Suspended penalties

A review of the SMART tests.

It is inevitable that sometimes things go wrong and when it comes to tax, the issue of penalties can arise. This can occur when the taxpayer has been careless – which in this context means a failure to take reasonable care. That generally means not doing what a reasonable taxpayer would have done in those circumstances.

There are three main areas of relief.

You may have a reasonable excuse for the default which would apply when you have taken reasonable care (like having taken competent and timely professional advice), and that can be a complete defence.

You can ask HMRC to reduce the penalty (possibly to zero) because of special circumstances. There are few guidelines for this, so lots of opportunities for special pleading.

The idea of the suspension is to encourage better compliance in the future

Or you can ask HMRC to exercise their discretion to suspend the penalty. That is not perfect because you still have the default and the penalty on your record (which won't help if you do something wrong in future), but at least you don't have to pay it. The suspension will be subject to a number of conditions, and HMRC have a number of criteria before they will consider suspension; these are called the SMART tests:

- Specific: The conditions must be directly related to the business or individual being penalised to encourage better compliance future.
- Measurable: It must be possible for the individual to show that conditions have been met during the suspension period.
- Achievable: The person must be able to meet the conditions. There is no point in setting a condition which a person can never meet.
- Realistic: The condition must be proportionate and reasonable and cannot include a condition that requires the person to incur costs.
- Time: The suspension period cannot exceed two years.

If HMRC are not sympathetic and insist on the penalty you can always appeal to the tribunal, which is what Mr Cox did in *Cox v HMRC* [2026] UKUT 7 (TCC).

Unfortunately, the careless error of Mr Cox related to a gift of shares and an erroneous claim to Entrepreneurs' Relief; this was a one-off event which was unlikely to be repeated. The idea of the suspension is to encourage better compliance in the future. HMRC refused to suspend the penalty on the grounds that compliance would not have been improved by a suspension. The tribunal accepted that this was a reasonable exercise by HMRC of their discretion.

The decision is perhaps a bit tough on the taxpayer because HMRC might well have said by that if Mr Cox had made a careless error once, he might make another careless error, and a suspension would have had the purpose of encouraging greater vigilance over compliance – which would be a good thing. But I suppose HMRC might have taken the view that having the penalty and not suspending it may be a greater incentive to proper compliance. ■

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The Supreme Court hearing in *Orsted Sands*

When does design become plant?

Judgment is now awaited following the Supreme Court's hearing of the appeal in *Orsted West of Duddon Sands (UK) Ltd and others v HMRC* (formerly *Gunfleet Sands*), on whether £40m of pre-construction development expenditure on four offshore wind farms – specifically environmental impact, metocean, geophysical and geotechnical design studies – constituted qualifying expenditure on the provision of plant and machinery under CAA 2001 s 11(4). The decision will be of interest beyond major infrastructure projects, as it should clarify the treatment of design and pre-development costs for capital allowance purposes, irrespective of scale.

A notable feature of the two-day hearing was the contrast in language. Counsel for HMRC, Ms Wilson KC (Pump Court Tax Chambers) used emphatic terms such as 'avoidance schemes', 'perverse situation' and 'parasitical expenditure/items'. In contrast, Mr Jones KC (Gray's Inn Tax Chambers), counsel for the taxpayer, referenced the legislative language of CAA 2001 and long-established precedent cases, principally *Barclay Curle*, *Ben Odeco* and *McVeigh*.

Ms Wilson spent considerable time describing capital allowances as a 'proxy for depreciation' and arguing that the studies 'only provided data and informed the design ... but only if you have the plant in your sights'. She challenged whether the studies could properly be 'connected' to future assets that were unknown at the time, other than with the benefit of hindsight. HMRC argued that only costs incurred once the plant in question had been identified could constitute qualifying expenditure.

Ms Wilson commented that 'capital allowances attracted lots of abusive tax schemes' – a characterisation that does not reflect the way capital allowances are commonly applied in projects.

Mr Jones submitted that the studies went beyond 'general information' and were integral to the 'cumulative design' and installation of the wind farms, previously accepted as single-entity assets rather than distinct generating, cabling, transformer and distribution assets. He noted that there is no restriction in the CAA 2001 preventing 'duality': expenditure may have two or more purposes, provided one is as 'plant' to be used within the trade – here renewable energy generation, contributing to the Government's stated objective of generating 43–50GW of offshore wind power by 2030.

Counsel for the taxpayer argued that the provision of plant is a process, not a moment in time

He emphasised that the 'final drawing emerges as part of the process', rather than being determined, as HMRC contended, by a fixed 'line' of eligibility. As he put it: 'If the final drawing and the physical process of making the item are part of the provision of plant, then why not the labour and materials of the stage that precedes it? To draw a line there seems to lack any reality or principle.'

By way of illustration, he referred to changes in the West of Duddon Sands turbine configuration layout following geotechnical findings, and concluded by pointing to HMRC's own guidance on professional fees (*Capital Allowances Manual* at CA20070), which Mr Jones argued that fees of quantity surveyors, architects and similar professionals are intellectually necessary to facilitate installation and construction, and are not confined to the physical act of construction alone.

While we await the Supreme Court's judgment, it is worth highlighting the broader commercial context of the litigation. Shortly after the Court of Appeal decision was challenged, Orsted divested a significant stake in these businesses. Whether coincidental or not, this illustrates the potential commercial consequences of uncertainty in HMRC policy and practice. ■

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