TC02211

Appeal number: TC/2012/00857

Income Tax; PAYE; Penalty for late payment; reasonable excuse; proportionality; Finance Act 2009, Schedule 56, para 16; Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

McTEAR CONTRACTS LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE J GORDON REID QC, FCIArb
Dr HEIDI POON, CA, CTA, PhD

Sitting in public at George House, Edinburgh on 10 July 2012

Karen Charnley, ACCA, WDM Chartered Accountants, Motherwell for the Appellant

William Kelly (HMRC) instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an Appeal against a penalty for late payment of PAYE (including associated Class I National Insurance Contributions). A Hearing took place at Edinburgh on 10 July 2012. Karen Charnley, ACCA of WDM, Chartered Accountants, Motherwell, appeared on behalf of the Appellant. She led the evidence of Mr and Mrs McTear, the Appellant's managing director and company secretary. William Kelly, the HMRC official representing the Respondents (the "Revenue"), led no oral evidence. He produced a bundle of documents, mainly correspondence and internal computerised records. There was no dispute about the authenticity of these records.

The Statutory Regime

2. Schedule 56 to the Finance Act 2009 contains a penalty regime for late implement of certain fiscal obligations. The Schedule, which has since been amended, came into force on 6 April 2010 by virtue of the Finance Act 2009, Schedule 56 (Appointed Day and Consequential Provisions) Order 2010 SI No 466, regulation 3(2)(a). The amendments to Schedule 56 were made by Schedule 11 to the Finance (No 3) Act 2010. Various parts of Schedule 11 were brought into force by the Finance (No 3) Act 2010, Schedule 11 (Appointed Day) Order 2011 SI No 132.

3. The relevant calculation for the purposes of this Appeal is set out in paragraph 6(6) of Schedule 56 (3% of the total amount of the defaults for 7, 8 or 9 defaults during the tax year). There is, in effect, a sliding scale of penalty charges, whereby the percentage of penalty increases in proportion to the number of defaults in a tax year, with the maximum being 4%. Provision is made for reduction of the penalty on the ground of special circumstances (paragraph 9) and for its suspension (paragraph 10). Liability can also be elided if the taxpayer establishes a reasonable excuse for the failure to make timeous payment (paragraph 16). Certain circumstances are deemed not to be a reasonable excuse (broadly, insufficiency of funds and reliance on a third party - paragraph 16(2)).

4. The effect of the Income Tax (Pay As You Earn) Regulations 2003 SI No 2682 (as read with the Income Tax (Pay As you Earn) (Amendment) Regulations 2012 SI No 822 regulation 27) is that PAYE payments have to be made on or before the 22nd day of the month of the relevant tax period (being 17 days after the 5th of the month) if payment is made electronically, and on or before the 19th day of that month (being 14 days after the 5th of the month) if payment is made by any other method. The penalties also covered associated Class I National Insurance Contributions in accordance with Regulation 67A of the Social Security (Contributions) Regulations 2001 SI 2001/1004, as added by the Social Security (Contributions)(Amendment No 4) Regulations 2010 SI 2010/721 part 2, regulation 3.

The Penalty

5. A penalty of £31,735.73 was imposed on the Appellant on 11 August 2011 under Schedule 56 to the Finance Act 2009, calculated at 4% of the aggregate amounts of the 10 defaults in the year. That sum was subsequently reduced on review to £29,700.53 conform to HMRC letter dated 25 November 2011. The reason for its reduction was two-fold. Firstly, it reversed a penalty on the P11D payment, which was paid on time. Secondly, the penalty for the month to 5 December was cancelled on account of a deferment agreement with HMRC reached on 14 December. The month 8 payment was received on 23 December before the agreed deferment date of 27 December.

6. The penalty assessment was further reduced by HMRC's letter of notification to the HM Courts & Tribunal Service dated 11 April 2011 to £16,360.49. following the effect of *Agar Ltd v RCC* 2011 UKFTT 773 (TC) at paragraphs 56-60, which found that payment falling due on 19 April 2011 to be a default for tax year 2011-12 and not 2010-11. As a result of month 12 dropping out of the default aggregate, the Appellant was assessed on 9 defaults instead of 10 and the relevant penalty percentage was reduced from 4% to 3%. The combined effect of month 12 being a significantly bigger payment (almost three times the monthly average for the year) and the penalty percentage reduction gives effect to the final assessment under appeal being almost half of the original.

These documents show that PAYE, due by the Appellant to the Revenue was paid late on ten occasions, generally by only a few days on each occasion. The first late payment does not *count* so there were only nine defaults which are relevant for the purposes of assessing the penalty. No point was taken about the effect of the revisions to the original penalty imposed.

Grounds of Appeal

7. In summary, these state that i) the consequences of late payment and the amount of penalties were not made clear; ii) the penalties were charged on a risk-assessed basis; iii) the penalty was disproportionate, based on the interest that would have been charged, iv) the Appellant relied on its book-keeper to make timeous payments; and v) the Appellant thought that it was paying on time and was unaware that penalties were being incurred when payments were late by only a few days.

Facts

8. The Appellant carries on business as electrical and plumbing contractors in the construction industry with an annual turnover of almost £8m. Mr McTear is effectively the principal of the business but he leaves the administration and book-keeping to his wife and to some extent Messrs WDM, who *inter alia* prepare monthly management accounts. Mrs McTear is the book-keeper, although she has no formal accounting or book-keeping qualifications. She takes responsibility for ensuring various payments are made to the Revenue by their due date.

9. The Appellant has about 80 employees (plumbers and electricians) with about ten apprentices. It also regularly engages the services of about 20 sub-contractors. The administrative staff comprises Mrs McTear, an office manager and an administrative assistant. Five of their employees are salaried and the rest are paid wages weekly.

10. The Revenue's records show that the Appellant has a history of numerous late payments (usually by a few days) of PAYE which is evident in the tax years 2007-2008, 2008-2009 and 2009-2010.

11. In recent years, the bulk of the Appellant's business has been with the construction company Carillion (in one of its manifestations) on one year contracts and with Centrica. More recently, they have engaged in local authority work. This has led to a more consistent and regular cash-flow.

12. The Appellant has had difficulty in obtaining full and timeous payment from Carillion. This problem seems to have subsisted for some time and seems to have come to a head in about January 2011. In a letter dated 26 June 2012 to Carillion, the Appellant asserted the wrongful withholding of monies, failure to pay for variations, erroneous deduction of main contractor's discount, failure to release contractual retention, a claim for interest, and a claim for loss and expense. The sum due by Carillion was said to be about £450,000. Carillion have offered only £100,000. We cannot determine whether any of these claims is well founded, when these claims arose, when the sums claimed ought to have been paid or how all this affected the Appellant's finances and cash-flow. However, they seem to be the familiar type of dispute and raise the sort of difficulties frequently encountered by a sub-contractor in the construction industry.

13. Mrs McTear was contacted on 25 May 2010 by the Revenue. She was informed that the PAYE payment was overdue. A standard warning letter was sent to the Appellant on or about 28 May 2010. The Revenue attempted to make telephone contact with the Appellant in June, July and August 2010, but for one reason or another, the Appellant did not respond. Contact was made with Mrs McTear on 14 December 2010; various arrangements were agreed and the PAYE payment for that month, though received on 23 December, was disregarded as a default on the grounds of the deferment agreement reached on 14 December. Four warning letters were sent to the Appellant in the course of the tax year 2010/2011; there was no response to a further attempt to contact the Appellant by telephone in March 2011.

14. With the exception of the communication in December 2010, at no other stage throughout the tax year 2010-2011 did the Appellant contact the Revenue with a view to making arrangements to defer payment of PAYE from time to time. The Revenue operates such arrangements in appropriate circumstances.

15. In about February 2011, the Appellant entered into a *time to pay* arrangement in relation to outstanding corporation tax. Two cheques were paid in June and July 2011, amounting in total to about £209,000. This included certain PAYE liabilities but did

not include the amount due under the penalty regime, although the Appellant may have been under the mistaken impression that it did.

16. Employer Bulletins have been regularly issued to employers such as the Appellant both before and after the coming into force of the Schedule 56 penalty regime explaining it at length in reasonably clear terms including how penalties are triggered and calculated, the dates for payment, bank clearing times which should be allowed to ensure these dates are met, and the arrangements which might be made if an employer is experiencing problems in paying, together with an explanation as to how to appeal.

17. In a Budget Release Note (BN90) dated 22/4/09, the Revenue explained that implementation of the new penalty regime would be based on a *risk based approach from April 2010* (paragraph 8).

18. In correspondence with the Revenue, WDM asserted that (i) the Appellant thought that it was paying on time by BACS payments on the 22nd of the month, (ii) the Appellant had cash flow problems with an overdraft facility of £115,000 against its turnover of about £8m, (iii) Mr and Mrs McTear injected substantial funds into their company, and (iv) oversight by the Appellant's book-keeper ie Mrs McTear. In fact, the Appellant did not make payments through BACS. They paid by cheque or through the more expensive CHAPS system.

Submissions

19. Ms Charnley for the Appellant submitted that the insufficiency of funds caused by Carillion and Centrica amounted to a reasonable excuse. Carillion simply did not pay when they said they would. The Appellant was not being paid on time by its debtors so it could not pay the Revenue on time. Under reference to *Agar* paragraphs 52-54, she submitted that the Appellant was genuinely trying to pay and should not have been on the Revenue's list of defaulters.

20. She submitted that the penalty was disproportionate and amounted to interest on the overdue payments for the periods they were overdue (usually for a few days only) at an average rate of 247%. She did not challenge the due dates or the actual dates on which payments were said to have been made.

21. Mr Kelly took us through the bundle. He submitted the Revenue had discharged the onus of showing that the penalty had been triggered; the *onus* was now on the Appellant to establish a reasonable excuse. He submitted that, having regard to the correspondence and the Revenue's internal records, there was no basis for the Appellant being unaware that penalties would be imposed for late payment of PAYE or for this having come as a surprise to the Appellant. He pointed out, correctly, that contrary to what was said in the correspondence on behalf of the Appellant, no payments were made by the BACS system, which takes about three days; they were paid by cheque or through the CHAPS system, which is a same-day service but which is relatively expensive.

22. In response to the assertion that the penalty was disproportionate, he pointed out the amount of the penalties is progressive; habitual offenders were charged at a higher rate. The penalty takes account of the number of defaults and the amounts paid late. The regime was designed to have a deterrent effect and was not to compensate for the loss of use of money during the (late) period of non-payment.

23. Reliance on a book-keeper, Mr Kelly submitted, was not a reasonable excuse. There were no special circumstances within the meaning of Schedule 56 paragraph 9; he referred to *Clarks of Hove Ltd v Bakers' Union* 1978 1 WLR 1207 (an employment case on the failure to consult before making employees redundant) for the meaning of *special circumstances* (something out of the ordinary run of events - per Geoffrey Lane LJ at 1216A) followed in *White v RCC* 2012 UKFTT 364 (TC) at paragraphs 52-54.

Discussion

24. The evidence of Mr and Mrs McTear can best be described as somewhat chaotic, unstructured and in places inconsistent. While they may have been doing their best to tell the truth we cannot regard all their evidence as reliable. In general, it lacked detail, was difficult to follow and was unsupported by any significant documentation.

25. Overall, it seemed quite clear on the evidence that the nine defaults on which the penalty has been calculated arose by reason of administrative inefficiency. Most payments were late by only a few days. This seems to have arisen because Mrs McTear failed to appreciate how long it would take for payments to clear through the banking system. If she is being blamed, this is not a reasonable excuse as the Appellant itself cannot be said to have taken reasonable care to avoid the failure to pay in time (Schedule 56 paragraph 16(2)(b)). Insofar as the Appellant founds on the fact that it or its officers did not appreciate the consequences of late payment, that is tantamount to saying that ignorance of the law is a good excuse. That cannot be accepted.

26. The evidence demonstrates that there was no general insufficiency of funds (which is not a reasonable excuse anyway). Rather, there was a failure to organise the financial affairs of the Appellant either through short-term overdraft or otherwise to accommodate the uncertainty about the dates when the Appellant's debtors paid their accounts, and in particular their key customer at the time, Carillion. This is a problem common to many businesses. It is not possible to know with certainty when a debtor will pay. No doubt there are *due dates* for payment. But universal commercial experience informs any reasonably prudent trader that he cannot always rely on particular debtors paying particular sums on particular dates. This is especially so in the construction industry where monthly payments throughout the duration of a contract (particularly one which endures for a year or more as the Appellant's contracts with Carillion did) are often based on interim valuations ascertained through the judgment of a contract administrator. These valuations are frequently the matter of dispute, particularly where a contractor claims for the cost of variations and loss and expense for delay and/or disruption. The quality of workmanship and the

entitlement of the employer or main contractor to retain funds may also be in issue. Even at the end of a contract it can take a very long time for a final account to be settled.

27. Part II of the Housing Grants, Construction and Regeneration Act 1996 was intended to provide a speedy, temporary remedy to the sort of cash-flow problem encountered by contractors in the construction industry in the circumstances described above. The Appellant has not apparently pursued the statutory adjudication process, which can be quick and effective. However, the Tribunal acknowledges that for a contractor such as the Appellant to challenge a giant in the construction industry such as Carillion at adjudication would, in reality, be a somewhat daunting task.

28. No separate argument was advanced on behalf of the Appellant based on special circumstances. The proportionality argument was not developed beyond the calculation of interest referred to above. There is nothing in the legislation, evidence or in the submissions which enables us to conclude that the penalty regime is disproportionate, whatever the Appellant's representative intended that much used word to mean. The penalty regime has been enacted by Parliament in an area where it has a very wide discretion. Arguments based on proportionality have been rejected in a number of other cases to which we were not referred (see for example *Dina Foods Ltd v RCC* 2011 UKFTT 709 (TC) paragraphs 41-42 (a PAYE case)*;* and *SLBT Ltd* 2012UKFTT 422 (TC) at paragraphs 25-27 (also a PAYE case). In these circumstances, it is not for this Tribunal to embark on its own detailed analysis of the case law without the assistance of the parties. We reserve our judgment on whether, if the penalty could be described as disproportionate, that indicates or might indicate the presence of *special circumstances* justifying a reduction by the Tribunal. Moreover, any finding that the penalty was not proportionate, could only lead to a declaration of incompatibility. The position is different where VAT is concerned. That is a fiscal regime within the competence of the European Union. By Article 6(3) TEU, Convention rights constitute general principles of European Union law. Accordingly, if a VAT penalty regime conflicts with the principle of proportionality whether as a violation of Convention rights or the general European law principle of proportionality (cf *Enersys Holdings Ltd v RCC* 2010 UKFTT 20 (TC), then a court or tribunal would be bound to disapply UK law which is incompatible with a taxpayer's rights under the law of the European Union.

29. Insofar as the Appellant may be arguing that the Revenue were acting unfairly, whether generally or because the Appellant has been selected as a regular defaulter, the facts show that this argument cannot be accepted. Several letters were written to the Appellant about late payment. There is no statutory obligation on the Revenue to warn the taxpayer that a penalty has been triggered in the course of the tax year in question. The penalty calculation cannot be made until the end of the tax year. Numerous attempts to contact the Appellant were made by telephone and the penalty regime was well publicised before and after its inception. The Revenue, having regard to the Appellant's payment history, was plainly entitled to consider imposing a penalty on them.

30. Whatever may be the nature and scope of a public body's duty to act fairly in its decision making processes and in the administration of its statutory powers (cf *Agar* at paragraphs 42-50; *HMD Response International v HMRC* 2011 UKFTT 472 at paragraph 18) the facts do not provide a platform for such arguments in this Appeal.

Result

31. While we have a certain degree of sympathy for the Appellant, there is no basis on the material and submissions presented to us on which the Appeal can, to any extent, be allowed. The Appeal is therefore dismissed.

32. 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.

J GORDON REID QC, FCIArb
TRIBUNAL JUDGE

RELEASE DATE: 22 August 2012