



**TC03874**

**Appeal number: TC/2013/09395**

*Income tax - Appellant claimed that payments made to directors were dividends but had been erroneously paid as remuneration - amended forms P35 which created PAYE and NIC 'overpayment' - amendments not accepted by HMRC - Regulation 80 Determinations - whether Appellant had provided sufficient evidence to show payments were dividends - no - Appeal dismissed*

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**KEY RECRUITMENT (UK) LIMITED**

**Appellant**

**- and -**

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

**Respondents**

**TRIBUNAL: JUDGE MICHAEL S CONNELL  
MR ALAN REDDEN FCA**

**Sitting in public at Alexandra House, Manchester on 7 July 2014**

**For the Appellant Mr Anthony Keary**

**For the Respondents Mr Kevin McMahon, Officer of HM Revenue and Customs**

## DECISION

### The Appeal

1. This is an appeal by Key Recruitment Limited (“the Appellant”) against  
5 Regulation 80 Determinations and Section 8 Decisions issued to the Appellant by  
HMRC on 4 September 2013. The total tax charged was £137,265.80 and the National  
Insurance charged was £70,790.44.

### The Background.

2. Key Recruitment (UK) Limited was incorporated at Companies House on 26  
10 April 1995 with a company registration no 3050197.

3. The directors of Key Recruitment (UK) Ltd are Mr Anthony Keary, Mr Tony  
Wallwork and Ms Kirstie Whitehead. The accounts submitted to HMRC and  
Companies House show that Mr Keary and Mr Wallwork were appointed directors on  
26 April 1995, and that each held 500 £1 shares in the company. Returns made to  
15 Companies House show that Ms Whitehead was appointed a director on 27 April 2008  
and was allocated 111 shares on 1 July 2008.

4. The Corporation Tax Accounts submitted to HMRC did not show Ms  
Whitehead as a director until the accounting period ended 30 June 2010. The share  
capital in the accounts for the accounting period ended 30 June 2009 is shown as  
20 £1,000 and did not increase to £1,111 until the following year.

5. A Form P35 is part of the annual employer's return. It sets out the total tax and  
national insurance deducted by a company during a specific tax year. When it is  
submitted to HMRC it is accompanied by form P14. A P14 is completed for every  
employee and sets out their pay and deductions for that year. The forms must be  
25 submitted to HMRC within a specified time after the end of each tax year.

6. The P35 for the year ended 5 April 2008 was submitted online by the Appellant  
on 19 May 2008 showing a tax liability of £255,516.85 and an NIC liability of  
£188,504.97.

7. The P35 for the year ended 5 April 2009 was submitted online by the Appellant  
30 on 9 April 2009 showing a tax liability of £234,883.00 and an NIC liability of  
£194,236.30.

8. The P35 for the year ended 5 April 2010 was submitted online by the Appellant  
on 9 April 2010 showing a tax liability of £129,527.26 and an NIC liability of  
£145,701.08.

9. The P35 for the year ended 5 April 2011 was submitted online by the Appellant  
35 on 11 April 2011 showing a tax liability of £129,435.26 and an NIC liability of  
£136,591.97.

10. Accounts have been submitted annually to HMRC and Companies House for the  
40 accounting periods ended 30 June 2011. The accounts support the figures on the P35's  
as set out above. The accounts show the following dividends -

|              |          |
|--------------|----------|
| APE 30/06/08 | None     |
| APE 30/06/09 | None     |
| APE 30/06/10 | £25,504  |
| APE 30/06/11 | £121,320 |

5 11. Self-Assessment Tax returns submitted by the directors show no receipt of dividends by any of the directors until the year to 5 April 2011. Mr Keary and Mr Wallwork show that they are directors on these returns but Ms Whitehead's returns show that she is not a director. The following dividends were returned in the directors' personal SA returns —

|    |                |         |         |
|----|----------------|---------|---------|
| 10 | Director       | 2010/11 | 2011/12 |
|    | Mr A Keary     | £33,660 | £13,525 |
|    | Mr T Wallwork  | £33,660 | £13,525 |
|    | Ms K Whitehead | £7,480  | £3,005  |

15 12. The Appellant now maintains that some of the payments made to directors during the four years up to 5 April 2011 were dividends and that they had been shown in error in the P35s and P14s already submitted. They say that this came about due to a misunderstanding by the company's payroll bureau. On 13 and 14 March 2012 the company submitted amended forms P35 changing their declaration of the amounts of PAYE tax and NIC due for the years.

20 13. An amended P35 for the year ended 5 April 2008 was submitted online by the Appellant on 13 March 2012 reducing the tax liability for the year by £68,656.34 and the NIC liability by £31,257.10.

25 14. An amended P35 for the year ended 5 April 2009 was submitted online by the Appellant on 13 March 2012 reducing the tax liability for the year by £53,583.60 and the NIC liability by £25,212.91.

15. An amended P35 for the year ended 5 April 2010 was submitted online by the Appellant on 13 March 2012 reducing the tax liability for the year by £11,174.26 and the NIC liability by £9,876.30.

30 16. An amended P35 for the year ended 5 April 2011 was submitted online by the Appellant on 14 March 2012 reducing the tax liability for the year by £3,851.60 and the NIC liability by £4,444.13.

17. The submission of the revised P35's created an overpayment in each of the years concerned. This resulted in a reduction to the company's PAYE and NIC liability of £208,056.24.

35 18. The Appellant's finance director, Mr Darren Howarth, wrote to HMRC on 23 March 2012 advising the rationale behind the submission of the amended P35's. He said:

“The amended returns relate to the two directors/shareholders, who believed several years ago that they were being paid a small salary (relating to their PA) and remaining

balance as a dividend. Unfortunately due to some miscommunication this is not was processed or reported. These two directors do not do their own tax returns which are done by an external accountant who only reports what information he is provided with, none of which came from these two directors.

5 Both directors assumed the amounts being paid into their bank accounts reflected their instruction several years ago which unfortunately has not been the case. This error has simply never been picked up until I questioned it recently as part of my brief to review all aspects of the financial affairs of the business”.

10 19. HMRC arranged a meeting with Mr Howarth on 20 November 2012. He explained that he was brought into the company some eighteen to twenty months previously ‘to bring some semblance of order to the finance department, the previous finance controller having passed away’. He said that he was the Financial Director in name only; he was not listed as a director at Company’s House. He explained that he was a self-employed accountant working two days a month for the company.

15 20. Mr Howarth said that whilst looking at the company accounts he found that the directors were receiving remuneration only, and not dividends. The directors said that that was not right as they had given instructions to their previous financial controller, Mr Fred Cunningham, that they were to be paid a minimum wage and the balance in dividends.

20 21. Mr Howarth accepted HMRC’s observation that the directors would have signed the company’s returns and it was their responsibility to check the accuracy of the declarations they were signing.

25 22. HMRC say that in order to re-categorise income previously declared as director’s remuneration as dividends, satisfactory evidence needed to be provided by the company to show that the income had been treated as remuneration in error during the years concerned, and that without such documentary evidence no claim could be entertained.

30 23. Mr Howarth then provided copy memos purporting to be from Mr Keary to ‘Fred’ (Cunningham) bearing the following dates; 21 March 2008, 10 April 2008, 27 April 2008 and 28 April 2008.

24. HMRC explained that due to the date of the memos, the claim for 2007/2008 would fail and that for the later years HMRC would be considering the evidence provided.

35 25. HMRC considered that the documentation provided by the Appellant, in support of the information on the new P35s and P14s, was insufficient to verify the claims made by the company. HMRC requested the company to revise the P35s back to the original figures. The company would not agree to this and so HMRC issued Regulation 80 Determinations and Section 8 Decisions in order to reinstate the amounts originally declared on the forms P35.

40 26. A meeting was arranged on 23 May 2013 between HMRC and Mr Keary. HMRC’s notes of the meeting state:

“Peter Morehead (PM) asked Anthony Keary (AK) what documentation he was producing to further the claim. AK produced his personal diaries for 2008 onwards along with the original memos dated 21 March 2008, 10 April 2008, 27 April 2008 and 28 April 2008.

5 PM asked AK to run through the sequence of events for him.

AK said that he first spoke to Tony Wallwork on the subject of pay and dividends on Wednesday 19 March 2008. AK showed PM the diary page which showed a meeting with TW but no detail of discussion undertaken. PM asked if there were any notes of the meeting anywhere and AK replied 'No'.

10 AK said that he then sent a memo on 21 March 2008, to Fred who previously dealt with the payroll, requesting remuneration information to be made available on AK's return from holiday. Original memo dated 21 March 2008 seen along with diary entry referring to memo to Fred.

15 AK said memo sent to Fred on 10 April 2008, having seen figures provided by him, requesting further information. Original memo dated 10 April 2008 seen.

AK said he had a meeting on 18 April 2008 with Kirstie Whitehead to discuss her salary. AK showed PM his diary for the day which showed meeting with KW. PM asked AK if there are any notes of the meeting anywhere and AK replied 'No'.

20 AK said he sent a memo dated 27 April 2008 to Fred concerning adjusting the previous year's earnings to 'small basic plus dividend'. Original memo dated 27 April 2008 seen.

AK said he sent another memo dated 28 April 2008 to Fred with instructions that going forward 'remuneration should be paid in a more tax efficient way'. Original memo dated 28 April 2008 seen.

25 PM asked AK if he is up to date with his Personal SA returns. AK said he is sure he is, but he just signs what his accountant puts in front of him. PM said that he thought AK was saying that he signs off his personal Self-Assessment Tax Returns without checking the figures and asked if that is what AK was saying. AK replied 'Yes'.

30 PM said that the Corporation Tax Accounts for the year ended 30 June 2011 were signed off by AK and had he read them. AK replied 'No'. PM said that the CT Accounts for the year ended 30 June 2010 had been signed off by Wallwork and Whitehead and had AK read them. AK replied 'No'. PM said that the accounts show the amount of Directors remuneration and the Dividends paid. AK said the figures could always be changed.

35 PM asked AK if he had any new documentation, such as board meeting notes or e-mails in which the matter was discussed, in support of the claim that the decision on the Remuneration/Dividend split was made on 21 March 2008 as he is claiming. AK replied 'No'.

40 AK then asked PM why he had refused the claim when he had previously accepted that a decision had been made in March 2008. PM said that he had not accepted the claim that a decision had been made in March 2008. PM asked on what day of the month the directors are paid. AK said they are paid on the last working day of the month.

Referring to AK's diary PM said that the directors would therefore have been paid their March 2008 wage on 31 March 2008 and that what he had previously said to Howarth

5 was that regardless of any decision made in respect of the claim, any payments made prior to the date of the first discussion, 19 March 2008, would have to be disregarded as the directors had already received the money as remuneration. If the claim was accepted, only payments made after the date of the decision by the company would be accepted, the decision could not be applied retrospectively.

AK asked PM under what law. PM referred AK to Section 15 & Section 18 Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003).

10 AK said he did not accept this and asked PM what would happen now? PM asked if AK would revise the P35's and AK said no. PM said he would write supplying notes of meeting confirming his intent to issue Regulation 80 Determinations and Section 8 Decisions to bring the PAYE tax and National Insurance into charge. The company would have the right to appeal and if it goes that far, to present its evidence to the First-tier Tax Tribunal."

15 27. An appeal was lodged against the determinations on 20 September 2013. The Appellant was offered an independent review on 24 September 2013, which was undertaken and the conclusion letter was issued on 12 November, upholding the decision. The Appellant then lodged an appeal with the Tribunal Service on 27 November 2013.

#### Relevant legislation

20 28. The Income Tax (Earnings and Pensions) Act 2003 provides a definition of what constitutes earnings and specifies particular rules for directors at

#### Section 18 (1)

"(1) General earnings consisting of money are to be treated for the purposes of this Chapter as received at the earliest of the following times—

25 Rule 1 - The time when payment is made of or on account of the earnings.

Rule 2 - The time when a person becomes entitled to payment of or on account of the earnings.

30 Rule 3 - If the employee is a director of a company and the earnings are from employment with the company (whether or not as director), whichever is the earliest of—

(a) the time when sums on account of the earnings are credited in the company's accounts or records (whether or not there is any restriction on the right to draw the sums);

35 (b) if the amount of the earnings for a period is determined by the end of the period, the time when the period ends;

(c) if the amount of the earnings for a period is not determined until after the period has ended, the time when the amount is determined."

29. Regulation 80 of the Income Tax (PAYE) Regulations 2003 allows HMRC to issue a determination when PAYE tax deducted has not been paid by a company.

30. Section 8 of the Social Security Contributions (Transfer Functions) Act 1999 allows an officer of HMRC to make a decision to charge National Insurance that has not been paid by a company.

31. The issue in this case is whether or not the company had paid salary in error and that the payments were in fact dividends.

#### The Appellant's submissions

32. Mr. Keary referred to his meeting with Peter Moorhead on 23 May 2013 at which he produced the original memos to Fred Cunningham as evidence in support of the appeal.

33. Mr. Keary says that the memos show that he had given a sequence of instructions to Mr. Cunningham to amend the returns for himself and Mr. Wallwork for the tax year 07/08 and that all subsequent payments to himself, Mr. Wallwork and and Kirstie Whitehead were to be paid in a similar manner.

34. He said that following a heart attack Mr. Cunningham left the Appellant's employ at the end of March 2009 and sadly passed away in 2012. Mr. Keary and the other directors were not aware that the instructions given to Mr. Cunningham in 2008 had not been implemented. It was only in 2012 after Darren Howarth replaced Mr. Cunningham as the company's accountant that the position came to light

35. Mr. Keary submits that there was a clear intention on the part of the directors to have the directors' remuneration paid as part salary and part dividends and that unequivocal instructions were given to Mr. Cunningham to that effect. At the very least, all the amendments to P35's for the years after 07/08 following the direct written instruction to Mr. Cunningham should be considered correct and applicable.

#### HMRC's submissions

36. Mr. McMahon for HMRC said that it is for the Appellant to produce evidence to support its contention that the payments made to the directors and others in the company were dividends. The standard of proof is the ordinary civil standard of the balance of probabilities.

37. HMRC's view is that there is no evidence, let alone contemporaneous evidence, that the payments were actually dividends. The amounts are not in proportion to the shareholdings, the accounts have not been (and in HMRC's submission could not be) corrected and the other tax consequences that flow from the position claimed by the Appellant have not been effected by them or the directors. In HMRC's submission, the evidence all points to the conclusion that the original returns were based on contemporaneous records which gave rise to the accounts as submitted which confirm the P35 returns as submitted originally.

38. The amended returns were prepared by Mr. Howarth and submitted in March 2012. Given the directors' apparent failure to notice the 'errors' in their returns and the company accounts and returns, it has to be asked how or why Mr. Howarth would suspect that there had been anything wrong at all. When asked by the officer  
5 investigating the amendments to the returns Mr. Howarth had to revert to the directors to obtain any further information to support the adjustments.

39. HMRC submits that the payments now said by the Appellant to have been dividends were not dividends and that they were correctly identified and returned as salary and that the Regulation 80 Determinations and Section 8 Decisions issued on 4  
10 September 2013 were correctly made.

### Conclusion

40. The Appellant does not dispute that forms P35 and forms P14 were made for all years concerned in which the company treated the payments to the directors as earnings and on that basis were taxed accordingly.

15 41. The Appellant company's annual accounts for the years concerned reflected the fact that the payments to the directors were by way of remuneration and were accordingly treated as deductions from the company's profits.

42. The director's self-assessment returns for each year concerned also declared the monies received by the directors to be earnings.

20 43. The directors now seek to change the tax treatment of the amounts involved so that payments made to the directors as remuneration should in fact be treated as payment of dividends. This means that the payments are not subject to PAYE or NIC and are also taxable at a lower rate.

25 44. As a result the amendments generated an 'overpayment' in relation to company's PAYE and NIC payments for the years concerned in sum of £208,056.24 and this was repaid to the company.

45. HMRC are not satisfied that the amendments relate to genuine errors (i.e. actual mistaken treatment of amounts paid).

30 46. The Income Tax (Earnings & Pensions) Act 2003 s18 sets out the point at which remuneration is to be treated as received (see paragraph 28 above).

47. In *Russell Baker v HMRC* [2013] UKFTT 394, the First-tier Tribunal said:

"It seems to us to be axiomatic that the nature of a transaction and its effect for tax purposes must be determined by reference to the time when that transaction took place. Later events may illuminate history, but they cannot change it."

35 48. Amendments to declared and taxed earnings after the event may be accepted if evidence provided by the employer shows that the amendments are justified and correct. The evidence produced by the Appellant comprises copy hand-written notes from Mr. Keary to Fred Cunningham the accounts clerk, and the Appellant maintains that this information is sufficient to support the correctness of their tax adjustments.



We are not satisfied that this is sufficient. Despite HMRC's request for more compelling evidence nothing further has been produced other than some personal diary entries of Mr. Keary, which although they mention meetings with 'Fred' and another director, contain no detail which could reasonably be regarded as supporting Mr. Keary's contentions .

49. All the other statutory returns made by the company and its directors for the years in question, either exactly (in the case of directors' Self-Assessment returns), or closely (in the case of company annual accounts, allowing for timing differences) reflect the declarations made on the original employers P14 and P35 returns. Mr. Keary says that he signed whatever his accountants put in front of him, without checking the documents. This does not support his submission that the matter was carefully considered and discussed amongst the directors and the accounts clerk. On no occasion during the years under appeal did the directors check that their instructions had been implemented. Apparently the directors did not look at the company accounts, their salary packets or P60's at any time over a period exceeding four years.

50. After giving instructions to Mr. Cunningham in 2007/08 there must have been many opportunities during the years under appeal, for the company directors to have noticed any 'errors' in the various company and individual returns. Had the directors taken reasonable care and exercised reasonable due diligence, any errors would have been obvious. As HMRC point out the amounts involved in the amended returns are considerable. It would not have been difficult for them to check that the company accounts, the self-assessment returns and the employers annual returns (all of which 'tallied') had been correctly prepared and submitted. It is therefore difficult to understand how the directors could possibly have allowed their returns to have been incorrectly submitted over such an extended period.

51. Assuming the hand-written notes of Mr. Keary to be contemporaneous, they do not, on their own, sufficiently explain why the errors occurred or more materially, why he and his co-directors allowed them to impact on the company's and directors' finances for a period of four years without being noticed.

52. We therefore find that the Appellant has not shown that HMRC's decisions and determinations are incorrect in law or unreasonable on the evidence.

53. We accordingly uphold the Regulation 80 Determinations and Section 8 Decisions issued to the Appellant by HMRC on 4 September 2013.

54. 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: 04 August 2014**



