TC02142

Appeal number: TC/2012/04254

INCOME TAX –penalties - late payment of PAYE – penalties under Schedule 56 Finance Act 2009 – taxpayer unaware of new penalty regime – whether reasonable excuse – whether decision flawed because of failure to consider special circumstances – whether special circumstances - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

ALGARVE GRANITE LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE GUY BRANNAN
LESLIE HOWARD

Sitting in public at St Katherine's House, Northampton on 12 June 2012

Alex Jennings, Director, for the Appellant

Lisa Taylor, presenting officer, for the Respondents

DECISION

Introduction

1. This is an appeal against penalties assessed under Schedule 56 Finance Act 2009 in respect of late payment of PAYE by the appellant in respect of the tax year 2010 – 2011.

The facts

2. In the tax year 2010 – 2011, in respect of the 11 periods ended 5 May 2010 to 5 March 2011, the appellant made late payments of PAYE totalling £101,289.84. There was no dispute about the amounts of PAYE due each month (which varied between approximately £8000 and £13,000) or that the payments were late. Under paragraph 6 (7) Schedule 56 Finance Act 2009 a penalty of 4% of the late paid PAYE was assessed. The penalty assessed was £4051.59.

3. Moreover, it was common ground that the appellant had also consistently made late payments of PAYE in the tax years 2008 – 2009 and 2009 – 2010. It was also common ground that in the tax year 2011 – 2012 (i.e. after the penalties in dispute were levied) the appellant made its payments of PAYE on time.

4. The appellant is engaged in the business of supplying granite work surfaces for kitchens. Mr Jennings, a director of the appellant and who appeared for the appellant at the hearing, explained that he had taken over the company (together with an associate) in 2007. The appellant used an outside adviser to calculate the amount of PAYE due each month which the appellant then paid.

5. Mr Jennings accepted that during 2008 – 2009 the appellant had started making late payments of PAYE. The appellant's cash flow was under pressure. The appellant had moved premises and the economic downturn caused the appellant's business to suffer, although it had managed to maintain its turnover. Customers were taking longer to settle their accounts and suppliers were reducing the period allowed for payment under their credit terms.

6. Although the appellant had been making late payments of PAYE in 2008 – 2009 and 2009 – 2010, HMRC had not complained about this and had not levied penalties. The late payments of PAYE continued throughout 2010 – 2011.

7. HMRC’s electronic records showed that a standard-form penalty default letter was issued to the appellant on 28 May 2010. Although the original letter was not on HMRC's files, a copy of the form of the letter which would have been sent was produced. In its first line the letter stated: "We have sent you this warning letter because it appears that you have not paid your PAYE on time. You may be liable to a penalty if you pay late more than once in a tax year…." The letter directed the recipient to HMRC's website for further information on penalties. Ms Taylor, for HMRC, informed us that HMRC had checked its records and these indicated that

there were no problems regarding the sending of electronically generated letters on that day. HMRC did not receive the letter back via Royal Mail returned letter service. Mr Jennings, a director of the appellant, stated that the appellant had not received this letter.

8. When he received a second letter from HMRC dated 9 June 2011, informing him that the appellant had incurred penalties under the new penalty regime contained in schedule 56 Finance Act 2009, Mr Jennings said that he was shocked. He had not been informed of this by his advisers. He understood that HMRC had sent a letter explaining the new regime but this had not been received. He could not understand how such severe penalties could have been put in place without being told about it. Mr Jennings considered that this was unfair.

9. At the hearing, HMRC produced details of their records of telephone calls made by HMRC to the appellant. These records indicated that on 26 March 2010 an HMRC officer telephoned the appellant and spoke to Mr Jennings in relation to the late payment of PAYE for month 11 in respect of the earlier 2009 – 2010 period. The log of the telephone call indicates that the officer warned Mr Jennings about potential legal action and penalties. Mr Jennings said that he did not recall having been told about penalties in telephone conversations.

10. On 2 June 2010 HMRC telephoned the appellant and left a message for Mr Jennings to call back at the end of the day. The call was not returned. HMRC called the appellant again on 6 July 2010 and another message was left by HMRC, this time for the company's accountant to call HMRC back. HMRC had no record of the call being returned.

11. On 8 July 2010 a telephone call was received by HMRC from the appellant's accountant (Mr Noble). Mr Noble was requested to ask Mr Jennings to call back by 13 July 2010. Mr Noble was, according to the electronic log, advised about penalties.

12. On to September 2010 and 29 October 2010 HMRC telephoned the appellant and left messages for Mr Jennings to call back. Again, HMRC have no record of Mr Jennings having returned their calls.

13. Mr Jennings telephoned HMRC on 25 November 2010 and advised that the payment for month seven had been made on 18 November 2010.

14. Another call was made by HMRC to the appellant on 23 December 2010. Another message was left for Mr Jennings to call HMRC back.

15. Finally, HMRC called the appellant on 25 January 2011 and left a further message requesting that Mr Jennings call them back.

16. As noted, notwithstanding numerous attempts to contact Mr Jennings, HMRC's calls were (with the exception of the call on 25 November 2010) not returned. Mr Jennings did not dispute this but said that penalties had not been mentioned on these calls.

17. It is hard to avoid the impression that the repeated failure by the appellant to make its PAYE payments on time, both as regards the period in question and the two previous tax years, and Mr Jennings's repeated failure to return HMRC's calls, indicated a somewhat relaxed attitude on the part of the appellant towards compliance with its PAYE payment obligations. This approach suggests to us that HMRC's records indicating that a penalty warning letter had been sent on 28 May 2010 were correct and we find that it is more likely than not that it was received by the appellant but either no attention was paid to it or it was simply overlooked. We also consider that HMRC's records of its telephone conversations with the appellant were more likely to be correct than Mr Jennings's recollection of those calls. In particular, we considered that it is more likely than not that HMRC did warn Mr Jennings and Mr Noble about penalties.

18. Ms Taylor also informed us that HMRC's Business Support Service – which assists taxpayers who find it difficult to make their tax payments on time – had not been contacted by the appellant prior to its failure to make PAYE payments on time. Mr Jennings did not suggest that he had attempted to contact this Business Support Service.

19. As noted above, HMRC wrote to the appellant on 9 June 2011 notifying it that a penalty in respect of late payment of PAYE in respect of tax year 2010 – 2011 had been incurred. The letter did not refer to the defence to a penalty of "reasonable excuse" nor to the part of HMRC to reduce the penalty in cases of "special circumstances". The letter did, however, note that further information about penalties could be found on HMRC's website. Similarly, a letter from HMRC's Debt Management & Banking unit dated 20 July 2011 and dealt with details in respect of the payment of the penalty but, again, did not mention "reasonable excuse" or "special circumstances".

20. In a letter dated 23 August 2011 from HMRC to the appellant, "reasonable excuse" was mentioned but there was no reference to "special circumstances."

21. The appellant requested that the penalty decision be reviewed and HMRC wrote to the appellant on 21 October 2011 informing the appellant that the penalty decision should be upheld. The letter contains no specific reference to "reasonable excuse" or to "special circumstances". The letter explained why HMRC had reached this conclusion. The letter contained the following paragraph:

> "HMRC are under a legal obligation to operate to impose penalties in all cases where we have a reasonable belief that they are merited by the facts. It would be unfair to administer penalties in any other way. We will not consider write-off of the penalty imposed."

The statutory provisions

22. The new penalty code for late payments of tax was introduced by Schedule 56 to the Finance Act 2009. The relevant paragraph of the Schedule, applying to late payments of PAYE, was paragraph 6, which came into force on 6 April 2010 (SI 2010/466 art 3). Although newly enacted, paragraph 6 was amended with effect from

25 January 2010 (SI2011/132 art 2(b)) by paragraphs 1 and 6 of Schedule 11 Finance (No2) Act 2010. For the purpose of this appeal, which spans the tax year 2010-2011 both versions of paragraph 6 are relevant and are set out below. We do not, however, believe that the difference in wording of the two versions paragraph 6 has any material impact on the outcome of this appeal, but set them out for ease of reference.

23. Paragraph 6, as originally enacted and in force for the period 6 April 2010 to 24 January 2011, read as follows:

> "6(1) P [the taxpayer] 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 P 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 penalty of 1% of the total amount of those defaults.
>
> (5)If P makes 4, 5 or 6 defaults during the tax year, P is liable to 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 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.
>
> (8)In this paragraph–
>
> (a) in accordance with sub-paragraph (1), the references in sub-paragraphs (4) to (7) to a default are references to a default in relation to the tax mentioned in sub-paragraph (3),
>
> (b) the amount of a default is the amount which P fails to pay, and
>
> (c) a default counts for the purposes of sub-paragraphs (4) to (7) even if the default is remedied before the end of the tax year."

24. The amended paragraph 6, in force from 25 January 2011 to the end of that tax year, read as follows:

> "(1) P[the taxpayer] is liable to a penalty, in relation to each tax, of an amount determined by reference to—
>
> (a) the number of defaults that P has made during the tax year (see sub-paragraphs (2) and (3)), and
>
> (b) the amount of that tax comprised in the total of those defaults (see sub-paragraphs (4) to (7)).
>
> (2) For the purposes of this paragraph, P makes a default when P fails to make one of the following payments (or to pay an amount

comprising two or more of those payments) in full on or before the date on which it becomes due and payable—

(a) a payment under PAYE regulations;

(b) a payment of earnings-related contributions within the meaning of the Social Security (Contributions) Regulations 2001 (SI 2001/1004);

(c) a payment due under the Income Tax (Construction Industry Scheme) Regulations 2005 (SI 2005/2045);

(d) a repayment in respect of a student loan due under the Education (Student Loans) (Repayments) Regulations 2009 (SI 2009/470) or the Education (Student Loans) (Repayments) Regulations (Northern Ireland) 2000 (SR 2000 No 121).

(3) But the first failure during a tax year to make one of those payments (or to pay an amount comprising two or more of those payments) does not count as a default for that tax year.

(4) If P makes 1, 2 or 3 defaults during the tax year, the amount of the penalty is 1% of the amount of the tax comprised in the total of those defaults.

(5) If P makes 4, 5 or 6 defaults during the tax year, the amount of the penalty is 2% of the amount of the tax comprised in the total of those defaults.

(6) If P makes 7, 8 or 9 defaults during the tax year, the amount of the penalty is 3% of the amount of the tax comprised in the total of those defaults.

(7) If P makes 10 or more defaults during the tax year, the amount of the penalty is 4% of the amount of the tax comprised in the total of those defaults.

(8) For the purposes of this paragraph—

(a) the amount of a tax comprised in a default is the amount of that tax comprised in the payment which P fails to make;

(b) a default counts for the purposes of sub-paragraphs (4) to (7) even if it is remedied before the end of the tax year.

(9) The Treasury may by order made by statutory instrument make such amendments to sub-paragraph (2) as they think fit in consequence of any amendment, revocation or re-enactment of the regulations mentioned in that sub-paragraph."

25. It will be seen from both versions of paragraph 6(3) that ten defaults in the tax year renders a taxpayer such as the appellant liable to a penalty of 4% of the total amount of tax comprised in those defaults.

26. Schedule 56 also contains provisions (paragraph 9) relating to a reduction in a penalty for "special circumstances" and (paragraph 16) removing liability for a penalty where there was a "reasonable excuse" for the failure. Paragraph 9 provides:

"(1) If HMRC think it right because of special circumstances, they may reduce a penalty under any paragraph of this Schedule.

(2) In sub-paragraph (1) “special circumstances” does not include—

(a) ability to pay, or

(b) the fact that a potential loss of revenue from one taxpayer is balanced by a potential over-payment by another.

(3) In sub-paragraph (1) the reference to reducing a penalty includes a reference to—

(a) staying a penalty, and

(b) agreeing a compromise in relation to proceedings for a penalty."

27. Paragraph 16 contains the provisions relating to "reasonable excuse". As was the case with paragraph 6, paragraph 16 was amended as regards PAYE payments with effect from 25 January 2011 (SI 2011/132 art 3). The original version of paragraph 16, in force from 6 April 2010 to 24 January 2011 read as follows:

"(1) Liability to a penalty under any paragraph of this Schedule does not arise in relation to a failure to make a payment if P satisfies HMRC or (on appeal) the First-tier Tribunal or Upper Tribunal that there is a reasonable excuse for the failure.

(2)For the purposes of sub-paragraph (1)–

(a)an insufficiency of funds is not a reasonable excuse unless attributable to events outside P´s control,

(b)where P relies on any other person to do anything, that is not a reasonable excuse unless P took reasonable care to avoid the failure, and

(c)where P had a reasonable excuse for the failure but the excuse has ceased, P is to be treated as having continued to have the excuse if the failure is remedied without unreasonable delay after the excuse ceased."

28. From 25 January 2011, paragraph 16 read as follows:

"(1) If P satisfies HMRC or (on appeal) the First-tier Tribunal or Upper Tribunal that there is a reasonable excuse for a failure to make a payment—

(a) liability to a penalty under any paragraph of this Schedule does not arise in relation to that failure, and

(b) the failure does not count as a default for the purposes of paragraphs 6, 8B, 8C, 8G and 8H.]

(2) For the purposes of sub-paragraph (1)—

(a) an insufficiency of funds is not a reasonable excuse unless attributable to events outside P's control,

(b) where P relies on any other person to do anything, that is not a reasonable excuse unless P took reasonable care to avoid the failure, and

> (c) where P had a reasonable excuse for the failure but the excuse has ceased, P is to be treated as having continued to have the excuse if the failure is remedied without unreasonable delay after the excuse ceased."

29. In our view, the different versions of paragraph 16 do not materially affect the outcome of this appeal.

30. Paragraph 13 of Schedule 56 introduces the provisions relating to appeals against penalties imposed under that Schedule. Paragraph 13 provides:

> "(1) P may appeal against a decision of HMRC that a penalty is payable by P.
>
> (2) P may appeal against a decision of HMRC as to the amount of a penalty payable by P."

31. An appeal in respect of the "reasonable excuse" provisions of paragraph 16 would fall under paragraph 13 (1) because if a reasonable excuse is found to exist no liability to a penalty arises. On the other hand, an appeal relating to "special circumstances" under paragraph 9 would fall under paragraph 13 (2) because it would relate to the amount of the penalty payable.

32. Paragraph 15 of Schedule 56 sets out this Tribunal's jurisdiction in relation to such appeals. Paragraph 15 provides:

> "(1) On an appeal under paragraph 13(1) that is notified to the tribunal, the tribunal may affirm or cancel HMRC's decision.
>
> (2) On an appeal under paragraph 13(2) that is notified to the tribunal, the tribunal may—
>
> (a) affirm HMRC's decision, or
>
> (b) substitute for HMRC's decision another decision that HMRC had power to make.
>
> (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.
>
> (5) In this paragraph “tribunal” means the First-tier Tribunal or Upper Tribunal (as appropriate by virtue of paragraph 14(1))."

33. Thus, in relation to an appeal involving "reasonable excuse" paragraph 15 (1) allows the Tribunal either to affirm or cancel HMRC's decision. In relation to an appeal involving the issue of "special circumstances", the Tribunal may rely on paragraph 9 to a different extent from HMRC only if the Tribunal considers HMRC's decision to be flawed in the judicial review sense of that expression.

Discussion

Reasonable excuse

34. We have considered the arguments put forward by Mr Jennings in paragraphs 5 to 8 above but consider that none of the points raised constitute a "reasonable excuse" for the purposes of paragraph 16. We have no doubt that in the general economic downturn trading conditions for the appellant have become more difficult. These are, however, the consequences of normal trading, albeit in adverse economic conditions. As Lord Donaldson MR said in *Customs and Excise Commissioners v Steptoe* [1992] STC 757 at 770:

> "…if the exercise of reasonable foresight and of due diligence and a proper regard for the fact that the tax would become due on a particular date would not have avoided the insufficiency of funds which led to the default, then the taxpayer may well have a reasonable excuse for non-payment, but that excuse will be exhausted by the date on which such foresight, diligence and regard would have overcome the insufficiency of funds."

35. In the present case, the appellant did not seem to exercise reasonable foresight nor did it display a proper regard for the date on which its PAYE was due and payable. Indeed, Mr Jennings stated that if he had known that penalties were to be imposed he would have paid the tax on the due date.

36. Moreover, we do not consider that this is a case in which HMRC have acted unfairly. As we have found, we considered it more likely than not that the appellant did receive HMRC's warning letter 28 May 2010. HMRC then attempted on several occasions to contact the appellant but Mr Jennings did not return HMRC's telephone calls.

37. In this context we should make it clear that we also agree with the observations of the Tribunal in respect of warnings given by HMRC in *Dina Foods Limited v Commissioners of HMRC* [2011] UKFTT 709 (TC) where the Tribunal (Judge Berner and Mr John Whiting) said at paragraphs 38-39:

> "38. In this context we have a number of observations to make concerning the scheme of Schedule 56 as a whole, as it applies to PAYE and NICs payments. The penalty regime is based on the number of defaults over a complete tax year. There is no separate penalty for each individual default; the penalty can only be assessed once the aggregate of the late paid tax comprised in the total of the defaults for a particular tax year has been ascertained. A taxpayer who continues to pay late, so increasing both the amount of tax (and NICs) on which the penalty may be levied and the rate of the penalty, may well complain that his behaviour (and thus the amount of his liability) would have been different had a penalty been levied in respect of a default early in the tax year or at least a warning issued. But on the scheme of penalties that has been laid down, the total would not then have been capable of being ascertained, so the penalty could not at that earlier time have been assessed.

> 39. We do not therefore consider that any failure on the part of HMRC to issue warnings to defaulting taxpayers, whether in respect of the imposition of penalties or the fact of late payment, is of itself capable of amounting either to a reasonable excuse or special circumstances."

38. For these reasons, we do not consider that the appellant had a reasonable excuse for its failure to make its PAYE payments on time.

Special circumstances

39. This Tribunal has the power to substitute for HMRC's decision another decision that HMRC had power to make and to rely on "special circumstances" within the meaning of paragraph 9 to a different extent than HMRC if, but only if, HMRC's decision was flawed in the judicial review sense of that expression (paragraph 15(3) and (4)). In other words, this Tribunal can reduce the penalties imposed in this case if it considers that it is right because of "special circumstances" provided it considers HMRC's decision to be flawed, in the judicial review sense of that expression. HMRC plainly have a discretion whether to reduce penalty under paragraph 9.

40. Schedule 56 to the Finance Act 2009 contains a new statutory code dealing with penalties for late payment of tax (Schedule 24 to the Finance Act 2007 contains similar provisions relating to penalties for incorrect returns). The format of Schedule 56 is as follows. First, the method of calculation of the penalty is set out (paragraphs 5-8). Next, HMRC has discretion to reduce a penalty, if HMRC thinks it right because of "special circumstances". Then, in addition, a taxpayer may request - the initiative must come from the taxpayer - a deferral in respect of the payment of tax that would otherwise be due and payable. If HMRC agrees to the deferral, any penalty is suspended and the taxpayer is not liable to that penalty (unless e.g. the agreement is breached): paragraph 10 Schedule 56 Finance Act 2009. Paragraphs 11 to 13 set out the procedure for assessment of and appeals in respect of penalties. Finally, there is a general exclusion from penalties in the case of "reasonable excuse".

41. This, therefore, is the statutory context in which paragraph 9 appears. In the documents before us there is no indication that HMRC considered whether a reduction of the penalty on account of "special circumstances" under paragraph 9 should be made.

42. It is possible that here is a divergence of view in this Tribunal whether the failure by HMRC to consider whether to exercise its discretion under paragraph 9 ("special circumstances") means that HMRC's decision is "flawed" for the purposes of paragraph 15.

43. In *Hardy v Revenue & Customs* [2011] UKFTT 592 (TC) (Judge Powell and Mrs de Alburquerque), a decision in respect of paragraph 11 Schedule 56 Finance Act 2009, the Tribunal held that a failure by HMRC to consider whether a reduction in a penalty should be applied because of "special circumstances" resulted in a flawed decision. The Tribunal said:

> "27. …However we believe that the decision was flawed because no account was taken of special circumstances and thus there was no consideration of a possible further reduction under paragraph 11. We think that HMRC's decision in respect of the application of paragraph 11 was flawed. In fact we do not consider HMRC thought about a paragraph 11 reduction at all but we consider it would be perverse if a decision in respect of its application can be flawed but a failure to think about it at all cannot be flawed."

44. The issue was also considered by this Tribunal (Judge Hellier and Mr Collard) in *Rodney Warren & Co v Revenue & Customs* [2012] UKFTT 57 (TC) in a case relating to paragraph 9 Schedule 56 Finance Act 2009 where the Tribunal held that a failure to consider whether "special circumstances" merited a reduction in the penalty resulted in HMRC's decision being flawed. The Tribunal said:

> "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."

45. A similar conclusion was reached by the Tribunal in relation to the equivalent provisions in Schedule 24 Finance Act 2007 in *Roche v Revenue & Customs* [2012] UKFTT 333 (TC) (Judge Aleksander and Mr Hughes). The Tribunal said:

> " 55. In our view HMRC's decision to apply no reduction was flawed.
>
> 56. Mr Reeve [for HMRC] in his submissions told us that HMRC had considered that paragraph 11 did not apply, as the reason for the inaccuracies in Ms Roche's return was her carelessness. However we find that HMRC did not give proper consideration to the issue of special circumstances. Although both the original letter calculating the amount of penalties (dated 2 February 2011) and the review letter (dated 13 May 2011) mention Ms Roche's redundancy, it is only to state that the redundancy occurred 21 months before the date of the tax return, and that therefore Ms Roche's stress would have diminished by then. No consideration was given to the reasons why Ms Roche had boxed-up her papers, and the stress she was under at the time she packed-up her home – even though these issues were raised by Ms Roche in her correspondence with HMRC.
>
> 57. In particular no reference is made in any of HMRC's letters to their discretion to reduce penalties to take account of special circumstances, and there is no statement that they had reached a decision that no such circumstances existed. Nor can the letters be read in any way that might suggest that, although no express reference is made in the correspondence to special circumstances, HMRC had in fact applied their mind to the issue and had reached the conclusion that there were none.

> 58. We therefore find that HMRC had not given proper consideration to the potential for there to have been special circumstances, and we find that HMRC's failure to turn their mind to this issue amounts to a "flaw".

46. In *White v Revenue & Customs* [2012] UKFTT 364 (TC) (Judge Brannan and Mr Williams) the Tribunal, citing the *Hardy* and *Rodney Warren* decisions held, in relation to the corresponding provisions of Schedule 24 Finance Act 2007, that a failure by HMRC to consider (until after the decision to impose a penalty had been taken) whether "special circumstances" justified a reduction in the penalty, resulted in a flawed decision. The Tribunal said:

> "65. First, there is no evidence before us, and Mrs Weare for HMRC accepted in answer to the Tribunal's questions at the hearing that she had seen none, that the officer (Mr Bains) considered whether to exercise his discretion reduce the penalty pursuant to paragraph 11 when issuing the penalty determination. We do not consider that an *ex post facto* consideration of whether the discretion in paragraph 11 should be exercised (as contained in Mr Bains's letter of 8 March 2012) validates the original decision – the determination has already been made. "

47. The Tribunal then went on to hold that, if it was wrong on this point, a failure by HMRC to give reasons for its decision in respect of "special circumstances" also flawed the decision because it effectively nullified the taxpayer's right of appeal under the equivalent of paragraph 15 Schedule 56 Finance Act 2009.

48. In contrast, this Tribunal has recently held in *Agar Ltd v Revenue & Customs* [2011] UKFTT 773 (TC) (Judge Poole and Ms Tanner) that a failure by HMRC to consider, before issuing a penalty assessment, whether to reduce a penalty to take account of "special circumstances" under paragraph 9 Schedule 56 Finance Act 2009 did not result in a flawed decision. It is not clear from the decision whether the question of "special circumstances" was considered at any stage (i.e. after the penalty decision was issued). In that case, the taxpayer argued that a failure by HMRC to consider the issue of "reasonable excuse" and "special circumstances" before issuing the penalty assessment resulted in a flawed decision. The Tribunal disagreed:

> 26. Mr Priddey [for the taxpayer] did not direct us to anything else in the wording of paragraph 9 or the context of schedule 56 generally which could be interpreted as laying down a requirement that HMRC must consider the question of "special circumstances" as an essential preliminary step before assessing a penalty.
>
> 27. So far as Mr Priddey's argument based on *Scofield* [[2011] UKFTT 199 – a case concerning HMRC's power to revoke registration for gross payment under the construction industry scheme] is concerned, we read that case as authority for the proposition that where HMRC are exercising a statutory discretion, they must consider all the issues that the statute requires them to consider before they can validly exercise that discretion. The crucial passage (at [144]) reads:

"The statute requires that the issue of reasonable excuse is considered before the determination is issued and not afterwards."

28. There is a key difference between the *Scofield* case and this appeal.

29. The *Scofield* case was concerned with a provision which conferred on HMRC a discretion to withdraw "gross payment" status under the construction industry scheme. HMRC had purported to withdraw that status from Mr Scofield on the basis that, if he were applying for gross payment status at the time, his application would be refused because he had made a late payment of tax; as a result, he would fail the "compliance test" set out in paragraph 4, schedule 11 Finance Act 2004; and because his application would be refused if he were a new applicant, they were required to withdraw his gross payment status. What *Scofield* said was that as the compliance test itself allowed for a default to be ignored if there was a reasonable excuse for it, HMRC could not properly have applied the compliance test without enquiring into the question of reasonable excuse for that default. By simply issuing an automatically computer-generated notice cancelling his gross payment status, they had clearly not considered whether there might be a reasonable excuse for the default and had therefore not exercised their discretion as the statute required.

30. The situation under paragraph 9 of schedule 56 is not the same. In *Scofield* it was clear that the compliance test could not be properly carried out without investigating whether there was any reasonable excuse for the default. The compliance test was a fundamental statutory requirement. HMRC could not do what they had purported to do (withdraw gross payment status) without forming a proper view on the compliance test. In the present case, paragraph 9 allows a penalty to be reduced "if HMRC think it right because of special circumstances". There is nothing in the existence of this "power to reduce" which is, in the same way, fundamental to the arisal of the penalty in the first place. Indeed, the use of the phrase "they may reduce a penalty" implies that a perfectly valid penalty may exist before the question of reducing it, by reason of "special circumstances", arises. For these reasons, we reject Mr Priddey's submissions.

31. Mr Priddey submitted no further arguments in support of this particular limb of the appeal, though it is fair to say that some of the arguments he raised on the second limb of the appeal could apply also to this limb.

32. We consider those arguments no further here, as they are fully explored below and our comments on them would apply equally if they were advanced in relation to this limb.

49. In our view, with respect, paragraph 9 Schedule 56 Finance Act 2009 does impose a requirement that HMRC should consider whether a penalty should be reduced in making a penalty assessment pursuant to paragraph 11. We reach this conclusion for the following reasons.

50. First, paragraph 9 gives HMRC a discretion to reduce the amount of penalty if it thinks it right because of special circumstances. In exercising HMRC's statutory duty to assess a penalty under paragraph 11 it is obvious that the assessment must specify the amount of the penalty. In quantifying the penalty HMRC must apply the mandatory quantification provisions of paragraphs 5 and 6 of Schedule 56 but in order to reach a final quantification of the penalty, for the purposes of the penalty assessment notification, HMRC must also consider whether a reduction under paragraph 9 of special circumstances should be made. Whether to make a reduction in the penalty because of special circumstances goes directly to the quantum of the penalty which is then assessed.

51. Secondly, when Parliament confers a discretion on a statutory body, such as HMRC, that statutory body must consider whether it is appropriate to exercise that discretion. It cannot fail to take account of its discretion e.g. by applying over-rigid policies or by simply ignoring the fact that it has a discretion. In this case there is no evidence that HMRC, either before or after it made the penalty assessment, took any account of whether special circumstances existed.

52. Thirdly, the exercise of HMRC's discretion under paragraph 9 must be initiated by HMRC and not by the taxpayer (unlike the power to suspend the penalty under paragraph 10). This suggests to us that the issue of whether special circumstances existed must be one which HMRC must consider of its own motion in deciding the amount of the penalty assessment, and not necessarily in response to an appeal by the taxpayer. To be clear, we believe that, even if HMRC have considered the "special circumstances" issue prior to issuing the penalty assessment and decided that no reduction should be made (e g because they are not aware of any information to suggest "special circumstances" existed), there is nothing to prevent HMRC from subsequently reconsidering the issue (e.g. if fresh information is made available). HMRC could then, if they believe that "special circumstances" warrant it, reduce the penalty assessment after it has been made.

53. Fourthly, the format of Schedule 56 suggests that the issue of "special circumstances" should be considered prior to the issue of a penalty assessment under paragraph 11. We have described the layout of the legislation in paragraph 40 above. There is a logical sequence to these provisions. The fact that paragraphs 9 (special circumstances) and 10 (suspension) follow immediately after the mandatory calculation provisions of paragraphs 5 to 8 and before the penalty assessment provisions of paragraph 10 suggests that the issue of "special circumstances" should have received some (even if not final) consideration prior to the issue of the penalty assessment under paragraph 11.

54. Fifthly, liability for a penalty is removed entirely if a taxpayer satisfies either HMRC or the First-tier or Upper Tribunal that there was a "reasonable excuse" for the default. There seems no reason why Parliament should not have required circumstances falling short of a "reasonable excuse" to be taken account in mitigation of a penalty, albeit that the circumstances would have to be "special".

55. Sixthly, the fact that paragraph 9 states that HMRC "may reduce a penalty" does not, in our view, imply that a valid penalty may exist without HMRC considering whether a reduction on account of "special circumstances" should be made. In our view, these words refer to the calculation of the penalty to which the taxpayer would otherwise be liable – absent "special circumstances" – pursuant to the provisions of the immediately preceding paragraphs 6 to 8.

56. Finally, as the Tribunal noted in *Hardy*, it would be strange if a decision in respect of "special circumstances" can be flawed (as paragraph 15 (3) contemplates) but a failure to think about the issue at all (either in assessing the penalty or subsequently) did not constitute a flaw.

57. For these reasons, with respect, we prefer the approach in the decisions *Hardy*, *Rodney Warren*, *Roche* and *White* to that in *Agar* on this point. As noted above, *Agar* may be a decision only on the question whether HMRC must consider "special circumstances" *before* issuing a penalty assessment whereas in *Hardy*, *Rodney Warren*, and *Roche*, as in the present appeal, there was no evidence that "special circumstances" had been considered at any stage.

58. In *Agar*, the taxpayer argued on the basis of *Scofield* [2011] UKFTT 199 that HMRC had to take into account whether the taxpayer had a "reasonable excuse" before making a penalty decision. We agree with the Tribunal in *Agar* that the provisions under consideration in *Scofield* were very different and did not support the taxpayer's arguments in that case relating to "reasonable excuse", but this was a subsidiary basis for the decision. The main basis for the decision in *Scofield* – which is relevant to this appeal – was that the determination made by HMRC was invalid because the statute required that HMRC exercise a discretion in deciding whether to make a determination and that HMRC had not considered whether to exercise this discretion (mistakenly believing that it had no discretion). As the Tribunal said:

> " 138. ... In order to make a determination under section 66 (1), HMRC must exercise its discretion. If it does not exercise its discretion it has not made a determination for the purposes of the statute. The determination is invalid and has no effect. See also per Lord Reid in *Anisminic Ltd v Foreign Compensation Commission* [1969] 2 AC 147 at 170 and per Lord Irvine LC in *Boddington v British Transport Police* [1999] 2AC 143 at 158."

59. In our view, therefore, HMRC's penalty assessment was flawed because of the failure by HMRC to consider whether "special circumstances" existed. In the papers before us and at the hearing HMRC put forward no evidence to suggest that this issue was considered at any stage (either before the penalty determination was made or thereafter). The onus is on HMRC to satisfy the Tribunal that the correct procedure has been followed in relation to penalty assessments, although plainly the onus is on the taxpayer to satisfy the Tribunal as regards certain matters e.g. whether a reasonable excuse existed for the purposes of paragraph 16.

60. On this basis, the Tribunal must now consider whether the circumstances put forward by the appellant constitute "special circumstances" justifying a reduction in the penalty in accordance with paragraph 9 of Schedule 56.

61. In this case, the appellant's argument is essentially that it was unfair for the penalties to be assessed against it when it was unaware of the change in the penalty regime, particularly when the appellant's business was facing pressure from the economic downturn. In our view, this does not constitute "special circumstances". As was noted in *White*, the expression "special circumstances" is an unusual one in the context of tax legislation. The Tribunal said in relation to the provisions of Schedule 24 Finance Act 2007 (which are equivalent to those of paragraph 9 Schedule 56 Finance Act 2009) :

> 52. Paragraph 11 Schedule 24 gives HMRC a discretion to reduce the penalty because of "special circumstances." The expression " special circumstances" is an unusual one in a tax context. It is, however, a phrase which is used in many other statutory contexts, but most notably in a labour law context in relation to the right of a trade union be consulted in cases of redundancy.
>
> 53. The expression " special circumstances " was considered in the well-known decision of the Court of Appeal in *Clarks of Hove Ltd. v Bakers' Union* [1978] 1 W.L.R. 1207 (Stephenson , Roskill and Geoffrey Lane LJJ). Geoffrey Lane LJ said (at page 1216), in a much-quoted passage:
>
> "What, then is meant by “special circumstances”? Here we come to the crux of the case…
>
> In other words, *to be special the event must be something out of the ordinary, something uncommon*; and that is the meaning of the words “special” in the context of this Act." (Emphasis added)
>
> 54. With respect, we think it is correct to adopt the same interpretation of the expression " special circumstances " as it appears in paragraph 11, save that the expression should, of course, be interpreted in accordance with its statutory context, i.e. Schedule 24 Finance Act 2007. It was evidently the *Bakers' Union* decision that those drafting paragraph 11 Schedule 24 had in mind (see the Drafting Notes to the Finance Bill 2007).

62. "Special circumstances" therefore means something more than circumstances that are simply unique or particular to the individual taxpayer. The correct test, therefore, is to determine whether the circumstances are "out of the ordinary, something uncommon." We also agree with the comments of the Tribunal in *Warren*:

> "53. …Plainly ["special circumstances"] 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. …They [i.e. special circumstances] must encompass the situation in which it would be significantly unfair to the taxpayer to bear the whole penalty."

63. The meaning of the expression "special circumstances", in the equivalent provisions of Schedule 24 Finance Act 2007, was also examined by the Tribunal in *Collis v Revenue & Customs* [2011] UKFTT 588 (TC) (Judge Berner and Mr Adams). The Tribunal said (at paragraph 40):

> "To be a special circumstance the circumstance in question must operate on the particular individual, and not be a mere general circumstance that applies to many taxpayers by virtue of the scheme of the provisions themselves."

64. We agree with the Tribunal's view on this point.

65. Applying these principles, it seems to us that the appellant's lack of awareness of the new penalty regime was its fault. HMRC made a number of efforts to contact the appellant by telephone, to warn it of its failure to pay its PAYE on time and, as we have found, mentioned the subject of penalties to Mr Jennings and Mr Noble. The downturn in the economy is a misfortune suffered by many businesses. In any event ability to pay cannot be taken into account by virtue of paragraph 9(2) (a). In short, there was nothing in the appellant's circumstances that seemed to us uncommon or out of the ordinary or which otherwise would make it an unfair for the appellant to bear the whole penalty.

66. Finally, we should observe that the limitation in paragraph 15(3)(b) on the Tribunal's jurisdiction in respect of an appeal in respect of the amount of the penalty raises questions in respect Article 6.1 of the European Convention on Human Rights. If, as we believe, the penalty in this case invokes the criminal head of Article 6.1(*Jussila v Finland* [2006] ECHR 73053/01 (2006) (A/73053/01)), the appellant's Convention rights entitle it to a fair hearing before a tribunal of full jurisdiction: see *Umlauft v Austria* [1995] ECHR 41, *Silvester's Horeca Service v Belgium* 47650/99 [2004] ECHR 97, *Segame SA v France* 4837/06 7 June 2012 and *A Menarini Diagnostics s.r.l. v Italy* 43509/0843509/08. As this Tribunal noted recently in *Jarvis v HMRC* TC/2012/00236:

> "If a penalty falls within the criminal head of Article 6.1 the Convention requires that the taxpayer should have access to a tribunal of full jurisdiction. In *Segame* the Court appears to have accepted a limitation on the principle established in *Silvester's Horeca*. If domestic law provides for a penalty at a fixed rate, the fact that a tribunal does not have discretion to reduce the rate set by the national legislature does not, of itself, prevent the tribunal being a tribunal of full jurisdiction. Provided that, otherwise, the tribunal has the power to determine all questions of fact and law and can substitute its own decision for that of the tax administration, and is not limited to a purely supervisory role (eg if the tribunal can intervene only where the decision is "unreasonable" in the *Wednesbury* sense), it will be a tribunal of full jurisdiction for the purposes of Article 6."

67. In the event, we have found that HMRC's determination was flawed, in the judicial review sense, and we were able to substitute our own decision for that of HMRC, finding that HMRC's original determination should be upheld. If, however, we had concluded that the decision was not flawed it would have been necessary for us to consider whether the limitation on this Tribunal's jurisdiction contained in paragraph 15(3)(b) could have been interpreted in a manner consistent with the appellant's Convention rights. The question, therefore, would be whether the Tribunal's power to intervene in relation to the amount of the penalty only where HMRC's decision was flawed meant that the Tribunal was not one of full jurisdiction. This seems to us a difficult question and, since it is unnecessary for our decision, we believe the issue should be left for another day.

Conclusions

68. In summary therefore we have decided that there was no reasonable excuse for the failure by the appellant to make its PAYE payments on time for the year 2010 – 2011. In addition, although HMRC's penalty decision was flawed because it failed to consider whether "special circumstances" existed, we have concluded that there were no "special circumstances" within the meaning of paragraph 9 of Schedule 56.

69. For these reasons, we dismiss this appeal.

70. 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.

GUY BRANNAN
TRIBUNAL JUDGE

RELEASE DATE: 20 July 2012