanges between HMRC and the Appellants' accountants. One letter from the Appellants' accountants to HMRC, dated 17 May 2017, stated that the Appellants were aware of the HMRC guidance but did not agree with it, and that HMRC guidance was not binding.

10. On 1 June 2017, HMRC issued to the Appellants discovery assessments under s 29 TMA for the tax year 2013-14, and notices of penalty assessments under Schedule 24.

11. On 26 June 2017, the Appellants appealed against the HMRC decisions.

12. In review decisions dated 8 September 2017, HMRC upheld the assessments and penalties, as well as the decision not to suspend the penalties.

13. On 6 October 2017, the Appellant commenced the present Tribunal appeal.

14. At the hearing, the Appellant clarified that the Appellants were no longer seeking to appeal against the assessment to tax on the redress payment, but were only appealing against the penalties.

Postponement of the hearing

15. On 24 September 2018, the Appellants' agent applied for the hearing of this appeal to be postponed, on the ground that there was a lead case dealing with the same matters as this appeal, TC/2017/04466 *Wilkinson v HMRC*, in which a hearing was expected within a few months.

16. On 24 October 2018, HMRC opposed the requested postponement, stating as follows. *Wilkinson* was not a lead case in any formal sense, even if certain other cases had been stayed behind it. The issues in the present case concerned primarily the penalties charged for inaccuracies in tax returns, and therefore extended beyond those in *Wilkinson*. The tax treatment of redress payments in relation to IRHPs had already been determined in *Gadhavi*.

17. In a direction released on 25 October 2018, the Tribunal refused the application for a postponement, finding that the Appellant had not explained how the present case is similar to the issues in the lead case to which they referred, but stating that the Appellants could renew the application to postpone at the hearing.

18. At the hearing, the Appellant renewed the request that the hearing be postponed. He said that a number of test cases involving IRHPs were in the process of being heard, and that there were at least two other cases that remained to be heard, the first of which was expected to be heard in early 2019.

19. The Tribunal refused the request for a postponement for the following reasons.

20. The Appellants in the present case now accept that they should have included the redress payment in their tax returns, and the only issues for determination in this appeal concern the penalties for their failure to do so.

21. *Gadhavi* was concerned only with the issues of liability to tax on an IRHP redress payment, and was not concerned with any inaccuracy penalty.

22. The Appellant provided the Tribunal with an e-mail from Rational Tax dated 6 November 2018. That e-mail indicates that Rational Tax are representing the appellant in *Wilkinson*, and that the issue in *Wilkinson* will be whether redress payments for mis-sold IRHPs should be taxed as capital rather than income. Although the e-mail indicates that Rational Tax are representing various taxpayers in relation to IRHP redress payments, there is no information before the Tribunal to suggest that *Wilkinson* will be concerned with issues around penalties, or if it is, that *Wilkinson* will deal with issues relating to penalties of potential application to all IRHP redress cases. Penalties depend normally on the facts and circumstances specific to each individual case.

The Appellant's evidence and submissions

23. The Appellants' notices of appeal contend that the tax returns were correctly completed. However, as noted above, the Appellants no longer dispute that the redress payment should have been included in their 2013-14 tax returns.

24. The Appellant stated in evidence amongst other matters the following.

25. The Appellants have been through extremely difficult financial and personal circumstances following the mis-selling of the IRHP by Barclays Bank in 2007. The bank sold the Appellants a complex product that was supposed to protect their small care homes from fluctuating interest rates but instead cost them over £140,000 which ultimately resulted in them selling two of the care homes. The complexities surrounding the IRHP were far beyond the Appellants' knowledge, and they did not have a basic understanding of the products that were mis-sold. The Appellants were honest and reliable small business people who through no fault of their own were forced by Barclays into a position where they fell behind their debt to HMRC. In the subsequent years, they were deemed by Barclays and the FCA to be "unsophisticated business people" and were refunded the moneys.

26. Initially the Appellants believed that the tax due on the repayment was deducted at source, as Barclays wrote to the Appellants with the proposal offering compensation and the 8% interest with tax deducted.

27. The Appellants were advised by Rational Tax Ltd, experts in the field, that tax should not be payable on the compensation. The Appellants made a mistake in believing them.

28. Barclays paid the redress payment in December 2013, but withheld the 8% interest that was owed until the Appellants signed a document to say that they would not sue Barclays for further consequential loss. Barclays finally made an additional payment less income tax in June 2017.

29. The Appellants made an error despite taking reasonable care. They did not know that they were being mis-sold a product that would cost them £140,000 over 5 years, and when it was paid back to them they did not realise that it would be taxable.

30. Alternatively, the penalty should be suspended. The reasoning of HMRC concerning the suspension of penalties is flawed. A condition concerning the IRHP can still be imposed on the Appellants, given that the Appellants still have a claim against Barclays for consequential losses.

31. In cross-examination, the Appellant said as follows. He is not a tax expert, and would be unable to say himself whether the redress payment was or was not taxable. His accountant had read the HMRC guidance. He was advised that the redress payment was not taxable by Rational Tax and another firm called Bully-Banks who assisted them to make the claim for the redress payment, and by Pragmaticum, another firm assisting them with their claim against the banks. He attended conferences at which this was stated. Although he did not receive individualised advice on his own specific circumstances, the advice that the redress payments were not taxable was given to hundreds of people, who were told that this advice applied to all of them. The Appellants did not specifically get advice from their accountants on the taxability of the redress payment before putting in their 2013-14 tax returns, but their accountants were in correspondence with Bully-Banks. The Appellants at the

time were fighting to keep their house and business, and were fighting to keep their heads above water, and had overwhelming volumes of information. They were receiving a myriad of advice on complex issues that they did not understand. The mis-selling of the IRHPs was an injustice. Bank managers did not understand these products. The Appellants also did not understand them. No-one at HMRC ever asked him to come up with conditions of suspension. A measurable condition would be a requirement to treat any further redress payment by the bank in the correct way.

The submissions of HMRC

32. The burden of proof is on HMRC to establish on a balance of probability that the Appellants' behaviour was careless.

33. The redress payment should have been treated as income for tax purposes. HMRC published guidance in July 2014 explaining how various elements of the redress payment should be treated for tax purposes. The Appellants' tax returns were received by HMRC in January 2015, which gave them sufficient time to seek professional advice on tax treatment. The 17 May 2017 letter from the Appellants' accountant indicates that they did consider the HMRC guidance, but did not agree with it. There is no evidence that the Appellant sought expert tax advice on the question. He simply acted on what he says was announced to an audience at a conference. The Appellant did not act in accordance with the standard of a reasonable and prudent taxpayer. The Appellant was at the very least careless in this respect. It is however accepted that anyone would have sympathy for the Appellants, in that this was an unusual receipt with a complicated background. However, reasonable care would have involved taking specialist advice.

34. The Appellant's disclosure was prompted. Under Schedule 24 to the Finance Act 2007, the minimum penalty percentage for a careless inaccuracy with a prompted disclosure is 15%, and the maximum is 30%. HMRC have given a 65% reduction in the maximum penalty for the quality of the Appellants' disclosure, such that the penalty imposed is 20.5%. There is no obvious reason for the Tribunal to go behind this penalty calculation.

35. Under paragraph 14(3) of Schedule 24, HMRC can only suspend a penalty if compliance with a condition of suspension *would* help avoid future penalties for a careless inaccuracy. In this case, HMRC cannot suspend the penalty, as it is not possible to set any suitable measurable suspension conditions. It cannot be known whether the Appellants will receive any similar one-off payment in the future. It is not possible to set ordinary compliance with the generality of UK tax legislation as a suspension condition. The Appellants have not offered any suspension conditions for HMRC to consider. HMRC cannot see how the Appellants would be able to demonstrate full compliance with any suspension conditions that might be imposed. The question whether the decision of HMRC is "flawed" must be based on the information before the decision-maker at the time of decision.

36. HMRC do not believe that there is any evidence of special circumstances, and therefore consider that a special reduction is not appropriate.

Applicable legislation

37. Paragraph 1 of Schedule 24 provides that a penalty is payable where a person gives HMRC a return which contains an inaccuracy that amounts to or leads to an understatement of a liability to tax, and where that inaccuracy was either "careless" or "deliberate".

38. Paragraph 11 of Schedule 24 provides for the reduction of penalties where HMRC think it right because of special circumstances.

39. Paragraph 15 of Schedule 24 provides for appeals to the Tribunal against decisions of HMRC in relation to penalties under that Schedule.

40. Paragraph 17 of Schedule 24 provides that in an appeal against the amount of a penalty, the Tribunal may rely on paragraph 11 to a different extent to HMRC, but only if the Tribunal thinks that HMRC's decision in respect of the application of paragraph 11 was flawed. "Flawed" means "flawed when considered in the light of the principles applicable in proceedings for judicial review".

The Tribunal's findings

41. The Tribunal considers that there are a number of features of the present case that are unusual, and make it unlike a typical careless failure to omit from a tax return a receipt that should have been included as income. These features are especially the following:

(1) The only reason why the Appellants received the payment was because they were the victims of mis-selling. The FSA found that there were "serious failings" by certain banks in the selling of IRHPs to small businesses who were "non-sophisticated" customers who were unlikely to have understood the risks associated with those products (see, for instance, https://www.fca.org.uk/publication/archive/fsa-interest-rate-swaps-2013.pdf). The Appellants were essentially in a situation not of their own making. The Tribunal accepts the Appellant's evidence that the Appellants did not understand the IRHP that they had purchased. The Tribunal further accepts the evidence that the Appellants were not themselves capable of appreciating the appropriate tax treatment of the redress payment.

(2) The Tribunal accepts the Appellant's evidence that the Appellants have been through extremely difficult financial and personal circumstances following the mis-selling of the IRHP, that they were at the time fighting to keep their heads above water, and that they had overwhelming volumes of information and were having to deal with complex issues that they did not understand.

(3) The Tribunal accepts that HMRC published guidance in July 2014 on the appropriate tax treatment of redress payments for mis-sold IRHPs, and that the 17 May 2017 letter from the Appellants' accountants confirms that the Appellants were aware of that guidance at the time that the 2013-

14 tax return was submitted. The Tribunal also accepts that the Appellant did not himself seek specialist advice before disagreeing with that guidance.

However, the Tribunal is not persuaded that any specialist advice that the Appellants might have sought would have been clear or conclusive. The issue of the appropriate tax treatment was subsequently litigated in *Gadhavi*, and appears set to be litigated again in *Wilkinson*. The Tribunal cannot say anything about the merits of either case, but it appears that a number of cases have been stayed behind *Wilkinson* (whether or not it has formally been identified as a lead case) notwithstanding that the issue has already been considered in *Gadhavi*. This suggests that there are even now arguable issues to be litigated in connection with the tax treatment of redress payments for mis-sold IRHPs. HMRC accept that the redress payment was an unusual receipt with a complicated background. HMRC have not suggested that the question of the appropriate tax treatment would have been a plain and simple matter for any tax adviser to answer independently. If professional advice had been sought, there seems that there would have been a realistic probability of significant fees being spent to obtain advice to the effect that the question cannot be answered with certainty but that HMRC take the position that it was taxable.

(4) The Appellant says that he heard from Rational Tax, Bully-Banks and/or Pragmaticum, at least as a member of the audience at one or more conferences, that the redress payment was not taxable. The Appellant was not specific in his evidence, and the Tribunal is not persuaded that he was told before the 2013-14 tax returns were submitted by anyone specifically that the payment was *not* taxable. However, it is probable that the Appellant was aware that there were proponents of the view that it was at least *arguably* not taxable. The Appellant admits that he was aware of the HMRC guidance at the time that the return was submitted, and HMRC expressly relied on that part of his evidence. HMRC do not suggest that he deliberately omitted to include in his return a payment which he knew should have been included. The HMRC case is that he omitted to get specialist advice on whether or not the HMRC guidance was correct. The Tribunal is therefore satisfied that the Appellants, while aware of the HMRC position on the matter, in their own minds considered it to be uncertain whether or not the payments were taxable.

(5) The Appellant contends that he considered the redress payment to be only a payment on account, and that he intended to return the full amount once the total amount of redress had finally been determined. This claim appears to have been raised for the first time in the Appellants' accountants' letter of 4 October 2016, after the 2013-14 tax return had been submitted and after HMRC had commenced looking into this matter. There is no contemporaneous evidence that this was in fact the Appellants' thinking at the time that their tax returns were submitted. The suggestion that this was the Appellants' thinking seems to contradict the Appellant's evidence that he was told that the payments were not taxable,

and that he believed this advice. It may be that at some point the thinking changed, but if so, there is no evidence of when this occurred.

(6) Unlike appellants in other cases, the Appellants in this case have not sought to dispute their liability to the tax. As early as in the Appellant's accountants' 4 October 2016 letter, the Appellants fully acknowledged that the redress payment was subject to tax. They did, however, even at the time of originally commencing this Tribunal appeal, continue to maintain that the payment did not need to be included in their 2013-14 tax returns.

42. The 28 April 2017 HMRC penalty explanation letter does not deal with special circumstances. Nor does other HMRC correspondence dated 28 November 2016, 22 February 2017 and 19 May 2017.

43. The 31 July 2107 HMRC "view of the matter" decision does not deal specifically with special circumstances, other than to state merely that "I have not been made aware of any particular circumstances which you feel may affect your case".

44. The section on "special circumstances in the 8 September 2017 review decision deals almost entirely with the definition of the expression "special circumstances". It then merely states: "Having considered the facts before me I have not found any evidence of circumstances that might allow a special reduction".

45. In deciding whether the HMRC decisions are "flawed when considered in the light of the principles applicable in proceedings for judicial review", the Tribunal can only have regard to matters that were before the decision maker at the time of decision. The Tribunal is satisfied that various matters raised by the Appellants' accountants in their correspondence following the initial 9 September 2016 HMRC letter amounted at least potentially to special circumstances justifying a special reduction in the penalty. There is no indication in the HMRC decisions that any of these specific matters, in isolation or in combination with others, were specifically considered from the point of view of whether or not they amounted to special circumstances. A bare statement that there are no special circumstances is insufficient to demonstrate that such consideration has been given. The Tribunal is therefore satisfied that the HMRC decision is flawed in this respect.

46. The Tribunal therefore determines the issue of whether there are special circumstances in the exercise of its own discretion. In the exercise of that discretion, the Tribunal can take into account matters up until the time of its own decision.

47. The minimum penalty percentage for a careless inaccuracy with a prompted disclosure is 15%. Having regard to the matters in paragraph 41 above, the Tribunal is satisfied that there are circumstances in the present case that justify a reduction in the penalty below that amount. This was an unusual one-off receipt, with a complicated background. It was received at a time when the Appellants were overwhelmed in dealing with various matters, some of which were financial consequences attributable to the IRHP which they had been mis-sold. The Appellants

no doubt wish that they had never been mis-sold the IRHP, in which case they never would have received this redress payment in the first place.

48. The question is how great a reduction in the penalty would be appropriate. The Appellants are not blameless. Apart from anything else, they might have disclosed the payment and explained the circumstances in the white space in their tax returns. However, having regard to the circumstances as a whole, including the fact that the Appellants accepted at an early stage that the redress payment is liable to tax even though this is a matter still subject to litigation in other cases, the Tribunal has decided that it is appropriate to reduce the penalty to zero.

Conclusion

49. For the reasons above, the appeal is allowed and the penalties are set aside.

50. 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.

DR CHRISTOPHER STAKER
TRIBUNAL JUDGE

RELEASE DATE: 22 JANUARY 2019