[2016] UKFTT 0536 (TC)

# TC05285

**Appeal number: TC/2014/05097**

***INCOME TAX – PAYE – direction under reg 72(5) that liability to be transferred to employee – whether tax deducted – meaning of "deducted" – tax remaining unpaid by employer – allocation of remuneration to discharge loan account – held on facts that this constituted payment of remuneration and that tax was deducted – National Insurance Contributions – primary contributions remaining unpaid by employer – decision by HMRC that employee liable to pay these contributions – whether employer wilfully failed to pay – held on facts that failure not wilful – no basis for transfer to employee of liabilities either for income tax or primary NICs – appeal allowed***

**FIRST-TIER TRIBUNAL**
**TAX CHAMBER**

**STEPHEN WEST** **Appellant**

**- and -**

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

**TRIBUNAL: JUDGE JOHN CLARK**
**SANDI O'NEILL**

**Sitting in public at Reading Employment Tribunal on 19 April 2016**

**Tony Slater of TS Tax Ltd for the Appellant**

**Simon Bates, Local Compliance, Appeals and Reviews, HM Revenue and Customs, for the Respondents**

DECISION

1. The Appellant, Mr West, appeals against directions made by the Respondents ("HMRC") under regulation 72 of the Income Tax (Pay As You Earn) Regulations 2003, SI 2003/2682 ("the PAYE Regulations") in respect of liability to income tax which HMRC considered that his employer had failed to deduct, and a decision made by HMRC under section 8(1)(c) of the Social Security (Transfer of Functions) Act 1999 and under regulation 86 of the Social Security (Contributions) Regulations 2001, SI 2001/1004, ("reg 86") in respect of liability to pay National Insurance Contributions ("NICs"). We refer to regulation 72 of the PAYE Regulations as "reg 72".

**The background facts**

2. The evidence consisted of a bundle of documents; these included witness statements given by Mr West and by Naresh Gunamal of HMRC. In addition, Mr West and Mr Gunamal both gave oral evidence. From the evidence we find the following background facts. We consider disputed matters of fact at a later point in this decision.

3. From 2003 Mr West was the sole director and shareholder of Astral Telecom Ltd ("Astral"); Astral's trade consisted of selling satellite space to the telecoms industry.

4. In evidence and in submissions for Mr West, it was stated that in accordance with the widespread practice customarily adopted by profitable small businesses, for a number of years Mr West regularly drew money from Astral during the year, those drawings being recorded in the director's loan account as loans. At the end of the year a small amount of remuneration and a much larger amount of dividend were approved and credited to the loan account, thereby extinguishing the loan. Corporation tax was paid on Astral's profits and income tax was paid by Mr West through self-assessment. However, according to the analysis of Astral's accounts which was included in the evidence, director's loans remained outstanding and increased in amount for the years ending 30 April 2007 to 2010 inclusive. The amount of the director's loan account as at 30 April 2010 was £40,719.

5. Towards the middle of 2011, Mr West became concerned about the state of Astral's business. He knew that he could be liable for Astral's debts if it traded while insolvent. Following advice from his accountant, he decided to seek advice from an authorised insolvency practitioner, whom he met in June 2011.

6. The insolvency practitioner advised him to put Astral into liquidation. In addition, he advised Mr West that Astral could not pay him any dividends for that year, as there were insufficient available profits. Instead, payment to him would have to be wholly by way of salary.

7. Mr West therefore gave instructions to his accountant to prepare a set of accounts for the liquidation proceedings making sure that payment to him was only by

way of salary, rather than following the previous practice of voting a small remuneration payment with the rest being by way of dividend.

8. Mr West also instructed his accountant to prepare accounts showing an amount of director's remuneration which, after deducting PAYE and NICs, would be sufficient to offset the drawings on the loan account. This "net" remuneration, which was equivalent to the outstanding director's loans of £129,150, would be "grossed up" by a calculated PAYE and NICs liability to arrive at the figure for director's remuneration in the profit and loss account of £202,967. The company's loan to Mr West would be repaid in full by the "net" remuneration. The PAYE and NICs were shown on the balance sheet as current liabilities.

9. Mr West received no further money from Astral. The draft Management Accounts for the period 1 May 2010 to 26 July 2011 were prepared and sent to him at the end of July 2011. They showed director's remuneration of £202,967 and employer's NICs of £26,061. Among the amounts shown as owing to creditors, £99,886 was shown as owing in respect of "Tax and NIC". For the purposes of this hearing we were asked to treat these draft Management Accounts as 'final' accounts. Public notice was given on 30 August 2011 that a meeting of the creditors of Astral would be held on 13 September 2011.

10. At the creditors' meeting a resolution was passed for the voluntary winding up of Astral. The joint liquidators' Statement of Affairs showed that the PAYE and NICs totalling £99,886 were still owing to HMRC. Corporation Tax and VAT owed to HMRC totalled £39,587 and trade and other creditors were £6,794. The total deficiency was £146,611.

11. In February 2013 HMRC began enquiries with a view to establishing why Astral had not paid its PAYE liability to HMRC. These enquiries were pursued by letters addressed to FA Simms & Partners Ltd, the firm which had dealt with the liquidation of Astral, and Mr West as the director and sole employee of Astral.

12. In his response, Mr West acknowledged that he had drawn monies from Astral and that the tax and NICs due in respect of these payments had not been paid to HMRC. He also stated that he was prepared to consider voluntarily paying the amounts due to HMRC.

13. In response to Mr West's offer to settle, HMRC wrote stating that they were prepared to recalculate the PAYE liability by treating the repayment of Mr West's £129,150 loan account rather than the figure for director's remuneration in the draft Management Accounts of £202,967 as his income, thereby considerably reducing the amount payable. They invited Mr West to settle with HMRC on this basis.

14. In October 2013, in the absence of a response to their settlement offer, HMRC issued separate income tax and NIC decisions formally transferring the PAYE liabilities from Astral to Mr West on the assumption that he received payments from Astral knowing that it had wilfully failed to deduct sufficient tax. The liabilities were calculated on the reduced basis described above. The amounts were:

| Year | Relevant Payments | Income Tax | National Insurance |
|---|---|---|---|
| 2010-11 | £59,413.00 | £16,285.60 | £4,352.98 |
| 2011-12 | £69,737.00 | £20,863.80 | £4,775.24 |

15. These decisions took different forms. In respect of the income tax for 2010-11, HMRC issued an assessment dated 2 October 2013. In respect of the income tax for 2011-12, HMRC issued a closure notice, also dated 2 October 2013. HMRC dealt with the NIC liabilities by issuing a decision dated 2 October 2013 under s 8(1)(c) of the Social Security Contributions (Transfer of Functions) Act 1999 ("SSCTFA 1999"), applying reg 86.

16. Following receipt of these decisions from HMRC, Mr West sent a without prejudice letter to HMRC offering to pay £25,000 in full and final settlement. HMRC refused this offer on the grounds that it was insufficient.

17. Subsequently there were various exchanges of correspondence and telephone calls between Mr West and HMRC. In early 2014, Mr West appointed Mr Slater to act for him in relation to the arrears of income tax and NICs owed by Astral; Mr Slater made contact with Mr Gunamal. On 5 March 2014, through Mr Slater, Mr West appealed to HMRC against the above decisions. In a letter dated 17 March 2014, Mr Gunamal agreed to accept the late appeal.

18. After considering information on his file, together with further information provided by Mr Slater, Mr Gunamal wrote to Mr West on 1 May 2014 confirming HMRC's view that the direction and decision to transfer the liabilities to Mr West was appropriate in his case. If Mr West did not agree, he could either ask for a review or notify his appeal to the Tribunal.

19. In his letter dated 7 June 2014, Mr Slater indicated that he and Mr West had accepted the offer of a review. Mr Slater set out detailed representations to be taken into account in the review in addition to his earlier correspondence. Mr Gunamal replied on 10 June 2014, confirming that he had passed the additional representations on to the reviewing officer, and reiterating his view that Astral had wilfully failed to deduct tax from the remuneration. Mr Slater replied on 12 June 2014 with additional comments. Mr Gunamal responded by a letter to Mr West, copied to Mr Slater, again stating that this view had not changed, and confirming that a copy of Mr Slater's further letter had been forwarded to the reviewing officer.

20. On 20 August 2014 the reviewing officer wrote to Mr West setting out the results of his review. He upheld the decisions in the sums set out above. We refer later to the matters covered by his review, so do not set out the details here.

21. On 17 September 2014, Mr Slater gave Notice of Appeal on Mr West's behalf to HM Courts & Tribunals Service ("HMCTS"). The Grounds of Appeal were set out in a ten page attachment to the Notice of Appeal. We deal at a later stage below with the arguments put by Mr Slater on Mr West's behalf.

22. Correspondence between the parties and HMCTS continued over a considerable period. On 13 October 2015 Mr Slater made an application under Rule 8(3)(c) of the Tribunal Rules to strike out the proceedings; as that application was made on behalf of Mr West as Appellant, this amounted to applying for HMRC to be barred from taking any further part in the proceedings. (We refer to this below.)

23. HMCTS responded on 10 November 2015, informing Mr Slater that the Tribunal had instructed that the strike-out application would be heard first and if refused, the Tribunal would then consider the appeal. HMCTS subsequently emailed to confirm that if the application was refused, the appeal would be considered immediately afterwards at the same hearing.

**The law**

24. Regulation 72 provides:

> "(1) This regulation applies if—
>
> (a) it appears to the Inland Revenue that the deductible amount exceeds the amount actually deducted, and
>
> (b) condition A or B is met.
>
> (2) In this regulation and regulations 72A and 72B
>
> "the deductible amount" is the amount which an employer was liable to deduct from relevant payments made to an employee in a tax period;
>
> "the amount actually deducted" is the amount actually deducted by the employer from relevant payments made to that employee during that tax period;
>
> "the excess" means the amount by which the deductible amount exceeds the amount actually deducted.
>
> (3) Condition A is that the employer satisfies the Inland Revenue—
>
> (a) that the employer took reasonable care to comply with these Regulations, and
>
> (b) that the failure to deduct the excess was due to an error made in good faith.
>
> (4) Condition B is that the Inland Revenue are of the opinion that the employee has received relevant payments knowing that the employer wilfully failed to deduct the amount of tax which should have been deducted from those payments.
>
> (5) The Inland Revenue may direct that the employer is not liable to pay the excess to the Inland Revenue.
>
> (5A) Any direction under paragraph (5) must be made by notice ("the direction notice"), stating the date the notice was issued, to—
>
> (a) the employer and the employee if condition A is met;
>
> (b) the employee if condition B is met.

. . ."

25. Regulation 86 provides:

> "(1) As respects any employed earner's employment—
>
> (a) where there has been a failure to pay any primary contribution which a secondary contributor is, or but for the provisions of this regulation would be, liable to pay on behalf of the earner and
>
> (i) the failure was due to an act or default of the earner and not to any negligence on the part of the secondary contributor, or
>
> (ii) it is shown to the satisfaction of an officer of the Board that the earner knows that the secondary contributor has wilfully failed to pay the primary contribution which the secondary contributor was liable to pay on behalf of the earner and has not recovered that primary contribution from the earner; or
>
> (b) . . .
>
> the provisions of paragraph 3(1) of Schedule 1 to the Act (method of paying Class 1 contributions) shall not apply in relation to that contribution.
>
> . . ."

**Arguments for Mr West**

26. Mr Slater had made the application under Rule 8(3)(c) and 8(7) of the Tribunal Rules, setting out detailed arguments. At the hearing he explained that he had done this with a view to saving time and costs; he had thought that there might be a separate hearing to deal with the application. He and his client were ready to carry on with the substantive hearing; the witnesses were present.

27. We agreed that the application should be treated as having been withdrawn.

28. Mr Slater referred to the withdrawal by HMRC of their argument based on the view that Mr West's drawings from Astral had been drawings on account of remuneration to be voted. Much was now agreed, and a great deal was no longer in dispute; the facts were agreed and the law accepted.

29. He referred to the general principles of PAYE; the basic rule was that the obligations fell on the employer. This basic rule was only set aside in limited circumstances. These were narrowly defined:

(1) The employer did not deduct PAYE;

(2) The failure was wilful and deliberate;

(3) The employee received the remuneration *knowing* that the employer had wilfully failed to deduct the tax.

30. In order for HMRC to succeed, they had to show that all three of these circumstances were present.

31. Mr Slater made various submissions on the facts; we consider these at a later point, together with those made by Mr Bates for HMRC.

32. He submitted that the facts in Mr West's case were materially different in many respects from those in the case of *R v Inland Revenue Commissioners, ex parte McVeigh* [1996] STC 91, [1996] BTC 35, on which HMRC relied in support of their argument that the reg 72 direction had been properly made. We consider these submissions when dealing with the other factual issues.

33. He referred to these words in *McVeigh* ([1996] STC 91 at 98):

> "In the modern world the fact of payment in an amount net of tax will normally constitute deduction, whether or not the employer also effects any money movement of the sum which is deducted, for example by transferring it to a tax reserve. There will be a pre-existing entitlement to gross pay and a deduction from this is effected by paying the net amount due after subtracting the tax. This accords with reg 14, where the employer has to ascertain, among other things, the tax and to deduct it 'on making the payment in question'."

(The latter reference is to the Income Tax (Employments) Regulations 1993, which have been superseded by the PAYE Regulations.)

34. He submitted that this was in line with the judgment in *Garforth v Newsmith Stainless Ltd* (1978) 52 TC 522; this established that there did not have to be a movement of cash to the employee for deduction to have taken place. A credit to the loan account was regarded as the payment point for PAYE.

35. Mr Slater submitted that the following proposition put forward by May J in *McVeigh* [1996] STC 91 at 99 could not be correct:

> ". . . In these circumstances I consider that it would be a misuse of language to say that the book-keeping and accounting alone, without actual payment, and without any of the procedures which the regulations require, constituted a deduction of tax from the gross payment."

36. Mr Slater argued that if the proposition were to be correct, then the unpaid liabilities of all cases such as the present case would be transferred to the employee irrespective of the facts.

37. In any event, he submitted that these words of May J in *McVeigh* were not binding on the Tribunal, as they were *obiter dicta*; as this was a judicial review case, May J was concerned with reviewing the legality and propriety of the facts found by HMRC, and not finding primary facts himself.

**Arguments for HMRC**

38. Mr Bates confirmed that HMRC's position had changed since the submission of their Statement of Case. Following discussions with Mr Slater and interested parties within HMRC, they now accepted that the monies drawn by Mr West during 2010-11 and 2011-12 were loans and not payments on account of remuneration. HMRC accordingly acknowledged that there was no failure to operate PAYE at the time when the payments were made, as had been suggested in the statutory review letter and earlier correspondence.

39. However, HMRC did contend that the retrospective exercise of grossing up director's remuneration to extinguish Mr West's indebtedness to the company carried out in the summer of 2011 by Astral's then accountant did not constitute the proper operation of PAYE as required by the relevant regulations. In support of this, HMRC relied on *McVeigh*, where it had been held that book-keeping entries without the concomitant payment of tax and NICs to HMRC did not constitute the operation of PAYE.

40. In addition, HMRC contended that this was no more than a "paper exercise" authorised by Mr West with the aim of clearing his overdraft loan account and with a view to preventing the joint liquidators from recovering the debt from him personally.

41. Mr Bates commented that in the strike-out application, Mr Slater had succinctly and eloquently described the difficult task faced by HMRC in this case. HMRC did not disagree with his analysis of the issues or his assertion that the matter in dispute was to be determined subjectively with regard to what Mr West knew or decided at the time.

42. In cases involving reg 72 and reg 86, it was unlikely that HMRC would be able to gather direct evidence at the enquiry stage that the employee was aware that tax had not been deducted correctly. There was seldom written evidence to such effect. It was common in such cases for witness evidence to be put in by the relevant appellant that directly refuted HMRC's assertions. In such cases HMRC reserved the right to test such appellant's evidence under cross-examination.

43. HMRC argued that, as Mr West was the sole shareholder and director of Astral, he was fully aware of the actions taken by Astral's accountant in preparing the draft Management Accounts and indeed authorised the accountants to repay his loan account.

44. On the question of onus of proof, whilst technically in reg 72 and reg 86 appeals this lay on HMRC, HMRC submitted that there was a rebuttable presumption that the reg 72 and reg 86 determinations had been validly made. The question was then whether the witness evidence of the relevant appellant was such as to persuade the Tribunal that the determinations under reg 72 and reg 86 should be disapplied.

45. The wording of reg 86 was different; it referred to payment of the NICs.

46. He did not intend to refer to any authorities in his oral submissions. (HMRC had provided a bundle of authorities, and in their Skeleton Argument they relied on *McVeigh*.)

47. He considered that regs 21, 66 and 69 of the PAYE Regulations were all useful in the context of Mr West's case. He referred to reg 4 of the PAYE Regulations in the context of NICs.

**Discussion and conclusions**

48. There is a difference of view between the members of the Tribunal panel. It has not proved possible to resolve that difference. As a result, we set out our respective views in this section of our decision. With great reluctance, the Judge has had to decide to use the casting vote available in the last resort to the chairman of the Tribunal panel. His views are set out first, and Member Ms Sandi O'Neill's views follow.

*Judge Clark's analysis and conclusions*

49. I agree with Mr Slater's submission (see [29]-[30] above) that there are three preconditions to liability to income tax in the circumstances of Mr West's case, and that if any of them is not fulfilled, no liability can arise.

50. In relation to the NICs, the position differs in the following way. As Mr Slater submitted in Mr West's grounds of appeal, for reg 86 to operate, the director has to know that the employer has wilfully failed to *pay* the NICs, rather than to *deduct* them.

51. I also accept Mr Slater's submissions concerning the words of May J in *McVeigh* cited above; I agree that if that statement was correct, the result would be that in all cases of this nature, the unpaid liabilities would be passed to the employee irrespective of the factual position.

52. I examine the factual position in relation to each of the three preconditions.

*Was PAYE deducted?*

53. Mr Slater submitted that the test to establish whether PAYE had been deducted was an objective one. I agree with that submission.

54. In his evidence, Mr West stated that the liquidator had advised him that Astral could not pay him any dividends for the period up to the liquidation to cover his drawings; Mr West thought that the reason for this was that there were no profits. Instead, the liquidator advised that the payment should all be by way of remuneration.

55. Mr West therefore asked his accountant to prepare a set of accounts for the liquidation proceedings making sure that Mr West had only remuneration, rather than the previous normal procedure of having a small salary and the remainder by way of

dividends. Mr West was aware that when someone was paid a salary above a certain minimum level, PAYE and NICs had to be deducted. The accountant prepared draft accounts for the purposes of the liquidation, and did a grossing up calculation which Mr West knew would produce a PAYE liability.

56. Mr West did not receive any more money from Astral. Astral was then put into liquidation, and Mr West remembered attending a meeting with the joint liquidators. He did not remember any creditors attending the meeting.

57. He had seen a print-out of an electronic version of Astral's form P35 for 2011-12. The accountant had completed this on Astral's behalf, and Mr West had signed it. He knew at the time that a PAYE liability had arisen.

58. He had seen the accounts prepared for the liquidator; he had signed the document headed "Company Creditors" on 13 September 2011. It showed that Astral owed £99,986, which he understood was the tax and NICs deducted from the gross salary that the accountant had calculated.

59. In oral evidence, Mr West emphasised his belief that PAYE had been operated. The accountant had produced a set of accounts showing that tax and NICs had been deducted. Mr West believed that for that year, PAYE was still being operated; he had signed accounts, and although these were marked "draft", they were *the* accounts. He had signed the necessary paperwork for the creditors meeting. For that particular year Mr West recalled signing a P35; this showed that PAYE and NICs had been deducted. Because of all of this, his belief was that PAYE was being operated as in previous years. He did not believe that PAYE was not being operated.

60. In cross-examination, Mr West stated that he had been very much reliant on the advice of professionals, based on what was accepted practice. His understanding had been that there would be a liability.

61. Before giving his oral evidence, Mr Gunamal expressed the view that what was in discussion in Mr West's case was a *calculation* of PAYE, which was different from a *deduction* of PAYE.

62. I regard that question as central to this case. I have set out above the relevant parts of reg 72; reg 72(1) sets out the preconditions to the application of reg 72. It has to appear to HMRC that the "deductible amount" exceeds the amount actually deducted. Under reg 72(2), the "deductible amount" is the amount which the employer was liable to deduct from relevant payments made to the relevant employee in the tax period.

63. "Payment" for such purposes is defined by s 686 of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA 2003"). Section 686(1) states:

> "**686 Meaning of "payment"**
>
> (1) For the purposes of PAYE regulations, a payment of, or on account of, PAYE income of a person is treated as made at the earliest of the following times—

> Rule 1
>
> The time when the payment is made.
>
> Rule 2
>
> The time when the person becomes entitled to the payment.
>
> Rule 3
>
> If the person is a director of a company and the income is income from employment with the company (whether or not as director), whichever is the earliest of—
>
> (a) the time when sums on account of the income are credited in the company's accounts or records (whether or not there is any restriction on the right to draw the sums);
>
> (b) if the amount of the income for a period is determined before the period ends, the time when the period ends;
>
> (c) if the amount of the income for a period is not determined until after the period has ended, the time when the amount is determined.
>
> . . ."

64. As Mr West was a director of Astral, the relevant rule is Rule 3.

65. On the basis of Mr West's evidence, corroborated by the draft Management Accounts of Astral for the period ended 26 July 2011 (which Mr West stated he had signed and had been the basis of the instructions to the joint liquidators), I am satisfied that the relevant net sum sufficient to discharge his loan account with Astral was credited to that account in Astral's books. (I find that, although the loan account had been outstanding at the end of the various years referred to above, the whole balance outstanding on that account was discharged at that point in 2011.) Under Rule 3, that amounted to "payment" for PAYE purposes. The relevant sub-paragraph of Rule 3 is (c).

66. Even if that process could be described as having been merely a paper exercise, it had a real and significant consequence; Astral was required by reg 21 of the PAYE Regulations to deduct tax in accordance with those Regulations.

67. In the Notes to those draft Management Accounts, under the heading "Creditors", there was an entry for "Tax and NIC" for the 2011 period; this showed the amount as £99,886.

68. In the Detailed Trading and Profit and Loss Account for the period, the directors' remuneration was shown as £202,976, and the employer's NIC as being £26,061.

69. I am satisfied that the draft Management Accounts formed the basis of the instructions given to the joint liquidators. In addition, I find that the approval shown by Mr West as the director of Astral by signing the accounts and subsequently using them as the basis of the instructions to the liquidators amounted to confirmation of the voting of the amount of director's remuneration shown in those accounts. Mr West's

evidence was that the amount of the remuneration had been arrived at by a grossing up calculation. Such calculations are designed to arrive at such a sum as, after deduction of the income tax and employee's NICs from that sum, equals the relevant net amount. In the present case, the relevant net amount was the outstanding balance on Mr West's director's loan account as it stood in Astral's books immediately before the preparation of the draft Management Accounts for the period to 26 July 2011.

70. Further corroboration of the payment of remuneration and the acknowledgment of the consequent indebtedness to HMRC is provided by the copy of the signed form P35 for 2011-12 supplied to us by Mr Slater at the hearing. That copy showed a date at the top. Although the date was not fully and clearly shown, it is possible to decipher the date as "31/08/11". The version supplied to us was also marked "inted 09/05/2012 14:35". Again, it can be deduced that the incomplete word was "Printed". The document was headed "Astral Telecom", and below that heading "P14/P35 Internet Filing Summary". I did not see any copy of the corresponding form for 2010-11. According to Mr Gunamal's letter to Mr West dated 1 May 2014, the original form P35 for that year had showed a nil liability, and a supplementary P35 for that year had been submitted late on 31 January 2012, showing a liability for PAYE and employee NICs of £39,308.43. I am satisfied that in the same way this acknowledged the indebtedness to HMRC for the year 2010-11 which resulted from the deduction of tax from the grossed up amount of remuneration for that year.

71. Accordingly, I find that tax was deducted from the remuneration provided by Astral to Mr West. It is clear from the draft Management Accounts, and from the Summary Statement of Affairs included in the joint liquidators' Report for Meeting of Creditors dated 13 September 2011, that the total amount of the PAYE and NIC liabilities shown in Astral's records was £99,886. Thus the indebtedness to HMRC resulting from the grossing up calculation was acknowledged, thereby confirming the deduction of the tax and employee NICs from the remuneration.

72. As I am satisfied that tax was properly deducted, I further find that the first precondition to the operation of reg 72 is not fulfilled. As all three must be fulfilled, there is no basis for transferring Astral's liability to account for income tax under PAYE to Mr West. (I return below to the question of NICs.)

73. On the basis of the latter conclusion, I do not need to deal with the question of the amount of the income tax outstanding. However, I would add the comment that I have not been in a position to check the calculations carried out by the accountant on Astral's behalf, but understand that the figures are not in dispute.

74. In *McVeigh* [1996] STC 91 at 98 May J referred to the difference between deduction of tax and payment of tax:

> "Mr Brennan, on behalf of the Revenue, accepts that deduction of tax is not the same as payment of tax. I agree."

On the basis of that agreement, I do not consider it to be arguable that the process carried out by Astral was merely a paper or cosmetic exercise which did not constitute

a deduction of employee PAYE and NICs, as contended both by Mr Bates and Mr Gunamal.

75. I find it necessary to set out in some detail the differences between the factual position in *McVeigh* and that in the present case. In *McVeigh*, payment had been made in round sum amounts some time before the bonus amounts were recorded, and thus at the time payment was made no deduction was suffered. The entries showing net pay and recording tax and NIC deducted were found to be merely accounting entries. Forms P14, P35 and P60 and Mr McVeigh's own personal tax returns were all completed and submitted without including amounts referable to the bonus.

76. The accountants had written to the Revenue to state that the bonuses for the two years in question had not been processed under PAYE. It was not clear to May J when the book-keeping entries had actually been made. He commented that they could not have been made on the dates actually entered in the ledger.

77. May J continued:

> "In my judgment in this case the crucial question whether the employer deducted the amount of tax which he was liable to deduct under the regulations cannot be determined by what I have described as 'normal considerations', for the simple reason that on the date when payment is to be treated as having been made no actual payment was in fact made. There was, accordingly, no deduction in the normal sense of a deduction constituted by the payment of a net sum against a pre-existing entitlement to gross pay."

78. Earlier in his judgment May J made clear that, under the law as it then stood, there was no right of appeal against a direction that the employee should pay the tax. It was common ground between the parties that in principle an application for judicial review was open to Mr McVeigh. At a later point he stated:

> "It will be understood that the court, upon judicial review, is not itself concerned to make primary findings of fact but to review the legality and propriety of facts found by others. It will be seen that the crucial question therefore is whether there was a failure to deduct."

79. To deal with the latter point first, the position under the legislation as it is now is that the employee has a right of appeal, initially to HMRC and then to the Tribunal. This right of appeal is given by reg 72C of the PAYE Regulations. Under reg 72C(3) the Tribunal may set aside the direction notice if it appears that it should not have been made, or (if it is not set aside for that reason) may increase or reduce the amount specified in the notice if it is incorrect.

80. Mr West's appeal does not concern the quantum of the "excess" specified in the notice of direction. His appeal is on the grounds that, for various reasons, the direction should not have been made.

81. The initial question is whether there was a failure to deduct tax under PAYE. I have concluded that there was no such failure. In my view, there are material differences between the facts in Mr West's case and those in *McVeigh*. I am satisfied

that Astral's accountant did process the payments on the bonus under PAYE. I have concluded that the amount of income tax on the remuneration was shown in the draft Management Accounts as being due to HMRC, and the corresponding amount (which also included the NICs) was shown in the Statement of Affairs as due to HMRC. In order to produce the figures for those purposes, a calculation of the amount due under PAYE had to be made. Contrary to the position in *McVeigh*, forms P14 and P35 showing the relevant amounts were completed. Mr West included the corresponding details in his returns, showing the gross remuneration and the tax deducted.

82. In *McVeigh*, May J stressed the abnormality of the circumstances under consideration. His comments must therefore be read in that context. It is apparent from the report of the case in Simon's Tax Cases that one of the cases mentioned in the skeleton argument for Mr McVeigh was *Garforth*. That case confirmed that putting money unreservedly at the disposal of a director amounted to payment. Thus May J was aware of that principle (subsequently confirmed by s 686 ITEPA 2003, as set out above). He found that on the relevant date, no actual payment was in fact made. It followed from that finding that there was no deduction.

83. I am satisfied that, contrary to the position in *McVeigh*, there was a payment when the remuneration was allocated to Mr West and set off against the amount outstanding on the director's loan account. I am further satisfied that deduction of tax was made in Astral's case as part of the process of producing the draft Management Accounts, with the result that those accounts contained an acknowledgment of the indebtedness to HMRC in respect of the amounts due under PAYE. I do not consider that the principles in *McVeigh* relating to circumstances described as other than normal apply in Mr West's case.

*Whether there was a wilful and deliberate failure by Astral*

84. I have found that Astral deducted tax from the payment to Mr West which was used to discharge the monies due from him to his director's loan account. Thus there was no wilful failure within the terms of reg 72(4).

*Did Mr West receive the remuneration knowing that Astral had failed to deduct tax?*

85. In the light of my above finding, this question does not arise. However, I have certain comments on this issue. I agree with Mr Slater's submission that the question whether Mr West knew of such a failure was subjective, by reference to what he actually knew, although I accept Mr Bates' qualification to this, namely that it is for the individual in Mr West's position to convince the Tribunal that his evidence is sound and credible. I also accept Mr Slater's submission that the word "knowing", as stated by McNeill J in *R v Commissioners of Inland Revenue (ex parte Chisholm)* (1981) 54 TC 722 at 725—

> ". . . means what it says and does not mean 'ought to have known' or should have been suspicious' or any other weakening of knowledge."

86. If as a result of making different findings I had been considering in detail Mr West's state of knowledge, certain matters would have raised questions in my mind. It

appeared from his evidence that Astral's financial situation was deteriorating over a period, and at the same time, as a result of Mr West's own financial and other circumstances, he drew increasing amounts from his director's loan account. This would have had implications in respect of Astral's creditors, particularly if it could be concluded on the evidence that Mr West was aware of the potential effects on the creditors' position.

87. I also note the complete absence of any evidence before me of correspondence sent from the liquidators to Astral or Mr West. In such circumstances, it would be normal for professional advice to be provided. In response to our question whether he had had any discussions with the insolvency practitioner concerning fraudulent preference, he said that he did not recall anything like that happening; it had always been his belief that if the director's loan was paid off, things would be all right. He explained that his head had been "in a state"; he had received letters and emails about the procedure, and that the accountant had done a lot for him. Although I have noted his evidence concerning his illness and the stress and depression from which he had been suffering, there was no documentary evidence as to this. (The only item of evidence relevant to his medical condition was his letter to Mr Gunamal dated 29 April 2013 in which he gave the name and address of his doctor.) I would have needed to consider in detail the implications of his inability to recall what his accountant or the insolvency practitioner had told him.

*Whether Mr West knew that Astral wilfully failed to pay the primary NICs*

88. The question to be considered under reg 86 is different from that under reg 72; it is whether there has been a wilful failure to *pay*, rather than a wilful failure to deduct. The issues to be considered are, first, whether the employer has wilfully failed to pay the employee's contributions on the latter's behalf, and secondly, if so, whether the employee knows that the employer has wilfully failed to pay those primary NICs

89. It is clear on the evidence that Astral has not paid these contributions. The initial question to be considered is therefore whether Astral's failure to pay was wilful.

90. In the Grounds for Appeal, Mr Slater made the following submission on Mr West's behalf:

> "Clearly, the company did not pay the NIC, and Mr West knew this. However, the failure to pay the NIC was not wilful, or deliberate, because by the time it became due for payment, the company had no means to pay the liability, and therefore could not pay it."

91. HMRC's arguments did not specifically address this separate issue concerning the NICs. On the evidence, I am satisfied that Astral's position, at the time when the draft Management Accounts were in preparation and the remuneration was allocated to discharge the outstanding balance on Mr West's director's loan account, was such that it would not have been open to it to pay the resulting NICs to HMRC. I therefore find that Astral's failure to pay the NICs was not wilful or deliberate.

92. It follows that the precondition in reg 86(1) (a) was not fulfilled, and that therefore Astral's liability to pay the NICs cannot be transferred to Mr West under reg 86(1).

*My general comments*

93. I have carefully considered the dissenting comments of Ms Sandi O'Neill as the other member of this Tribunal panel. Although I have concerns as to the consequences of allowing Mr West's appeal, I do not consider that the legislation in its current state is sufficient to deal with the problems to which she refers. Any changes to the legislation would have to take account not only of the tax implications but also of the much wider legal implications. There is a case for seeking change, but only after careful consultation with all relevant professional and commercial bodies and other interested parties.

94. While acknowledging those dissenting views, my conclusion is that Mr West's appeal must, on the basis of the law as it stands, be allowed for the reasons which I have stated above.

*Member Ms Sandi O'Neill's dissenting views*

95. I gratefully adopt most of the description of the chronology and relevant facts which Judge Clark has set out but I wish to add to them from the oral and written evidence presented at the hearing. I respectfully disagree with Judge Clark about the conclusions to be drawn from the facts and on the proper outcome of the Appeal.

96. In paragraph 87 of his decision, Judge Clark noted Mr West's evidence about his illness and that his "head had been in a state" in mid-2011, while recording that we had no documentary evidence of this save for the letter to HMRC in April 2013 from Mr West saying that he could not deal with correspondence then because of ill-health and giving the name of his doctor. Mr West said that he lost a major customer in 2011 and faced demands for mortgage arrears but he also said that the problems in his business and personal affairs had built up from, I understand, 2009. However, he was not unfamiliar with dealing with business failures. Under cross-examination, Mr West said that he had liquidated two companies "in the 1990s" and in 2006 and his personal and health problems did not prevent him incorporating a new company, Astral Media Ltd., as "a vehicle to earn a living" in June 2011, the month he had been concerned about Astral's trading and had sought advice from his accountant and an insolvency practitioner.

97. Draft Management Accounts were drawn up by the accountants on Mr West's instructions for the liquidation proceedings. The outstanding balance on Mr West's loan account of £129,151 at 26 July 2011 was repaid in full. Gross profit for the period was £101,301 and no other income was receivable. Retained profits were less than £250. The book value of fixed and current assets was £3,475. Astral, therefore, had no means of paying the PAYE and NICs liability of £99,886 on 28 July 2011 when Mr West saw the accounts, nor would Astral be able to generate funds in the future as it was going to be wound up imminently. The position in this case is quite

different from a struggling but on-going company where the owner/manager and accountants have a reasonable belief that the company will be able to meet its liability to HMRC – when due – from trading income or realisable assets. Here, the book-keeping entries in relation to the deduction of PAYE and NICs on the gross remuneration of £202,967 were entirely notional. They had no substance in reality.

98. Mr West was advised to vote himself remuneration rather than dividends and he gave instructions to his accountant which, as his representative, Mr Slater, said "put in train the arrangements for which a calculation was made of the net remuneration to pay off his loan account and of the relevant [grossed up] PAYE and NICs". Mr West's loan account had not been repaid in full in any of the previous three years but on this occasion it was because, as Mr West knew, repayment of his indebtedness to Astral in full, would leave the Joint Liquidators with no recourse to him for the company's liabilities to outstanding creditors. Mr West saw the Draft Management Accounts and he signed off the list of creditors for the Joint Liquidators' Statement of Affairs for the Meeting of Creditors on 13 September 2011. He knew that the PAYE and NICs liabilities had not been paid to HMRC and that it would be impossible to pay them from the liquidation of the assets of the company. Mr West knew that the deductions for PAYE and NICs were book-keeping entries which were merely a cosmetic calculation and that in reality no such deductions had taken place because the gross remuneration of £202,967 from which the deductions were supposedly made was not in Astral's possession and that Astral had no means of paying the sums due to HMRC.

99. In the grounds of appeal Mr West, as sole shareholder and director, accepts that for practical purposes he and the company are one and the same. As Mr West was Astral's "controlling mind" and his knowledge was Astral's knowledge, I would, therefore, conclude that, by creating obligations – to deduct in the case of PAYE and to pay in the case of NICs – which Astral knew it could not meet, Astral has wilfully failed to discharge those obligations and has done so, in the knowledge, indeed at the instigation of, Mr West. I would dismiss the appeal.

100. It would appear to me that Judge Clark's decision to allow the appeal leaves the door open for owner/managers of small businesses that are about to fail and go into liquidation to make preferential and potentially unfair payments to themselves at the expense of trade or other creditors, like HMRC, who are then unable to receive their rightful distribution from a liquidation of the companies' assets. I do not feel that this can be an appropriate interpretation of the regulations in the circumstances of this and similar cases.

**Outcome of the appeal**

101. Mr West's appeal against HMRC's direction under reg 72(5) Condition B, the consequent assessment for 2010-11, the closure notice for 2011-12, and against HMRC's decision under s 8(1)(c) SSCTFA 1999, is allowed.

**Right to apply for permission to appeal**

102. 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.

**JOHN CLARK**
**TRIBUNAL JUDGE**

**RELEASE DATE: 3 AUGUST 2016**