TC02636

Appeal number: TC/2012/07100

Income Tax - Claimed under-payment of Income Tax under the PAYE Regulations - payments to part-time bar workers (generally students) - Penalties under section 98A(2)(a) Taxes Management Act 1970 for failing to deliver returns for PAYE purposes - whether there was neglect, enabling HMRC to make assessments for earlier years - Appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

MR. & MRS. BROWN **Appellants**
trading as
GAMEKEEPER INN

-and-

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

TRIBUNAL: JUDGE HOWARD M. NOWLAN
ELIZABETH BRIDGE

Sitting in public at 45 Bedford Square in London on 25th March 2013

Mr. Brown, in person, on behalf of the Appellants

David Glassonbury of HMRC Local Compliance Appeals and Reviews Unit on behalf of the Respondents

DECISION

Introduction

1. This was a short, relatively simple, and indeed sad case relating to the fact that the Appellants, ignorant of the fact that they were required to complete either Forms P46 or P38S when employing part-time and student bar workers, waiters and waitresses who had no P45s to illustrate past-earnings when first employed by the Appellants, paid those staff without deducting anything in respect of PAYE. The non-deduction was based on the general belief that the earnings of the relevant recipients would have been well below the level at which any tax or National Insurance was due.

2. HMRC commenced its enquiries into this case in 2010, prompted by the fact that the partnership returns indicated that salaries of roughly £20,000 had been paid in all the years since 2003/2004, without any PAYE tax having been accounted for, and without the Forms P46 or P38S, or end of year returns on Forms 35 having been completed and submitted to HMRC.

3. To their credit, HMRC invited the Appellants to complete, and to ask the relevant part-time employees to complete, the relevant forms in arrear, HMRC making it clear that they had no interest in seeking to impose tax when none had been owing. Not surprisingly, the Appellants had not entirely understood how the forms should be completed, and what information they should expect ex-employees to provide, and for the earlier years when students who had been engaged during holidays and had left the area, it proved difficult to complete the forms correctly, and in most case for the earlier years, impossible to submit them at all.

4. The initial result of the largely unsuccessful endeavour to complete Forms P46 retrospectively was that HMRC was satisfied that some of the employees would not have suffered any tax on what they were paid, but it was suggested that some would have suffered tax. Where the information was incomplete and particularly where no forms had been submitted at all, largely for the earlier years, HMRC made assessments at the basic rate for the difference between the minor level of payments made to identified employees in the earlier years **who they were satisfied would have suffered no tax** and the total figures of salary claimed in the partnership accounts. This was naturally on the basis that the Appellants had been unable to demonstrate that no tax would have been owing, and so basic rate tax was charged.

5. By the time, in 2009/2010, that the Appellants had appreciated that they needed to make the relevant returns, there was no disparity at all between the wages paid, and the deduction for salary claimed in the partnership accounts. The progressive lack of information for the earlier years meant, however, that for the reason mentioned in the last sentence of the previous paragraph, the tax claimed for the earlier years increased considerably. In addition the basic rate of tax had been 22% not 20% and the charge for interest was naturally higher.

6. The initial tax, interest, and the penalties for non-presentation of end of year returns thus came to the figures of £21,634.66, £5,206.64 and £8,400, or £35,241.30 in total.

7. The figures were, however, reduced on review. The reviewer made no adjustments for the years 2008/2009 and 2009/10. Those were the years for which much more reliable information had been provided, and accordingly for which HMRC

had concluded that about half the recipients would have been non-taxable, such that the claimed tax liabilities were fairly modest. The reviewer then took the manifestly sensible view that it was inappropriate to proceed for the earlier years on the basis that tax would always have been due when no information was available. Instead the reviewer took the ratio from the year 2009/2010, namely that tax would only have been due in respect of 50% of the payments, and applied that 50/50 fraction to the earlier years from 2007/2008 back to 2003/2004. This lead of course to a considerable reduction in the total tax claimed from £21,634.66 to £15,682.36. There would accordingly be a significant reduction in the interest claimed, though no adjustment to the penalty charge of £8,400 since the Appellants had not asked for that to be reviewed, and had indeed not appealed against the penalties.

8. It is worth making two final points by way of introduction. First, it is fairly obvious that there was relatively little dialogue between HMRC and the Appellants and that Mr. Brown, who represented the Appellants before us, thought that his only expedient was somehow to obtain more completed Forms 46, which was obviously going to be difficult. It is equally obvious, particularly when correspondence from HMRC threatened him with bankruptcy, that Mr. Brown had little idea what he should do and was obviously terrified by the problems that the Appellants faced. The second point to make is that until actually appearing before us, he had no idea that his general Appeal to the Tribunal related only to the tax claimed and not the penalties totalling £8,400.

The evidence, the facts in more detail and our Decision

9. We have absolutely no hesitation in saying that Mr. Brown was honest and we accepted everything that he said. The significance of what he said will become clearer when we expand on the facts but the essential points that he was keen to make were that HMRC had been wrong in at least two cases, namely the payments made to a Craig Howells (in the years 2003/2004, 2004/2005 and 2005/2006) and the payments made to Christina Whitlock (in the years 2006/2007 to 2009/2010) in saying that their wages would have been taxable. As we will explain below he was adamant that they would have suffered no tax.

10. The reviewer based his 50/50 calculations on the facts in relation to the year 2009/2010, and in relation to the far from illuminating information derived from those retrospective Forms 46 than had been provided. As we have already said, the amounts paid to identified employees in 2009/2010 exactly corresponded to the salary deductions claimed in the partnership accounts, the total figure being £19,080. HMRC were satisfied that no tax would have been due in respect of five of the nine part-time employees engaged in that year, and so the wages payments to the other four were the ones where HMRC suggested that basic rate tax should have been paid. Those other four employees (indicating against each the wages paid) were Christina Whitlock (£4160), Lee Pudge (£3,120), H. Teague (£1,300) and S. Brown (£1,114). The total of those payments was £9694, which was approximately half the total salaries for the year of £19,080, which is of course where the 50/50 fraction came from.

11. HMRC indicated that when Christina Whitlock had first been engaged (in May 2006, i.e. just one month after the start of the tax year) she had had previous employment, and that therefore tax should have been deducted from her wages. According to Mr. Brown, Christina Whitlock had been employed as a waitress by Little Chef until April or May 2006, and that to his absolute knowledge she had had no other employment whilst employed by the Appellants. She had been paid £4,000

in the first three of those years and £4,160 in 2009/2010. Apparently she no longer works for the Appellants, but now works for some similar chain to Little Chef. She was in her 30s, and has two children.

12. We are quite satisfied that, when HMRC decided that her past employment meant that tax should have been deducted from the wages paid to Christina Whitlock, that this conclusion was wrong. We accept Mr. Brown's evidence that there was no possibility of Christina Whitlock having remained employed by Little Chef at the time she actually worked for the Appellants, or to have had any other employment when working for the Appellants, with the obvious result that her wages fell well below the tax threshold, and no tax should have been deducted.

13. Taking the cases of H. Teague and S. Brown, it appears that they were treated as employees in respect of whom tax should have been deducted because they had not completed Forms P46. Mr. Brown told us that S. Brown was in fact one of his sons, who was 16 in the year 2009/2010, and that he had no other income than the £1,114 recorded in the present figures. Mr. Brown also indicated that H. Teague was a friend of one of his sons and that he had had no other employment.

14. Lee Pudge completed his Form P46, and indicated that he had some other employment. Mr. Brown confirmed that he was a building worker and that he did intermittently have employment as a builder, though was often also out of work. Mr. Glassonbury, representing HMRC, indicated that Lee Pudge had at least in one year recovered the whole of the CIS tax deducted from his earnings. Whether, thus, he might have had further income that he could have received without being liable to tax, or whether the CIS payments happened exactly to match the level of income that was not liable to tax, we do not know. For present purposes, we accept that tax should have been deducted from Lee Pudge's income in 2009/2010 at least for the reason that Mr. Brown could not establish that any of that income should have been tax free.

Our Decision for 2009/2010

15. It follows from our conclusion that tax would only have been deductible (or at least "arguably deductible") in 2009/2010 in respect of approximately 16% of the total salary paid, rather than 50%. We accordingly conclude that the tax that should have been deducted by the Appellants in 2009/2010 was 20% tax in respect of £3,120 or £624.

The two immediately earlier years and our Decision for those years

16. In the tax years, 2006/2007 to 2008/2009, the only identified employees who HMRC claimed should have suffered tax were Christina Whitlock and Lee Pudge. On the reasoning that that conclusion was plainly wrong in relation to Christina Whitlock, the only identified employee who should, or rather "might properly", have suffered tax was again Lee Pudge, and he received £2340 in 2006/2007 and £3120 in the later two years.

17. Rather than follow the reviewer's entirely understandable approach of applying his 50/50 fraction to the total salary payments in each of the years, preceding 2008/2009, we consider that the most appropriate approach is to treat the salary that should (or "might" properly) have suffered deduction of tax in the years 2006/2007, 2007/2008 and 2008/2009 as £2,340, £3,210 and £3120. Those were the payments paid in the three years to Lee Pudge. We leave aside, at this point, the separate

question of whether HMRC can demonstrate "neglect" on the part of the Appellants such that HMRC can make an assessment for the period 2006/2007 at all. Subject to that, the figures just given are the ones in respect of which the assessments should be confirmed, the assessable tax therefore being £514.80 for 2006/2007, £686.40 for 2007/2008, and £624 for 2008/2009 and 2009/2010.

The three earliest years

18. The three earlier years, namely 2003/2004 to 2005/2006, raise two points. First there obviously arises again the question of whether HMRC can demonstrate neglect so as to make assessments for these periods at all, and secondly there is the point that HMRC have only identified one person in each of the three years in respect of whom it is said that tax should have been deducted. That person is Craig Howells, who was paid £3,120 in each of the three years. The ground on which HMRC indicated that tax should have been deducted from his earnings was that he had some form of tax liability in 2005. We are unclear as to precisely what that liability may have been but we certainly understood from Mr. Brown that Craig Howells was 13 in 2003, and therefore still only 15 in 2005.

19. One approach that we might take (leaving aside the "neglect" issue) would be to follow the approach of the reviewer, who applied his 50% multiplier to the total salary of the earlier years, save that we would apply the figure of 16% rather than 50%. We consider that this would not be appropriate. When the only identified employee who HMRC believed should have had tax deducted was aged 13,14 and 15 in the relevant years, such that HMRC's conclusion looked plainly to have been wrong, and when the invariable pattern appears to have been that payments were only made to school children and students and other part-time workers, we consider that tax should have been deducted from 8% rather than 16% of the total salaries paid in the three years 2003/2004 to 2005/2006. The resultant maths is that the salaries from which tax should have been deducted in those three years should have been £1,606.08, £!,681.04 and £1898.

Further observations

20. Still ignoring the "neglect" issue, we should add three observations to the figures in which we are inclined to confirm the assessments. First, we entirely understand how the reviewer, simply proceeding from the documents that we have seen and without the evidence of Mr. Brown, adopted the approach that he did. That approach was constructive in the sense that it made matters fairer for the earlier years. We find it easy to understand how Mr. Brown did not know quite what to represent to HMRC in letters, and was doubtless transfixed by the size of the figures claimed and the overt threat of bankruptcy. We were entirely satisfied that his evidence was honest, and it is that evidence that has led us to make considerable reductions in the assessments from those adopted by the reviewer.

21. Our second observation is that if it was possible to obtain all the facts, we have little doubt that the figures in which we are confirming the assessments would emerge to be excessive, rather than under-estimates. The plain reality in this case is that very part-time employees, most of them students, friends of Mr and Mrs. Brown's children, and a few other part-timers would have been well below the taxable income threshold.

22. Our third observation, which indeed we mentioned to Mr. Brown during the hearing, was that when the Appellants do not have the required information to demonstrate that the assessments are still excessive, the Appellants must realise that

there is always some risk that the confirmed assessments will be slightly excessive. We believe that Mr. Brown understood and accepted that. To be threatened with an impossible total bill, however, and bankruptcy in this situation, and the loss of Mr. and Mrs. Brown's business would be an absolute travesty.

The penalties

23. As we have indicated, the Appellants were charged 7 penalties of £1,200 (100 a month) and therefore £8,400 in total for the failure to made end of year PAYE returns.

24. As we have also indicated, the Appellants had not specifically appealed against the penalties, clearly believing that their general appeal extended to the penalties. Indeed we accepted Mr. Brown's word when he said during the hearing that it was not until discussions with the Respondents' representative immediately prior to the hearing that he first learnt that the Appeal before us did not extend to the penalties.

25. In view of the fact that he thought that the Appellants' Appeal before us already extended to an appeal against the penalties, we invited the Appellant to submit a late appeal and indeed wrote it out for him, and invited him to sign it. To his great credit, Mr. Glassonbury made no objection to the late application. We naturally therefore decided to accept the late application to appeal out of time.

26. Under section 118(2) Taxes Management Act, 1970, it is provided that *"where a person had a reasonable excuse for not doing anything required to be done he shall be deemed not to have failed to do it unless the excuse ceased and, after the excuse ceased, he shall be deemed not to have failed to do it if he did it without unreasonable delay after the excuse had ceased."*

27. In contrast to the reasonable excuse provisions in relation to VAT, we are able to discern a reasonable excuse where a taxpayer has sought advice and failed to do something required by virtue of that advice. In other words reliance on a professional or agent can constitute a reasonable excuse for the purposes of section 118(2).

28. We note that in the first meeting between Mr. Brown and HMRC officers on 18 August 2010, the very first material paragraph of the HMRC note of the meeting contained the following text after the officers had asked Mr. Brown why there was no PAYE scheme open when roughly £20,000 salaries had been deducted in the accounts for a number of years. It recorded that *"Mr. Brown said that they had done what their accountant, Mr. Oversby, had suggested they do and that was keep the names, addresses and details of amounts paid to all workers used."* Further down the same meeting note, the note also recorded that *"Mr. Brown does not hold any completed forms P38S or P46 for any of the workers used. As already stated he simply has a record of who has worked and the amounts paid to them, as suggested by Barry Oversby"*. We might add that it was implicit that Mr. Brown had no blank and uncompleted forms either, and almost certainly had not heard of their existence.

29. Our decision is that Mr. Brown did have a reasonable excuse for not having filed the end of year returns, because he had sought, and acted on his accountant's advice. Moreover, while the following point on its own would be a mistake of law and not something that would provide a reasonable excuse, Mr. Brown almost certainly thought that there was no need to deduct tax from wages that would be below the tax threshold, and that the absence of that need was not based first on obtaining some confirmation from HMRC to that effect, following presentation of the

Forms P38 or P46. This frame of mind, however, made it all the more understandable that the Appellants did do what their accountant had suggested they should do, and acted on that advice. That provides the Appellants with a reasonable excuse under section 118(2). We accordingly discharge the penalties.

30. We might just add the point that we feel entirely justified in relying on these statements attributed to Mr. Brown, first because they have actually been recorded by HMRC officers, and secondly and more significantly because they were made at a time when it is inconceivable that Mr. Brown could have known the possible significance of these statements in relation to his having a reasonable excuse, and thus a defence against penalties.

The late assessments

31. We finally address the question of whether HMRC has demonstrated neglect on the part of the taxpayers or the taxpayers' advisers pursuant to section 36 Taxes Management Act, 1970 in order to be able to make assessments for the earlier years outside the normal time limits. Since the taxpayer plainly failed to make returns of wage payments made, and apparently could only explain that failure by indicating reliance on his accountant's advice, we conclude that as in section 36 late assessments can be made whether the neglect was on the part of the taxpayer or of a "person acting on his behalf", HMRC do demonstrate the required "neglect".

National Insurance contributions

32. The Respondents confirmed that all payments appeared to have been below the weekly level at which NIC deductions were required, such that no liability was asserted in respect of NICs.

Two final observations

33. We would like to thank Mr. Glassonbury for exhibiting a sympathetic and highly sensible approach throughout the hearing, and for his patience in dealing with a Tribunal Judge who was less than familiar with the various notices and other details. Our conclusions would have been the same whatever his approach had been but it was extremely encouraging to see HMRC being realistic, and not wishing to inflict pain and bankruptcy on an honest taxpayer, for whom the initially claimed debts would have been not only financially fatal but utterly disproportionate.

34. We understand that HMRC's procedures for identifying amounts owing and collecting the resultant amounts are entirely distinct. We do however express a hope that HMRC will afford the Appellants' some time or assistance in meeting the liability, albeit much reduced, that remains owing.

Right of Appeal

35. 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.

HOWARD M. NOWLAN

TRIBUNAL JUDGE

RELEASE DATE: 9 April 2013