[2015] UKFTT 0213 (TC)

TC04404

Appeal number: TC/2012/03588

INCOME TAX – subcontractors – appellant company contracted with a third party provider to supply "operatives" – third party provider "net" for CIS purposes – company's failure to make CIS returns – fixed monthly penalties of £28,500 – Month 13 penalties of £56,500 – whether reasonable excuse – held, no – whether disproportionate as a breach of A1P1 - Tribunal's jurisdiction and interaction with mitigation – **Bosher** ***followed – fixed penalties upheld – Month 13 penalties set aside as excessive – appeal allowed in part***

FIRST-TIER TRIBUNAL
TAX CHAMBER

CJS EASTERN LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE ANNE REDSTON
MR DUNCAN MCBRIDE

Sitting in public at the Tribunal Centre, Bedford Square on 14 October 2014

Mr Sanders, director of the Appellant, for the Appellant

Ms Patel, of HM Revenue & Customs' Appeals and Reviews Unit, for the Respondents

DECISION

1. This was the appeal of CJS Eastern Limited ("the company") against penalties totalling £81,000 for the failure to submit monthly returns under the Construction Industry Scheme ("CIS").

2. We allowed the appeal in part and issued a summary decision. Mr Sanders, who represented the company in the appeal, has asked for permission to appeal our decision to the Upper Tribunal.

3. It is not possible to appeal against a summary decision but only against a full decision. This is that full decision. We draw Mr Sander's attention, in particular, to [21] below.

Outline of the case

4. The penalties charged on the company were made up of:

(1) fixed penalties, each of £100, charged under Taxes Management Act 1970 ("TMA") s 98A(2)(a) for failures to submit CIS returns in accordance with the relevant regulations. These totalled £28,500; and

(2) discretionary penalties for each of three years, charged under TMA s 98A(2)(b), in relation to the CIS failures which had lasted for more than twelve months. These are known as "Month 13 penalties" and totalled £52,500.

5. HMRC had offered to use their statutory discretion to reduce ("mitigate") the penalties, by following the rules which apply to more recent CIS failures, set out in Finance Act 2009, Schedule 55 ("Sch 55").

6. After HMRC's recalculation using the Sch 55 rules, the total penalty reduced to £20,700. The company refused to accept this mitigated amount, and appealed the original penalties to the Tribunal on the grounds of reasonable excuse and proportionality. The mitigated penalty was not under appeal before the Tribunal, which has no jurisdiction over the extent to which HMRC mitigates penalties.

7. For the reasons set out in the main body of this decision, we decided that the company did not have a reasonable excuse for its CIS failures.

8. However, the relevant legislation allows us to reduce the Month 13 penalties if we consider they are excessive. We found that they were excessive and reduced them to nil.

9. A different statutory provision applies to fixed penalties. The Tribunal cannot reduce them if we think they are "excessive" but only if they are "incorrect."

10. In *Anthony Bosher v HMRC* [2012] UKFTT 631 TC ("*Bosher FTT*"), the First-tier tribunal (Judge Aleksander and Ms Hewitt) decided that the CIS fixed penalties charged on Mr Bosher were disproportionate and breached Mr Bosher's rights under

Article 1 Protocol 1 ("A1P1") of the European Convention on Human Rights ("the Convention").

11. Since the Human Rights Act 1998 ("HRA"), s 3(1) requires that legislation be interpreted "so far as it is possible to do so…in a way which is compatible with the Convention rights," the tribunal decided that "incorrect" should be read down as meaning "disproportionate." As a result, the tribunal cancelled the fixed penalties.

12. When that case reached the Upper Tribunal, as *HMRC v Bosher* [2013] UKUT 579 TCC ("*Bosher*") (Warren J and Judge Bishopp), that Tribunal decided at [47(f)] that the scheme of the CIS legislation was not disproportionate and that:

(1) the word "incorrect" could not be interpreted as meaning "disproportionate," see [45]-[46], [47(a)] and [68(2)];

(2) it was not possible for the First-tier tribunal to assess, before a penalty had been mitigated by HMRC, whether it was proportionate, see [36];

(3) after HMRC had mitigated the penalty, the First–tier tribunal had no jurisdiction to consider the proportionality of that mitigated penalty, see [47g] and [61]; and

(4) a legal challenge to the extent of HMRC's penalty mitigation can only made by judicial review, again, see [47g] and [61].

13. When the principles in *Bosher* are applied to the facts of the company's appeal, it follows that:

(1) the fixed monthly penalties charged on the company were not "incorrect";

(2) although HMRC had offered to mitigate the penalties, the final position will only be known after the conclusion of the appeal proceedings. It is not possible for this Tribunal to assess the proportionality of the penalties as they are still subject to mitigation;

(3) after these appeal proceedings have concluded, this Tribunal has no further jurisdiction;

(4) the only way the company can mount a legal challenge to HMRC's final mitigated penalty decision is by judicial review.

14. The Tribunal was therefore unable to consider the company's submissions on proportionality in the context of the fixed penalties.

15. As the company had no reasonable excuse, and as the fixed penalties of £28,500 were correctly calculated, we upheld them.

After the hearing

16. We gave our decision at the end of the hearing. The outcome, of course, was that we had reduced the total penalties charged to £28,500, but this was higher than the £20,700 mitigated amount which had previously been offered by HMRC.

17. Mr Sanders found this confusing. We did our best to explain that the Tribunal had no jurisdiction over the extent of HMRC's mitigation and that this was a matter for HMRC in the light of any representations which might be made by the company.

18. On 30 October 2014, we issued a "summary" decision, at the end of which we referred to HMRC's discretion over mitigation in the context of Sch 55. Mr Sanders subsequently communicated with HMRC in an attempt to settle the matter. After several failed attempts to obtain a response, he made a complaint. Finally, HMRC responded by saying that the original mitigation offer remained open but would not be further reduced.

Summary of the position

19. After he received that letter, Mr Sanders made an application for the company to be given permission to appeal our decision to the Upper Tribunal, and attached the correspondence between himself and HMRC.

20. Having read those documents, it is clear that there is some continuing confusion. In particular, Mr Sanders ends the company's application by saying:

> "I want to escalate this complaint to the adjudicator and on to the parliamentary ombudsman because the HMRC did not take one bit of notice of the Judge - Anne Redston or the so called HM Courts & Tribunals Service, also as the tribunal does not appear to have any power what so ever with HMRC I feel this needs to be addressed by someone that actually has some power and if that is by going through the Upper Tribunal (Tax & Chancery) Chamber then I have been left with no alternative to follow this route.
>
> Please advise what I have to do as none of the literature or the websites provide a clear instruction for a reasonable let alone an ucated person to follow."

21. In an effort to clarify the matter, we set out the position as follows.

(1) Mr Sanders can send this full decision to HMRC along with any other points he wishes to make, and ask HMRC to make a final decision as to the amount of the reduced ("mitigated") penalty. He may wish to draw HMRC's attention in particular to [105]-[108] below.

(2) It is however entirely a matter for HMRC as to whether they decide that the mitigated penalty should remain at £20,700, or be further reduced.

(3) The Tribunal has no jurisdiction (broadly speaking, this means power) to decide the amount of the mitigated penalty.

(4) This is because the Tribunal only has the jurisdiction given to it by Parliament, and that jurisdiction does not extend to deciding whether HMRC's mitigated penalty amount is fair or proportionate.

(5) If Mr Sanders considers that HMRC's final decision on mitigation is disproportionate, he can only challenge that decision by taking judicial review proceedings. This is a separate legal process at the High Court. The company

may wish to obtain independent legal advice on whether to challenge HMRC's mitigation decision by way of judicial review.

(6) The decision of this Tribunal, set out in this document, does not deal with the mitigated penalty at all. Instead, it decides the company's appeal against the original penalties of £81,000.

(7) Now that the company has this full decision, it can ask this Tribunal for permission to appeal to the Upper Tribunal against this decision.

(8) An application for permission to appeal to the Upper Tribunal must be made within the time limit set out at [114]. There is no automatic extension to that time limit, simply because the company is trying to negotiate a settlement with HMRC.

(9) It is not possible to appeal against HMRC's final mitigated offer by appealing against this decision. As already stated, HMRC's final mitigated offer can only be challenged by way of judicial review proceedings in the High Court.

(10) Mr Sanders' application also says that he wants to refer the company's complaint to the Adjudicator and the Parliamentary Ombudsman. If Mr Sanders is not happy with the outcome of his complaint to HMRC he can escalate that complaint to the Adjudicator, and/or to the Ombudsman, but both are completely separate from this Tribunal.

(11) In other words, Mr Sanders cannot escalate his complaint against HMRC by writing to the Tribunals Service or by applying for permission to appeal to the Upper Tribunal.

The evidence

22. The Tribunal was provided with a helpful bundle of documents which contained:

(1) the correspondence between the parties and between the parties and the Tribunal;

(2) three HMRC notes of telephone conversations between Mr Neal (the HMRC Officer who opened the enquiry into the company) and Mr Sanders;

(3) three letters from Hudson Contract Services Limited ("Hudson") to the company;

(4) a document produced by Hudson, headed "Client – Terms of Business" ("the Contract");

(5) two invoices from Hudson to the company;

(6) four documents headed "invoice" which detailed amounts paid by the company to Mr Dawson, a sub-contractor;

(7) HMRC's Booklet entitled "Construction Industry Scheme: guide for contractors and subcontractors," together with two pages from HMRC's online guidance, being CISR61010 and CISR65040, although no reference was made to these during the hearing.

23. In addition, Mr Sanders gave oral evidence and answered questions from Ms Patel and the Tribunal. We found him to be an entirely credible witness.

24. From that evidence, we found the facts set out in the next section of this decision.

The facts

25. The company is a specialist provider of lightning protection. At the relevant time, Mr Sanders was its owner and director, although the company has subsequently been sold: Mr Sanders now works for the new owners.

26. Mr Sanders's expertise is his trade; by his own admission he is not very good with figures or with paperwork, which was dealt with by an office administrator, and signed off by Mr Sanders. The company used an external firm of accountants for its VAT and year-end tax returns and accounts.

The period before 2008-09

27. The company had for many years engaged the services of a number of subcontractors to deliver the lightning protection services. All the subcontractors were "net" for CIS purposes. This meant that the company took a 20% deduction from their pay (other than in respect of any reimbursement for materials), and paid it over to HMRC on a monthly basis. The CIS deductions are then credited against the subcontractors' own tax liabilities. It is possible for subcontractors to be "gross" for CIS purposes, allowing them to be paid without deduction of tax, but none of the company's subcontractors were "gross."

28. Mr Sanders knew that the CIS amount paid over to HMRC was a form of advance deduction of tax from his subcontractors' pay, and the company had a very good record at dealing correctly and promptly with its CIS obligations.

The company contracts with Hudson

29. On 21 September 2007, the company received a letter from Hudson. The letter was headed "Construction Industry Scheme" and the subheading was "Penalty Notice." Its text said (emphasis in original):

> "Hundreds of construction firms around the country will be receiving 'threatening' CIS return reminders from HMRC which they will, with great enthusiasm, bin - and HMRC won't be able to do a single thing about it.
>
> Why? Because these firms chose to detach themselves completely from all self-employment 'status' issues, by engaging our uniquely legally defined service to provide a robust and lawful solution that simply eliminated their risk.
>
> **You can ignore the HMRC dictate** [sic] **if you engage your operatives through Hudson**. So rather than being penalised for late returns or fined for classifying your workforce incorrectly, contact Hudson today, and your firm can continue to contract operatives on a

self-employed basis to work on any site, without fear of or interference from HMRC.

Don't be bullied by the Revenue…call us today on [number].”

30. Mr Sanders contacted Hudson, and received a second letter, dated 21 December 2007, which said (emphasis in original):

> “Thank you for your recent enquiry. I enclose our brochure in confirmation of our unique service to the construction industry, of contract audit and payroll.
>
> **We take full responsibility for labour-only subcontractors and eliminate risk.**
> Standing between your company and any self-employed operative working on your sites, you no longer have to make decisions on the status of operatives. Quite simply, we contract their agreed service to your company accepting all responsibility under tax law, employment law and the working time regulations.
>
> **The Hudson Contract Service will save cost to your company**
> When appointed, the costs associated with direct employment, including Employers National Insurance can be offset as we eliminate the risk posed by HMRC finding that labour only sub-contractors should be treated as employees.
>
> **Utilising Hudson will reduce your administrative burden and payroll functions**
> On receipt of your instructions, we make the wage payments to the individuals under CIS deduction. Your transaction day is determined by you as we are here to meet your pay arrangements. All monies are transferred by BACS and direct debit and we issue confirming documentation to all concerned, including the necessary status declaration to HMRC.”

31. On 14 January 2008, Mr Richard Crisp, a director of Hudson, visited the company and met Mr Sanders. Mr Crisp explained what Hudson would do and Mr Sanders understood from that conversation that CIS obligations would be removed from the company.

32. Mr Sanders and Mr Crisp then signed the Contract on behalf of the company and Hudson respectively. Its first page ends with the following paragraph:

> “**Clients should note**
> Hudson Contract Services Limited are providers of a specific service to companies in th construction industry. Hudson undertakes to contract with labour that you select. Hudson will accept responsibility for HMRC compliance matters, status enquiries and claims for holiday pay, statutory sick pay, inferred employment rights etc…”

33. The next three pages are headed “Contractual requirements,” being the terms and conditions under which Hudson “undertakes to contract with other parties (“the Operatives”) the labour of whom the Client shall require for use in the course of its

business." The "Client" was the company and "the Operatives" were the subcontractors who had until then been engaged by the company.

34. The Contract included the following terms:

> "2. The service to be provided by Hudson is that of acting as engager of such Operatives as the Client may select and the supply of such labour to the Client…
>
> 8. The Client further agrees with Hudson:…
>
> (iii) it has no right to and it shall not purport to exercise any control over the manner in which the Operative (or such labour as is furnished under the Operative contract) shall affect the engagement;
>
> (iv) it shall raise no objection to any substitution or supplementing by the Operative of another's labour for or additional to his…
>
> 9. The Client shall…allow payment to Hudson to be collected by Direct Debit on the same day as the Operatives are to receive their payments, in the following amounts:
>
> (i) the aggregate sum of money (less such statutory deduction as may be appropriate under CIS and the Hudson UTR) which the Client notifies Hudson it is liable to pay to its Operatives…
>
> (iii) in the case of an Operative engaged on a Self-Employed Contract, the sum of £15 per Operative for every week that the Operative is supplied by Hudson;
>
> (iv) VAT at the appropriate rate from time to time on the aggregate of (i) plus…(iii)…
>
> 12. Hudson agrees:
>
> (i) to comply with all relevant tax, national insurance, and employment law obligations which in consequence of it engaging the Operatives fall upon it rather than upon the Client…
>
> (iii) to make such payments to the Operatives as it receives compliant payments in respect of Clause 9 above…"

35. By Clause 13 of the Contract, Hudson agreed to bear the risk consequential on a court or tribunal finding that an Operative was employed by Hudson, providing that the Client had complied with its obligations under the Contract and "does not make any statement to any Operative or potential Operative which has the intention or effect of undermining or being inconsistent with the Hudson Contractual arrangements."

36. Mr Sanders assumed from Hudson's two letters and his meeting with Mr Crisp, that he did not need to worry about CIS any more. His understanding was confirmed when he received a third Hudson marketing letter, dated 4 March 2008, which began:

> "**6 APRIL 2008 – SAY GOODBYE TO YOUR CIS LIABILITY**.
>
> **WE'LL HELP YOU MAKE THE MOVE IN TIME FOR THE NEW TAX YEAR**

> if you were going to choose a perfect time to move your CIS workforce over to Hudson, then 6th April represents that day. Not only does the end of the tax year represent a logical point to 'say goodbye to your CIS liability' but from previous experience such a move will add immense weight to your argument with HMRC, should they decide to carry out a random CIS 'status' investigation."

37. Mr Sanders understood that the arrangement with Hudson worked as follows: the company would no longer engage the four individuals as sub-contractors. Instead, it would pay Hudson an amount equal to the individuals' total pay, plus a £15 fee per "operative." Hudson would separately contract with and pay the four operatives, who would remain within CIS and continue to be "net."

38. Hudson's weekly invoices looked like this (for a single operative):

	Unit Price	**Net**	**VAT**
CIS Operative	737.50	737.50	110.63
Operative's CIS fee	15.00	15.00	2.25
Total Net Amount			752.50
Total VAT Amount			112.88
Total			865.38
Less 20% of Net			150.50
Grand Total			714.88

39. Using that example, the company would have paid Hudson £714.88.

40. In around April 2009 the company wanted to use the services of another subcontractor, Mr Dawson, for short periods. Hudson suggested it would be simpler for the company to deal with Mr Dawson directly. The company therefore completed CIS forms for Mr Dawson for the five tax months ending December 2008; April, May and December 2009 and July 2010.

HMRC open a compliance review

41. By letter dated 2 August 2011, Mr Neal wrote to the company saying he was about to begin a compliance check into its payments to Hudson.

42. Immediately on receipt of the letter, on 5 August 2011, Mr Sanders called Mr Neal and asked why there was a problem. Mr Neal explained that Hudson were "net" for CIS purposes, and so the company should be deducting 20% from the payments and passing that amount to HMRC under CIS, as well as completing monthly returns in relation to the Hudson payments.

43. Mr Sanders was shocked. He immediately contacted his accountant, and Hudson. They confirmed that HMRC were right and that the 20% deducted from the invoiced amounts should have been paid over to HMRC.

44. Mr Sanders called Mr Neal back on the same day and agreed to send HMRC a cheque for £5,000 on account of the CIS liability. Mr Neal's file note, which Mr Sanders accepted was accurate, records Mr Sanders as saying that "although not happy with the position, he recognises his business is in the wrong and should have submitted monthly returns and remittances relat[ing] to Hudson."

45. On 10 August 2011 Mr Sanders sent the cheque, along with a letter explaining the background and stating that he had been "totally taken in" by Hudson's promise to "say goodbye to our CIS liability."

46. On 24 August 2011, Mr Neal informed Mr Sanders that the outstanding CIS liability was £13,924, which was 20% of all payments made to Hudson for the tax year 2008-09 and subsequently. As the company had paid £5,000 on account, the outstanding balance was £8,924, plus interest. Mr Neal said he was taking advice on the penalty position.

47. On 16 September 2011, Mr Neal wrote again, saying that the penalty legislation in force at the time of the company's CIS failures was TMA s 98A(2). The penalty chargeable under that legislation was £81,000. Mr Neal went on to say:

> "the Department has recognised that these penalties, in some instances, can be excessive and are to introduce legislation October 2011 under section 55 Finance Act 2009. As this new legislation is not due to be introduced until October 2011 and is not retrospective, the Department has agreed to consider all cases before the introduction on the basis of the new legislation. I am therefore authorised to reduce the total amount payment from £81,000 to £20,700, which is the amount that would be charged under Schedule 55."

48. On 10 October 2011, Mr Sanders sent a further cheque for £9,141.71 to clear the CIS liability, together with a letter containing submissions about the penalties. His submissions are summarised in the next part of this decision.

49. On 31 October 2011, Mr Neal confirmed that HMRC's position was unchanged. On 2 December 2011 he issued formal determinations for the CIS amounts unpaid and for penalties totalling £81,000, made up as follows:

	2008-09	**2009-10**	**2010-11**	**Total**
CIS liability	5,431.50	6,013.50	2,479.00	**£13,924**
£100 fixed penalties	12,000.00	12,000.00	4,500,00	28,500
Month 13 penalties	15,300.00	30,000.00	7,200,00	56,500
Total penalties				**£81,000**

50. Mr Sanders did not dispute the CIS liabilities. However, he appealed the penalties on behalf of the company and asked for a statutory review, which upheld Mr Neal's determinations. On 29 February 2012, the company notified the appeal to the Tribunal.

The legislation

51. Finance Act ("FA") 2004, Part 3 and Schedule 12 FA 2004 contain the primary legislation relating to the CIS. FA 2004, s 70 gives HMRC the power to introduce regulations relating to CIS returns, and the relevant part of that section is as follows:

> **"Periodic returns by contractors etc**
>
> (1) The Board of Inland Revenue may make regulations requiring persons who make payments under construction contracts—
>
> (a) to make to the Board, at such times and in respect of such periods as may be prescribed, returns relating to such payments…
>
> (5) In this section "prescribed" means prescribed by regulations under this section."

52. The regulations laid under the power given by FA 2004 are the Income Tax (Construction Industry) Regulations (SI 2005/2045) ("the CIS regulations"). Regulation 4 of the CIS regulations provides as follows, again so far as relevant to this case:

> "(1) A return must be made to the Commissioners for Her Majesty's Revenue and Customs in a document or format provided or approved by the Commissioners–
>
> (a) not later than 14 days after the end of every tax month, by a contractor making contract payments…
>
> (2) The return under paragraph (1) must contain the following information--
>
> (a) the contractor's name,
>
> (b) the contractor's unique taxpayer reference (UTR) and Accounts' Office reference,
>
> (c) the tax month to which the return relates, and
>
> (d) in respect of each sub-contractor to whom, or to whose nominee, payments under construction contracts were made by the contractor during that month,--
>
> (i) the sub-contractor's name;
>
> (ii) the sub-contractor's national insurance number (NINO) or company registration number (CRN), if known; and
>
> (iii) the information specified in paragraph (3).
>
> (3) The information specified is….
>
> (c) if the sub-contractor is not registered for gross payment or payment under deduction–
>
> (i) the sub-contractor's unique taxpayer reference (UTR), if known,

(ii) the total amount of contract payments made by the contractor to the sub-contractor during the tax month,

(iii) the total amount included in those payments which the contractor is satisfied represents the direct cost to any person other than the contractor of materials used or to be used in carrying out the construction contract to which the contract payment relates,

(iv) the total amount deducted from the payments mentioned in paragraph (3)(c)(ii) under section 61 of the Act, and

(v) the verification reference for higher rate deduction….

(12) Subject to paragraph (13), section 98A of TMA (special penalties in the case of certain returns) applies to the requirements in–

(a) paragraph (1),

(b) paragraph (3)(b),

(c) paragraph (3)(c),

(d) paragraph (10).

(13) A penalty under section 98A of TMA in relation to a failure to make a return in accordance with paragraphs (1) or (10) arises for each month (or part of a month) during which the failure continues after the 19th day of the sixth month following the appointed day."

53. TMA s 98A, referred to in Reg 4(13) of the CIS regulations, provides for penalties where there has been a failure to comply with the requirements of regulations made, *inter alia*, under FA 2004, s 70(1)(a):

"Special penalties in the case of certain returns

(1) PAYE regulations or regulations under section 70(1)(a) or 71 of the Finance Act 2004 (sub-contractors) may provide that this section shall apply in relation to any specified provision of the regulations.

(2) Where this section applies in relation to a provision of regulations, any person who fails to make a return in accordance with the provision shall be liable–

(a) to a penalty or penalties of the relevant monthly amount for each month (or part of a month) during which the failure continues, but excluding any month after the twelfth or for which a penalty under this paragraph has already been imposed, and

(b) if the failure continues beyond twelve months, without prejudice to any penalty under paragraph (a) above, to a penalty not exceeding--

(i) …or

(ii) in the case of a provision of regulations under section 70(1)(a) or 71 of the Finance Act 2004, £3,000.

(3) For the purposes of subsection (2)(a) above, the relevant monthly amount in the case of a failure to make a return–

(a) where the number of persons in respect of whom particulars should be included in the return is fifty or less, is £100, and

(b) where that number is greater than fifty, is £100 for each fifty such persons and an additional £100 where that number is not a multiple of fifty…"

54. TMA s 100 is headed "Determination of penalties by officer of Board" and begins:

"(1) …an officer of the Board authorised by the Board for the purposes of this section may make a determination imposing a penalty under any provision of the Taxes Acts and setting it at such amount as, in his opinion, is correct or appropriate."

55. TMA s 100B includes the following provisions:

"(2) On an appeal against the determination of a penalty under section 100 above…

(a) in the case of a penalty which is required to be of a particular amount, the First-tier Tribunal may--

(i) if it appears that no penalty has been incurred, set the determination aside,

(ii) if the amount determined appears to be correct, confirm the determination, or

(iii) if the amount determined appears to be incorrect, increase or reduce it to the correct amount,

(b) in the case of any other penalty, the First-tier Tribunal may--

(i) if it appears that no penalty has been incurred, set the determination aside,

(ii) if the amount determined appears to be appropriate, confirm the determination,

(iii) if the amount determined appears to be excessive, reduce it to such other amount (including nil) as it considers appropriate, or

(iv) if the amount determined appears to be insufficient, increase it to such amount not exceeding the permitted maximum as it considers appropriate."

56. TMA s 102 is headed "mitigation of penalties" and reads:

"The Board may in their discretion mitigate any penalty, or stay or compound any proceedings for a penalty, and may also, after judgment, further mitigate or entirely remit the penalty."

57. TMA s118(2) provides, so far as relevant to this case, as follows:

"For the purposes of this Act…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 ceased."

The scope of this appeal

58. For the avoidance of doubt, this Tribunal cannot consider the following issues.

(1) In the course of the hearing and his correspondence Mr Sanders has made a number of complaints against Hudson, to the effect that it misrepresented the nature of the service being provided. Disputes between contracting parties are dealt with in the County Court or the High Court, and are not part of the Tribunal's jurisdiction.

(2) The company accepted that it was liable to pay the CIS amounts contained with the three liability determinations totalling £13,924, and these determinations were not under appeal. We were thus unable to consider any matters relating to that liability, including the nature of the relationship between the company and Hudson.

(3) The Tribunal has no jurisdiction to decide whether or not the penalties should be mitigated. As we have already stated, mitigation is entirely a matter for HMRC.

59. The only issue we are deciding in this appeal is the company's liability for the penalties of £81,000 which have been charged on the basis of the law that applied at the time, namely TMA s 98A(2).

Submissions on behalf of the company

60. Mr Sanders said the company had an unblemished record of dealing with CIS until the Contract. It had also properly dealt with the CIS returns for Mr Dawson, who was not a Hudson's operative.

61. Mr Sanders reiterated that there was no intention not to comply: he thought that Hudson were dealing with everything to do with CIS in relation to the operatives they were paying. He had not realised, either from the invoices or from the Contract, that Hudson were "net" for CIS purposes. The invoices did not say that the 20% deduction related to CIS but simply referred to "less 20% of Net."

62. Mr Sanders said that Hudson had represented itself as an expert firm, and he had acted reasonably in relying on their promise that signing the Contract would allow the company to "say goodbye to its CIS liability." He described the Hudson arrangement as "a plausible offering by an apparently professional organisation."

Case law on reasonable excuse

63. Mr Sanders submitted that he had taken reasonable care. He relied on three cases. The first was *HMD Response International v HMRC* [2011] UKFTT 472 (TC) (Judge Jones and Mr Hughes) where the tribunal said at [27]:

> "We asked Miss Weare [HMRC's presenting officer] whether she accepted that if a person genuinely and honestly believes that a successful online filing has been completed, that might amount to a reasonable excuse, at least until such time as that person is informed that that belief is incorrect. She agreed that such circumstances would

> amount to a reasonable excuse. We take the view that she was entirely correct to do so."

64. The second was *Leachman v HMRC* [2011] UKFTT 261 (TC), where Judge Jones said at [5]:

> "I am entirely satisfied that, as a matter of law, a mistake of fact is capable of amounting to a reasonable excuse…There is no good reason either in law or in logic, why such a mistake of fact should not amount to a reasonable excuse for a failure to file a particular document on time or to undertake some other task. Admittedly, it is a mistake relied upon by the person who is under the obligation to file by a particular time but that, of itself, does not make it something other than an excuse which is 'reasonable'. In my judgement, provided that there is a genuine mistake of fact (which, itself, is an issue of fact), that, in law, is capable of amounting to a reasonable excuse for the identified failure."

65. Finally, Mr Sanders referred to *Rowland v HMRC* [2006] STC (SCD) 536 where Special Commissioner Shipwright said that where reliance on a third party had led to the default, reliance on that third party can be a reasonable excuse.

66. Mr Sanders submitted that:

> "the principles these cases have established are that reasonable excuse does exist where someone genuinely believes that they have met their compliance obligations, which includes a situation where they have mistakenly believed that someone else is to undertake the task on their behalf."

67. He said that when these principles were applied to the facts of the company's appeal, it was clear that the company had a reasonable excuse. He had reasonably relied upon Hudson, who "appeared to be a specialist in their field"; he had read their letters and been impressed by Mr Crisp; Hudson had "sold the relationship on the basis that the company would no longer have to deal with CIS" and he had genuinely believed that the company was meeting its CIS compliance obligations by contracting with Hudson.

Proportionality

68. Mr Sanders also said that the penalty was disproportionate, even the mitigated amount. The company was a "tiny micro-business with less than 10 employees" and its 2010-11 profit was £95,000, which was "the best year ever." At £81,000, the penalty was over 85% of the company's annual profit, and even the mitigated amount was over 20%.

69. In contrast, the CIS amount underpaid had been less than £15,000 and he had paid that sum to HMRC almost immediately after he had been informed of his mistake. There had been no loss to the exchequer. The penalty did not take this into account, and neither did it make any allowance for the fact that it had been an honest mistake. He contrasted the penalty with HMRC's willingness to make "deals with

larger firms that owe millions/billions of pounds" and said that HMRC's approach to the penalty was "completely immoral."

Submissions on behalf of HMRC

70. For HMRC, Ms Patel said that it was not reasonable of Mr Sanders to have thought that the CIS liability could disappear in this way. The Contract did not include any promise by Hudson to pay over the CIS to HMRC or to submit the monthly returns. Furthermore, Mr Sanders should also should have realised that there was a 20% deduction on the invoices, and been alerted by this to the company's obligation to pay the 20% to HMRC with the monthly CIS return form.

71. Ms Patel also referred to correspondence from Mr Neal, who had pointed out that Mr Sanders had not consulted his own accountants or HMRC as to the validity of the advice he had believed he had received from Hudson.

72. As a result, she said, the company did not have a reasonable excuse.

73. She also submitted that the case of *Bosher* meant that proportionality could not be considered by this Tribunal in relation to the fixed penalties.

Discussion: reasonable excuse

74. Mr Sanders has put forward two bases for the company's reasonable excuse:

(1) he honestly believed that by contracting with Hudson, he had removed the CIS liability from the company, and his honest belief provides the company with a reasonable excuse; and

(2) he had reasonably relied on Hudson, which had represented itself as an expert, and reliance on a third party can constitute a reasonable excuse.

75. These two possible "reasonable excuses" are linked, in the sense that Mr Sanders' reasonable belief rested at least in part on his reliance that Hudson was an expert. However, it is simplest to consider them separately, while recognising that there is some overlap.

Genuine and honest belief

76. We accept that Mr Sanders genuinely and honestly believed that the CIS liability had been removed because he contracted with Hudson. Ms Patel also did not dispute that this was the position.

77. We also acknowledge that some judgments of this tribunal, including *HMD Response International* and *Leachman*, state that a genuine and honest belief is sufficient to provide a reasonable excuse. Other judgments, such as *Coales v HMRC* [2012] UKFTT 477(TC) (Judge Brannan) have, however, taken a different approach finding that the correct test is that set out by Judge Medd QC in *The Clean Car Co Ltd v C&E Comrs* [1991] VATTR 234.

78. Judge Medd said that in deciding whether a reasonable excuse exists:

> "…the first question that arises is can the fact that the taxpayer honestly and genuinely believed that what he did was in accordance with his duty in relation to claiming input tax, by itself provide him with a reasonable excuse. In my view it can not. It has been said before in cases arising from default surcharges that the test of whether or not there is a reasonable excuse is an objective one. In my judgment it is an objective test in this sense. One must ask oneself: was what the taxpayer did a reasonable thing for a responsible trader conscious of and intending to comply with his obligations regarding tax, but having the experience and other relevant attributes of the taxpayer and placed in the situation that the taxpayer found himself at the relevant time, a reasonable thing to do?"

79. Our own view is set out in *Christine Perrin v HMRC* [2014] UKFTT 488 (TC) (Judge Redston and Ms Stalker) at [83]-[100]. We do not repeat that analysis here, but import it by reference. In summary, we agree with the approach taken in *The Clean Car Co Ltd* and have applied it to the facts of the company's case.

80. We considered what a reasonable person in Mr Sander's position would have done. He is not financially sophisticated and so was glad to be rid of another onerous compliance obligation. He was impressed by Mr Crisp's expertise. This is all reasonable.

81. However, we find that the reasonable person in Mr Sander's position, who was about to sign a difficult legal document such as the Contract, would have checked with a lawyer or accountant to make sure he had properly understood its terms, and in particular to confirm whether Hudson were in fact promising to remove the company's CIS compliance obligation, as Mr Sanders thought was the case. However, Mr Sanders did not discuss the Contract with his accountant until after Mr Neal had begun his compliance check.

82. We also find that the reasonable person would have looked at the invoices he was paying, and having done so, would have asked Hudson about the 20% deduction. We accept that the total on the invoice – at £714.88 – is not very different from that which the company had been paying the subcontractor, at £737.50. But the lower Hudson figure also contains VAT of £112.88 and a £15 fee.

83. In our judgment, the reasonable person, who understood CIS as Mr Sanders does, would have wondered how the Hudson arrangement worked. Mr Sanders knew that the operative would be taxable on his pay. He knew that the 20% was a form of advance tax deduction from that pay, and he knew that the operatives had remained within CIS and were still "net." The reasonable person would have asked himself: how can the company be paying less than previously, despite the addition of VAT and a fee to Hudson, but still leave the operatives in the same position?

84. In short, we find that the reasonable person would have asked more questions, both at the beginning (of his accountant, or a lawyer, or even of HMRC) and as time went on, when he saw the invoices. We find that Mr Sanders' belief, while honest and genuine, was not reasonable.

Reliance on Hudson

85. We also considered whether Mr Sanders had a reasonable excuse because he relied on Hudson. We accept that reliance on a third party can provide a reasonable excuse, as it did in *Rowland*, but it does not do so automatically. The reliance must be "reasonable" taking into account all the facts of the case, and in particular, the nature of the issue in question and the status of the third party.

The issue in question

86. The case of *Rowland* involved a "difficult and complex area of tax law", including "the arcane matters of film finance partnerships." The tribunal in *The Research and Development Partnership Ltd v HMRC* [2009] UKFTT 328 (TC) (Judge Brooks and Mr Miles), which concerned complicated questions of research and development tax credits, also found that reliance on an adviser provided a reasonable excuse.

87. But in more straightforward cases, such as a failure to file a tax return, the tribunal has frequently found that it is not reasonable for a person to transfer a task to a third party, without checking that it has been carried out correctly and on a timely basis, see for example *Gabriella Sas v HMRC* [2012] UKFTT 69 (TC) (Judge Clark) at [50]. More generally, in *B&J Shopfitting Services v HMRC* [2010] UKFTT 78 (TC) at [12], Judge Mosedale said that "reliance on a third party as a matter of policy will not normally be a reasonable excuse because a taxpayer should not be able to avoid his liabilities by passing them on to someone else."

88. In the company's case, the issue in question was simple: had responsibility for complying with the CIS obligations been transferred to Hudson, as Mr Sanders thought? The answer to this question could be found within the Contract, which we accept was a complex document. Had the Contract been the only document provided to Mr Sanders, and had he obtained advice from an independent professional as to the meaning of the Contract, and had he subsequently relied on that advice, we might well have found that his reliance on that third party professional would have provided the company with a reasonable excuse.

89. However, those are not our facts. First, the Contract was not the only document provided to Mr Sanders. He also received regular monthly invoices. Mr Sanders understood how CIS worked. He knew that his subcontractors were "net" for CIS purposes. Yet the invoices showed that he was paying less than before, despite the addition of 20% VAT and Hudson's £15 fee. As we have already said, the invoices would have caused a reasonable person in his position to ask questions about what was happening.

The status of the third party

90. Second, Hudson were not a professional firm giving independent advice, but the other party to the Contract. Hudson was being paid a fee for each subcontractor. Its letters do not contain an objective, neutral analysis of the Hudson arrangement, but are instead marketing leaflets using colourful language, inviting people to "ignore the

HMRC dictate" and put an end to being "bullied by the Revenue." We find that reliance on Hudson does not provide the company with a reasonable excuse.

Conclusion on reasonable excuse

91. On the facts of this case, considered in the context of the *Clean Car Co* test which we have applied, we find that the company does not have a reasonable excuse.

The Tribunal's statutory jurisdiction over the Month 13 penalties

92. TMA s 100B(2) distinguishes between (a) penalties which are "required to be of a particular amount" – namely, fixed penalties, and (b) other penalties. The Tribunal's jurisdiction over these two types of penalty is different.

93. If a penalty is not required to be of a particular amount, TMA s 100B(2)(b) allows the Tribunal to confirm the penalty if we think it "appropriate," reduce it if we think it "excessive" and increase it if we think it is "insufficient." Month 13 penalties are not "required to be of a particular amount" and so fall within TMA s 100B(2)(b).

94. In considering whether the Month 13 penalties charged on the company of £56,500 are excessive, we take into account the following:

(1) Mr Sanders misunderstood what Hudson were offering, and acted honestly at all times. In other words, he made an innocent mistake, albeit not a reasonable one.

(2) As soon as Mr Sanders received HMRC's opening letter, he called Mr Neal. Having received the shocking news that CJS had failed to comply with the law, he checked with his accountant and immediately agreed to pay any outstanding amount. Until he spoke to Mr Neal he had no knowledge of the outstanding liability.

(3) The company is a micro-business with a previously excellent compliance record.

(4) The Month 13 penalties are over 50% of the company's annual profit in its "best year ever."

95. We accept that the Month 13 penalties must be considered separately from the fixed penalties, see *Bosher* at [65]-[66]. However, the Month 13 penalties apply where "the failure continues beyond 12 months." Here, Mr Sanders was not aware of the failures until contacted by Mr Neal; he was simply unaware that they had "continued for over 12 months."

96. The facts of the company's appeal are in sharp contrast to those in *Bosher FTT*. In that case the tribunal decided that Mr Bosher's explanations as to why he had failed to comply with his CIS obligations were "not credible" and "implausible," see [64] and [81] of that decision, and went on to conclude that "the high penalties incurred by Mr Bosher in this case are as a result of the extreme and repeated nature of his default," see [117].

97. TMA s 100B(2)(b)(iii) allows the Tribunal to reduce the penalties "to such other amount (including nil) as it considers appropriate." Taking into account all the facts of this case, we find that it is excessive for the company to be required to pay the Month 13 penalties and we reduce them to nil.

The Tribunal's jurisdiction over the fixed penalties

98. Our jurisdiction in relation to fixed penalties is more limited, see TMA s 100B(2)(a). The Tribunal can correct such penalties if they are incorrect, but we cannot otherwise change them.

The decision in Bosher

99. As we set out in our summary at the beginning of this decision, in *Bosher FTT* the tribunal decided that that £26,600 of CIS fixed penalties charged on Mr Bosher were disproportionate and so breached Mr Bosher's rights under A1P1. Since the HRA s 3(1) requires that legislation be interpreted "so far as it is possible to do so…in a way which is compatible with the Convention rights," the tribunal decided that "incorrect" should be read down as meaning "disproportionate." As a result, they reduced the penalties to nil, see [142]-[143] of that decision.

100. However, when that case reached the Upper Tribunal, that Tribunal decided at [47(f)] that the scheme of the CIS legislation was not disproportionate and that:

(1) the word "incorrect" could not be interpreted in the way decided by the tribunal in *Bosher FTT,* see *Bosher* at [45]-[46], [47(a)] and [68(2)];

(2) it was not possible for the First-tier tribunal to assess, before a penalty had been mitigated by HMRC, whether it was proportionate, see [36];

(3) after HMRC had mitigated the penalty, the First–tier tribunal had no jurisdiction to consider proportionality, see [47g] and [61]; and

(4) a legal challenge to the extent of HMRC's penalty mitigation can only made by judicial review, again, see [47g] and [61].

101. The Upper Tribunal explain these last three points at [59] of their judgment (emphasis in original):

> "…Parliament has imposed a fixed penalty for monthly defaults in failing to make returns and has also given a power to *HMRC* to mitigate any penalty with no provision for an appeal against a decision on mitigation. It would be entirely contrary to a fundamental feature of that scheme if the Tax Chamber were to be able to impose its own view of the appropriate amount of the penalty at the date of determination under s 100(1) of TMA at a time before mitigation had even been considered by HMRC under s 102. Once that is recognised, it can be seen that the real complaint is the absence of an appeal from a decision of HMRC under s 102: but in that regard, a taxpayer's Convention rights are, for the reasons already given, adequately protected by his right to apply for permission to bring judicial review."

Application to the company

102. It is only possible for the Tribunal to change the fixed penalties if they are "incorrect," and the meaning of that word has been put beyond doubt by *Bosher*. A fixed penalty would be "incorrect" if, for example, the numbers had been wrongly calculated, or the company had not, in fact, failed to submit CIS returns for the relevant periods.

103. Mr Sanders did not submit that the £28,500 of fixed penalties charged on the company were incorrect, and we agree. In particular we note that although a CIS return was filed for the five tax months of December 2008, April, May and December 2009 and July 2010, see [40], those CIS returns did not include all the information required under Reg 4(3)(c) of the CIS regulations. As a result, a fixed penalty was due under TMA s 98A(2), see Reg 4(12)(c) and Reg 4(13).

104. HMRC have said that under TMA s 102 they will mitigate the penalties charged on the company in line with those which would have been calculated under Sch 55 for more recent CIS failures. They have informed Mr Sanders that when the company's penalties were recalculated using those rules, the penalties reduced to £20,700.

105. However, the £20,700 may not be the final position. In particular, HMRC may consider:

(1) whether enforcement of the penalty would cause the company "genuine and absolute hardship", see HMRC's guidance cited in *Bosher* at [13];

(2) whether the Tribunal's setting aside of the Month 13 penalties is a relevant consideration (although it appeared not to be in *Bosher*, see [21]);

(3) whether a "special reduction" should be given. Under Sch 55, para 16 it is possible to reduce any penalty. including those arising under the CIS parts of the Schedule, because of "special circumstances." The Court of Appeal in *Clarks of Hove v Bakers' Union* [1978] 1 WLR 1207 held (at page 1216) that in the context of special circumstances, the word "special" means "something out of the ordinary, something uncommon." In a case such as this, where an honest man had misunderstood what was being offered by a specialist firm, and where the company had an otherwise excellent compliance history, HMRC may wish to consider whether there is "something out of the ordinary."

106. The Tribunal has no jurisdiction to consider mitigation or to direct HMRC to consider any of the above factors. We simply raise them as possibilities which HMRC may consider when finalising the mitigated penalty.

107. In our summary decision, we made a similar comment about "special circumstances." Mr Sanders asked HMRC to consider whether they could apply a special reduction by analogy with a person penalised under Sch 55. After several failed attempts to obtain a response, he made a complaint. On 12 February 2015 he received a reply from the Complaints Officer of HMRC's Local Compliance Office, who said:

> "The matter was referred to our Central Policy team who advised that the judge was incorrect to say that we can use 'special reduction' to further reduce the penalties. Our powers of mitigation under Section 102 TMA 1970 are limited by Section 103ZA which says that Sections 102 to 103 do not apply to penalties under Schedule 55."

108. Mr Sanders was confused by this explanation, and so are we. In the hopes of avoiding further confusion:

(1) HMRC are mitigating the company's penalty under TMA s 102.

(2) How they mitigate the penalty is a matter for them, not this Tribunal.

(3) They have decided, as a matter of policy, to mitigate CIS penalties in line with Sch 55.

(4) In deciding that the company's mitigated penalty is £20,700, they have used Sch 55, paras 8-11, which are the calculation paragraphs

(5) HMRC were not being asked, by Mr Sanders, to consider applying TMA s 102 to Sch 55.

(6) HMRC were being asked whether they were able to make an offer of mitigation based on *all* of the relevant provisions of Sch 55, including para 16, and not simply the calculation paragraphs. This approach would seem to accord with the policy intention set out in the letter of 16 September 2011, and cited at [47] above (emphasis added):

> "As this new legislation is not due to be introduced until October 2011 and is not retrospective, the Department has agreed to consider all cases before the introduction *on the basis of the new legislation*."

109. It may of course be that HMRC decide either (a) not to consider the special reduction provision at para 16 of Sch 55 when offering mitigation, or (b) that there are no special circumstances on the facts of this case. Their decision on mitigation is, as we have said, entirely a matter for them.

110. As far as the Tribunal is concerned, following *Bosher* the position is clear:

(1) we are not able to consider whether or not the £20,700 of mitigated penalties on the company breaches A1P1 because it is disproportionate; and

(2) we do not yet know what the mitigated penalty will be. That will only become clear after the conclusion of the appeal proceedings. At that point too the Tribunal has no jurisdiction.

111. We therefore confirm the monthly penalties.

Decision

112. Our decision is as follows:

(1) the company does not have a reasonable excuse for its failures to comply with its CIS obligations;

(2) the fixed penalties of £28,500 were correct. We are not able to consider whether they are proportionate;

(3) the Month 13 penalties of £56,500 are set aside as excessive.

Appeal rights

113. This document contains full findings of fact and reasons for the decision summarised in the previous paragraph. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Rules.

114. 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.

ANNE REDSTON
TRIBUNAL JUDGE

RELEASE DATE: 13 May 2015