TC01326

Appeal number: TC/2011/01857

Penalty; late filing; fairness; s98A(2)(a) TMA 1970. Common law fairness. Conscionable conduct. Burden of proof. Jusilla v Finland. Article 6 ECHR.

FIRST-TIER TRIBUNAL

TAX

WALTON KIDDIWINKS PRIVATE DAY NURSERY **Appellant**

- and -

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

TRIBUNAL: GERAINT JONES Q.C. (TRIBUNAL JUDGE)
ANTHONY HUGHES ESQ (TRIBUNAL MEMBER)

The Tribunal determined the appeal on 07 July 2011 without a hearing under the provisions of Rule 26 of the Tribunal Procedure (First-tier Tribunal)(Tax Chamber) Rules 2009 (default paper cases) having first read the Notice of Appeal dated 03 March 2011 and HMRC's Statement of Case submitted on 05 April 2011.

DECISION

Introduction.

1. On the 27 September 2010 HMRC sent the appellant, Walton Kiddiwinks Private Day Nursery, a penalty notice in the sum of £400 on the basis that the appellant had failed to file its end of year employer's return, P35, by 19 May 2010. A further penalty notice was sent on the 20 October 2010 in the sum of £100 because, even though the first penalty notice acted as a reminder to the appellant, it was sent too late to allow the appellant to avoid a penalty for a further one month.

2. On 11 December 2010 the appellant, by its Mr Hession, wrote to HMRC pointing out that the appellant was a small business with a good record in its dealings with HMRC. Mr Hession went on to say *"I honestly thought that I had filed them online as the program I use to do the wages lets you know when your end of year returns are due, as I do every year, I filed them online through the Payroll Manager Program, please reconsider your decision as a £400 fine is such a big amount to us."*

3. HMRC undertook a Review with the outcome of that Review being set out in its letter of 25 January 2011. It decided to uphold the total penalty.

4. The appellant has now appealed to this Tribunal.

5. The basis upon which the appellant puts its appeal appears somewhat equivocal. Initially it seemed that the appellant was saying that it had, or it honestly and genuinely believed that it had, sent the P35 on or prior to 19 May 2010. However, in the Grounds of Appeal Mr Hession says that he is sorry for *"this misunderstanding"*, without identifying the misunderstanding to which he refers. The Grounds of Appeal are made clearer only by reference to the letter of 11 December 2010 in which Mr Hession says that he honestly thought that the P35 had been filed on time.

The Law.

6. Before we turn to the facts of this appeal and to our conclusions in respect of it, it is appropriate that we set out the law as we now perceive it to be. In G. Deacon & Sons v Commissioners of Inland Revenue 33TC 66 Mr Justice Donovan dismissed a request for a case to be stated in respect of conclusions drawn by General Commissioners, holding that from the primary facts adduced in evidence, they were entitled to draw the inferences that they drew against the then appellant, Mr Deacon.

7. In Johnson v Scott (1987) STC 476 Mr Justice Walton expressly considered where the onus of proof lay in a case where an appellant was challenging amended assessments that had been upheld by the Commissioners. He observed that counsel for the Crown had correctly accepted that where, as in that case, neglect on the part of the taxpayer had to be established, the onus of establishing such neglect lay with the Crown. He went on to hold that if a finding of neglect is made, and justified on the evidence, that enabled the Crown to make assessments for the purpose of making good any tax lost as a result of such neglect. He went on to observe that if that stage

was reached, then the onus would pass to the taxpayer to adduce evidence to show that the assessment is too large.

8. His Lordship desisted from indicating whether the onus that then shifted to the taxpayer was a legal burden or an evidential burden, but usually a reference to a party then having a burden to adduce evidence, refers to an evidential rather than a legal burden. It is also relevant to observe that in that case the learned judge was considering section 50(6) of the Taxes Management Act 1970 in its original, unamended, form. The learned judge also emphasised that where the Crown's case was based upon inferences drawn from primary facts, such inferences had to be "fair" inferences. One would not have expected otherwise. The Court of Appeal upheld that judgment. It was a case in which the taxpayer failed, by adducing acceptable or probative evidence, to discharge the evidential burden upon him of showing that the inferences drawn by the Crown were not fair or appropriate.

9. I set out the foregoing because it is often, incorrectly, stated that once an assessment is raised or a surcharge demanded, the burden of proving that it is incorrect rests upon the taxpayer. That may be an approximation of the de facto position in respect of an assessment (but not a surcharge or penalty) but it fails to analyse the true legal position.

10. In our judgment the true legal position now has to be considered bearing in mind the amendments to section 50 of the Taxes Management Act 1970, the most recent having come into effect from the 1st April 2009, but more importantly having in mind the decision of the European Court in the **Jussila v Finland (2009) STC 29** where, in the context of default penalties and surcharges being levied against a taxpayer, the Court determined that Article 6 of the European Convention on Human Rights was applicable, as such penalties and surcharges, despite being regarded by the Finnish authorities as civil penalties, nonetheless amounted to criminal penalties despite them being levied without the involvement of a criminal court. At paragraph 31 of its judgment the court said that if the default or offence renders a person liable to a penalty which by its nature and degree of severity belongs in the general criminal sphere, article 6 ECHR is engaged. It went on to say that the relative lack of seriousness of the penalty would not divest an offence of it inherently criminal character. It specifically pointed out, at paragraph 36 in the judgment, that a tax surcharge or penalty does not fall outside article 6 ECHR.

11. This is a case involving penalties. The European Court has recognised that in certain circumstances a reversal of the burden of proof may be compatible with Article 6 ECHR, but did not go on to deal with the issue of whether a reversal of the burden of proof is compatible in a case involving penalties or surcharges. This is important because a penalty or surcharge can only be levied if there has been a relevant default. If it is for HMRC to prove that a penalty or surcharge is justified, then it follows that it must first prove the relevant default, which is the trigger for any such penalty or surcharge to be levied.

12. In our judgement there can be no good reason for there to be a reverse burden of proof in a surcharge or penalty case. A surcharge or penalty is normally levied where

a specified default has taken place. The default might be the failure to file a document or category of documents or it may be a failure to pay a sum of money. In such circumstances there is no good reason why the normal position should not prevail, that is, that the person alleging the default should bear the onus of proving the allegation made. In such a case HMRC would have to prove facts within its own knowledge; not facts peculiarly within the knowledge of the taxpayer.

13. Section 98A(2)(a) Taxes Management Act 1970 provides that any person who fails to make a return in accordance with the relevant provisions *"shall be liable to a penalty or penalties of the relevant monthly amount for each month (or part of a month) during which the failure continues ....."*.

14. So far as the State and its several organs are concerned (HMRC being one such organ), there is a common law duty of fairness. In R v S. S. Home Department [2003] EWCA Civ 364 at paragraph 69 the Court of Appeal expounded the principle as related to the decision making process under scrutiny in that appeal. In S. S. Home Department v Thakur [2011] UKUT 151 the Upper Tribunal, in paragraph 12 of its Decision, also recognised that principle, again in the context of a decision making process.

15. Thus, the issue arises whether that common law principle has any application where a statutory provision renders a person "liable" to a specified penalty. It must be noted that the statute does not provide that the penalty or any part of it must be levied. It does no more than to indicate that a person is "liable" to the penalty which means not that the specified penalty must apply, but may apply and may be demanded. If we take a criminal analogy it is that, for a specified offence, a statute might provide that a convicted person is liable to a fine not exceeding £500. In our judgement the words "not exceeding" make little, if any, difference. They are not words which import discretion but simply make it clear that the fine must not exceed £500. The discretion of a court to impose a fine below the specified maximum does not arise by reason of the words "not exceeding" but by the use of the expression that a person is "liable" to a fine, capped at £500.

16. Thus, in our judgement, the appellant is entitled to rely upon the common law duty of a public body to act fairly not just in its decision-making process but also in administering its statutory powers. We are in no doubt that such a body does not act fairly when it deliberately desists from sending a penalty notice, for four months or more, knowing that the likely effect will be to impose a minimum penalty of £500 upon somebody whose sin may be nothing more than oversight or forgetfulness.

17. We should also add that when HMRC sent the result of its Review to the appellant on 25 January 2011 it made it clear that it had undertaken the Review process on the basis that for the appellant to show that it had a "reasonable excuse" for failing to file its P35, it needed to demonstrate that there had been some exceptional event beyond its control that had prevented it from sending its return on time. As a matter of law, that is not the correct test and is totally misleading. Thus HMRC misdirected itself in law. Parliament has said that an appellant must demonstrate that it has a "reasonable excuse. Those are ordinary English words in everyday use. They

must be given their ordinary and natural meaning. If Parliament had intended to say that an appellant must prove some exceptional circumstance, it could and should have said so. It did not choose to say so. Instead, it used the expression "reasonable excuse" which HMRC has quite wrongly sought to elevate to something more onerous than the test specified by Parliament. The fact that section 118 Taxes Management Act 1970 (the definition section) does not contain a statutory definition of "reasonable excuse" is sufficient to indicate that those words or that expression must be given the plain and ordinary meaning that they bear in everyday usage. That meaning cannot be said to extend to demanding that an appellant demonstrates that there were exceptional circumstances, or some exceptional event beyond its control, before a "reasonable excuse" can be established.

18. It is for HMRC to prove that a penalty is due. That involves HMRC proving, at least on the balance of probabilities, that the required end of year filing did not take place by 19 May 2010. The need for such evidence is clear in a case where the appellant asserts that it, by Mr Hession, is sure that its P35 was filed timeously. That assertion is sufficient to place HMRC on notice that it must prove the allegation that it makes. Article 6 ECHR applies, with the requirement that he who alleges, must prove. HMRC has produced no evidence to that effect and, for that reason alone, this appeal must succeed. An assertion or allegation unsubstantiated by evidence is not self proving.

19. Even if we had not come to the foregoing conclusion it seems inevitable to us that the penalty would have had to be reduced to £100 by reason of the manifest unfairness caused by HMRC choosing not to notify the appellant that it had incurred any penalty until well into September 2010.

20. It seems plain to us that HMRC deliberately chose to wait until four months had gone by and did not issue the first interim penalty notice until September 2010. By that time a penalty of £400, being four times £100 per month, was said to be due. The penalty notice, if issued timeously, would *de facto* operate as a reminder and the taxpayer could then undertake any necessary filing forthwith. In fact a further one month penalty arises because the *de facto* reminder was received only after it was too late to avoid a further £100 penalty. Thus, the effect of HMRC desisting from sending out a penalty liability notice very soon after 19 May of the relevant year, and choosing deliberately to delay that penalty notice until four months has gone by, is likely to result in the taxpayer facing a minimum penalty of £500. We appreciate that HMRC takes the stance that it is the responsibility of the taxpayer to make the necessary filing and that it is its stance that it has no obligation to issue any reminder. However, we have no doubt that any fair minded member of society would consider that to be unfair and falling very far below the standard of fair dealing and conscionable conduct to be expected of a manifestation of the State that is empowered to issue penalties as a means of ensuring compliance.

21. There can be no logical reason whatsoever for HMRC to delay sending out a penalty notice for four months so that, in effect, a minimum penalty of £500 will be levied unless the taxpayer has unilaterally realised that it has failed to undertake the

necessary filing. Its computers could be set to issue a penalty notice at any time after 19 May in each year; but it chooses to wait until mid/late September in each year.

22. HMRC is a manifestation of the State. It is no function of the State to use the penalty system as a cash generating scheme. The penalty system has a legitimate aim, which is to ensure that appropriate filings take place in good time and to discourage default. Given that that is the legitimate aim, it is inexplicable why HMRC deliberately delays sending out a penalty notice for four months, with the effect that a penalty for five months becomes payable, that is, £500. In our judgement it would be a very simple matter for HMRC to set its computer settings so that a default or penalty notice was sent out soon after 19 May in any year, instead of some four months later. That fair approach might generate less penalty cash for the State, but it would be fair and conscionable as between the taxpayer and the State (acting by HMRC).

23. HMRC makes the point that it is not under an obligation to remind a taxpayer of its obligation to file documents. It is true that it is under no obligation to do so, but that does not mean that good practice and conscionable conduct does not require it either (i) to send a reminder soon after 19 May in each year when it knows that a default has taken place or, more likely (ii) soon after 19 May each year to issue a £100 penalty notice which would levy the penalty then due and have the effect of acting as a reminder (whether or not intended to have that effect) before further monthly penalties are incurred.

24. It has long been part of the common law of this country that manifestations of the State must act fairly and in good conscience with its citizens. In our judgement there is nothing fair or reasonable in setting a computer system so that it does not generate a penalty notice until four months have gone by from the date of default, thereby ensuring that a penalty of not less than £500 will be due. We are in no doubt that the computer system could easily be set to generate a single £100 penalty notice soon after the 19 May in each year. That is the course that a fair manifestation of the State, acting in good conscience towards the citizens of the State, would adopt.

<u>The Facts and our Findings.</u>

25. We find there to be insufficient evidence to allow us to conclude that HMRC has proved the alleged default. In a case where, as the European Court of Human Rights has explained, Article 6 applies, we have to pay particular attention to whether the party making a particular allegation has proved it to the requisite standard, by admissible and reliable evidence. We bear in mind that the strict rules of evidence are relaxed in this Tribunal, but not to the extent that alleged facts can be proved by nothing more than HMRC adducing the penalty notices.

26. This Tribunal has held that where a person honestly and genuinely believes that a particular filing has taken place, but may nonetheless be incorrect, that state of mind can amount to a reasonable excuse until such time as he receives information demonstrating that that genuine and honest belief is in fact incorrect. As we have not been satisfied by any reliable evidence adduced by HMRC that the alleged default has

been proved, we need not go on to express a concluded view as to whether the appellant had a reasonable excuse of the type postulated in this paragraph.

27. As, in our judgement, HMRC has neither acted fairly nor in good conscience, in the manner described above, we do not consider that any penalty would be recoverable over and above the £100 penalty for the first month, unless HMRC proved (the onus being upon it) that even if such a penalty notice, which would *de facto* have acted as a reminder, had been issued, the default would nonetheless have continued. It has proved no such thing.

28. It follows from the foregoing that we find as follows:

(1) HMRC has not proved the alleged default.

(2) Even if we had found that the alleged default had been proved, the penalty would have been reduced from £500 to £100 given that HMRC deliberately desisted from sending out a penalty notice until September 2010, by which time it could demand a penalty of £500.

(3) This appeal must be allowed in full. The £500 penalty is set aside.

29. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

TRIBUNAL JUDGE
RELEASE DATE: 15 JULY 2011