



**Appeal numbers: FTC/56/2013**

*INCOME TAX - penalty for careless inaccuracy within a self assessment return leading to understatement of liability to tax - appellant in receipt of compensation payment exceeding £30,000 on termination of employment - appellant failed to include payment in tax return - compensation sum subsequently taxed and penalty levied - appeal against penalty - FTT held that appellant had been careless and penalty affirmed - FTT decision upheld and appellant's appeal dismissed*

**UPPER TRIBUNAL  
TAX AND CHANCERY CHAMBER**

**TIMOTHY HARDING**

**Appellant**

**- and -**

**THE COMMISSIONERS FOR HER MAJESTY'S  
REVENUE AND CUSTOMS**

**Respondents**

**TRIBUNAL: JUDGE COLIN BISHOPP  
JUDGE EDWARD SADLER**

**Sitting in public in London on 21 October 2013**

**The Appellant appeared in person**

**Andrew Sharland, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents**

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## DECISION

### *Introduction*

1. This is an appeal by the taxpayer, Mr Timothy Harding (“the Appellant”), against a decision of the First-tier Tribunal (“FTT”) (Judge Geraint Jones QC and Mrs Sheila Cheesman). The FTT, in its decision released on 8 October 2012, dismissed the  
5 Appellant’s appeal against a penalty of £2,778.18 assessed on him by The Commissioners for Her Majesty’s Revenue and Customs (“HMRC”) for a careless inaccuracy in his self assessment return for income tax purposes where that led to an understatement of the Appellant’s liability to income tax.

10 2. The income which the Appellant failed to include in his self assessment return is a compensation payment which the Appellant received in connection with the termination of his employment. HMRC subsequently assessed £79,793 of that payment as liable to income tax. The Appellant has not disputed that assessment. He has, however, disputed the penalty which HMRC additionally assessed on him.

15 3. The grounds of the Appellant’s appeal to this tribunal are that the FTT erred in law in reaching its decision to affirm the decision to assess the penalty in that it ignored or misrepresented both oral and written evidence which the Appellant put before the FTT which supported the Appellant’s case that he had reasonable grounds for concluding, at the time he made his self assessment return, that the compensation  
20 sum he received was not taxable.

4. The disputed penalty was assessed by HMRC under the provisions of Schedule 24 to the Finance Act 2007 (the self assessment return in question is for the tax year ended 5 April 2009). Paragraph 1 of Schedule 24 (so far as relevant, and as it applied for the tax year in question in this appeal) provides as follows:

25 (1) *A penalty is payable by a person (P) where -*

(a) *P gives HMRC a document of a kind listed in the Table below [a self assessment return is such a document], and*

(b) *Conditions 1 and 2 are satisfied.*

30 (2) *Condition 1 is that the document contains an inaccuracy which amounts to, or leads to -*

(a) *an understatement of P’s liability to tax,*

...

(3) *Condition 2 is that the inaccuracy was careless or deliberate (within the meaning of paragraph 3).*

35 5. Paragraph 3 of Schedule 24 (again, so far as relevant, and for the tax year in question) provides:

(1) *Inaccuracy in a document given by P to HMRC is -*

(a) “careless” if the inaccuracy is due to failure by P to take reasonable care.

5 6. Subsequent provisions in Schedule 24 set out the way in which a penalty is to be calculated, depending upon a number of circumstances. It is not necessary for us to consider those provisions as the Appellant has no quarrel with the amount of the penalty assessed if the penalty is found to be properly payable.

10 7. More generally, the Appellant has no quarrel with the terms of Schedule 24 as such - his case is that no penalty is due because the inaccuracy in his self assessment return (the failure to include the compensation payment as income) was not careless: he had, he argues, a belief based on reasonable grounds that the payment was free of tax and so the inaccuracy in his self assessment return could not be said to be careless.

*Outline of the facts and of the proceedings before the FTT*

15 8. The Appellant was employed by KPMG UK Limited from 1988 until 31 October 2008. The Appellant’s employment was terminated in accordance with the terms of a compromise agreement. That agreement provided for the employment to be terminated on 31 October 2008 and for KPMG UK Limited to make a “severance payment” to the Appellant within 21 days of his providing to them a certificate (in specified form) that he had had independent legal advice as to the legal effect and consequences of entering into the compromise agreement. The “severance payment” was expressed to be “compensation for the early termination of [the Appellant’s] employment”. It comprised what is described in the compromise agreement as “an *ex gratia* payment of £109,793” and £12,500 to be paid directly into the Appellant’s pension fund. The *ex gratia* amount is said to include any payment for which the Appellant was eligible under KPMG UK Limited’s Director Profit Share Plan and the Director Performance Bonus. (We refer below to further provisions of the compromise agreement, since, as we explain, the FTT saw in evidence only the first page of this document, which included the terms summarised above.)

30 9. On 10 August 2009 the Appellant completed his self assessment return for the tax year ended 5 April 2009 and submitted it to HMRC. He used what is known as a Short Tax Return (essentially the form of return used when a taxpayer’s income or tax affairs are routine in nature). He did not disclose in that return the “severance payment” he had received from KPMG UK Limited. The notes “How to fill in your Short Tax Return” published by HMRC, and which the Appellant received with his tax return, include a section headed “Who cannot use the Short Tax Return” in which it is stated: “You must **not** use the Short Tax Return if, in the year 6 April 2008 to 5 April 2009, you: ... received a lump sum from your employer (or a former employer) unless it was a redundancy payment below £30,000 ... .”

40 10. KPMG UK Limited made a return to HMRC in respect of the “severance payment” it had made to the Appellant. The Appellant was not aware, until after he had submitted his self assessment return, that KPMG UK Limited had made such a return. In consequence of that return the Appellant was subsequently assessed to income tax in respect of £79,793 of the “severance payment” under the provisions of

section 401 Income Tax (Earnings and Pensions) Act 2003 which brings into the income tax charge “payments and other benefits which are received directly or indirectly in consideration or in consequence of, or otherwise in connection with the termination of a person’s employment”. It provides that the first £30,000 of any such payment or benefit is free of tax.

11. Following that assessment, on 10 August 2010 HMRC assessed the Appellant under Schedule 24 to a penalty of £2,778.18.

12. The Appellant appealed to the FTT against the penalty assessment. His grounds of appeal were that at the time he completed his self assessment return he believed that a compensation payment made in connection with termination of employment was not taxable if such payment was made after (and not on or before) the termination of the employment. Therefore his failure to include the severance payment in his self assessment return was not negligent or careless.

13. At the hearing of the Appellant’s appeal by the FTT (on 7 March 2012) it appears that the Appellant made reference to documents not included in the papers the Appellant had produced in evidence for the hearing (including the compromise agreement). In its decision the FTT records matters as follows:

“3 At the hearing before us it became clear that there might be other documents relevant to the issue of what the appellant believed to be the position concerning the liability to tax of the redundancy payment and the appellant was given an opportunity to submit such further documents as he saw fit.

4 The appellant submitted a letter dated 26 March 2012, which had attached to it the first page (only) of a (draft) (Redundancy) Agreement. The appellant says in the fourth paragraph of that letter: ‘I was told, separately by both my solicitor and KPM, that I was not being advised on taxation matters. Nevertheless, I understood there was a *possibility* [emphasis added] of no income tax being payable if payment was received after my employment had been officially terminated, as indeed it was in my case.’ “

*The FTT’s decision*

14. The FTT’s decision was released on 8 October 2012. The FTT dismissed the Appellant’s appeal. The decision is brief, running to 10 paragraphs. After the paragraphs set out above, the decision continues:

“5 That paragraph [that is, the paragraph quoted from the Appellant’s letter of 26 March 2012] chimes with the evidence that the appellant gave to us during the hearing, which left us in little doubt that the appellant did not know, one way or the other, whether the amount that he subsequently received from his erstwhile employer was or was not taxable.

5 6 There is no evidence that the appellant then took appropriate advice either from an independent expert or by seeking advice from HMRC as to whether that sum should or should not be disclosed as being taxable or as being arguably taxable. If the appellant had wanted to act out of an abundance of caution, it would have been open to him to disclose the payment on the basis that if it was not taxable, then no tax would be demanded based upon that disclosure.

10 7 HMRC subsequently discovered that this sum had been paid and subjected it to tax. The tax due, together with interest thereon, has been paid.

15 8 HMRC imposed a penalty in the sum of £2778.18 being 15% of the additional tax payable. The appellant contends that such a penalty should not have been levied because he had not been negligent or careless in any material respect. We are unable to agree with the appellant's submission. We are satisfied from hearing his evidence and from the letter of 26 March 2012 that he entertained considerable doubt as to whether this additional sum was or was not taxable, but failed to take any steps to ascertain the correct position and/or to disclose it on the basis that if it was not properly taxable, then no tax would be demanded in respect of it. We are satisfied that the appellant decided not to disclose the payment notwithstanding that he entertained considerable doubt as to whether it was or was not taxable, on the basis that he might thereby avoid the excess over £30,000 being subject to tax."

25 *The Appellant's submissions*

30 15. As mentioned, the grounds of the Appellant's appeal to this tribunal are that the FTT failed to take account of the Appellant's evidence that by August 2009 he had reached a reasonable conclusion that the "severance payment" was not taxable (resolving any doubts he might have had on the point when the payment was received). That evidence included the compromise agreement (a complete copy of which the Appellant had sent to the tribunal office with his letter of 26 March 2012) and also an extract from an article on the WoltersKluwer UK website on the taxation of termination payments which not only evidenced that the Appellant had researched the matter, but also supported his view that the "severance payment" he had received  
35 was not taxable.

16. The Appellant reiterated these points at the hearing before this tribunal, and he handed in a complete copy of the compromise agreement and two pages from the article taken from the WoltersKluwer UK website.

40 17. The Appellant's case is that whilst in October 2008 he might have entertained the possibility that the "severance payment" was taxable (which he had acknowledged in his letter of 26 March 2012 to the FTT), he had subsequently researched the point on the WoltersKluwer UK website, where he learnt that if a severance payment is made after the employment is terminated, it is not taxable. That, in his submission, accorded with the circumstances in which he received his "severance payment". Thus, by the

time he completed his self assessment return in August 2009 he believed, and believed on reasonable grounds, that the payment was not taxable and that therefore he was not required to include it in his tax return. He pointed out that he was unaware, until much later he was advised of the point by HMRC, that KPMG UK Limited had made a compliance return to HMRC indicating that in their view the “severance payment” was taxable.

18. The FTT in reaching its decision took no account of these matters. Had it done so it would have concluded that the Appellant had not acted carelessly or negligently in failing to include the “severance payment” in his self assessment return. The FTT’s decision is therefore flawed, and the appeal against that decision should be allowed.

*HMRC’s submissions*

19. Mr Andrew Sharland appeared for HMRC (he was not instructed when the appeal was before the FTT). In his submission the FTT’s conclusions are reasonable having regard to the evidence it was asked by the Appellant to consider, and accordingly its decision should be upheld.

20. By his own admission to the FTT (the Appellant’s letter to the FTT of 26 March 2012) the Appellant acknowledged that at some time before he completed his self assessment return he understood that there was only a possibility that the “severance payment” was free of tax, and that if it was received after termination of the employment. The Appellant failed to satisfy the FTT that, by the time he came to complete his self assessment return, his uncertainties on the matter had, on reasonable grounds, been resolved so that he could justifiably conclude that the “severance payment” was not taxable.

21. The Appellant placed reliance on the article from the WoltersKluwer UK website, and had supplied the tribunal with two pages from that article. The article in question runs to four pages. It is clear, if the article is read as a whole, that only the first £30,000 of any payment on termination of employment is free of tax. It is also clearly stated that the article provides general advice only and is not to be regarded as a complete or authoritative statement of the law.

22. The Appellant was clearly informed in the notes accompanying his Short Tax Return that he should not use that form of self assessment return if he had received a payment on termination of his employment where that payment exceeded £30,000, and the Appellant had chosen to ignore that information and had failed to act on it.

23. In all the circumstances the Appellant had failed to take reasonable care in completing his self assessment tax return which had resulted in an inaccuracy giving rise to an understatement of his liability to tax. The FTT had been right to conclude that the penalty decision should be affirmed, and the Appellant had no basis for challenging its decision to that effect.

*Discussion and decision*

24. We need first to mention some additional matters relating to the circumstances of the termination of the Appellant's employment and the payment of the "severance payment". These were explained to us by the Appellant and by his account were also explained by him to the FTT. They are not recorded in the FTT's decision.

25. The compromise agreement (the Appellant supplied to us an undated and unsigned copy) was negotiated prior to the end of October 2008 between the Appellant's solicitor and KPMG UK Limited, and its terms agreed such that, on or just before 31 October 2008, the Appellant signed his part and sent it to KPMG UK Limited. They signed their part on or shortly after 31 October 2008. The "severance payment" was made to the Appellant later in November 2008.

26. As to the terms of the compromise agreement, we have already recorded that it provides for the Appellant's employment to be terminated on 31 October 2008 (by which date the Appellant had agreed the terms on which the employment was to be terminated) and also sets out the terms on which the "severance payment" was determined. These matters appear on the first page of the compromise agreement, which was before the FTT.

27. It is not clear why the complete version of the compromise agreement was not available to the FTT: the Appellant sent it to the tribunal office, but it seems not to have reached the FTT itself in its complete form. Be that as it may, we note that the second page of the compromise agreement contains a clause headed "Taxation", which includes the following:

*"3.1 The Company and the Employee understand that the first £30,000 of the Severance Payment under Clause 2.1(a) will not be subject to tax pursuant to sections 309, 401 and 403 of the Income Tax (Earnings and Pensions) Act 2003. Any remaining balance shall be subject to deductions in respect of tax at the appropriate rate."*

There then follows a provision to the effect that the Employee is responsible for all tax arising in respect of payments made under the compromise agreement, the employee indemnifying the Company (that is, KPMG UK Limited) against any liability it may incur for any such tax.

28. It is therefore clear that the matter of the taxation of the "severance payment" was an issue in the minds of the parties in their reaching agreement as to the termination of the Appellant's employment and the terms on which he should be compensated for that termination. At that time, at the very least, the Appellant knew that there was a definite possibility that the payment he received was taxable. Of course, he acknowledged as much to the FTT in his letter of 26 March 2012.

29. Did the Appellant then have good grounds for concluding, by the time he completed his self assessment return in the following August, that there was no basis on which the "severance payment" was taxable?



30. His only ground for his contention that this was so is the evidence he put before the FTT of the WoltersKluwer UK article on the taxation of employment termination payments. In particular, the Appellant points to the following sentence in that article, which is in the context of compromise agreements and whether such an agreement is reached before or after the employment is terminated:

*“This being said, provided the arrangements are made and the compromise agreement is signed after the original contract has officially terminated, it is still possible for any extra compensation payment element to be treated as non-taxable.”*

31. To read this sentence as an unequivocal statement that the payment the Appellant received was not subject to tax is to ignore the clear context in which the sentence is to be found.

32. First, a reading of the article as a whole makes it clear that any payment received in connection with the termination of employment is taxable, but that in some circumstances the first £30,000 of such a payment is tax free. For example, the very first paragraph of the article is in these terms:

*“This fact sheet aims to cover the tax treatment of payments that are made on the termination of an employee’s employment. Termination payments fall into two categories. They either arise from the employment, so are taxable as payments under s 62 ITEPA 2003 as they are a reward for services. Otherwise they are a termination payment under s 401 as they are made to compensate an employee for the loss of rights in respect of his employment. If they are a payment under s 401 then the first £30,000 of the payment can be made tax-free.”*

There are, we might add, a number of other references throughout the article to the taxation of compensation payments and to the circumstances in which the first £30,000 (only) of such payments are free of tax.

33. Secondly, the immediate context of the sentence to which the Appellant refers is a discussion about payments made before the employment contract is terminated (which, it is stated, are taxable in full as a payment for employment services) and arrangements made after the termination of the contract, where the payment is not taxable as a payment for employment services. It has nothing to say about the taxation of termination payments where those payments are made in connection with the termination of the employment (rather than as payments pursuant to a contract which is yet to be terminated) - and as we have mentioned, other parts of the article make it clear that payments received in connection with the termination of the employment are, to the extent they exceed £30,000, taxable.

34. The Appellant placed much emphasis on the point that he received his termination payment after his contract was terminated - that was the factor that led him to conclude that the payment was tax free. The point does not stand up to scrutiny. First, the compromise agreement clearly states that the “severance payment” is to be paid

“as compensation for the early termination of the Employee’s employment” - by no stretch of the imagination can this be seen as a case where, after, and unrelated to, the termination of the employment the employer decides to make a payment to the employee. Secondly, although the payment may actually have been made after the Appellant’s employment terminated on 31 October 2008, it is clear from the compromise agreement itself and from the Appellant’s account of the chronology of events that KPMG UK Limited became liable to make the payment immediately upon the termination of the employment. Thirdly, the “Taxation” clause in the compromise agreement shows that the taxation of the “severance payment” was an issue between the parties notwithstanding that the compromise agreement contemplated that the “severance payment” would be paid at a point after the termination of the employment.

35. For these reasons we do not accept that the Appellant, who admits that he considered that the “severance payment” was possibly liable to tax in October 2008, could, by August 2009, reasonably have reached the conclusion that it was definitely not liable to tax. The Appellant is an intelligent person, and held a senior position (such as made him eligible to participate in his employer’s profit share and bonus plans reserved for directors) in a company which forms part of a leading accountancy practice. The case he put to the FTT, and to us, is not credible.

36. We conclude that when he made his self assessment return he must, on any reasonable basis, have considered that the “severance payment” was - at the very least - possibly taxable. Even if he had any lingering doubts, the notes accompanying his Short Tax Return should have prompted him to make a full self assessment return to include the payment or at least indicate that he had received a payment, but that he did not consider it was liable to tax.

37. In the terms of paragraph 1 of Schedule 4 to the Finance Act 2007, the self assessment return which the Appellant made contained an inaccuracy (the failure to declare the “severance payment”) which led to an understatement of his liability to tax. That inaccuracy was careless, since it was due to the failure by the Appellant to take reasonable care. He failed to take reasonable care because he knew, or should reasonably have known, that there was at least a possibility that the “severance payment” was liable to tax.

38. This being the case, the FTT was right to conclude that the decision by HMRC to assess the Appellant for a penalty for the inaccuracy in the Appellant’s self assessment return was correct and should be affirmed. No other decision was available to the FTT.

39. We therefore dismiss the Appellant’s appeal to this tribunal.

#### *Costs*

40. HMRC have applied to us to make, should the Appellant’s appeal fail, an order under Rule 10 of The Tribunal Procedure (Upper Tribunal) Rules 2008 directing the

Appellant to pay their costs. They have delivered a schedule of the costs for which they seek an order.

5 41. The Appellant is entitled to make representations to us in response to HMRC's application for a costs order. Those representations may relate to whether in the circumstances of this case a costs order should be made by the tribunal and also as to the amount of costs for which HMRC are requesting an order as set out in their schedule.

10 42. We direct that the Appellant makes any representations on these matters which he wishes to make on or before the date which is 21 days from the date on which this decision is released.

15 **COLIN BISHOPP**  
**UPPER TRIBUNAL JUDGE**

**EDWARD SADLER**  
**UPPER TRIBUNAL JUDGE**

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**Released 15 November 2013**