[2013] UKFTT 065 (TC)

TC02485

Appeal number: TC/2012/00556

INCOME TAX - Penalty - late payment of PAYE and NICs - FA 2009, Schedule 56 - Whether an insufficiency of funds was a reasonable excuse for late payment - no - whether lack of specific warning a reasonable excuse – no- whether any special circumstances existed to justify a reduction in the penalty amount - no - whether the penalty was disproportionate - no appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

WESTSIDE PUBLICATIONS LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE MICHAEL S CONNELL
ANN CHRISTIAN

Sitting in public at City Exchange, 11 Albion Street, Leeds LS1 5ES on 9 July 2012

Mr. J Murphy Director of the Company and Mr. Halliday Accountant for the Appellant

Miss Lisa Taylor Officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal against a penalty assessment (as amended) of £4,619.63 imposed under Schedule 56 of the Finance Act 2009 ("Schedule 56") in respect of the late payment by the Appellant of monthly payments of PAYE and National Insurance contributions ("NICs") in months of the year ending 5 April 2011.

2. The Appellant did not pay PAYE and NIC on time in eight of the months in the year 2010 – 11. HMRC originally incorrectly imposed penalties which were not due, either because of a misallocation of payments or because a time to pay arrangement was in place. Once these had been corrected, the dates and amounts of the PAYE payments due and made were not in dispute apart from month two when the Appellant said a time to pay arrangement existed. This appears to be confirmed by HMRC's summary of defaults in the document bundle produced to the Tribunal. The total amount of defaults was £153,987.15 and because there were eight defaults during the tax year that counted towards the penalty, the penalty rate was assessed at 3% of that amount. The appeal was mainly based on "reasonable excuse", and that the penalties were unfair and excessive. The Appellant argued that the reason for late payments was insufficiency of funds and that the insufficiency was attributable to events outside its control.

Background

3. The Appellant has 35 employees and operates as part of the Regional Magazine Company specialising in publishing, editorial design and local advertising in the form of books and magazines. It sells to retailers and other businesses.

4. From 6 April 2010, a new penalty regime was introduced by HMRC for late payment of monthly PAYE and NIC by employers. Previously, there was a mandatory electronic payment surcharge on large employers (those with over 250 employees). The surcharge ranged from 0% to 0.83% of the amount paid late and depended on the number of defaults in any one year. It was therefore possible for many employers to delay payments to HMRC without incurring any material costs. Under Schedule 56 Finance Act 2009, however, this possibility was removed. Schedule 56 imposes penalties for late payment of PAYE. The legislation in relevant part is set out in below.

5. The penalties under Schedule 56 are based on a sliding scale as shown in the table below. The penalty varies as provided by paragraph 6, subparagraphs (4) to (7). The first default in any year is disregarded altogether. The remaining defaults trigger a penalty of 1%, 2%, 3% or 4% depending on their number. A 4% penalty is payable if there are ten or more defaults during the tax year.

No of failures	Penalty
1	no penalty providing the payment is less than six months late
2-3	1%
4-6	2%
7-9	3%
10 or more	4%

The penalty will not be levied if a) a time to pay agreement had been agreed in advance of the due date(s), b) if there are "special circumstances in terms of paragraph 9 Schedule 56 or c) if the Appellant can establish that there was a reasonable excuse for each or any default.

6. HMRC produced for the hearing, a table showing the amounts of PAYE and NIC due for each of the relevant months, the penalty trigger date for each month, the date that payment was made for each of the months, and number of days that the payment was late in each of the 8 months in which payment was said by HMRC to have been late. The amounts, the due dates, the actual payment dates and the penalty amounts charged are set out in the table below.

PAYE and NIC Due and paid late	Due Date	Payment Date	Days Late	Penalty @ 3%
£21,490.30	19.05.2010	2010	18	£0
£16,780.15	19.06.2010	2010	12	£503.40
£6712.06	19.07.2010	2010	TTP	£0
£0	19.08.2010	2010	0	£0
£18,851.71	19.09.2010	2010	3	£565.55
£19,598.89	19.10.2010	2010	7	£587.97
£20,646.21	19.11.2010	2010	5	£619.39
£20,729.22	19.12.2010	2011	17	£621.88
£18,514.97	19.01.2011	2011	7	£555.45
£19,873.17	19.02.2011	2011	12	£596.20
£18,992.84	19.03.2011	2011	19	£569.79
£0	19.04.2011	2011		
£153,987.15		TOTALS		£4619.61

7**.** HMRC assessed the penalty at the 3% and notified it to the Appellant in a letter dated 10th of August 2011. A revised assessment and was issued on 24th of September 2011 and a further revised assessment on 24 November 2011. Following a review and after the Appellant had appealed to the Tribunal on 24th of December 2011, HMRC issued a final confirmation of the penalty 10th of May 2012.

8. Some of the arguments in the Appellant's Notice of Appeal were superseded by HMRC's final reduced penalty assessment. The Appellant's grounds of appeal, so far as relevant to the revised assessment were:

1. In respect of month 2 a time to pay arrangement (TTPA) existed. The Appellant says that HMRC incorrectly allocated a time to pay payment against a separate liability as opposed to the TTPA to which it actually related. The Appellant disputes that the time to pay arrangement was not adhered to, as argued by HMRC and in particular that they had not received any notification from HMRC that the agreement had been breached. There was also a dispute over the penalty imposed in respect of month 12 but following the decision in *Agar* (see below), to the effect that month 12 falls in the following tax year, HMRC agreed that no penalty was due for that month.
2. The Appellant was never informed by HMRC that penalties would be raised in respect of the late payments despite the fact that during the default period there was ongoing

dialogue between the Appellant and HMRC. The Appellant also denied having received HMRC's initial letter of 28 May 2010, following the first default, warning of the possibility of penalties.

3. The fines are unjust, punitive and excessive particularly for some of the months in which penalties were raised given the relative modest delays in payment. The Appellant also submits that the fines are disproportionate.

4. The Appellant says that in almost every month in the PAYE default year it had had numerous discussions with the local tax office either in connection with the time to pay arrangements or to give assurances that the PAYE and NIC would be paid, albeit some days late. The Appellant says this caused the management to believe that HMRC acknowledged the Appellant's trading difficulties and that the PAYE and NIC would eventually be paid.

The legislation

9. The relevant legislation is contained in Finance Act 2009, Schedule 56.

Paragraph 1 of Schedule 56 states as follows:

'(1) A penalty is payable by a person ("P") where P fails to pay an amount of tax specified in column 3 of the Table below on or before the date specified in column 4.

(2) Paragraphs 3 to 8 set out—

(a) the circumstances in which a penalty is payable, and

(b) subject to paragraph 9, the amount of the penalty.

(3) If P's failure falls within more than one provision of this Schedule, P is liable to a penalty under each of those provisions.

(4) In the following provisions of this Schedule, the "penalty date", in relation to an amount of tax, means the date on which a penalty is first payable for failing to pay the amount (that is to say, the day after the date specified in or for the purposes of column 4 of the Table)'.

10. The table lists numerous various categories of taxes of which those referred to in items 1 and 2 (as shown in the extract from the Table below) are relevant to this appeal.

	Tax to which payment relates	*Amount of tax payable*	*Date after which penalty is incurred*
PRINCIPAL AMOUNTS			
1	Income tax or capital gains tax	Amount payable under section 59B(3) or (4) of TMA 1970	The date falling 30 days after the date specified in section 59B(3) or (4) of TMA 1970 as the date by which the amount must be paid
2	Income tax	Amount payable under PAYE regulations ...	The date determined by or under PAYE regulations as the date by

			which the amount must be paid
3	Income tax	Amount shown in return under section 254(1) of FA 2004	The date falling 30 days after the date specified in section 254(5) of FA 2004 as the date by which the amount must be paid

11. Regulations 67A and 67B of the Social Security Contributions Regulations (SI 2001/1004 as amended) provide that Schedule 56 applies also to Class 1 National Insurance contributions as if they were an amount of tax falling within item 2 of the above Table, and to Class 1A and Class 1B National Insurance contributions as if they were an amount of tax falling within item 3 of the above Table.

12. Paragraph 5 of Schedule 56 states that paragraphs 6 to 8 of Schedule 56 apply in the case of a payment of tax falling within item 2 or 4 in the Table.

13. Paragraph 6 of Schedule 56 states as follows:

(1) P 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);

(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.

14. Paragraph 9 of Schedule 56 allows HMRC to reduce a penalty if special circumstances exist.

Paragraph 9 states as follows:

(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.

15. Paragraph 10 of Schedule 56 states as follows:

(1) This paragraph applies if--

(a) P fails to pay an amount of tax when it becomes due and payable,

(b) P makes a request to HMRC that payment of the amount of tax be deferred, and

(c) HMRC agrees that payment of that amount may be deferred for a period ("the deferral period").

(2) If P would (apart from this sub-paragraph) become liable, between the date on which P makes the request and the end of the deferral period, to a penalty under any paragraph of this Schedule for failing to pay that amount, P is not liable to that penalty.

(3) But if--

(a) P breaks the agreement (see sub-paragraph (4)), and

(b) HMRC serves on P a notice specifying any penalty to which P would become liable apart from sub-paragraph (2),

P becomes liable, at the date of the notice, to that penalty.

(4) P breaks an agreement if--

(a) P fails to pay the amount of tax in question when the deferral period ends, or

(b) the deferral is subject to P complying with a condition (including a condition that part of the amount be paid during the deferral period) and P fails to comply with it.

(5) If the agreement mentioned in sub-paragraph (1)(c) is varied at any time by a further agreement between P and HMRC, this paragraph applies from that time to the agreement as varied.

16. Paragraph 11 states in mandatory terms that HMRC must levy a penalty where P is liable:

11(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.

17. Paragraphs 13-15 of Schedule 56 provide for appeals to the Tribunal against a decision of HMRC that a penalty is payable, or against a decision by HMRC as to the amount of the penalty that is payable. The Tribunal's powers are laid down in paragraph 15:

15(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)).

18. As observed in *Dina Foods Limited*, [TC01546] under paragraph 15 the Tribunal is given power:

> 'to confirm or cancel the penalty, or substitute for HMRC's decision another decision, but only one that HMRC had the power to make. The Tribunal can only rely upon the "special circumstances" provision in paragraph 9 to a different extent than that applied by HMRC if it thinks that HMRC's decision in that respect was flawed. Applying judicial review principles, the Tribunal must consider whether HMRC acted in a way that no reasonable body of commissioners could have acted, or whether they took into account some irrelevant matter or disregarded something to which they should have given weight. The Tribunal should also consider whether HMRC have erred on a point of law.'

19. Under paragraph 16 of Schedule 56, the Appellant may escape liability for a penalty if the Tribunal is satisfied that there was a reasonable excuse. Paragraph 16 was amended by Schedule 11 of the Finance (No 3) Act 2010 (c,33). As originally drafted, paragraph 16 provided that liability to a penalty did not arise in relation to any failure for which there was a reasonable excuse. In the amended version, the paragraph also went on to say: "the failure does not count as a default for the purposes of paragraph 6...". The effect of this change is therefore that under the amended legislation, it is clear that defaults for which there is a reasonable excuse are not to be counted when fixing the appropriate rate of penalty to be charged.

Paragraph 16 of Schedule 56 states 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 paragraph 6 ...

(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.

20. In considering a reasonable excuse the Tribunal examines the actions of the Appellant from the perspective of a prudent tax payer exercising reasonable foresight and due diligence and having proper regard for its responsibilities under the Taxes Acts.

21. The operation of Schedule 56 was considered in *Dina Foods*. It was observed that:

'(1) the legislation became operative with a commencement date of 6 April 2010, so that the first time penalties could be raised under these rules was after the end of the 2010/11 tax year, given the way that the penalties talk in terms of the number of defaults during the year in question (at [11]);

(2) except in the case of special circumstances, the scheme laid down by the statute gives no discretion: the rate of penalty is simply driven by the number of PAYE late payments in the tax year by the employer (at [31]);

(3) the scheme of the PAYE legislation requires taxpayers to pay over PAYE on time; the legislation does not require HMRC to issue warnings to individual employers, though it would be expected that a responsible tax authority would issue general material about the new system (at [33]);

(4) lack of awareness of the penalty regime is not capable of constituting a special circumstance; in any event, no reasonable employer, aware generally of its responsibilities to make timely payments of PAYE and NICs amounts due, could fail to have seen and taken note of at least some of the information published and provided by HMRC (at [37]);

(5) 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 not of itself capable of amounting either to a reasonable excuse or special circumstances (given that there is no separate penalty for each individual default, and 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) (at [38]-[39]);

……

Evidence and submissions

22. HMRC's bundle of documents included copies of correspondence, computerized records of telephone attendance notes and HMRC notices, together with the materials by which the new penalty system had been publicised.

23**.** It was not in dispute that the Appellant was required throughout the relevant year to make monthly payments of PAYE and NICs by the 19th day of each month. Nor was there any dispute between the parties as to the amount of PAYE and NIC required to be paid by the Appellant in each of the months in question apart from month 2. It was otherwise accepted by the Appellant that each of the payments in respect of which a penalty has been imposed was indeed late. There was also no dispute as to the method of calculation of the penalties apart from the potential application of paragraphs 9 and 16 of Schedule 56.

24**.** HMRC produced for the hearing a revised penalty notice dated 10 May 2012. This revised penalty notice revised the amount of the penalty previously imposed to take account of corrections that were necessary and the decision in *Agar Ltd v Revenue & Customs* [2011] UKFTT 773 (TC). The revised penalty was calculated on the basis that the effect of *Agar* is that the 12th penalty should not have been included in the penalty notice, as the Appellant did not become liable to it until after the end of the tax year in question. Consequently the original penalty total of £6,223.26 was reduced to £4,619.61

The Appellant's submissions

25. Mr. Murphy said that monthly reminders issued in respect of late payments never mentioned either that penalties had already been incurred or that penalties would accumulate both in terms of the number and percentage rate of penalty. He said that he was totally unaware that the PAYE penalty regime had changed and considered it extremely unfair that HMRC never mentioned this fact once, in all the conversations they had. Mr. Murphy argues that HMRC would have known, at the time of the first late payment which counted as a default, that there would be a penalty. He therefore argues that HMRC should at that time, have informed the Appellant that a penalty had been incurred and that any further defaults would incur penalties. He said that in phone calls, HMRC only ever mentioned that they had the right to impose penalties, they were never told then that penalties *would* be imposed. Mr. Murphy stressed that the company had never received HMRC's notification of 28 May 2010.

26. Mr. Murphy acknowledged that HMRC did not have a duty to warn taxpayers of a change in the PAYE penalty regime. However, he said that because HMRC never mentioned penalties even though they were being incurred on a monthly basis, this was tantamount to acquiescence or possibly deliberate non-disclosure which plainly made the penalties unfair. HMRC's tacit acknowledgement that the Appellant was suffering financially and the fact that penalties were not imposed and pursued until after the year-end was also unfair, given that HMRC under legislation had an obligation to raise penalties. He said that he was aware of the old penalty system but totally unaware of the new penalty regime and its severity. He accepted that he had received notices and reminders from HMRC but assumed that because he was in constant dialogue with HMRC and because the Appellant was making regular but late payments of PAYE, there was no problem. He said that in all his conversations with HMRC they seem to understand the difficulties and never once mentioned that substantial penalties would be payable at the end of the year or that the penalties would be based on the number of defaults. He says that had he know this he would may have considered introducing capital into the company from the directors own personal resources.

27. Mr. Murphy also argued that the Appellant should be relieved of the penalties by reason of having a reasonable excuse for the default. The reasonable excuse on which he seeks to rely is that the Appellant was suffering from a severe shortage of funds during the relevant period, attributable entirely to events outside its control. He referred to the case of *C and E Commissioners v JB Steptoe*, and a number of First-Tier Tribunal decisions (which are not binding on this Tribunal) where the appeal had been allowed because of exceptional trading conditions faced by traders in securing overdraft or other similar facilities from their banks; [*Dudman Group Limited; Northern Bulk Transport Ltd HS, CM Electrical Ltd*]. Mr. Murphy said that the Appellant suffered a 10% reduction in sales and incurred over 48 bad debts which resulted in over £50,000 being written off. He said that the proprietors of the company had tried their best but that at the beginning of the 2010 tax year the company was suffering from very difficult trading conditions. In March 2011 the Appellant was finally able to secure the overdraft which it had been promised in May 2010. Various options were discussed with the Appellant's bankers, which included large redundancies or downsizing. He was eventually able to agree a £225,000 overdraft but only after the directors gave personal guarantees to the bank. He said that unfortunately in April 2010 the bank manager was moved to another branch and the conclusion of formalities for the overdraft with the new bank manager took an inordinate length of time, putting further pressure on the business. Financial pressures increased when the cost of raw materials rose and suppliers reduced their usual 90 day terms to 60 days under pressure from their own bankers. In the event the Appellant was able to agree with their suppliers that prices be

put on hold for a period of one year which helped them to get through the crisis. The £225,000 overdraft was eventually secured in April 2011 and it was around this time that the Appellant was able to start paying its PAYE and NIC on time.

28. Mr. Murphy argues that when he spoke to HMRC on 30.06 2010 a time to pay arrangement was agreed with HMRC for months 2 and 3 of 2010. He said that this was clearly evidenced in HMRC's own records of telephone conversations with the Appellant.

29. Mr. Murphy asserted that the penalties were unfair. He referred to the case of *Hok*. This case was decided by the First Tier Tribunal and supported the argument that HMRC have a common law duty to act fairly and not unconscionably in the raising of penalties. He argued that it is inherently wrong for HMRC to delay raising penalties, when clearly aware of defaults, in the knowledge that any further defaults would have the effect of increasing the percentage rate of penalty to the detriment of the Appellant.

30. Finally, Mr. Murphy said that in all the circumstances the penalties were punitive, excessive and totally disproportionate.

HMRC's submissions

31. Miss Taylor submitted that the Appellant had no reasonable excuse for the late payment of the PAYE. She submitted that under paragraphs 11 of Schedule 56 HMRC had no discretion as to the imposition of the penalty. She submitted that the amount of the penalty was set down in paragraph 6 of Schedule 56 and if the tax payer paid late HMRC were obliged to impose a penalty. She said that in the first year of the penalty regime HMRC had targeted taxpayers who were the most persistent defaulters. This was what was meant by the selection of taxpayers on a risk-assessed basis. In the tax year 2008 – 09 the Appellant had defaulted in every month. In the tax year 2009 – 10, the Appellant defaulted in every month. The default period was on average between 20 and 50 days. In 2011–12 the Appellant was late only for the first four months. After that, there had been no defaults.

32. Miss Taylor submitted that lack of awareness of the penalty regime was not a special circumstance. She said that HMRC publicised the late payment penalties for PAYE and NICs extensively both before and after they came into effect. An employer pack including a CD-ROM was mailed to all employers in February 2010, flyers were mailed to employers and factsheets were distributed at face to face events (such as "Employer Talk" and published on the HMRC website). Late payment penalties also featured in issues of Employer Bulletin, on the PAYE pages of the website (and on a podcast), on Businesslink and in published guidance and employer help books. There was also communication with accountants and other tax agents, and publication in local and national media. HMRC's Employer Bulletins refer employers to HMRC's website.

33. Miss Taylor said that the Appellant was sent a letter on 28 May 2010 advising that the payment had been late, that any further late payments may incur a penalty, and giving an internet address at which further information about the penalty regime could be found. She said the website makes the deadlines for payment quite clear. The website says:

> 'PAYE/Class 1 NICs electronic payment deadline
>
> Your cleared payment must reach HMRC's bank account no later than the 22nd of the month following the end of the tax month or quarter to which it relates.

PAYE/Class 1 NICs postal payment deadlines

.....please ensure your cheque reaches HMRC no later than the 19th of the month following the end of the tax month or quarter to which it relates.'

34. Miss Taylor said that there appeared to be some confusion as to whether there had been a time to pay arrangement in month 2. She agreed that the Appellant had requested time to pay months 2 and 3 when they spoke to HMRC on 30th of June 2010, but that because the request in respect of month 2 was made after the date on which the PAYE fell due, a TTPA could not be agreed and that therefore the TTPA could only apply to month 3.

Conclusion

35. At the end of the hearing the Tribunal reserved its decision which now follows.

36. The adverse trading circumstances affecting the Appellant were not in dispute. We accept that the Appellant's late payments were almost entirely due to cash flow pressures on its business and the difficulties it encountered with its bank. However as clearly stated in paragraph 6(2)(a) of Schedule 56, an insufficiency of funds does not qualify as a reasonable excuse. An inability to pay does not represent *special circumstances* which might justify a reduction in a penalty. An exceptional or unforeseen event which caused the insufficiency of funds may to amount to a reasonable excuse but on the facts of this appeal there was no such event. Something specific and related to the particular taxpayer is required. Adverse economic conditions and particularly late payments by customers or stricter credit terms which happen on a regular basis do not suffice. There were no unusual or exceptional circumstances which might have caused the insufficiency of funds save perhaps for the delays relating to the overdraft. Since the imposition of the penalties, the Appellant's PAYE and NIC have been paid on time which clearly suggests that the Appellant could have put in place measures earlier than they did to ensure that PAYE was paid on time. As Mr. Murphy said during the hearing, if they been fully aware of the new penalty regime, the proprietors would have considered injecting their own capital into the company. This was therefore clearly an option which the proprietors could have considered.

37. HMRC were not under any statutory duty to warn the Appellant of the change in the penalty regime and the potential penalties. The legislation does not require HMRC to issue warnings to individual employers. It is settled law that that any failure by HMRC to give warning of the penalty regime, cannot provide a reasonable excuse. The obligation is to make payment by the due date – see *Rodney Warren & Co* [2012] UKFTT 57 (TC) and *Dina Foods Limited* above.

38. The Tribunal is satisfied that there was an extensive campaign of advance publicity and that there was no reason why Appellant should not have been sufficiently alerted. The Appellant's apparent lack of awareness of the new penalty regime is not capable of constituting a special circumstance or reasonable excuse.

39. The Appellant received an initial Penalty Default Warning letter in May 2010 (which explained about time to pay arrangements) and numerous enforcement warning letters. The Appellant says that it did not receive this letter. However, it was correctly addressed and, our finding is that the company must have received the letter. In any event the Appellant should have been aware of the change in legislation and the prospect of penalties in the event of any default of its obligation to pay PAYE and NIC on time. There was a considerable amount of contact with HMRC throughout the year about late payments of PAYE. There were several telephone conversations and meetings with representatives of the company. A reasonably prudent

employer, aware of its responsibilities to make timely payments of PAYE and NICs amounts, would have been prompted to make enquiries of HMRC to ascertain the cause of the problem and obtain information about the penalty regime.

40. On the evidence, we accept that in letters and telephone conversations which followed the initial warning letter, the Appellant was not told in unequivocal terms that it had already incurred penalties. As the Appellant says, had HMRC informed the Appellant that a penalty or penalties had already been incurred following the first late payment that counted as a default, steps could have been taken to reduce or eliminate the possibility of further defaults. Nonetheless this does not absolve the Appellant of its obligations to pay PAYE on time and it's liability to penalty in the event of default.

41. It is only when the end of the tax year has elapsed that HMRC can consider whether a penalty (or penalties) has been triggered and only then can they consider, whether special circumstances exist or whether there is a reasonable excuse for late payment.

42. In *Dina Foods*, at [40]-[42], the Tribunal considered whether the penalty was disproportionate, and said as follows:

> '40. In its initial appeal letter and in its formal notice of appeal, the company referred to the penalty being excessive. It is clearly not excessive on the terms of Schedule 56 itself because the system laid down prescribes the penalties. Nonetheless, whilst no specific argument was addressed to us on proportionality, we have considered whether, in the circumstances of this case, the 4% penalty that was levied on the total of the relevant defaults in the tax year can be said to be disproportionate.
>
> 41. The issue of proportionality in this context is one of human rights, and whether, in accordance with the European Convention on Human Rights, Dina Foods Ltd could demonstrate that the imposition of the penalty is an unjustified interference with a possession. According to the settled law, in matters of taxation the State enjoys a wide margin of appreciation, and the European Court of Human Rights will respect the legislature's assessment in such matters unless it is devoid of reasonable foundation. Nevertheless, it has been recognised that not merely must the impairment of the individual's rights be no more than is necessary for the attainment of the public policy objective sought, but it must also not impose an excessive burden on the individual concerned. The test is whether the scheme is not merely harsh but plainly unfair so that, however effectively that unfairness may assist in achieving the social objective, it simply cannot be permitted.
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> 42. Applying this test, whilst any penalty may be perceived as harsh, we do not consider that the levying of the penalty in this case was plainly unfair. It is in our view clear that the scheme of the legislation as a whole, which seeks to provide both an incentive for taxpayers to comply with their payment obligations, and the consequence of penalties should they fail to do so, cannot be described as wholly devoid of reasonable foundation. We have described earlier the graduated level of penalties depending on the number of defaults in a tax year, the fact that the first late payment is not counted as a default, the availability of a reasonable excuse defence and the ability to reduce a penalty in special circumstances. The taxpayer also has the right of an appeal to the Tribunal. Although the size of penalty that has rapidly accrued in the current case may seem harsh, the scheme of the legislation is in our view within the margin of appreciation afforded to the State in this respect. Accordingly we find that no Convention right has been infringed and the appeal cannot succeed on that basis'.

We agree with the observations made in *Dina Foods* as set out above. The principles were endorsed by the recent Upper Tribunal decision in *Total Technology (Engineering)*. We do not consider the penalties to be disproportionate to the defaults involved.

43. As stated in *Dina Foods*, the penalty regime may be harsh in order to act as a deterrent, but it is not "unfair". The penalty scheme as laid down by the statute provides no discretion (except where "special circumstances" apply, which was not suggested here). The penalty rate rises in accordance with the incidence of default and is a fixed percentage. The penalty cannot be excessive where it was correctly assessed and calculated. We therefore follow *Dina Foods Limited*, at [40] to [42], and *Agar* at [46] and find that the penalties raised were not disproportionate.

44. The Tribunal's jurisdiction on appeal against fixed penalties was considered by the Upper Tribunal in *Hok Ltd*, where it was confirmed that the Tribunal's power is limited to correcting mistakes. It may decide that HMRC were wrong in deciding that a penalty was due and discharge it; or it may decide that HMRC imposed a penalty of the wrong amount, and replace it with the correct amount. However, the Tribunal does not have a power to substitute an amount other than the correct amount, whether on the basis of fairness or otherwise. Thus if HMRC have imposed a penalty in circumstances where one is due, and the penalty imposed is of the correct amount, there is nothing the Tribunal is permitted to do. No such power is granted by the statute and none arises under the general or common law. Similarly with regard to the possible existence of 'special circumstances' although s9 states that HMRC 'may' reduce a penalty, thus affording the Commissioners some discretion, there is no mechanism by which the Tribunal may review the exercise of that discretion. The discretion to mitigate a penalty is conferred on HMRC, but not on the Tribunal, and the legislation does not provide any mechanism by which the refusal of HMRC to exercise that discretion under s 9 may be challenged before the First-tier Tribunal.

45. For the above reasons the Tribunal finds that the Appellant has not established a reasonable excuse for any of the late payments, or that there were special circumstances justifying a mitigation of the penalty. The penalty was not disproportionate and the administration of the penalty regime was not unfair to the Appellant. It therefore follows that the appeal must be dismissed and the penalties confirmed.

46**.** 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.

MICHAEL S CONNELL

TRIBUNAL JUDGE

RELEASE DATE: 10 January 2013