



TC04860

Appeal number: TC/2014/05526

VALUE ADDED TAX – penalty for inaccuracies in returns – timing errors ‘deliberate but not concealed’ – determination of potential lost revenue – paragraphs 5 and 8 of Schedule 24 to FA 2007 – whether ‘normal rule’ or ‘delayed tax’ approach – regulations 34 and 35 of VAT Regulations 1995 considered – interaction with default surcharge regime – appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

M J HICKEY PLANT HIRE AND CONTRACTS LTD Appellant

- and -

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

**TRIBUNAL: JUDGE DR HEIDI POON
PETER SHEPPARD FCIS, FCIB, CTA**

Sitting in public at Immigration Appellate Authority, King’s Court, Royal Quays, Earl Grey Way, North Shields on 18 June 2015

Mr Richard Stubbs, Counsel for the Appellant

Mrs Elizabeth McIntyre, Presenting Officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. The appellant (M J Hickey Plant Hire and Contracts Ltd) appeals against the penalty assessment in the quantum of £149,186.10, which covers the period from 1
5 December 2009 to 31 August 2013 for inaccuracies in the VAT returns submitted.

2. It is not in dispute that penalties are due for the inaccuracies in the returns. The principal issue for the Tribunal to decide is the correct basis whereby the Potential Lost Revenue (PLR) is to be determined for the purpose of calculating the penalties.

3. The respondents ('HMRC') have raised the penalty assessment by applying the
10 'normal rule' for determining the PLR under paragraph 5 of Schedule 24 to the Finance Act 2007 ('FA 2007'). The appellant contends that the PLR should be determined under paragraph 8 of Schedule 24 to FA 2007 as relevant to 'delayed tax'.

Findings of fact

4. From the documents made available to the Tribunal and the oral evidence given
15 by Mrs Diane Muir (Mrs Muir) for HMRC, and Mr Paul John Kelly (Mr Kelly) for the appellant, we make the following findings of fact.

5. The appellant is engaged in business as a hirer of plant and machinery, and has been registered for VAT since 14 July 1975.

6. In November 2013, HMRC arranged to visit the appellant for VAT assurance
20 purposes. The first visit took place on 11 December 2013, and Mrs Muir was the VAT Assurance Officer who conducted the check into the appellant's VAT records.

7. Greaves Grindle is the firm of chartered accountants acting for the appellant. Mr Kelly, who has worked for Greaves Grindle on VAT matters for nearly 27 years, was present at the December visit to liaise with Mrs Muir. Mr Kelly had been providing
25 technical assistance to the appellant for some nine years by then, principally in respect of accounting entries into Sage Line 50 bookkeeping software system, and occasionally on matters relating to VAT.

8. Among the information provided by Mr Kelly to Mrs Muir during the
30 December visit was a schedule summarising the inaccuracies in the appellant's submitted returns from the quarter ended 31 August 2009 through to the quarter ended 31 August 2013. The inaccuracies have arisen in these returns as a result of the omission of the last day of entries for both input and output VAT for each quarter. The VAT entries of the last day of a quarter so excluded were then included in the following quarter, where the omission of the last day of entries was repeated. The
35 result of the appellant's practice meant that every VAT quarter had included the last day of entries of the previous quarter, and excluded the last day of entries of the relevant quarter. The reason given for the omissions was to assist the appellant's cash flow, as the output VAT omitted for the last day of the quarter invariably exceeded the input VAT for the one day.

9. In evidence, Mr Kelly informed the Tribunal that the ‘default’ date range of the appellant’s software system for preparing figures for VAT returns was set to start with the last day of the previous quarter and to end with the penultimate day of the relevant quarter, which the Tribunal understands to mean, for example, the date range for:

- 5
- (a) VAT Period 02/10 – from 30 November 2009 to 27 February 2010
 - (b) VAT Period 05/10 – from 28 February 2010 to 30 May 2010
 - (c) VAT Period 08/10 – from 31 May 2010 to 30 August 2010
 - (d) VAT Period 11/10 – from 31 August 2010 to 29 November 2010

10. When Mrs Muir visited the appellant in December 2013, the VAT return for the period 11/13 was being prepared. In accordance with Mrs Muir’s instruction, the appellant prepared the 11/13 return by re-setting the date range to start from 1 September 2013 and to end on 30 November 2013. As a result of re-setting the date range, the entries for the one day of 31 August 2013 were not included in the VAT return for period 11/13. A separate VAT assessment was raised to account for the input and output VAT related to entries arising on 31 August 2013. The VAT assessment in respect of entries for 31 August 2013 (and other sundry errors) in the amount of £272,713 was not in dispute.

11. Mr Kelly gave evidence on the significant hurdles posed by the accounting system to re-set the date range to include 30 November 2013, and to exclude the entries for the one day of 31 August 2013. He spoke of the considerable difficulties entailed in reversing the entries related to 31 August 2013 when the accounting system had been set up by default to include the day’s entries in the following quarter.

12. The Tribunal has no reasons to doubt any part of Mr Kelly’s evidence, and accepts that the accounting system had been operating at the material time for the penalty assessment on a default setting whereby every VAT quarter was out of alignment by one day at each end of the date range.

13. The facts in relation to the penalty assessment raised for the inaccuracies in the appellant’s VAT returns have the following components:

- 30
- (1) The *penalty percentage* as determined by the degree of culpability and reduction for the quality of disclosure;
 - (2) The *potential lost revenue* as determined according to statute; and
 - (3) The *period range* for which penalties are due.

14. For the purpose of determining the penalty percentage, the appellant emphasised from the outset that there is no contention as regards the categorisation of behaviour into ‘*deliberate but not concealed*’. For inaccuracies caused by behaviour that is ‘*deliberate but not concealed*’, the statutory penalty percentage is 70%.

15. In respect of any reduction of the penalty percentage due to disclosure, it is accepted that the disclosure was ‘prompted’ by the VAT visit. HMRC have the power under paragraph 9 of Schedule 24 to reduce the penalty percentage according to the

quality of disclosure. The maximum reduction allowed for ‘deliberate but not concealed’ inaccuracies is 35%, being the difference between the highest 70% and the lowest 35% of the prescribed penalty range (paragraph 10 of Schedule 24). The appellant received the maximum reduction of 35% (against the full 70%) to reflect the co-operation and access to records given to HMRC. There is no dispute between the parties as regards the penalty percentage being reduced to 35%.

16. The penalty assessment was raised with reference to the four-year period immediately preceding the date of the VAT visit in December 2013. From the schedule prepared by Mr Kelly, the differences between the VAT *paid* for each quarter and the amount that would have been *payable* using the correct date range, were adopted by HMRC for the purpose of quantifying the potential lost revenue for each quarter.

17. The four-year period from 1 December 2009 to 30 November 2013 would have covered sixteen VAT return quarters. The VAT period 11/13 is excluded from the penalty assessment for the reason that it was prepared to the correct date range in accordance with HMRC’s direction during the December 2013 VAT inspection visit.

18. Of the fifteen VAT quarters covered by the penalty assessment, nine of which produced a net underpayment between the VAT paid and payable, and the figures of the net underpayment for the relevant quarters are aggregated to form the PLR for the penalty assessment. The aggregate PLR for these nine quarters is £426,246. The penalty percentage of 35% is then applied to the PLR to arrive at the penalty assessment of £149,186.

19. The other six VAT quarters where there was an ‘overpayment’ between VAT paid and payable did not form part of the PLR calculation. An ‘overpayment’ in this context arose where the last day of VAT payable from the previous quarter exceeded the last day of VAT payable that was excluded from the relevant quarter.

Applicable legislation

20. Excerpts from Part 1 (‘**Liability for Penalty**’) of Schedule 24 to FA 2007:

‘Error in taxpayer’s document

- 30 1 (1) A penalty is payable by a person (P) where –
- (a) P gives HMRC a document of a kind listed in the Table below, and
 - (b) Conditions 1 and 2 are satisfied.
- 35 (2) Condition 1 is that the document contains an inaccuracy which amounts to, or leads to –
- (a) an understatement of a liability to tax, or
 - (b) a false or inflated statement of a loss, or
 - (c) a false or inflated claim to repayment of tax.

(3) Condition 2 is that the inaccuracy was careless (within the meaning of paragraph 3) or deliberate on P's part.

(4) Where a document contains more than one inaccuracy, a penalty is payable for each inaccuracy.

5

...

(The 'Table below' referred to in paragraph 1(1)(a) above is lengthy and is not reproduced here; the Tribunal notes that the Table includes VAT returns as relevant documents.)

...

10

Error in taxpayer's document attributable to another person

1A (1) A penalty is payable by a person (T) where -

(a) another person (P) gives HMRC a document of a kind listed in the Table in paragraph 1,

(b) the document contain a relevant inaccuracy, *and*

15

(c) the inaccuracy *was attributable to T deliberately supplying false information to P (whether directly or indirectly), or to T deliberately withholding information from P, with the intention of the document containing the inaccuracy. (emphasis added)*

...

20

Under-assessment by HMRC

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

(a) an assessment issued to P by HMRC understates P's liability to a relevant tax, and

25

(b) P has failed to take reasonable steps to notify HMRC, within the period of 30 days beginning with the date of the assessment, that it is an under-assessment.

(2) In deciding what steps (if any) were reasonable HMRC must consider -

30

(a) whether P knew, or should have known, about the under-assessment, and

(b) what steps would have been reasonable to take to notify HMRC.

...

Degrees of culpability

35

3 (1) [For the purposes of a penalty under paragraph 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,

40

(b) "deliberate but not concealed" if the inaccuracy is deliberate [on P's part] but P does not make arrangements to conceal it, and

(c) “deliberate and concealed” if the inaccuracy is deliberate [on P’s part] but P makes arrangements to conceal it (for example, by submitting false evidence in support of an inaccurate figure).

5 (2) An inaccuracy in a document given by P to HMRC, which was *neither careless nor deliberate on P’s part* when the document was given, is to be treated as careless if P –

(a) *discovered the inaccuracy at some later time*, and

(b) did not take reasonable steps to inform HMRC.’ (emphasis added)

10 21. Excerpts from Part 2 (‘**Amount of Penalty**’) of Schedule 24 to FA2007:

‘Standard amount

4 (1) This paragraph sets out the penalty payable under paragraph 1.

(2) If the inaccuracy is in category 1, the penalty is –

- 15 (a) for careless action, 30% of the potential lost revenue,
(b) for deliberate but not concealed action, 70% of the potential lost revenue, and
(c) for deliberate and concealed action, 100% of the potential lost revenue ...

Potential lost revenue: normal rule

20 5 (1) “The potential lost revenue” in respect of an inaccuracy in a document [(including an inaccuracy attributable to a supply of false information or withholding of information)] or a failure to notify an under-assessment is the additional amount due or payable in respect of tax as a result of correcting the inaccuracy or assessment.

25 ...

Potential lost revenue: multiple errors

6 (1) Where P is liable to a penalty under paragraph 1 in respect of more than one inaccuracy, and the calculation of potential lost revenue under paragraph 5 in respect of each inaccuracy depends on the order in which they are corrected –

- 30 (a) careless inaccuracies shall be taken to be corrected before deliberate inaccuracies, and
(b) deliberate but not concealed inaccuracies shall be taken to be corrected before deliberate and concealed inaccuracies.

35 ...

Potential lost revenue: losses

7 (1) Where an inaccuracy has the result that a loss is wrongly recorded for purposes of direct tax and the loss has been wholly used to reduce the amount due or payable in respect of tax, the potential lost revenue is calculated in accordance with paragraph 5.

40 (2) Where an inaccuracy has the result that a loss is wrongly recorded for purposes of direct tax and the loss has *not* been wholly

used to reduce the amount due or payable in respect of tax, the potential lost revenue is –

- 5 (a) the potential lost revenue calculated in accordance with paragraph 5 in respect of any part of the loss that has been used to reduce the amount due or payable in respect of tax , plus
(b) 10% of any part that has not.

...

- 10 (5) The potential lost revenue in respect of a loss is nil where, because of the nature of the loss or P's circumstances, there is no reasonable prospect of the loss being used to support a claim to reduce a tax liability (of any person).

...

Potential lost revenue: delayed tax

- 15 8 (1) Where an inaccuracy resulted in an amount of tax being declared later than it should have been (“the delayed tax”), the potential lost revenue is –

- (a) 5% of the delayed tax for each year of the delay, or
(b) a percentage of the delayed tax, for each separate period of delay of less than a year, equating to 5% per year.

- 20 (2) This paragraph does not apply to a case to which paragraph 7 applies.

...

Interaction with other penalties [and late payment surcharges]

- 25 12 (1) ...
(2) The amount of a penalty for which P is liable under paragraph 1 or 2 in respect of a document relating to a tax period shall be reduced by the amount of any other penalty [incurred by P, or any surcharge for late payment of tax imposed on P, if the amount of the penalty or surcharge is determined by reference to the same tax liability.] ...’

35 22. It is worth highlighting that paragraph 5 ‘*Potential lost revenue: normal rule*’ was amended a year later by section 122 of FA2008. The amendment is in the form of an insertion: ‘(including an inaccuracy attributable to a supply of false information or withholding of information)’. The wording for the parenthesis is given under paragraph 7 of Schedule 40 to FA2008, and took effect from 1 April 2009.

23. Section 122 of FA2008 (and paragraph 3 of Schedule 40) introduced a ‘new’ error penalty to Schedule 24 under paragraph 1A ‘*Error in taxpayer’s document attributable to another person*’ with effect from 1 April 2009.

40 24. In a penalty appeal, the statutory onus of proof that normally rests with the taxpayer is set aside by the specific exclusion under section 100B(2) of the Taxes Management Act 1970 (‘TMA’). The onus is reverted to HMRC, as it is in this case, to prove that the penalty is correctly determined in terms of the relevant statute.

HMRC's case

25. HMRC assessed the penalty by adopting the 'normal rule' under paragraph 5 of Schedule 24 for determining the PLR.

5 26. The basis for HMRC's position for rejecting the 'delayed tax' approach under paragraph 8 is set out in the Assurance Officer's letter dated 6 August 2014, which accompanied the penalty assessment notices, and was in response to the appellant's letter dated 15 July 2014:

10 'Our guidance [CH82391] on delayed tax states that two conditions must be met for the delayed tax provisions to apply. These two conditions are:

Condition 1 – The nature of the inaccuracy is such that, when discovered, and without the person taking any action to correct it, the inaccuracy

- 15
- has already been automatically reversed in one or more returns for a later period or periods, or
 - would have been automatically reversed in one or more returns, but for HMRC intervention.

Condition 2 – An amount of tax

- 20
- is identified in the return for a later period that matches an amount which, but for the inaccuracy, would have been declared in the earlier period, or
 - would have appeared in the return for a later period but for HMRC intervention.'

27. The letter continued with the officer's interpretation of the guidance:

25 'I do not consider that the errors met the criteria for delayed tax, as Condition 1 is not met.

30 The condition states – 'without the person taking any action to correct it'. The action to correct the errors in question was not an automatic reversal by the system, the business had to take action to ensure the omitted transactions were included in the next or later return.'

28. The appellant requested a review of the penalty assessment; the Review Officer confirmed the assessment by letter on 24 September 2014, with the following reasons:

35 '... my view is that more importantly the Guidance says, "*The nature of the inaccuracy is such that, when **discovered (my emphasis)**, and without the person taking any action*". It is not just the fact that the correction was not made automatically as referred to in the Guidance and Revenue and Customs Brief 15/11 but that first and foremost the inaccuracy has to be discovered. As I will explain in more detail the inaccuracy cannot have been discovered in the first place because the

40 inaccuracy was deliberate.' (emphasis in bold and parenthesis original)

29. The Review Officer then gave his detailed explanation with regard to inaccuracies 'discovered by the taxable person' as follows:

'The correction of VAT errors is explained in VAT Regulation 34 "Correction of Errors" SI1995/2518, HMRC Notice 700/45 and in HMRC's Guidance VAEC7100.

5 VAT Regulation 34(3) SI1995/2518 says, "*Where, in relation to all such overstatements or understatements **discovered by the taxable person (my emphasis)** during a prescribed accounting period ...* The Notes to VAT Regulation 34 refer to a Tribunal case, Chan [2012] TC01850: "*no recovery of VAT deliberately overpaid in earlier period by adjusting subsequent returns without making voluntary disclosure*".
10 (emphasis in bold and parenthesis original)

30. In conclusion, the Review Officer stated HMRC's position as follows:

15 '... For an error to be eligible for correction on a taxable person's VAT returns it has to have been discovered by a taxable person. If the taxable person already knows about the inaccuracy because the inaccuracy was deliberate, then it cannot have discovered the error.

20 There cannot in my view be "**deliberate delayed tax**" and therefore [the appellant] cannot make adjustments to their VAT returns under VAT Regulation 34 as the inaccuracies were deliberate and [the appellant] could not have discovered them. Therefore the delayed tax provisions in paragraph 8 of Schedule 24 are not applicable and the PLR cannot be calculated on this basis.' (emphasis added)

The appellant's case

31. The appellant submitted that:

25 (1) HMRC's case is 'based on guidance and not on law', and that the stated position 'is wrong in law and on the application of its own guidance'; that the guidance does not support HMRC's submissions:

(a) Guidance CH82397 provides an example (no. 2) that appears to fit the appellant's situation;

30 (b) Guidance CH82390 provides an explanation for delayed tax that appears to fit the appellant's situation;

(c) Business Brief 15/11 appears to specially envisage what took place in relation to the August 2013 return and the alleged underpayment to be assessed to penalty under the 'delayed tax' approach.

35 (2) The correct starting point is to apply the statute; paragraph 8 of Schedule 24 provides the statutory basis for calculation of PLR where delayed tax has been paid.

(3) Paragraph 8 provisions make no reference to any requirements for 'automatic corrections' or 'discoveries' of errors; these requirements appear in HMRC guidance and have no statutory force.

40 (4) The inaccuracy in the appellant's Sage accounting methods meant that any tax payable for the last day of the period was declared in the next period; this means that paragraph 8 applies, which the guidance cannot override.

5 (5) HMRC suggested that the inaccuracy must be corrected automatically (Condition 1 of the guidance). The appellant had explained that the inaccuracies were corrected automatically by the accounting system in the next return, and Mr Kelly had to intervene to stop the inaccuracies related to 31 August 2013 from being corrected automatically in the next VAT return.

(6) The Review Officer adopted a different position, relying on the term ‘when discovered’ in Condition 1 of the guidance. The appellant submits that ‘[t]his is to entirely misconstrue the condition. In context “discovered” relates to the discovery by [HMRC]; not the person filing the return.’

10 (7) The case of *Chan* concerned a different set of circumstances, relating to an assessment for VAT and not a penalty. VAT Regulation 34(3) refers to overstatements and understatements being ‘*discovered by the taxable person*’ and ‘is entirely distinct from [HMRC’s] Conditions. ... There is no reference to discovery at all in Schedule 24 or to discovery by the taxable person in the
15 guidance’.

Statutory construction of the relevant provisions

The course of the hearing

20 32. The hearing was, to a large extent, dominated by the parties advancing their respective interpretation of the ‘delayed tax’ approach. For the appellant, Mr Stubbs asserted the relevance of the ‘delayed tax’ approach as applied to the facts of the case, and mounted a formidable rebuttal of the views postulated by HMRC in rejecting its relevance. In turn, the dominance of the ‘delayed tax’ approach in the proceedings has meant that the respondents’ case was advanced more as a defence against the
25 relevance of ‘delayed tax’ approach – than as a positive case for the application of the ‘normal rule’ under the circumstances.

33. The Guidance CH82391 was heavily relied upon by the respondents in stating their position on the ‘delayed tax’ approach. The guidance has no statutory force; it represents the official interpretation of the relevant statute, but is no substitute for an independent interpretation of the statute that is required of the Tribunal.

30 34. The appeal has to be determined on a judicial interpretation of the relevant statute. There is no case law precedent bearing directly on the interpretation of the provisions pertaining to PLR determination under Part 2 of Schedule 24 to FA2007. The Tribunal has therefore found it necessary to set out a judicial interpretation of the relevant legislation in order to determine the correct quantification of the potential lost
35 revenue in this case as a matter of law.

The legislative context for Schedule 24 penalty regime

40 35. A purposive construction of Schedule 24 has to contextualise the role of the error penalty regime in the legislative landscape that now governs the enforcement of compliance. It is within this wider legislative context that the relevant paragraphs of Schedule 24 should be accorded their respective meaning.

36. Leaving aside penalties in relation to the taxpayer's duty to keep and preserve records (Schedule 10 to FA2003), Schedule 24 to FA 2007 was the first¹ to be introduced in the legislative reform that sought to align the powers, deterrents, and safeguards for direct and indirect taxes in the areas of compliance enforcement. The suite of penalties for compliance enforcement of direct relevance to this case includes:

5 (a) The *error penalty* regime under Schedule 24 to FA 2007; for errors occurring in return periods beginning on or after 1 April 2008 that had a filing due date on or after 1 April 2009;

10 (b) The *late filing* and the *late payment* penalty regime under Schedules 55 and 56 to FA 2009 respectively, which came into force on 6 April 2011 for self-assessment returns in relation to years ending after 5 April 2010;

(c) The *default surcharge* regime under Section 59 of Value Added Tax Act 1994 ('VATA 1994') (and first introduced in 1985) for penalties relating to the *late filing* and *payment* of VAT.

15 37. The error penalty regime is aligned between direct and indirect taxes, but the late filing and payment penalty regime for VAT is yet to be aligned with the direct taxes, and currently remains under the default surcharge regime. The legislative provisions under Schedules 10 and 11 to Finance (No 3) Act 2010 are intended to align the default surcharge regime with Schedules 55 and 56 to FA 2009. However, no commencement date has yet been announced for the incorporation of the late filing and late payment penalty regime for VAT into the mainstream penalty regime under Schedules 55 and 56.

38. The wider legislative context for compliance enforcement into which Schedule 24 penalty regime was introduced is relevant to this appeal for two reasons:

25 (1) First, as a general principle, error penalties are designed to give rise to proportionately heavier penalties than those incurred for late filing or late payment. On the scale of severity, the suite of legislation taken together expresses a consistent intention that errors in taxpayer's documents are intrinsically a more serious breach in compliance than lateness *per se*.

30 (2) Secondly, the errors in the current appeal resulted in a habitual pattern of late payment of VAT related to the last day of the quarter. Default surcharge penalty would have been imposed for the late VAT payment each quarter – in place of an error penalty – *had the VAT returns been accurate*.

35 39. Paragraph 8 for the 'delayed tax' approach cannot be construed in isolation of the legislative landscape into which Schedule 24 was introduced; the error penalty is intended to operate alongside the default surcharge regime. The concept of *legal compatibility* demands a comparison of what could have been the default surcharge liability (had all the returns been correct) against a Schedule 24 penalty determined by adopting the 'delayed tax' approach. The differential between the potential default

¹ Penalties in relation to failure to comply with requirements made under HMRC's investigatory powers, and to notify liability to tax were introduced respectively under Schedule 36 and 41 to FA 2008, after the introduction of error penalty regime under FA 2007.

surcharge that could have been imposed, and an error penalty based on the ‘delayed tax’ approach, will be instructive as to whether Parliament could ever have intended the ‘delayed tax’ approach to be applicable in this instant case.

The architecture of Schedule 24

5 40. Schedule 24 is entitled ‘Penalties for Errors’ and the architecture of the schedule is informative of the sequence of factors to be taken into account in arriving at a penalty assessment. The sequence is reflected in the order of the paragraphs:

Part 1 ‘Liability for Penalty’

- (1) Define a *relevant error* for an error penalty (para 1);
- 10 (2) Define when an *under-assessment* by HMRC becomes subject to an error penalty (para 2);
- (3) Categorise *behaviour* by the degrees of culpability (para 3).

Part 2 ‘Amount of Penalty’

- 15 (4) Define the *standard amount* of penalty as the *penalty percentage* of the potential lost revenue for each category of culpable behaviour (para 4).
- (5) Quantify *potential lost revenue* according to the –
 - (a) Normal rule (para 5);
 - (b) Multiple errors – order of allocation to PLR (para 6);
 - (c) Losses wrongly recorded (para 7);
 - 20 (d) Delayed tax (para 8).
- (6) Apply any *reductions* of penalty due to the nature and quality of disclosure (paras 9, 10), or special circumstances (para 11).
- (7) Consider the relevance of *interaction* with other penalties and late payment surcharges (para 12).

25 41. Part 1 sets out the conditions that need to be met for an error penalty to apply. Condition 1 under paragraph 1(2) identifies *when* there is a relevant error for Schedule 24 penalty purposes. Condition 2 concerns *how* the error is caused, with paragraph 1(3) classifying inaccuracy into ‘careless’ and ‘deliberate’. The *when* and *how* are the twin criteria that underpin the design of Schedule 24.

30 42. Apart from ‘careless’ and ‘deliberate’, a third category of inaccuracy is described under paragraph 3(2) as ‘*neither careless nor deliberate*’. Such an inaccuracy does not fall under Condition 2, and hence will not attract an error penalty *unless* the taxpayer, on discovery of the inaccuracy at some later time, has failed to take reasonable steps to inform HMRC. Paragraph 3(2) is a deeming provision that
35 has relevance to the determination of PLR under paragraph 8, as discussed later.

43. It is for good reasons that Schedule 24 penalties are often described as ‘behavioural’ penalties. In arriving at a penalty assessment, the significance of ‘behaviour’ is not limited to the fixing of the penalty percentage alone. Not only is

the *penalty percentage* varies according to the degree of culpability, ‘behaviour’ as regards *how* the inaccuracy was caused directly impinges on the determination of the potential lost revenue.

The determination of the ‘Standard amount’

5 44. Paragraph 4 fixes the penalty percentage as proportional to the *degree of culpability*, with the three categories of culpability giving rise to progressively higher penalty percentage: *careless* at 35%, *deliberate but not concealed* at 70%, and *deliberate and concealed* at 100%.

10 45. Paragraph 4 also sets down the formula for calculating the ‘standard amount’ of penalty, which is stated in all instances as the penalty percentage of the potential lost revenue; for example – *‘for careless action, 30% of the potential lost revenue’*. The amount being ‘standard’ is to be taken in the sense that the formula is the starting point of the error penalty calculation, before any reductions for disclosure or special circumstances being applied.

15 46. At one point in HMRC’s submissions, there was uncertainty as regards whether the penalty percentage would still be applied to the PLR under the ‘delayed tax’ determination. Inherent in the ‘delayed tax’ PLR determination are various factors to scale down the PLR, and the uncertainty concerned whether further scaling down of the PLR by the penalty percentage would be in point. It is clear from the definition of
20 ‘Standard amount’ that the relevant penalty percentage is to be applied in *all* instances to the PLR as provided by the formula.

47. If Part 1 defines the *when* and *how* for the purpose of a Schedule 24 error, the *how* as pertaining to the behavioural aspect of the inaccuracy is carried right through into Part 2 for the provisions on PLR determination. With the focus of contention in
25 this appeal being so much on the ‘potential lost revenue’, it is worth emphasising that the PLR provisions are *predicated* on ‘behaviour’.

Interpretation of the ‘normal rule’ under paragraph 5

48. The quantification of the potential lost revenue starts with the ‘normal rule’ under paragraph 5 of Schedule 24. The normal rule is a reminder of the old charging
30 provision for error penalty under section 95(2)(b) of TMA, which applied where a person ‘fraudulently or negligently’ made an incorrect return, and the related penalty was to be ‘the amount which would have been the amount so payable if the return, ... submitted ... had been correct’. In both the old and current regimes, the starting point in quantifying the penalty remains the same; namely, the full amount of tax that has
35 been under-assessed.

49. The normal rule carries a parenthesis under paragraph 5(1) with the wording – (*including an inaccuracy attributable to a supply of false information or withholding of information*). The parenthesis mirrors closely the key wording in paragraph 1A of Schedule 24 ‘*Error in taxpayer’s document attributable to another person*’, which
40 starts by stating:

(1) A penalty is payable by a person (T) where -

(a) another person (P) gives HMRC a document of a kind listed in the Table in paragraph 1,

(b) the document contain a relevant inaccuracy, *and*

5 (c) the inaccuracy *was attributable to T deliberately supplying false information* to P (whether directly or indirectly), or to T *deliberately withholding information* from P, with the intention of the document containing the inaccuracy.’ (emphasis added)

10 50. Both the parenthesis under paragraph 5(1) and paragraph 1A were introduced by section 122 of FA 2008 as amendments to Schedule 24 to FA 2007.

15 51. It is clear that paragraph 1A is intended to restrict the imposition of error penalties, where the inaccuracies are attributable to a third party, to only those that have been *deliberately* caused. Whether it is by commission as in ‘a supply of false information’, or by omission as in ‘withholding of information’, deliberate action indicating intent is involved.

20 52. In respect of ‘a supply of false information’, the dictionary meaning of ‘false’ is – *of a statement, deliberately asserting what is known to be untrue*; and the meaning of ‘information’ – *knowledge of facts communicated about a particular subject, event etc.* ‘False information’, taken together, connotes that there is *knowledge (of the truth)* on the part of the information provider on the one hand, and *deliberate assertion of the untruth* on the other.

25 53. As to the *withholding of information*, the dictionary meaning for ‘withhold’ is – *keep back (what belongs to, is due to, or is desired by another); refrain from giving, granting, or allowing.* Again, ‘withholding of information’ connotes a deliberate act; there is *knowledge (of what is due)* on the part of the taxpayer or the third party on the one hand, and *refraining from giving* on the other.

30 54. On one level, the parenthesis in paragraph 5(1) inserted by FA 2008, serves as a cross-reference to the additional penalty provision under paragraph 1A. On a general level, the word ‘*including*’ in the parenthesis introduces the rule of *eiusdem generis*, denoting that the application of the normal rule is not exclusive to inaccuracies caused by deliberate action. In the context of Schedule 24, inaccuracies caused by careless behaviour fall equally under the ‘normal rule’ for PLR determination. However, the parenthesis in sub-paragraph 5(1) has the effect of singling out the occurrences of inaccuracy caused by deliberate action whereby the normal rule *must* apply.

35 *Interpretation of the ‘delayed tax’ approach under paragraph 8*

55. The provisions under paragraphs 6 to 8 that follow the ‘normal rule’ function as exceptions to the application of the normal rule, and are intended to apply only where specific circumstances obtain.

40 56. Paragraph 6 ‘*Potential lost revenue: multiple errors*’ applies where multiple errors attributable to different degrees of culpability are in point, and sets out the *order* for assigning the PLR as determined under the normal rule to the different

penalty percentages. *Careless* errors at 35% are to be taken as corrected before *deliberate* errors at 70%, and *deliberate but not concealed* errors to be taken as corrected before *deliberate and concealed* at 100%. The purpose of paragraph 6 is to calculate the overall penalties for multiple errors in the least punitive manner.

5 57. Paragraph 7 ‘*Potential lost revenue: losses*’ concerns a loss that is ‘*wrongly recorded*’. The inaccuracy that has resulted in a ‘*wrongly recorded*’ loss has to be interpreted in the current context, and as discussed above, as ‘*not knowingly caused*’, as due to carelessness and not deliberate action. Paragraph 7 provides for the normal rule for the PLR to apply to the loss that has been *wholly used* to reduce a tax liability; 10 where the loss has *not been wholly used*, then the PLR related to the portion of unused loss is deemed to be at 10% of the PLR calculated under the normal rule; where there is *no reasonable prospect* of the loss being used, the PLR in respect of the loss is nil.

15 58. Paragraph 8 ‘*Potential lost revenue: delayed tax*’ applies where ‘an inaccuracy resulted in an amount of tax being declared later than it should have been (“the delayed tax”)’. The dictionary meaning of ‘delayed’ is – *that has been delayed, retarded, deferred, held back*.

20 59. The operative words in paragraph 8 would seem to be ‘delayed’ and ‘declared’, and are both past participles used as adjectives, with ‘delayed’ being used attributively and ‘declared’, predicatively. As part of the verb form for the perfect tense, a past participle connotes a state of affair that has resulted from the action associated with the verb. In association with ‘delayed’, the dictionary gives the meaning for ‘delayed action’ as – *operating, or designed to operate, after a predetermined interval of time*. The ‘delayed tax’ as a form of ‘delayed action’ is rendered as ‘tax being *declared* later than it should have been’ in the legislation.

25 60. In this sense, paragraph 8 reads just like a tautology and describes a state of affair *when* ‘delayed tax’ has occurred. Of itself, paragraph 8 does not permit any inference of meaning as regards *how* the delay was caused. In the context of an error penalty that is geared in accordance with the mode of behaviour that has caused the error, it is *not sufficient* for paragraph 8 to apply by merely establishing ‘the delayed tax’ as a state of affair that has obtained. As discussed earlier in connection with 30 paragraph 1 of Schedule 24, for an error penalty to apply, the twin conditions pertaining to the *when* and the *how* of an inaccuracy must be established.

35 61. In the statutory wording, the inaccuracy and the delay are conjoined in a causal manner – ‘*the inaccuracy resulted in* an amount of tax being declared later than it should have been’. If the state of affair of ‘delayed tax’ is meeting the first condition of a ‘relevant error’ having existed (the *when*), the second condition as regards *how* the inaccuracy occurred is to be found within the immediate context of paragraph 3(2) of Schedule 24, under the paragraph heading for ‘*Degrees of culpability*’.

Relevance of paragraph 3(2) to the application of paragraph 8

40 62. Within Part 1 of Schedule 24, paragraph 3(2) concerns an inaccuracy, which was ‘*neither careless nor deliberate*’, and is not otherwise subject to Schedule 24

penalty regime because Condition 2 for culpability is not met. Such inaccuracy is to be treated as *careless* if the inaccuracy assumes culpability whereby the taxpayer –

- ‘(a) discovered the inaccuracy at some later time, and
- (b) did not take reasonable steps to inform HMRC.’

5 An error penalty is then impossible with this assumption of culpability, and the PLR is to be determined with the inaccuracy being treated as *careless*. In the context of paragraph 3(2), the *discovery* of the error has to be made by the taxpayer. Where the relevant inaccuracy that assumes carelessness under this deeming provision has resulted in a timing difference of the tax being declared later than it should, then the
10 ‘delayed tax’ PLR determination can apply.

63. Paragraph 3(2) concerns an inaccuracy ‘discovered’ at some later time. The dictionary meaning for ‘discover’ that best fits the context is – *become aware of for the first time (a thing previously unknown or overlooked)*. An inaccuracy is only capable of being ‘discovered’ if it was *not knowingly made* in the first place. If the
15 error was knowingly made, then knowledge of the error existed from its inception, and the error cannot have been ‘discovered’ at a later stage. Where an error is not capable of being ‘discovered’, paragraph 3(2) does not apply.

64. In the context of tax management for VAT, the deeming provision under paragraph 3(2) leads directly to the provision for ‘Correction of errors’ under
20 regulation 34 of VAT Regulations 1995 (SI 1995/2518). Though referred to by the Review Officer, the relevance of regulation 34 to the present appeal was not addressed in HMRC’s submissions, nor was the relevance of paragraph 3(2) of Schedule 24 to the ‘delayed tax’ PLR determination discussed.

65. The Tribunal considers regulation 34 instructive of the circumstances under
25 which the ‘delayed tax’ PLR can apply, and that paragraph 3(2) of Schedule 24 provides the connection between the application of the ‘delayed tax’ PLR and the errors corrected under regulation 34 that become subject to a Schedule 24 penalty.

Correction of VAT return errors – provisions under regulations 34 and 35

66. A VAT return error that is *discovered* by the taxable person can be corrected in
30 a subsequent return within a prescribed accounting period as provided under regulation 34 of the VAT Regulations 1995, excerpts of which are as follows:

‘(3) Where, in relation to all such overstatements or understatements
discovered by the taxable person during a prescribed accounting period, the difference between –

- 35 (a) under-declaration of liability, and
- (b) over-declaration of liability,

does not exceed [50,000], the taxable person may correct his VAT account in accordance with this regulation.’ (emphasis added)

67. Regulation 34(3) further provides that in terms of the errors that can be
40 corrected by adjusting the VAT account for the current period, the aggregate amounts of the understatements and overstatements of VAT, taken together:

- (a) The net value of the errors does not exceed £10,000, or
- (b) if exceeding £10,000, then not exceeding 1% of the figure in Box 6 (ie: total value of net sales) of the current VAT return, up to a maximum of £50,000 – that means total net sales cannot exceed £5 million.

5 68. The provisions as regards time limits for this method of correction come under regulation 34(1), and it is worth noting the slight difference in time limit between errors for input and output tax –

- (a) four years from the due date of the return for the accounting period for input tax errors;
- 10 (b) four years from the end of the accounting period concerned for output tax errors.

15 69. The prominent role of regulation 34 in VAT administration cannot be overstated. It enables VAT return errors to be corrected without undue administration burden for the taxable person and the tax authority. The upper limits on the net value of errors and the time limits are far from being restrictive to debar its wide use, but achieve the purpose of delineating the scope for its legitimate use. While the quantum and time limits set boundary for the use of regulation 34, its legitimate use is in fact predicated on the errors being ‘discovered’.

20 70. As defined earlier, an error is only capable of being ‘discovered’ if it was *not knowingly made* in the first place. Where an error is not capable of being ‘discovered’, the correction mechanism under regulation 34 cannot be used. In other words, deliberate errors cannot be corrected by dint of regulation 34 adjustments in the next VAT return. Only errors that are ‘*careless*’ or ‘*neither careless nor deliberate*’ can be ‘discovered’ and corrected by regulation 34 adjustments.

25 71. Any errors that cannot be corrected by regulation 34 adjustments can only be corrected by way of voluntary disclosure under regulation 35 of the VAT Regulations 1995, and by using form VAT652. There are basically two classes of errors that have to be corrected via regulation 35 disclosure – (a) all deliberate errors, and (b) any non-deliberate errors that cannot be corrected under regulation 34 for exceeding the stipulated amounts of net value of errors, or for being discovered out of time.

30 72. Regulations 34 and 35 have been in force since October 1995, and the new error penalty regime does not expressly refer to how errors corrected under regulations 34 and 35 may be penalised. The connection between the imposition of Schedule 24 penalties and the error correction provisions for VAT returns is to some extent provided by paragraph 3(2) of Schedule 24 as explained earlier, notwithstanding the fact that the application of paragraph 3(2) is not exclusive to VAT.

35 73. The connection between the Schedule 24 penalty regime and regulations 34 and 35 is expressly made in the VAT Notice 700/45 (updated 23 July 2015), which specifies under paragraph 4.1 that –

40 ‘careless or deliberate inaccuracies relating to returns commencing on or after 1 April 2008 with a due date on or after 1 April 2009 that are

being corrected [under regulation 34 or 35] will be subject to the new penalty regime.’

74. Furthermore, the Notice explicitly states that the correction method under regulation 34 only applies to careless errors:

5 ‘... careless errors may be adjusted on your next VAT return subject to the limits described [under regulation 34]; ...

In contrast, a deliberate error cannot be adjusted under regulation 34 on the next return, and must always be notified to HMRC using form VAT652.

75. In respect of disclosure, the Notice emphasises that it is not just deliberate errors that are subject to disclosure under form VAT652. Careless errors that have been corrected under regulation 34 by adjustments in the next return should still be notified to HMRC for reasons stated in the Notice as follows:

15 ‘if you have adjusted a careless error/inaccuracy on your return within the limits described ... you may still write to HMRC asking us to consider any reduction to a penalty. Your letter should contain the same information that is required on form VAT 652 ...

20 The majority of such errors will not be careless or deliberate, so no penalty will be due. People make mistakes and we do not expect perfection. When considering whether an error was careless, we are simply seeking to establish whether the person has taken the care and attention that could be expected from a reasonable person taking reasonable care in similar circumstances.’

76. Before the introduction of Schedule 24, penalty provisions for VAT errors were under the term of ‘*misdeclaration*’, and came under section 63 of VATA 1994 with the heading ‘*Penalty for misdeclaration or neglect resulting in VAT loss for one accounting period equalling or exceeding certain amounts*’. Section 63 was repealed by section 97(1) of FA 2007 to make way for the new error penalty regime introduced under Schedule 24 to FA 2007.

77. Timing errors covered by paragraph 8 of Schedule 24 are a form of misdeclaration – ‘*resulting in an amount of tax being declared later than it should have been*’. Under the misdeclaration penalty regime, timing errors corrected in a subsequent return under regulation 34 did not normally attract any penalty. Significantly, the dispensation for timing errors is not replicated, or certainly not by reference to the type of error being of a timing difference. Instead, under Schedule 24, the dispensation is pitched to the ‘behaviour’ that has occasioned the error through the category of ‘neither careless nor deliberate’. A comparison between the old and new penalty regimes in respect of the treatment of timing errors again reiterates the centrality of ‘behaviour’ in the design of Schedule 24 regime.

78. From the foregoing, and with the express reference to the disclosure requirement even for non-deliberate errors as stated in the VAT Notice 700/45, careless and non-careless errors capable of being corrected under regulation 34 should still be notified for their potential liability to an error penalty to be assessed. Any

dilatoriness in notification can trigger a paragraph 3(2) assumption of culpability, and escalates a non-careless error to careless for a penalty to be imposed.

79. The very mechanism whereby errors capable of being corrected under regulation 34 means that the tax effect of the errors is that of the 'delayed tax'. It is a great handicap to the proceedings that the importance of the regulation 34 provision leading directly to the 'delayed tax' PLR was never addressed. Whereas formerly, errors corrected under regulation 34 were not subject to any misdeclaration penalty under section 63 of VATA 1994 (now repealed), the 'delayed tax' PLR can be considered a new feature in the Schedule 24 penalty regime, bringing corrections made under regulation 34 to a potential charge of error penalty. The significance of regulation 34 as a widely used mechanism for correcting VAT return errors makes it imperative that the circumstances giving rise to the 'delayed tax' PLR determination are properly understood.

80. The crucial conclusion for the purpose of this appeal is that if 'delayed tax' PLR is designed to penalise errors corrected under regulation 34, and only careless errors can be corrected under regulation 34; *ergo* only careless errors can be subject to the 'delayed tax' PLR.

Interaction of 'delayed tax' with the default surcharge regime

81. It is not only from the immediate context of Schedule 24 to FA 2007 and the provisions under regulations 34 and 35 of VAT Regulations 1995 that we can discern the circumstances under which the 'delayed tax' PLR determination is to apply. In the broader context of how an error penalty for 'delayed tax' interacts with the default surcharge regime, the Tribunal arrives at the firm conclusion that Parliament could never have intended the 'delayed tax' approach to apply in the appellant's case.

82. The error penalty regime is intended to operate in tandem with other penalty regimes. Paragraph 12 of Schedule 24 provides against the same tax liability being penalised twice under different regimes, and also indicates that the quantum of an error penalty in respect of the same tax liability is likely to be the greater of the two, where another penalty is also imposed.

83. In its design, the 'delayed tax' PLR is comparable to a charge of interest, both in its quantum at 5% of the full amount of tax under-assessed, and in the time reference of it being '*per annum*' and to be pro-rated for part year. It would be fair to infer from the design of the 'delayed tax' PLR that its purpose is to compensate the Exchequer for the loss of use of tax revenues as a result of a timing error of a careless nature.

84. In the context of paragraph 3(2), the safeguard against the abuse of the 'delayed tax' PLR is that the inaccuracy concerned would have been '*neither careless nor deliberate*' at its inception, and would have been outwith the error penalty regime, but for the assumption of culpability through dilatoriness in notification after discovery. In the context of a regulation 34 correction, the error would have been careless in its origin to be capable of being 'discovered' and corrected under regulation 34.

85. If the ‘delayed tax’ approach under paragraph 8 were to apply in the appellant’s case, the PLR and the related penalty would be determined as follows:

- (1) Potential lost revenue under the normal rule is £426,246;
- (2) The PLR under normal rule is then scaled down to:
 - 5 (a) 5% for each year of the delay, or
 - (b) a percentage of the delayed tax, for each separate period of delay of less than a year, equating to 5% per year;
- (3) The delay in the appellant’s case was a quarter (3/12 months) in every instance; the percentage of PLR would therefore be reduced to 5% x 3/12;
- 10 (4) The PLR would be reduced to £5,328 (being £426,246 x 5% x 3/12) under the ‘delayed tax’ approach;
- (5) The Standard amount of penalty is the penalty percentage multiplied by the PLR, 70% x £5,328;
- 15 (6) Penalty percentage is mitigated from 70% to 35% for the quality and nature of disclosure; the penalty would be equal to 35% x £5,328;
- (7) The error penalty under ‘delayed tax’ PLR would therefore be £1,865.

86. The errors in the current appeal had resulted in a habitual pattern of late payment of VAT related to the last day of the quarter. Default surcharge penalties would have been imposed for the late payment in each quarter – in place of an error penalty – *had the VAT returns been accurate*. Suppose the appellant had submitted returns with the correct date range for all the relevant quarters, and being in habitual default, the same ‘underpayments’ for nine of those quarters in the penalty assessment period would have attracted a default surcharge at the highest rate of 15%, applied to the total of underpayments of £426,246, to give an overall surcharge of £63,937.

25 87. As related earlier, errors are considered intrinsically a more serious breach of compliance than lateness *per se*. It is discernible in the legislative design of the various penalty regimes that error penalties are proportionately heavier than penalties incurred for late filing or late payment. The default surcharge at £63,937 is thirty-four times the penalty chargeable of £1,865 under the ‘delayed tax’ PLR approach. Viewed
30 in this light, it cannot be the intention of Parliament that the ‘delayed tax’ approach for PLR determination should ever apply in the appellant’s case.

88. The appellant concedes that the inaccuracies were *deliberately* caused. While the Tribunal understands that the deliberate action of excluding the last day of entries in every VAT quarter was done out of expediency to ease cash flow, the action has to
35 be analysed objectively under the terms of the legislation as deliberate action of a degree of culpability. Furthermore, it is also required of the Tribunal to take a broader view and to compare the appellant’s action under the error penalty regime against another trader’s action under the default surcharge regime.

89. To allow the ‘delayed tax’ approach in this instance would be an anathema to all
40 other traders who submit correct returns to report their full liabilities, even when they

know they have to suffer the default surcharge for failing to meet their liabilities in full, on time. The default surcharge is often appealed against on the ground of it being disproportionate because the surcharge is imposable on any part of the tax paid late, even if it is late by only a day. By comparison, if the ‘delayed tax’ error penalty were to apply in the appellant’s case, not only would the ultimate penalty liability be a fraction (at less than 3%) of the surcharge penalty, but that the package would come with a three-month credit at a very low cost. The concept of legal compatibility would have been grossly violated if deliberate action of any degree of culpability should be much more lightly penalised than dilatoriness.

90. The law would be irrational if it should encourage ‘penalty shopping’ by taxpayers with the choice between the default surcharge and the error penalty under the ‘delayed tax’ approach. Indeed there could be no choice if the ‘delayed tax’ error penalty in such circumstances were ‘lawful’ (in the sense of being intended by the legislature) – no one in the right frame of mind would opt to be penalised under the default surcharge regime, and the ‘delayed tax’ approach would become a licence to render incorrect returns to fit the cash flow. The irrationality is stark; the premise that the ‘delayed tax’ approach should apply in this appeal ultimately leads to the absurd conclusion that the State had directly (not even obliquely), through its law, encouraged its citizens to submit false information *deliberately* to its executive branch for the purpose of assessing the citizens’ indebtedness to the State.

91. The foregoing on the construction of Schedule 24 – within its immediate context and in the wider context of its interaction with ‘Correction of errors’ provisions and the default surcharge regime – is the ultimate basis why this appeal is to be dismissed. There are, however, many issues that the parties’ submissions have brought up which the Tribunal will address in turn for the sake of clarifying the application of the relevant law.

Discussion of the parties’ arguments

The appellant’s case against the ‘normal rule’

92. The appellant’s case was advanced principally by asserting that the ‘delayed tax’ approach should apply. The arguments against the ‘normal rule’ being applicable were not in the written submissions. Nevertheless, in the course of oral submissions and as part of the appellant’s rebuttal, two main arguments emerged against the application of paragraph 5 to the facts of this appeal, and they are:

(1) That to calculate the PLR by the normal rule represents a ‘*double test of deliberate action*’ which the legislation does not allow; that paragraph 3 represents the test of behaviour and paragraph 4 penalises the behaviour, and to deny the ‘delayed tax’ approach because the errors were caused by deliberate action is to penalise the action twice.

(2) That the PLR is defined under the normal rule as ‘*the additional amount due or payable in respect of tax as a result of correcting the inaccuracy or assessment*’; that there is no *additional* tax due or payable as a result of the

inaccuracies in the quarterly returns; the inaccuracies had merely caused a delay in the tax being paid; a delay is not a loss of revenue that accords with ‘additional’, which connotes ‘extra’.

5 93. The first argument was advanced in rebuttal of HMRC’s argument that there can never be ‘*deliberate delayed tax*’ in the application of paragraph 8, in the sense that paragraph 8 is denied to any inaccuracy caused by deliberate action.

94. For the appellant, Mr Stubbs argued that the concept of ‘deliberate delayed tax’ would amount to a ‘*double test of deliberate action*’, which the legislation does not permit. It was argued that Schedule 24 is designed to penalise the mode of behaviour by dint of the penalty percentage; the determination of the PLR represents a
10 completely separate step, and the mode of behaviour already penalised by means of fixing the penalty percentage, cannot impinge upon the determination of PLR. With respect, the Tribunal disagrees.

95. While the route taken by the respondents in arriving at the conclusion that there
15 can never be ‘deliberate delayed tax’ may not be immediately obvious, the conclusion nevertheless has statutory basis. The statutory construction in the previous section of this decision concludes that the ‘delayed tax’ approach applies only where an inaccuracy resulting in the ‘delayed tax’ is *careless*. The corollary is therefore ‘delayed tax’ can never be ‘deliberate’.

20 96. As to Mr Stubbs’ submissions that the legislation does not intend a ‘double test of deliberate action’, the Tribunal disagrees for the following reasons:

(1) The quantification of the potential lost revenue starts with the ‘normal rule’, which mirrors the previous charging provision for error penalty under
25 section 95(2)(b) of TMA that the starting point of *any* penalty determination is the *full* amount of the tax that had been under-assessed had a correct return been submitted. It is the *same* treatment for all errors, whether careless or deliberate.

(2) The ensuing paragraphs to the ‘normal rule’ under paragraph 5 are designed to mitigate the penalty assessment that would otherwise be subject to the full amount of tax under-assessed.

30 (3) If the provisions under paragraphs 6 to 8 are to mitigate the quantification of PLR, their relevance and application depend on whether the necessary criteria are met for the *mitigation* to apply. The denial of mitigating provisions cannot be construed as penalising ‘deliberate action’ twice in the sense of it being a double penalty.

35 97. As for the second argument, the appellant’s case against the normal rule being applicable is that there is no overall additional tax due, and it was only a timing difference in the tax paid. The appellant’s argument in this respect focuses only on the tax effect of the error as a timing error, but the error penalty regime has two aspects – *how* the timing error was caused is as important as the tax effect of the error.
40 Where the delay in the additional tax being paid late is the direct result of a deliberate error, that fixes the PLR determination to the ‘normal rule’.

98. It is significant that the legislation uses the adjective ‘potential’ and not ‘actual’ in respect of the ‘lost revenue’. On the most basic level, by the time an error penalty is imposed, the ‘lost revenue’ would have been identified and quantified, and in the process of being collected – it cannot therefore be described as an actual loss of revenue. On another level, all inaccuracies, however caused, and result in an understatement of tax liabilities, will have caused a delay in the ‘additional’ tax being paid by the time the errors come to light. In other words, all inaccuracies that result in an understatement of tax have delayed the payment of the rightful amount of ‘additional’ tax, and the timing effect by delay is not peculiar to the appellant’s case.

99. Furthermore, in the context of Schedule 24, ‘potential’ means – *possible as opposed to actual; capable of coming into being or action; latent*. The definition for ‘the potential lost revenue’ under paragraph 5 as ‘the additional amount *due or payable in respect of tax* as a result of correcting the inaccuracy or assessment’ carries within itself a temporal framework to interpret ‘additional’.

100. The temporal framework provided by the phrase ‘*due or payable in respect of tax*’ is referential to the normal due date or payable date for a particular payment of tax as defined by the relevant legislation. The nuanced difference between *due* and *payable* lies in the sense of whether the tax liability has materialised, with *due* connoting a liability that has materialised, while *payable* suggests that the liability either will materialise, or has the potential of materialising at a later date.

101. In this respect, the Tribunal is of the view that ‘*potential* lost revenue’ does not connote an actual loss of revenue, but of an additional amount of tax that should have been assessed *by* a certain point in time. The potential lost revenue in the appellant’s case is therefore the additional amounts of VAT that *should have been due* had the relevant quarterly returns submitted been accurately prepared.

The arguments in respect of the application of the ‘delayed tax’ PLR

102. Both parties focus their arguments for and against the application of the ‘delayed tax’ PLR to the current appeal. The issues raised by the parties in connection with paragraph 8 of Schedule 24 can be grouped under three headings:

- (1) Interpretation of HMRC’s Guidance CH82391;
- (2) Interaction of regulation 34 of VAT Regulations 1995 with ‘delayed tax’;
- (3) Interpretation of HMRC’s Business Brief 15/11.

HMRC’s Guidance CH82391 – ‘automatically reversed’

103. The Guidance was heavily relied upon by the Assurance Officer and was the subject of intense scrutiny during the hearing, especially in respect of the meaning of ‘*automatically reversed*’ used in the Guidance, which was singled out by the Assurance Officer as the ground for the denial of the ‘delayed tax’ approach.

104. The phrase ‘automatically reversed’ in the context of the Guidance comes under Condition 1 as concerned the ‘nature of inaccuracy’:

‘The nature of the inaccuracy is such that, *when discovered*, and *without the person taking any action to correct it*, the inaccuracy

- has already been *automatically reversed* in one or more returns for a later period or periods, or
- 5 • would have been automatically reversed in one or more later return(s), but for HMRC intervention.’

This means the delayed tax provisions do not apply to any inaccuracy where a person has taken any extra action to correct it.

10 If *you discover an inaccuracy before the person files a later return*, and if you are satisfied on the balance of probabilities that the person’s *accounting system* would *automatically reverse* the inaccuracy in the later period, then this condition has been met.’ (emphasis added)

15 105. The Assurance Officer’s interpretation of ‘*automatically reversed*’ was the principal reason for the decision to deny the ‘delayed tax’ PLR in the appellant’s case. The reasoning is stated in the following terms:

‘The condition states – “without the person taking any action to correct it”. The action to correct the errors in question was not automatic reversal by the system, the business had to take action to ensure the omitted transactions were included in the next or later return.’

20 106. While the mechanism of ‘automatic reversal’ was the main ground in the Assurance Officer’s reasoning for rejecting the application of ‘delayed tax’ PLR in the appellant’s case, the phrase was harnessed by the appellant to assert the fact that all the inaccuracies were ‘automatically reversed’ by the system; and hence the ‘delayed tax’ PLR should apply. The focus on ‘automatic reversal’ resulted in a
25 lacuna in the respondents’ submissions, which the appellant exploited to good effect.

107. For the appellant, Mr Stubbs asserted that the accounting system *automatically reversed* all the inaccuracies in the next quarter, with the date range set to run on default from the last day of the previous quarter and to finish on the penultimate day of the current quarter. Furthermore, Mr Kelly’s evidence of the considerable efforts
30 required in ‘arresting’ this automatic reversal of the entries related to the one day of 31 August 2013 in order to comply with HMRC’s instruction was proof that the inaccuracies were set to be automatically reversed.

108. The appellant further submitted that the two examples in Guidance CH82397 on ‘*VAT claimed prematurely*’ and ‘*VAT declared late*’ fit the appellant’s situation; that
35 the explanation in Guidance CH82390 for the ‘delayed tax’ matches the appellant’s circumstances; and in conjunction with Guidance CH82391, HMRC’s own guidance supports the appellant’s case that the ‘delayed tax’ PLR applies; that the interpretation of the respondents of their own guidance on ‘delayed tax’ PLR was at fault – not the guidance itself.

40 109. It is not for the Tribunal to suggest how HMRC guidance should be written or re-written. We note, however, that the phrase ‘automatically reversed’ in Guidance

CH82391 has caused considerable difficulties to the respondents in supporting why the ‘delayed tax’ PLR is to be denied in the appellant’s case.

110. Within Guidance CH82391 on the ‘delayed tax’ PLR, Condition 2 entitled ‘*amount of tax*’ would seem to deal with the statutory condition as regards *when* a relevant error for ‘delayed tax’ has occurred; and the parties agreed that Condition 2 in the Guidance is met. Condition 1 in the Guidance entitled ‘*nature of the inaccuracy*’ would seem to deal with the statutory condition pertaining to *how* a relevant error is caused, and is an attempt to circumscribe the condition as being met only by non-deliberate errors.

111. The crux of the matter in this appeal is the *behaviour* causing the inaccuracy. The Assurance Officer was correct in identifying that the condition pertaining to *the nature of inaccuracy* as not met for the ‘delayed tax’ PLR to apply. However, by placing the emphasis on ‘automatically reversed’, the Assurance Officer highlighted a state of affair that seemed to support the appellant’s case.

112. Even though within the Guidance, ‘automatically reversed’ comes under the condition for the ‘*nature of inaccuracy*’, the phrase itself does not so much address *how* an inaccuracy arose but *when* an inaccuracy has arisen for ‘delayed tax’ purposes. It is not disputed that the condition pertaining to *when* for delayed tax PLR is met; so by focusing on the phrase ‘automatically reversed’ as the reason for denying the ‘delayed tax’ approach, the respondents’ case was advanced seemingly supported by the wrong premise.

113. The wrong premise upon which HMRC argued their case led them into a logical uroboros – the conclusion is contradicted by the premise upon which it was drawn; the premise of ‘automatic reversal’ would seem to support the appellant’s case, not HMRC’s. The reference to ‘automatic reversal by the accounting system’ in the Guidance would appear to be an attempt to demarcate inaccuracies that are not deliberately caused, but the terminology is fraught with difficulty in achieving its intended purpose, as illustrated by the instant case. In respect of the condition concerning the ‘*nature of inaccuracy*’ in the Guidance, clarity would have been gained by simply stating that the behaviour that has caused the inaccuracies has to be categorised as *careless*. (Whether the behaviour concerned falls within the category of carelessness is then largely a separate matter to be determined.) It is instructive that the categorisation of behaviour is uncontentious right from the outset in this case.

The Review Officer’s opinion – deliberate inaccuracy cannot be discovered

114. On review, the officer quite rightly identified that the correct issue to be addressed should have been *how* the errors leading to delayed tax arose. In shifting the focus of HMRC’s case onto the issue of *how*, the Review Officer moved from dwelling on ‘automatically reversed’ to giving a critical analysis of the implications of ‘*when discovered*’ in the Guidance for the application of the ‘delayed tax’ PLR.

115. The Guidance CH82391 was interpreted by cross-referencing ‘*when discovered*’ to the Business Brief 15/11 in the following manner:

‘... my view is that more importantly the Guidance says, “*The nature of the inaccuracy is such that, when **discovered (my emphasis)**, and without the person taking any action*”.

5 It is not just the fact that the correction was not made automatically as referred to in the Guidance and Revenue and Customs Brief 15/11 but that first and foremost the inaccuracy has to be discovered. As I will explain in more detail the inaccuracy cannot have been discovered in the first place because the inaccuracy was deliberate.’ (emphasis and parenthesis original)

10 116. The Review Officer then gave his detailed explanation with regard to inaccuracies ‘discovered by the taxable person’ as follows:

‘The correction of VAT errors is explained in VAT Regulation 34 “Correction of Errors” SI1995/2518, HMRC Notice 700/45 and in HMRC’s Guidance VAEC7100.

15 VAT Regulation 34(3) SI SI1995/2518 says, “*Where, in relation to all such overstatements or understatements **discovered by the taxable person (my emphasis)** during a prescribed accounting period ...* The Notes to VAT Regulation 34 refer to a Tribunal case, Chan [2012] TC01850: “*no recovery of VAT deliberately overpaid in earlier period by adjusting subsequent returns without making voluntary disclosure*’.

20 (emphasis and parenthesis original)

117. The Review Officer was correct in emphasising that an error has to be capable of being *discovered* – and therefore not knowingly made – for the ‘delayed tax’ PLR to apply. By focussing on ‘when discovered’, the Review Officer was addressing the condition pertaining to *how* an error arose in order that the ‘delayed tax’ PLR can apply. The Tribunal agrees with the Review Officer’s conclusion that there can never be ‘deliberate delayed tax’ in the context of paragraph 8 of Schedule 24.

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118. Having conceded that the inaccuracies were deliberate at the outset of the hearing, the appellant’s submissions tactically focused on the issue of *when* the ‘delayed tax’ condition is met. The issue of *how* the inaccuracies were caused that resulted in the delayed tax was derogated, while in fact the issue of *how* the inaccuracies were caused is the crux of the matter that determines whether the ‘delayed tax’ PLR can apply.

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Regulation 34 of VAT Regulations 1995 and ‘Chan’

35 119. The appellant submitted that the Review Officer’s attempt to bring in regulation 34 of VAT Regulations 1995 to support HMRC’s position on the ‘delayed tax’ PLR application is misguided; that the case on *Chan* concerns an assessment, not a penalty; that *Chan* relates only to regulation 34 not Schedule 24; that the paragraph 34(3) of regulation 34 specifically refers to overstatements and understatements being

40 ‘*discovered by the taxable person*’ and accordingly is entirely distinct from HMRC’s Conditions set out in the Guidance (where the person making the discovery is the officer, not the taxable person); that ‘*there is no reference to discovery at all in Schedule 24*’, or to ‘discovery by the taxable person’ in the Guidance.

120. The Tribunal will respectfully highlight that Schedule 24 does have a reference to discovery under paragraph 3(2), albeit in the verb form of ‘*discovered an inaccuracy at some later time*’ instead of the noun ‘discovery’.

121. The Tribunal has discussed the direct relevance of regulation 34 error correction provisions to the application of the ‘delayed tax’ PLR, and hence, the appellant’s contention against the relevance of regulation 34 to the current appeal is unjustified.

122. As regards the application of *Chan v HMRC* [2012] UKFTT 155 (TC) to the current appeal, the appellant is correct in stating that the case does not concern an error penalty under Schedule 24 but an assessment pursuant to section 73 of VATA 1994. However, it seems to the Tribunal that the material point the Review Officer was drawing from the authority is that – ‘Only overstatements or understatements “discovered” by a taxable person may be corrected’ under the provisions of regulation 34(3) of the 1995 Regulations, (at [12] of *Chan*).

123. The Review Officer then concluded that ‘for an error to be eligible for correction on a taxable person’s VAT returns, it has to have been discovered by a taxable person.’ Further –

‘If the taxable person already knows about the inaccuracy because the inaccuracy was deliberate, then it cannot have discovered the error.

There cannot in my view be “deliberate delayed tax” and therefore [the appellant] cannot make adjustments to their VAT returns under VAT Regulation 34 as the inaccuracies were deliberate and [the appellant] could not have discovered them.’

124. What is missing in the Review Officer’s arguments is the crucial link between the relevance of regulation 34 error correction provisions to the application of the ‘delayed tax’ PLR. It involves a leap in understanding to make that connection, that the timing errors to be penalised under the ‘delayed tax’ PLR are those that are capable of being corrected under regulation 34; (that is, errors not knowingly made and capable of being discovered at a later time.) The missing link of the relevance of regulation 34 to the ‘delayed tax’ PLR is provided earlier in the Tribunal’s construction of the relevant statute.

125. Finally, Mr Stubbs highlighted the difference in the identity of the ‘person’ who is supposed to make the discovery in Guidance CH82391 and in regulation 34 of the VAT Regulations 1995. In regulation 34, the provision is ‘in relation to all overstatements or understatements *discovered by the taxable person*’. In the Guidance the *dramatis personae* are designated as ‘a person’ or ‘the person’ and ‘you’ without any headnote or postscript to aid the deciphering of who ‘the person’ and ‘you’ are supposed to be. There is one clause within the Guidance – ‘*If you discover an inaccuracy before the person files a later return*’ – which seems to provide the clue to fixing the identity of ‘you’ to an HMRC officer, and ‘the person’ to the taxpayer or his representative. The crucial sentence from the Guidance quoted by the Review Officer – ‘The nature of the inaccuracy is such that, when *discovered*, and without the person taking any action ...’ has to be read therefore as an HMRC officer making the discovery.

126. The discovery of errors in regulation 34 is by a taxable person while the Guidance refers to an error being discovered by an HMRC officer. The material point in this part of Mr Stubbs' submissions is that given the different identity of the person making the discovery in the two publications, there can be no connection between the
5 Guidance and regulation 34 as the Review Officer suggested. Furthermore, that the Review Officer has confused the identity of who should be making the discovery further undermines his arguments.

127. In the substantive paragraph of the review conclusion, the officer refers to the Guidance and the Business Brief in turn – *'It is not just the fact that the correction was not made automatically as referred to in the Guidance and Revenue and Customs Brief 15/11 but that first and foremost the inaccuracy has to be discovered.'* The
10 Tribunal will point out that in the Business Brief 15/11, the taxpayer is being addressed as 'you' (as in *'If you have been charged a penalty for an inaccuracy'*) and also being referred to as the 'customer'. An average taxpayer, having read the
15 Business Brief 15/11 and proceeds to seek further guidance from Guidance CH82391, is likely to be confounded by the shift in the identity of 'you'.

128. Notwithstanding the observations concerning the designation of 'you' in the published Guidance and Brief, and the change in the identity of the person supposed to be making the error discovery in the Guidance and in regulation 34, the key issue
20 remains that an error capable of being 'discovered' cannot have been knowingly made. Whether the error is discovered by the taxpayer and then corrected under regulation 34, or discovered by an HMRC officer, is not the issue for the purpose of determining whether the 'delayed tax' PLR applies. That a timing error has not been
25 knowingly made due to carelessness, and hence capable of being discovered, is the only criterion of direct consequence as regards whether 'delayed tax' PLR can apply. The identity of the person making the error discovery is not critical for the purpose of determining whether paragraph 8 'delayed tax' PLR is to apply.

HMRC's Business Brief 15/11

129. On the basis of Mr Kelly's evidence, Mr Stubbs asserted that the situation
30 relating to the inaccuracies for 31 August 2013 was four square with the wording of the revised position of HMRC's Business Brief 15/11 – that *'but for [HMRC's] intervention, the inaccuracy would have been automatically corrected in a subsequent return'*.

130. The Brief announced a change in HMRC's position on 6 April 2011 as regards
35 the 'delayed tax' provision in the following terms:

40 'Under these penalties, if a return contains an inaccuracy that relates to a timing error which is *automatically reversed* in a subsequent tax period, the penalty is not calculated on the full amount of tax underpaid in the first period, but on a reduced amount to take account of the timing error.' (emphasis added)

131. HMRC's change of position focuses on an inaccuracy that has been corrected as a result of 'intervention' from HMRC. The position *before* the revision in this respect is stated as follows:

5 'HMRC's approach to date has been that in order for the penalty to be
calculated in this way, the customer had to have submitted both the
return containing the initial inaccuracy, and the one containing the
automatic reversal of the inaccuracy in a later period. This means that
10 in some cases HMRC has charged a penalty on the full amount because
they acted to correct the inaccuracy on the first return before the
second return could be submitted, thereby preventing the inaccuracy
from being reversed.'

132. The revised position for an inaccuracy corrected with HMRC's intervention is:

15 'HMRC is changing its approach for cases where HMRC intervened to
correct the inaccuracy before the second return was received,
preventing the inaccuracy from being reversed. When HMRC are
satisfied that, ***but for their intervention***, the inaccuracy would have
been *automatically corrected* in a subsequent return, customers will
receive the reduced penalty based on the rules for delayed tax.'
(emphasis added)

20 133. The appellant submitted that the revised position in the Brief addresses directly
the situation pertaining to the VAT entries for the one day of 31 August 2013. On the
instruction of HMRC, the appellant removed the VAT entries for the day from being
included in the VAT return for the quarter ended 30 November 2013.

25 134. The appellant contended that *but for* HMRC's intervention, the entries for 31
August 2013 would have been included in the return for period 11/13. The '*but for*'
test in the revised position connotes a similar concept to the 'but for' test in the tort of
negligence for the proof of factual causation (as distinct from legal causation), and as
such the Tribunal considers it as a *prime facie* test based on findings of fact.

30 135. We find Mr Kelly a credible witness and accept what he gave in evidence of the
considerable difficulties entailed in reversing the entries related to 31 August 2013
when the accounting system had been set up to include in the next quarter by default.
We find as a fact that *but for [HMRC's] intervention, the inaccuracy would have been
automatically corrected in a subsequent return.*

35 136. On the basis of Mr Kelly's evidence, HMRC indicated in the course of the
hearing that they might concede to applying the 'delayed tax' PLR to the inaccuracies
relating to 31 August 2013, which amount to £188,538 and is the largest quarterly
total, representing 44% of the aggregate potential lost revenue under the normal rule.

40 137. The Tribunal is not unsympathetic if such a concession were to be granted in the
appellant's case, but we cannot establish any legal basis for such a concession to be
granted. While there is a finding of fact that meets the 'but for' test, the legal
argument for the revised position being applicable in this case cannot be made.

138. The legal case for the revised position of the Brief to apply is that the inaccuracies must have been found to be non-deliberate in the first place, and would have been eligible for PLR determination under the ‘delayed tax’ approach. The revised position outlined in the Brief therefore cannot be applicable to the appellant’s case, because the inaccuracies were deliberate and would not have merited being assessed to penalty on the basis of ‘delayed tax’ PLR in the first place.

139. The revised position set out in the Brief is to remove the inherent injustice whereby *an inaccuracy that would have merited the ‘delayed tax’ approach* was to be penalised under the ‘normal rule’ just because HMRC intervened at a certain juncture, thereby depriving the taxpayer of the opportunity to declare the inaccuracy without external promptings. The application of the revised position is not communicative – it cannot apply to errors that would have been assessed under the ‘normal rule’ PLR.

140. One must not lose sight of the origin of the revised position – that it only applies to an inaccuracy that would have been penalised on the ‘delayed tax’ PLR without the intervention of HMRC directing its correction. Given that the nature of inaccuracies for all the quarters is exactly the same, it is illogical to allow the penalty to be assessed under the ‘delayed tax’ PLR for the last quarter, and seek to impose penalty on the basis of the ‘normal rule’ for all other preceding quarters.

141. Indeed, the appellant has rightly argued that if HMRC are prepared to concede to the day’s entries relating to 31 August 2013 being assessed to penalty on ‘delayed tax’ PLR, it is inconsistent not to apply the ‘delayed tax’ PLR to inaccuracies relating to other VAT quarters, given the nature of the inaccuracies for all quarters is identical.

142. The Tribunal has found, as a matter of law, that the ‘delayed tax’ PLR cannot apply to any of the inaccuracies in the VAT returns in the appellant’s case because the inaccuracies were deliberately caused. Nor does the application of the revised position outlined in the Brief fall within the ambit of HMRC’s exercise of discretionary power to grant special reduction. It follows therefore that any concession to inaccuracies relating to 31 August 2013 being assessed to penalty under the ‘delayed tax’ approach would not only be illogical, but would also be *ultra vires*.

30 **Decision**

143. The Tribunal concludes that the correct approach for the determination of the potential lost revenue for the purpose of assessing the error penalty in this instant case is with reference to the ‘normal rule’ under paragraph 5 of Schedule 24 to FA 2007.

144. In reaching our decision, we place emphasis on our analysis of the statutory construction of paragraphs 5 and 8 within the immediate context of Schedule 24 to FA 2007. We consider the relevance of the VAT return error correction provisions under regulation 34 of VAT Regulations 1995 and of paragraph 3(2) of Schedule 24 for the purpose of the ‘delayed tax’ PLR provision. We further consider the legislative intention of Schedule 24 within the wider context of the compliance penalty regimes, having regard to the fact that as a general principle of legislative design, errors are intended to be more heavily penalised than late payments. We have special regard to

the *absurdity* that would have resulted had the ‘delayed tax’ approach been applied, when the error penalty based on ‘delayed tax’ is contrasted with the default surcharge to be borne by a trader who had been minded to make accurate quarterly returns and suffered the consequence of late payment surcharge. We conclude that Parliament
5 could never have intended the ‘delayed tax’ approach to apply to inaccuracies in VAT returns that have been deliberately caused.

145. The appeal is accordingly dismissed. The penalty assessment in the quantum of £149,186.10 is confirmed.

146. This document contains full findings of fact and reasons for the decision. Any
10 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
15 “Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)” which accompanies and forms part of this decision notice.

**DR HEIDI POON
TRIBUNAL JUDGE**

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