TC02477

Appeal number: TC/2012/05331

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

ALKEMI M F TECHNOLOGIES LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE MICHAEL S CONNELL
SUSAN STOTT FCA CTA

Sitting in public at Alexandra House the Parsonage Manchester on 23 August 2012

Mr. Stephen Schwarz Director of the Appellant Company

Mr. P Jones Officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal against a penalty assessment (as amended) of £1,307.31 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 dates and amounts of the PAYE payments due and made were not in dispute. The appeal was mainly based on "reasonable excuse". The Appellant argued that the main reason for late payments was insufficiency of funds and that the insufficiency was attributable to events outside its control. The Appellant also argued that it was unaware of the new penalty regime.

Background

3. The Appellant is based in Flintshire and provides electroplating, shot blasting and powder coating services to engineering, aerospace, automotive and various other industries. It has 15 employees.

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. The Appellant was late in paying its monthly PAYE and NICs to HMRC ten months in the 2010-11 tax year. The first month is disregarded and therefore there were nine defaults. 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 9 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	Due Date	Payment Date	Days Late	Penalty @ 4%
£4231.81	19.05.2010	2010	5	disregarded
£4781.46	19.06.2010	2010	1	£191.26
£4555.33	19.07.2010	2010	6	£182.21
£4625.47	19.08.2010	2010	24	£185.02
£4518.62	19.09.2010	2010	26	£180.74
£4662.09	19.10.2010	2010	52	£186.48
£4840.43	19.11.2010	2010	79	£193.62
£5393.46	19.12.2010	2011	98	£215.74
£5209.75	19.01.2011	2011	87	£208.39
£4990.54	19.02.2011	2011	94	£199.62
£0	19.03.2011	2011	No payment	£0
£0	19.04.2011	2011	N/A	£0
£43,577.15		TOTALS		£1307.31

7. HMRC assessed a penalty at the 3% and notified it to the Appellant in a letter dated 10th November 2011. The Appellant did not ask HMRC for an independent review and appealed to the Tribunal on 1st May 2012.

8. The arguments in the Appellant's notice of appeal and the letters to HMRC were that

1. In a terrible economic climate they have always made arrangements with HMRC for time to pay and have always paid in full under the arrangements made
2. They have suffered bad debts over the years and have had to extend payment terms from 30 days to over 60 days to be flexible and support its customers who are also struggling to pay. This affected the company's cash flow drastically
3. They were unaware of the extreme penalties being imposed on small businesses.
4. It is unfair to penalise a struggling small company with further financial burden.

<u>The legislation</u>

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. It was 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 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 28 March 2012. This revised penalty notice revised the amount of the penalty previously imposed to take account of 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 £2,168.24 was reduced to £1,307.31

The Appellants submissions

25 Mr. Schwarz said that the penalties should not be confirmed because the Appellant had a reasonable excuse for the default. The reasonable excuse on which he sought to rely was that the Appellant was suffering from a severe shortage of funds during the relevant period, attributable to a number of reasons, but mainly unforeseen circumstances and events outside its control. It was obliged to pay employees and suppliers but suffered late payments from its customers. The Appellant was unable to borrow any more monies from its bank because it was already committed to other funding arrangements, which had not been properly explained to it by the bank concerned. It is a family business and the shareholders had put all their available capital into the company, even to the extent of using their own properties as collateral security with personal guarantees and borrowing on credit cards. The Appellant has three of four major customers and a good spread of small ones. Its trading terms are 60 days but many customers take 90 days or more to settle invoices. In the default year they had £30,000 of bad debts which Mr. Schwarz described as being 'not as bad as it could have been'. The company had moved to a new site and purchased another business. During that process the company consolidated its borrowings, which was secured over its new premises. This was achieved under a hedge fund arrangement which Mr. Schwarz felt had not been fully explained to him by the funder, Barclays bank Plc. The bank had taken all of the equity in the new premises and therefore there was nothing left for the Appellant to use if it was to increase its overdraft facility. Although the combined companies achieved economies of scale, the capital outlay, economic crisis and constraints imposed by the borrowing arrangements created a severe cash flow shortage.

26. Mr. Schwarz said that monthly reminders issued in respect of late payments never mentioned penalties and he was totally unaware that the PAYE penalty regime had changed. In phone calls, HMRC only ever mentioned that they had the right to impose penalties. The Appellant was never told that penalties *would* be imposed. The first time the Appellant was informed that a penalty had been incurred was in the notification of 10 November 2011. Mr. Schwarz argued that even if HMRC could not have known the final amount of a penalty until the end of the year in question, they would have known, at the time of the first late payment which counted as a default, that there would be a penalty and the minimum amount of the penalty. He therefore argues that HMRC should at that time have informed the Appellant or raised a penalty.

27. Mr. Schwarz send that they were now operating a factoring arrangement, which basically involved invoice discounting through their new bankers.

28. Mr. Schwarz said that the penalties were unfair and totally disproportionate. He said the Appellant's company had tried its best and that the Appellant was now paying its PAYE and NIC mostly on time and that this was a result of introducing new systems. 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 contact with HMRC and because the Appellant was making regular 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 "may have been able to do something about it"

HMRC's submissions

29. Mr. Jones for HMRC said that the Respondents accept that the onus is on them to show default, but as that Appellant had accepted the payments were late it is for them to show why the penalty should not be charged and that the standard of proof is on the balance of probabilities.

30 Mr. Jones submitted that the Appellant had no reasonable excuse for the late payment of the PAYE. He submitted that under paragraphs 11 of Schedule 56, HMRC had no discretion as to the imposition of the penalty. He 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 the penalty. He said that in the first year of the penalty regime HMRC had targeted taxpayers who were the most persistent defaulters on a risk-assessed basis.

31. Mr. Jones submitted that lack of awareness of the penalty regime was not a special circumstance. He 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. He said that all of this should have acted as an early warning to the Appellant that the penalty regime was about to change. HMRC made every effort to educate employers on the changes .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. The website makes the deadlines for payment quite clear:

'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.'

32. Mr. Jones said that the Appellant was sent a warning 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. HMRC were not able to produce a copy of the original letter as it was a computer-generated letter, which could not just be printed off. He was able to produce a copy of the format of the letter, which warned that continued late payment could result in a penalty being charged. As referred to above he said that the letter gave links to various web-pages were more information could be obtained. The letter also included an offer to sign up to receive e-mail alerts as due dates approach, and informs the addressee to contact the business payment support service in the event of the employer being unable to pay PAYE on time. Mr. Jones said that the Appellant appear to have made little or no effort to make itself aware of its obligations,

33. Mr. Jones explained that the Appellant did have a time to pay arrangement with HMRC for the previous year, 2009–10. This was set up on 5 May 2010 and was in respect of an underpayment for 2009–10. Unfortunately, the arrangement was not adhered to and therefore cancelled in April 2011. There was no time to pay arrangement for the default year 2010–11. He said that bad debts and difficult trading conditions are a normal part of business suffered by most companies. The company had not demonstrated anything unusual or unexpected beyond the problems encountered during the normal course of trade.

34. Mr. Jones said that in order to obtain payment, HMRC had to specify amounts due for payment by the Appellant in months 9, 10, 11 and 12, under regulation 78 of the Income Tax (Pay as you earn) Regulations 2003.

35. Finally, Mr. Jones confirmed that the new penalty regime appeared to have created some improvements in terms of the Appellant adhering to its obligations to pay PAYE on time but that there had still been for defaults after August 2011

Conclusion

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

37. 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. 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, which happen on a regular basis, do not suffice. There were no unusual circumstances, which might have caused the insufficiency of funds. 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 similarly put in place measures to avoid late payments of PAYE and NIC in the default year

38. HMRC were not under any statutory duty to seek to warn the Appellant of change and 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.

39. 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.

40. 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 first default would have attracted no penalty if there had been no further defaults for the remainder of the tax year. 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.

41. 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 would have taken to reduce or eliminate the possibility of further defaults. Nonetheless this does not absolve the Appellant of its liability to penalties. Moreover HMRC's use of terminology such as 'may' does not lack clarity and is not inconsistent with its obligations under Schedule 56. 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.

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, as these are, 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 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