[2011] UKFTT 525 (TC)

TC01372

Appeal number TC/2009/14787 & 14788

PAYE- Company failed to pay tax in circumstances where the directors and owners knew that PAYE and NIC had not been deducted- the Income Tax (Pay As You Earn) regulations 2003 Regulations 72 and 188 – Social Security (Contributions) Regulations 2001 Regulations 86 – PAYE and NIC payable by directors - appeal dismissed.

FIRST-TIER TRIBUNAL

TAX

DEREK STUART PINION **Appellants**
and
CHRISTINE ANNE PINION

- and -

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

TRIBUNAL: DAVID S PORTER (JUDGE)
PETER WHITEHEAD (MEMBER)

Sitting in public at Alexandra House, Manchester on 15 July 2011

Mr Derek Stuart Pinion for the Appellants

Mr Eugene Walsh, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. Derek Stuart Pinion (Mr Pinion) appeals on behalf of himself and his wife, Christine Anne Pinion (Mrs Pinion), against the Directions raised under Regulation 72 of the Income Tax (Pay As You Earn) Regulations 2003 and Regulation 86 of the Social Security (Contributions) Regulations 2001 in the sum of £39,720.64 for him and £34,233.58 for Mrs Pinion, and the discovery assessments on 3 December 2008 under section 29 the Taxes Management Act 1970 (the 1970 Act) to give effect to the same. Mr Pinion says that he and his wife relied on the accountants for Expernet Ltd (the company) to prepare the PAYE and NIC returns and that they were unaware that the amounts due had not been paid. They had submitted and amended their self-assessment returns and the Respondents (HMRC) should have been aware that PAYE and NIC had not been paid and they could not now raise a discovery assessment, as they were out of time. Furthermore the company's accountant had not taken into account either an allowance for the research and development relief, to which the company was entitled, or start up or terminal loss allowances. HMRC say that Regulation 72 of the Income Tax (Pay As You Earn) Regulations 2003 and Regulation 86 of the Social Security (Contributions) Regulations 2001 allowed HMRC to assess Mr and Mrs Pinion to the company's PAYE and NIC obligations because Mr and Mrs Pinion knew that the company had wilfully failed to deduct the correct amount of Tax and NIC.

2. Mr Eugene Walsh (Mr Walsh), an Inspector for HMRC, appeared on behalf of HMRC and called Douglas Smalley, a Higher Officer of HMRC and a case worker for the PAYE Directions unit, who gave evidence under oath. Mr Walsh produced a bundle of documents for the tribunal. Mr Pinion appeared for the Appellants and gave evidence.

3. We were referred to the case of *Regina v Commissioners of Inland Revenue; Queen's Bench Division.* C)/3724/94

The Law

4. The Income Tax (Pay As You Earn) Regulations 2003, Regulation 21 requires an employer to deduct the appropriate tax from an employee based on that employee's Tax Code and under Regulation 66 prepare the appropriate work sheet.

Regulation 72 (and Regulation 86 (1) a (ii) of the Social Security (Contributions) Regulations 2001, which is in similar terms) allow HMRC to recover PAYE and NIC respectively from an employee where insufficient PAYE and NIC have been deducted and:-

A. Not applicable

B. They are of the opinion that the employee has received the relevant payments knowing that the employer wilfully failed to deduct the amount of tax which should have been deducted from those payments.

an appropriate Notice has to be served on the parties.

Regulation 73 requires an employee to provide forms P35 and P14 identifying the employees and the amount of tax deducted before the 20 May following the end of a tax year.

Regulation 686 identifies the time when the payment is to be made in respect of directors who receive income from their employment. Rule 3 (a) provides that this is when the sums on account of income are credited in the company's accounts or records…..

Section 8 (1) (c) of the Social security Contributions (Transfer of Functions etc) Act 1999 provides for Officers of the Board to decide whether a person is or was liable to pay contributions by removing the liability for NIC from the employer and transferring it to the employee.

Section 9A of the 1970 Act allows HMRC to enquire into a return within 12 months of the filing date of the return or if delivered after the filing date up to and including the quarter day next following the anniversary of the day on which it was delivered

Section 29 of the 1970 Act refers to the raising of the assessment and provides that an assessment may not be raised outside the above time limits unless:

> Section 29 (4) .. the situation is attributable to fraud or negligent conduct on the part of the taxpayer **or the person acting on his behalf** (our emphasis)
>
> Section 29 (5) (b) there was insufficient information either in the return or accompanying documentation for the Officer of the Board to have been aware of the matter which gave rise to the further assessment.

Section 54 of the 1970 Act allows HMRC and the taxpayer to reach an agreement as to any liability which agreement has the same effect as a decision by the Tribunal.

Preliminary matters

5. Mr Walsh sort to introduce a second witness statement by Mr Smalley dated 22 June 2011 and invited the Tribunal and Mr Pinion to read the same. Having done so, the Judge observed that the statement consisted almost entirely of the 'without prejudice' negotiations between the parties leading up to the raising of the assessment and the appeal. As a result, the Judge disallowed the introduction of that evidence. Mr Pinion advised that he had been unable to afford to instruct the TACS Partnership, who had been instructed as experts by his second accountants, Messrs G J Wood & Co, and as a result he appeared on behalf of himself and his wife. The hearing was adjourned at 1.00pm for lunch, at which point Mr Pinion advised the Tribunal that he had a medical appointment in Crewe at 3.00pm and that he would not be returning after lunch. The Judge pointed out to him that since he must have known the appeal was listed for one day, he should either have sought an adjournment or cancelled his medical appointment. Mr Pinion indicated that he only knew of the hearing date on Wednesday 13 July (this week) and that he needed to go to the medical appointment although he did not indicate what the appointment was for. The Judge asked if there were any points upon which he wished to cross-examine Mr Smalley, who by that

time had given evidence (as had Mr Pinion) and he indicated that he and his wife had relied on the accountant, Robert Graves (Mr Graves), against whom it was intended to commence proceedings for negligence, depending on the outcome of this appeal. Furthermore, he submitted that if the company's accounts had been completed correctly by Mr Graves there would be nothing fanciful about their content. The Judge told Mr Pinion that in view of the fact that all the evidence had been heard and there was nothing more Mr Pinion wished to add, the Judge and the member would hear the submissions from Mr Walsh in Mr Pinion's absence as it was not appropriate, so far into the appeal, to adjourn the case. Mr Pinion understood that the appeal would continue in his absence.

The facts

6. Mr Pinion gave evidence under oath. The company was formed in 1999 and had initially traded as website designers. The company had expanded into traditional software developers and had designed a programme which interrogated information within a business computer in such a way that useful data could be extracted for management purposes. The accounts for the company have been produced for the years 31 May 2004 and 2005 by Mr Graves, the proprietor of the franchise business "Tax Assist". The accounts revealed a turnover of £229,081 and £178,738 respectively. Mr Pinion told us that the company outsourced its accountancy function to Mr Graves. Mr Pinion appeared to know surprisingly little about the financial arrangements within the business. He could not say what the profits for the two years were or the amount of the PAYE and VAT outstanding. He indicated that he and his wife did not realise the company was in difficulties until Mr Graves advised them that it was insolvent. Mr Pinion appeared unable to explain why that should be, but said that Mr Graves had recommended that the company should cease trading. The company has been struck off the register by companies house on 9 March 2010. It appears from his letter to Mrs England, acting for HMRC, dated 5 July 2006 that he acquired some furniture and computer servers from the company for £10,940. He was unable to tell the Tribunal what had happened to that money save that he assumed it had been paid into the company's account. He also indicated in the letter that the company had very few creditors, an overdraft facility of £15000, and owed £11,358.86 by way of VAT. When cross-examined by Mr Walsh, he confirmed that he and his wife had formed three other companies; Chiron Solutions Ltd; Chiron Support Ltd and Chiron Software Ltd. He thought that Chiron Solutions might owe some PAYE but he was not sure. We found his evidence to be unbelievable. There are in the bundles, copies of the accounts as mentioned above. The accounts to 31 May 2005 reveal an operating loss of £155,924. The turnover, however, was only £50,000 less than the year to 2004. We note, however, that the directors emoluments have increased from £9,400 in the year to 2004 to £147,965 in the financial year ending 31 may 2005. Mr Pinion told us that he and his wife were drawing between £50 - 60,000 each year from the bank. We do not believe that Mr Pinion had no idea how much profit the company was making or how much money he and his wife had drawn out of the company. £147,965 is a considerable sum of money to receive as drawings in one year and almost equated to the turnover for the year to 31 May 2005. He has formed several companies and had designed a software application to provide this type of information to businesses.

7. Mr Pinion referred us to the letter from the TACS Partnership, dated 11 August 2010, and invited us to read the same as he did not understand the technicalities of the appeal. The letter indicated that the company accounts revealed a director's overdrawn loan account of £45,957 as at 31 May 2004 and £82,082.14 by 31 May 2005. It appears that Mr Graves had recommended that Mr and Mrs Pinion should vote themselves a bonus of £82,082.14. In the Notice of Appeal the accountants stated that Mr Pinion had given specific written instructions to Mr Graves that no action should be taken that would result in the directors incurring liability for the company's future debts, although a copy of these instructions were not shown to us. They appeared as one of the reasons for the appeal in the appeal notice. Following that bonus payment, the loan account became overdrawn again, such that by November 2005 the balance had reached a total of £33,538.44, at which time a further bonus was voted. The TACS Partnership suggested that it was necessary to decide when the relevant payments were made. HMRC had suggested that this must have been when the monies were drawn from the business. The TACS partnership suggested, however, that Mr and Mrs Pinion were merely paying back sums they had borrowed from the company. This was consistent with the entry "other debtors" to note 8 in the accounts to 31 May 2004. On that basis, the relevant payment for PAYE purposes did not arise when the monies were loaned to the directors, but rather at the point when the bonus was voted to clear the loan account. When the bonus was paid the company's previous accountants grossed up the payment as follows:-

Overdrawn balance to be dealt with by bonus			£82,082.14
Salary payments			
	Mr Pinion	£37,191.07	
	Tax	£ 3,850.00	
	Mrs Pinion	£37,191.07	
		£ 3,850.00	£82,082.14

Overdrawn balance May 2005			Nil
Drawings May 2005 – November 2006			£33,538.44
Salary payments		16,769 x 2	£33,538.44

			Nil

The net benefit to Mr and Mrs Pinion was the amount of salary voted less the tax deducted. As a result it was suggested that Regulation 72 could not apply because condition B requires the employer (the company) wilfully to fail to deduct the amount

of tax which should have been deducted from the payments. The failure to pay over the tax to HMRC is not dealt with by the Regulation and not, therefore, in their view relevant. Mr and Mrs Pinion had in their self-assessment returns, as repaired in March 2006, shown their incomes as £62,351.89 with tax paid of £17,141.30 which had resulted in a tax refund of £2,958. Although forms P35 and P14 had been submitted on time to HMRC, as required by the legislation, the record of payments made to HMRC for both years 2004/05 and 2005/6 showed underpayments. Mr and Mrs Pinion had been receiving drawings on a monthly basis in advance of salaries, which had not had the PAYE tax and NIC deducted at the time of payment.

8. We have been advised that an enquiry had been opened into the company's accounts for the period ending 31 May 2005 on 26 May 2006 and closed on 30 October 2006. During the course of the enquiry, the review of the loan account took place and it was accepted by HMRC that disclosure of the conversion of the debt to salary was disclosed when the accounts were received. As a result, the grounds of appeal submitted that as the 2005 return had been repaired in March 2006 and a letter detailing the circumstances of the repair had been submitted to HMRC, HMRC could not rely on the discovery provisions and the 2005 tax return could not be amended as the time limit had expired in July 2007 and section 29 (5) (b) of the 1970 Act applied.

9. HMRC had agreed that Mr Graves should have claimed a Research and Development tax credit of £38,959, but that no corporation tax loss or section 419 (4) Income and Corporation Taxes Act 1988 (loans to participators) was available to the company in the absence of the receipts of Returns for the relevant periods and in respect of which there was a two year time limit and any application would now be out of time. As a result of the appropriate allowances being made, the liability under the PAYE and NIC legislation is as follows:

		Tax and NIC
2004/5		£77,329.00
Mr & Mrs Pinion	£54,262	
Non Director	£23,067	
2005/6		£47193.00
Mr & Mrs Pinion	£32,780	
Non director	£14,413	
---	---	---
Total tax due		£124,522.00
R & D Tax credits		£ 38,959.00
Tax due		£ 85,563,.00

Submissions

10. Mr Walsh submitted, in Mr Pinion's absence, that Mr Pinion must have been aware of the amounts outstanding as he had specifically written to the accountant to make sure that he and his wife should not incur any liability. The appropriate amounts of PAYE and NIC had not been paid over to HMRC and Mr and Mrs Pinion knew that was the case. HMRC were entitled to rely on Regulation 72 in such circumstances and although there was no apparent time limit in which such claims could be made, HMRC had acted within the relevant time limits. Mr and Mrs Pinion were 50% shareholders in the company and must have been aware of the company's financial position. Company Law requires directors to act responsibly in the running of their companies and Mr Pinion could not abrogate his responsibility by relying entirely on the company's accountants. He had signed the forms P35 and P14 and it was his responsibility to ensure that they were completed correctly and that the PAYE and NIC contributions had been properly accounted for. Mr Walsh referred us to Mr Justice May's decision in *Regina v Commissioners of Inland Revenue; Queen's Bench Division.* C)/3724/94. That case dealt with earlier legislation, but the facts were not materially different. Mr McVeigh, the director in question, had been paid a bonus and details of the tax deductable had been entered in the books of McVeigh Construction (Nottingham) Limited of which Mr McVeigh was a 50% owner. Mr Justice May decided that as the tax had never been paid it could not be said to have been deducted and Mr McVeigh was therefore liable to pay the tax personally as he had acted wilfully. In the circumstances the assessments should be confirmed.

11. Mr Pinion had not been present to sum up the position from his point of view. He made it abundantly clear at the hearing that he and his wife had relied on the accountant to whom the company had outsourced all the taxation matters. For his part, he started that he did not understand the legal representation made by his accountants in the Notice of Appeal. As a result, it was not unreasonable for him and his wife to be unaware of what was required. In his absence, we can only refer to the comments by Mr Graves and the grounds for the appeal set out in the Appeal Notice. It appears that the accountants are of the opinion that section 29 (5) (b) of the 1970 Act applies as HMRC had sufficient information at the time of the submission of the self-assessment return, as repaired, to have been alerted to the fact that that PAYE and NIC had not been paid, the more so because the company had been subjected to an enquiry. HMRC could not avoid that section by relying on Regulation 72. In any event they had taken over two years to raise the assessment and it was not reasonable in the circumstances for them so to do.

The decision

12. We have considered the law and the facts and have decided that the assessment should be confirmed. We do not accept that Mr Pinion was unaware of the reasons why the company was insolvent. He had seen the accounts for 2003/4 and must have known that the company had only made a profit of £2,624. He told us that he and his wife were drawing £50,000 to £60,000 out of the business and that the company turned over between £150,000 and £200,000. He must have known that in drawing the bonuses in addition to the drawings, a total of £147,965 that the emoluments would have equated to the gross turnover of the company. He told us the company had developed a software system that allowed businesses to interrogate their own computers to obtain the salient information to improve the ability to run their business. Mr Pinion could not have developed such a system without himself having the knowledge as to how a business operated. In fact he and his wife had 3 other companies and he conceded that one of those companies might also owe PAYE to HMRC. We find that Mr Pinion acted negligently and that he knew that the company had wilfully failed to deduct the appropriate PAYE and NIC and that an assessment under Regulation 72 was properly raised. The company's accountants contention that the discovery assessment could not be raised because of section 29 (5) (b) of the 1970 Act applies is ill-conceived. Mr Pinion has told us that he will be suing Mr Graves in negligence as a result of this decision. Section 29 (4) of the 1970 Act allows a discovery assessment where the return resulted from the fraudulent or negligent conduct on the part of the taxpayer or **the person acting on his behalf**. The discovery assessment can be raised as a result of the negligence on Mr Pinion's and his accountant's part. There appears to be no time limit as to when the Regulation 72 direction should be made. We do not consider that HMRC have taken an unreasonable time in making the direction. As Mr Justice May has said in *Regina v Commissioners of Inland Revenue; Queen's Bench Division.* C)/3724/94:

> ".. But in this case the employer, to Mr MCVeigh's knowledge, has neither accounted for nor paid the tax and these failures were wilful… In these circumstances I consider it would be a misuse of language to say that the book-keeping and accounting alone, without actual payment, and without any procedures which the Regulations require, constitute a deduction of tax from the gross payments. There was, on the contrary, a wilful failure to do anything relating to Tax obligations, beyond making some internal paper entries which the company proceeded to ignore for tax accounting purposes and which Mr McVeigh also ignored when he submitted his own tax return".

We confirm the assessment and make no order as to costs since the cost regime under Rule 10 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 applies.

13. 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.

5

TRIBUNAL JUDGE
RELEASE DATE: 2 August 2011