TC01754

Appeal number TC/2011/6358

Penalty for late payment of PAYE – sch 56 FA 2009 – reasonable excuse – special circumstances – duty to act fairly – whether HMRC could or should have assessed during the year.

FIRST-TIER TRIBUNAL

TAX

RODNEY WARREN & CO **Appellant**

- and -

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

TRIBUNAL: CHARLES HELLIER
NIGEL COLLARD

Sitting in public in Brighton on 7 December 2011

Mr Warren in person

Mark Ratcliff for the Respondents

DECISION

Introduction

1. The appellant appealed against penalties assessed for the late payment of PAYE and NIC in 2010/11.

2. The appellant practices as Rodney Warren & Co, a firm of solicitors, the substantial majority of whose income derives from legal aid work. It has some 20 employees. Each month the appellant pays some £10,000 in PAYE and NIC to HMRC.

3. By regulation 69 of the 2003 PAYE regulations, an employer must make payment of PAYE and NIC to HMRC by the 19th of the month (or the 22nd if paying electronically) following the period ending on the fifth of that month. Each payment made by the firm in 2010/11 was some 10 to 14 days late.

4. On 10 June 2011 HMRC wrote to the firm to notify it of the assessment of penalties under schedule 56 FA 2009 of £4464.88 in respect of the late payments. The appellant appeals against those penalties.

5. We had before us a bundle of correspondence between HMRC and the appellant which also included copies of HMRC's computerised telephone notes. We heard oral evidence from Mr. Warren and Mr. Barry, the business manager of Rodney Warren & Co. We find the facts set out below.

The facts

6. The appellant's income derives principally from the payments made by the Legal Services Commission. These payments are normally made on or some time after the fifth of each month and several weeks after the relevant work has been done. However in April or May 2010 additional delays arose in relation to payments for work in the Crown Court. Such payments became delayed by between six weeks and four months. The volume of delayed payments peaked in or about July 2010 and then declined until the problems were substantially reduced in May 2011. During this period the appellant's work in progress and debtors peaked at about £380,000, some £80,000 above its normal level

7. The appellant saw this difficulty coming and spoke to his bank about additional borrowing. He was not given an encouraging response. He therefore borrowed £30,000 from his family and, together with £50,000 of his own monies, he injected £80,000 into the business to finance its continued operations. Those monies have remained in the business.

8. For the 10 years or so before 2010 the appellant made payments of its PAYE and NIC liabilities some time after the due date following the receipt of the payment from the Legal Services Commission. Between 5 April 2008 and 5 April 2010 payments were made between the second and the 15th of the following month.

9. On occasion in this period, when it was later than normal in making its payments, the firm received a notice P101 from HMRC. This notice stated that payments were overdue, required payment to be made within seven days and contained a warning that unless payment was made distraint would follow. The appellant always paid within seven days of receiving such a notice.

10. The Schedule 56 FA 2009 penalty regime came into effect from 6 April 2010. Prior to that date HMRC publicised the new penalty scheme. It is likely that they sent information to the Appellant in an information pack which is likely to have been passed directly to its payroll providers.

11. Forms P101 were sent to the appellant for months 1, 3-7,and 9-12 of 2010/11. These notices continued to warn of distraint but made no mention of the new penalty regime.

12. Mr. Ratcliff told us that, on 28 May 2010, HMRC's computer systems generated a "warning letter" which was addressed to the appellant. This said that because the payment was late the appellant "may be liable to a penalty", and suggested that if the appellant was unable to pay on time he should contact Business Support Services. Mr. Warren told us that his practice was scrupulous in its attention to incoming post and that he has no recollection or record of having received this letter. Mr. Ratcliff told us that there was no evidence of it having been returned from the appellant's address. Other correspondence from HMRC was received at that address. We find that letter was not received.

13. On 6 February 2010 an officer from HMRC telephoned Mr. Warren about the late payment for the previous month. A note was made of the conversation which records that payment was promised. The note finished:

> "reminded of pyt. dates. WLAP".

14. Mr. Ratcliff told us that "WLAP" was short for "warning of local action and penalties". Local action meant distraint.

15. On 26 November 2011 another telephone call was made to Mr. Barry, the practice business manager, about a delay in payment for the preceding period. The note of that call finished with the same words "reminded of pyt dates. WLAP". Mr. Barry was unable to recall the detail of the call.

16. Mr. Ratcliff argued that by this route both on 6 February 2010 and 26 November 2010 the appellant had been given warning of the possible imposition of penalties. Mr. Warren asked how a warning of penalties could have been given on 6 February when the regime was not then in force. Mr Ratcliff said that the officers would have known of the new regime.

17. On eight other occasions in 2010/11 officers from HMRC telephoned the appellant to speak about the late payment. On some occasions messages were left simply asking that the appellant call back but on 26 January 2011 there was an

unpleasant and unfortunate exchange between Mr. Warren and an officer from HMRC.

18. Overall it was clear to us that the appellant both knew and had been made aware that HMRC were concerned that his payments were late. On balance we find that, in telephone calls on 6 February and 26 November, some warning was given of the penalty regime.

The law

19. Schedule 56 FA 2009 makes provision for the imposition of penalties for the late payment of certain taxes. By paragraph 1 those taxes include amounts payable under the PAYE regulations. That paragraph provides that penalties are payable by a person ("P") where P fails to pay an amount payable under those regulations by the date provided in them.

20. Paragraph 6 applies to such payments and provides:

> (1) "P is liable to a penalty under this paragraph of an amount determined by reference to the number of defaults in relation to the same tax that P has made during the tax year.
>
> (2) P makes a default in relation to a tax when he fails to pay an amount of that tax in full on or before the date on which it becomes due and payable.
>
> (3) But the first failure during a tax year to pay an amount of tax does not count as a default in relation to that tax during that tax year.
>
> (4) If P makes 1, 2 or 3 defaults during the tax year, P is liable to a penalty of 1% of the total amount of those defaults.
>
> (5) If P makes 4, 5or 6 defaults during the tax year, P is liable to a penalty of 2% of the total amount of those defaults.
>
> (6) If P makes 7, 8 or 9 defaults during the tax year, P is liable to a penalty of 3% of the total amount of those defaults.
>
> (7) If P makes 10 or more defaults during the tax year, P is liable to penalty of 4% of the total amount of those defaults."

21. It will be seen that paragraph 6(1) creates the liability to a penalty. Paragraph 11 (below) deals with the assessment of that penalty. We shall deal with that paragraph now before returning to paragraphs which deal with ways in which the penalty may be avoided or reduced.

22. Paragraph 11 deals with assessment. It provides

> "(1) Where P is liable for a penalty under any paragraph of this schedule HMRC must -
>
> (a) assess the penalty,
>
> (b) notify P, and

(c) state in the notice the period in respect of which the penalty is assessed.

...

"(4) A supplementary assessment may be made in respect of a penalty if an earlier assessment operated by reference to an underestimate of an amount of unpaid tax.

"(5) A supplementary assessment may be made in respect of a penalty under paragraph 6 if -

(a) notice of the assessment of the penalty was issued before the end of the tax year, and

(b) before the end of the year, P makes a further default (so that the penalty for the earlier default is increased)."

23. It will be seen that paragraph 11(1) confers no discretion on HMRC. If a person is liable to a penalty HMRC must assess it.

24. Paragraph 11(1) also requires that, where P is liable, HMRC must "notify" P. The question arises as to whether this must be notice of the assessment of the penalty or notice that he is liable to the penalty. That question is resolved by paragraph 11(1) (c): that subparagraph makes clear that "the notice" - which must be the notice required by paragraph 11(1)(b) - must state the period in respect of which the penalty is assessed: thus the notice must carry news not only of the liability to the penalty but also of its assessment.

25. Thus the statute, while imposing an obligation on HMRC to assess and notify the assessment, imposes no wider duty on HMRC to notify P that its default will lead to a penalty.

26. The percentage rate at which a penalty for a default in any month is calculated will depend upon the number of defaults which occur in a tax year. If a default occurs before the last month in the year, the eventual number of defaults in that year will not be known and the eventual percentage rate may as a result also not be known. Thus the question arises as to whether HMRC may or must assess a penalty in respect of a default before the end of the year.

27. Mr. Ratcliff said that HMRC was unable to raise penalties until the end of the year form P35 had been submitted as there was no knowledge of the amounts due in respect of each month. Without that HMRC was unable to establish the amount of the late payment: it could not base the penalty on the amount paid as it could not be sure the full payment had been made. The legislation allowed HMRC to issue a supplementary assessment if the percentage penalty was increased but not because the underlying amount was incorrect.

28. We did not agree with Mr. Ratcliff's submissions on this point. First the form P35 does not show what amounts were due in relation to specific months but only the amount which was due for the whole year. Second, paragraph 11(4) expressly permits a supplementary assessment to be made where the earlier assessment was based on an underestimate of the amount of unpaid tax. The legislation permitted supplementary

assessments to be issued both in respect of an increase in the percentage penalty, and because of an increase in the underlying amount.

29. In relation to question posed in paragraph [26] it seems to us that the following considerations are relevant:

(1) Paragraph 6(1) provides that P is liable to a penalty determined by reference to the number of defaults "P *has made* during the year". The use of the word "has" indicates that this liability can be determined at any time before the end of the year; otherwise "P made during the year" would have been apposite.

That construction is fair, because a person should be able to compute his liability at any time.

(2) Paragraph 11(5) provides for a supplementary assessment to be made where an in-year assessment is notified and then P makes a further default. That paragraph clearly contemplates the possibility of an early assessment which is subsequently supplemented because the taxpayer has made more defaults.

There is thus no statutory assumption that the penalties can be assessed only after the year has ended. In fact the reverse.

(3)Paragraph 12 provides that an assessment of the penalty must be made within a particular time limit. For present purposes it is necessary only to note that this period may be two years from the date the tax was due.

Thus the legislation envisages that a penalty may not be assessed immediately or even soon after the liability to tax arose - being assessable up to two years thereafter. Indeed a consideration of the case where a person conceals his obligation to deduct and pay shows the need for some latitude in the period in which the penalty may be assessed.

30. From this review we draw the following conclusions:

(1) if a penalty arises HMRC must assess it at some time;

(2) HMRC may assess the liability before the end of the year; they may so assess by reference to facts and estimates known to them before the year end, and may make later supplementary assessments to reflect new information; and

(3) HMRC are not obliged by the legislation to assess the liability before the end of the year.

31. We now turn to the legislative provisions for exculpation from, or reduction of, penalty.

32. Paragraph 9, headed "special reduction", provides, in subparagraph (1), that: “If HMRC think it is right because of special circumstances, they may reduce the penalty under any paragraph of this Schedule." But subparagraph (2) provides that "special circumstances” does not include - (a) ability to pay, or…”

33. Mr Warren suggested that there was a difference between the ability to pay and the ability to pay *on time*. His firm’s difficulty had been paying on time; they had

always paid. We think that the natural meaning of this phrase in the context of provisions about late payment is that it embraces an inability to pay on time.

34. Paragraph 10 provides that a penalty will be suspended in circumstances where HMRC agreed that payment of the amount might be deferred.

35. Paragraph 16 deals with reasonable excuse. It provides that the liability to a penalty does not arise if P satisfies HMRC or the tribunal that "there is a reasonable excuse for the failure". The use of the definite article "the" means that the tribunal is required to consider each failure separately. But subparagraph (2) provides that

> "For the purposes of subparagraph (1) --
>
> "(a) an insufficiency of funds is not a reasonable excuse unless attributable to events outside P's control…"

36. Paragraphs 13 to 15 deal with appeals. We need note only para 15(2) which provides that in an appeal against the amount of a penalty the tribunal may affirm HMRC's decision or substitute any other decision which HMRC had power to make. Para 15(3) limits this power in relation to the "special circumstances" provisions of para 9 by providing:

> "(3) If the tribunal substitutes its decision for HMRC's , the tribunal may rely on paragraph 9-
>
> (a) to the same extent as HMRC (which may mean applying the same percentage reduction as HMRC to a different starting point), or
>
> (b) to a different extent, but only if the tribunal thinks that HMRC's decision in respect of the application of paragraph 9 was flawed.
>
> "(4) In sub-paragraph(3)(b) "flawed" means flawed when considered in the light of the principles applicable in proceedings for judicial review."

The Appellant's arguments.

37. Mr. Warren put fairness at the centre of his submissions. He said that HMRC did not act fairly:

(1) HMRC did not act fairly when it sent forms P101 after the introduction of the new penalty regime, as they had not been amended to giveany warning of a penalty and no other warning. The firm's history of payments suggested that it would have responded to a warning by making payment, and ensuring future payments were made within the time limit, or seeking a more formal agreement for further time to pay;

(2) HMRC did not act fairly when it tried only once to give a written warning of a penalty (and failed), and after there had already been several defaults;

(3) HMRC had a duty to be fair in the exercise of its obligation to assess under paragraph 11 and that meant not waiting until the end of the year but making an assessment as soon as reasonably possible after they had facts on which to make

it. It was plain that HMRC could and should have notified and assessed in say July 2010 in respect of earlier defaults in the tax year.

38. Mr. Warren says that in assessing whether a taxpayer had a reasonable excuse not only should the appellant's difficulties with the Legal Services Commission, and the steps it had taken (approaching its bank and injecting additional cash into the business) be taken into account, but also the unfair conduct of HMRC. He referred in this context to the *HMD v HMRC* (TC 01322 [2001] UKFTT 472 (TC)) decision and the emphasis there given to the statutory question of whether there was a reasonable excuse, not whether there were exceptional circumstances.

39. Mr Warren says that HMRC should have considered whether there were special circumstances within paragraph 9, and in addressing that question they should have taken into account their earlier unfair conduct.

HMRC's arguments

40. Mr. Ratcliff accepted that paragraph 6 required the penalty to be calculated by reference to the "number of defaults ... that P has made during the tax year" and that a failure to pay on time for the period ending 5 April 2011 was not a default in the 2010/11 tax year because the failure occurred after 5 April 2011. To that extent the appeal against the last penalty that had been assessed should be allowed.

41. Mr. Ratcliff referred to HMRC's publicity, said that ignorance of the law could not be an excuse for non-compliance with a statutory obligation, and argued that the Appellant's history of late payment showed that there was no reasonable excuse for its 2010/11 defaults. He maintained HMRC had acted fairly in giving warnings of the new regime.

Discussion – (i) reasonable excuse

42. Was there a reasonable excuse for any of the defaults? It was plain that the late payment of PAYE and NIC was part of the normal cash management of the appellant's business: like all carefully managed businesses it took credit where it could. But although cash flow management may be a reason for late payment, it cannot be an excuse within the meaning of paragraph 16 for what that paragraph describes as a "failure".

43. The appellant's needs for funds became more acute in 2010/11 because of the delays in the payment by the Legal Services Commission. Was that a reasonable excuse?

44. An insufficiency of funds on its own could not be a reasonable excuse because of paragraph 16 (2) unless attributable to events outside the taxpayer's control. It seemed clear to us that the additional delay in payment by the Legal Services Commission were circumstances outside the appellant's control and accordingly that the insufficiency of funds occasioned thereby was not barred from being a reasonable excuse by virtue of that subparagraph.

45. But in order for an event to exculpate a taxpayer from a default it must be a reasonable excuse "*for*" the default: in other words there must be a causal link between the event and the default. In this case that link did not seem to be present because in the previous year, when there had not been the additional delay in payment by the Legal Services Commission, the appellant had been late in payment (although by not quite so many days). At least the initial few days of each later period were as the result of the policies developed in earlier years of paying late. The legal services commission delays may have made the payment even *later* but they were not the reason for the failure.

46. We conclude that the delays in the payments from the Legal Services Commission were not a reasonable excuse for the defaults.

47. Was any failure by HMRC to give warning of the penalty regime a reasonable excuse for the appellant's defaults? It does not seem to us that it can be. The obligation is to make payment: the lack of a warning (or early assessment)of a penalty is not an excuse for failing to make payment (particularly where the authority's inaction extends for a fairly limited period as was the case here).

(ii) Special circumstances

48. Mr. Ratcliff told is that penalty assessments were not raised by computer but were done manually by HMRC officers. He said that in raising the penalty notices and on later review the officer would have regard to whether the evidence in the hands of HMRC constituted a reasonable excuse, and whether there were special circumstances which warranted a reduction under paragraph 9.

49. We accept this evidence of HMRC's normal procedure. However a letter of 14 July 2011 indicated to us that those procedures were not followed in this case. The letter states:

> "... an appeal against [an] HMRC decision can be accepted on one of the following grounds:
>
> - the penalty is not due
>
> - the amount of the penalty is incorrect
>
> -reasonable excuse. For example you had a reasonable excuse for the failure and you put this right without unreasonable delay after the excuse ended.
>
> "Your letter regarding the above penalty does not fall under any of these grounds and I cannot is therefore accept it as an appeal."

50. Whilst that letter indicates that reasonable excuse had been considered, its terms make plain to us that the "special circumstances" provisions of paragraph 9 had not been considered at all.

51. That failure to consider paragraph 9 at all is a flawed decision for the purposes of paragraph 15(3). It is thus open to the tribunal to rely upon paragraph 9 to the extent it considers it right in the circumstances.

52. In this case it seemed to us that the following circumstances were relevant:

(1) this is a new penalty regime of which it is likely that the appellant had some general notice;

(2) that the appellant had been in previous years habitually a few days late with its payment but had received no penalty (not being within the, then, limited penalty regime) although it had been threatened with distraint;

(3) although HMRC's computer had probably printed a warning letter the appellant had not received it;

(4) no change had been made in form P101 to give a warning of the penalty

(5) HMRC could have assessed the penalty and notified the appellant earlier in the year in respect of each default but did not do so;

(6) between September 2010 and March 2011 the Appellant's cash flow was materially adversely affected by delays in legal aid payments.

53. We were not referred to (and could not find) any authority on the meaning of "special circumstances". Plainly it must mean something different from, and wider than, reasonable excuse, for (i) if its meaning were confined within that of reasonable excuse, paragraph 9 would be otiose, and (ii) because paragraph 9 envisages a reduction in a penalty rather than absolution, it must be capable of encompassing circumstances in which there is some culpability for the default: where it is right that some part of the penalty should be borne by the taxpayer.

54. The adjective "special" requires simply that the circumstances be peculiar or distinctive. But that does not necessarily mean that the circumstances which affect all or most taxpayers could not be special: an ultra vires assertion by HMRC that for a period penalties would be halved might well be special circumstances; but generally special circumstances will be those confined to particular taxpayers or possibly classes of taxpayers. They must encompass the situation in which it would be significantly unfair to the taxpayer to bear the whole penalty.

55. In our view however the circumstances referred to do not warrant any reduction in the penalty. The strongest argument for the Appellant is that HMRC did not give warning about or assess the penalties early in the period and that, had it done so, the Appellant could have mended its ways and would have avoided penalties in relation to later periods. The appellant was a habitual late payer. HMRC did not amend its form P101. We think it should have done so. But a firm of lawyers which always paid late should itself have taken all reasonable steps itself to ensure that that practice did not incur penalties and should not be relieved of its liability by reason of a lack of warning in a particular notice. Where the information arrived in a payroll pack from HMRC, just passing information on to the payroll provider is not sufficient in these

circumstances, without reading it and checking whether it affects the firm's current business practice.

Discussion - (iii) fairness

56. Mr. Warren accepts that section 6(1) Human Rights Act 1998 precludes an attack on the assessment of the penalty because paragraph 11 provides that HMRC "must" assess the penalty: as a result of that provision of primary legislation HMRC could not have acted otherwise.

57. But he says that under the common law HMRC had a duty to act fairly. He says that duty included notifying a subject of a liability when they knew that the liability had arisen. HMRC should exercise the powers and duties given by paragraph 11 Sch 28 (and section 1 TMA) fairly. That meant giving a taxpayer timeous notice that a liability has arisen.

58. We agree with Mr. Warren that the powers and duties given to HMRC are subject to general public law considerations and constraints which may include an appreciation of whether they acted fairly, but we do not believe that in these circumstances this tribunal has any general power to give effect to such considerations.

59. That is because this tribunal is constituted by statute to hear appeals in relation to matters prescribed by the statute. It does not have any jurisdiction other than that given by the statute and thus no inherent jurisdiction to interfere with the exercise by HMRC of their powers and duties.

60. There are some occasions where the tribunal is given such power expressly or implicitly: thus, for example, it is given expressly by the statute in a minor way by paragraph 15(3) which we have considered above; and such jurisdiction may be implicit in a VAT appeal because Human Rights Convention precepts are implicit in the proper interpretation of the EU directives which domestic legislation implements (see for example *Enersys v HMRC 2010 UKFTT 20 (TC)*). It is also possible that the legitimate expectations of a taxpayer in relation to the imposition or otherwise of a tax may properly be treated by the tribunal as giving rise to remedy under section 7 Human Rights Act to which the tribunal may give effect - see *CGI Group (Europe) Ltd v* HMRC 2010 UKFTT 224 (TC) and *Oxfam v HMRC I2009 EWHC 3078 Ch*)

61. But the present case does not fall within any of these categories. There is no express power given to the tribunal to review HMRC's actions in relation to these penalties; the penalty legislation is not derived from an EU directive suffused with Convention rights; in our view the taxpayer in this case had no legitimate expectation that HMRC would not abide by its statutory duty to assess. If there was a procedural or substantive unfairness in the imposition of the penalties on this taxpayer its remedy must lie elsewhere.

Conclusion

62. We allow the appeal in relation to the penalty for Month12 (see para [40]). We dismiss the appeal in relation to the other periods.

Rights of Appeal

63. 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.

CHARLES HELLIER

TRIBUNAL JUDGE
RELEASE DATE: 17/01/2012