



TC07764

PAYE and NICs payable by employer – HMRC application at the hearing for the tribunal to vary the NICs decision – refused – employer’s lack of records – HMRC best judgment assessment – presumption of continuity – burden of proof on taxpayer not discharged – careless inaccuracy penalties – appeal dismissed.

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

Appeal number: TC/2019/01419

BETWEEN

PLANET DOUBLE GLAZING LIMITED

Appellant

-and-

**THE COMMISSIONERS FOR
HER MAJESTY’S REVENUE AND CUSTOMS**

Respondents

**TRIBUNAL: JUDGE TRACEY BOWLER
CAROLINE DE ALBUQUERQUE**

Sitting in public at Taylor House on 19 February 2020

Mr R Attwal of RSA Associates for the Appellant

Ms A. Moore, litigator of HM Revenue and Customs’ Solicitor’s Office, for the Respondents

DECISION

INTRODUCTION

1. HMRC have imposed assessments and penalties totalling £58,822.48 on Planet Double Glazing Limited (“PDG”) in relation to the tax years from 2011-2012 until 2014-2015 because HMRC has decided that PDG failed to comply with its reporting requirements and payment obligations as a result, in essence, of paying wages to staff without correctly operating the PAYE and National Insurance Contributions (“NICs”) system. PDG has been unable to provide records of its employees and payments made to them other than summaries of PAYE reports, some Real Time Information (“RTI”) reports and some P14s. HMRC has made its assessments on the basis of what it says is its best judgement and in that calculation has relied on the presumption of continuity. PDG disputes HMRC’s basis of calculation. HMRC has also imposed penalties for careless inaccuracies which PDG have appealed.

BACKGROUND

2. An enquiry was opened on 6 January 2015 by HMRC into PDG’s PAYE records. On 12 February 2015 a meeting was held between HMRC, Mr Singh Johal, the sole director of PDG, and Mr Singh Johal’s wife, Mrs Johal.

3. HMRC wrote to PDG on 17 March 2015 requesting further information including details of hours worked by employees. PDG’s agent, Mr Attwal, replied on 18 April 2015.

4. On 21 April 2015 HMRC issued an information notice under paragraph 1 of Schedule 36 to the Finance Act 2008 specifying records required. Records were provided, but HMRC identified inconsistencies in the information provided and a meeting followed in October 2015.

5. A further information notice was issued under paragraph 1 of Schedule 36 to the Finance Act 2008 on 12 January 2016. The documents requested included a detailed breakdown of the director’s loan account. That notice was followed on 29 March 2016 by a notice of a penalty of £300 for failure to comply with the information notice. In a letter dated 22 April 2016 Mr Attwal appealed the penalties explaining that the director’s loan account was a balancing figure and therefore there were no separate details of transactions relating to the loan account to be provided. Following this explanation HMRC withdrew the penalty in a letter dated 6 June 2016.

6. Further correspondence and meetings followed.

7. In a letter dated 2 June 2017 HMRC warned that, in view of the ongoing dispute and perceived lack of progress, determinations would be issued under Regulation 80 Income Tax (Pay As You Earn) Regulations 2003 (“the PAYE Regs”) as it was believed that the employee costs were higher than reported to generate the level of reported turnover. An opportunity to settle was offered.

8. On 28 March 2018 HMRC issued notices of determination under Regulation 80 of the PAYE Regs for £8394 in respect of the tax year 2011-2012. In a letter of the same date it was explained that the NICs would not be pursued for the 2011/12 tax year. In a letter dated 23 April 2018 Mr Attwal appealed on behalf of PDG.

9. On 8 May 2018 HMRC issued notices of determination under Regulation 80 of the PAYE Regs for:

- (1) £12,089 in respect of the tax year 2012-2013;
- (2) £6,138 in respect of the tax year 2013-2014;
- (3) £4,751 in respect of the tax year 2014-2015.

10. On 8 May 2018 HMRC also issued a notice of decision under section 8 Social Security Contributions (Transfer of Functions) Act 1999 (“SSCTFA”) that PDG was liable to pay primary and secondary Class 1 contributions of £19,758 for the period 6 April 2012 to 5 April 2015.

11. In a letter dated 8 May 2018 HMRC said that the liabilities are been calculated on the basis of payments made as top-up wages and to off-record workers.

12. In a letter dated 22 May 2018 Mr Attwal confirmed that PDG relied on the same appeal grounds in relation to the notices issued on 8 May 2018 as for the notice issued on 28 March 2018. An independent review was requested.

13. On 29 June 2018 HMRC warned that penalties may be applied on the basis of PDG’s behaviour having been deliberate and the disclosures having been prompted.

14. On 22 October 2018 HMRC issued a penalty notice for inaccuracy penalties totalling £11,111.36 under Schedule 24 Finance Act 2007 (“Schedule 24”) in respect of the tax years 2012-13, 2013-14 and 2014-15. In a letter dated 26 November 2018 HMRC explained the basis of calculation of the penalty, stating that it was for careless and prompted behaviour.

15. On 18 December 2018 Mr Attwal wrote to HMRC to appeal the penalties.

16. The conclusion of the independent review of the HMRC decisions to issue the notices described above was set out in a letter dated 1 February 2019. The decisions to issue the notices were upheld, but it was concluded that the decision not to suspend the penalties had been given insufficient consideration and that decision was cancelled.

17. In a letter dated 27 February 2019 Mr Attwal set out PDG’s grounds of appeal in relation to the notices of assessment.

18. On 8 April 2019 HMRC issued a revised notice of penalty assessment for inaccuracy penalties totalling £7692.48 under Schedule 24 in respect of the tax years 2012-13, 2013-14 and 2014-15. HMRC decided not to suspend the penalties.

19. On 23 August 2019 PDG applied for alternative dispute resolution (“ADR”) but this was refused by HMRC in a letter dated 20 September 2019 on the basis that the circumstances did not fit within the published criteria for acceptance.

PROCEDURAL ISSUE

20. It became clear during the hearing that Mr Attwal was not experienced in representing appellants in litigation and so, for example, did not understand the process of cross-examination. I told Mr Attwal that we would treat the appellants as being akin to litigants in person. This meant that I would assist with the process, although I could not make the case for PDG. As an example we gave Mr Attwal additional time to prepare questions to put to HMRC’s witness, Ms Lakhani, and I assisted with the process of adoption of the Witness Statements by Mr Singh Johal and Mrs Johal.

PRELIMINARY ISSUE

21. At the hearing HMRC said that the amount of NICs claimed from PDG had increased from the figure of £19,758 stated in the Section 8 notice to £22,044. This was because the calculation of suppressed wages for the year 2012/13 (page 627 of the bundle) had allocated the estimated wages to 3 employees, but the calculation had only used a multiple of two rather than three. The correct amount was shown in the table on page 729 of the bundle. However, this change had not been identified in the Statement of Case or in HMRC’s skeleton argument. HMRC submitted that the tribunal could vary the amount of NICs in the section 8 notice by virtue of its powers under Regulation 10 of the Social Security Contributions (Decisions and Appeals) Regulations 1999.

22. Regulation 10 states:

If, on an appeal ... under Part II of the Transfer Act that is notified to the tribunal, it appears to the tribunal that the decision should be varied in a particular manner, the decision shall be varied in that manner, but otherwise shall stand good.

23. Although Regulation 10 does not include any limitation in its own terms to the variations which the tribunal is entitled to make, we decided that in this case we would not vary the section 8 decision for the following reasons.

24. Under Section 49A TMA the appellant first notifies HMRC that he requires HMRC to review “the matter in question” which is defined by Section 49I as the matter to which an appeal relates. After the review is concluded the appellant may notify the tribunal and under Section 49G TMA if that happens “the tribunal is to determine the matter in question”.

25. In this case the matter in question was whether PDG is liable to pay primary and secondary Class 1 contributions for the period from 6 April 2012 to 5 April 2015 totalling £19,758. The amount being increased is the amount attributable to the period 6 April 2012 to 5 April 2013. HMRC has relied on section 9 of the Limitation Act 1980 to maintain that the Section 8 notice was issued in time, but HMRC would be time-barred from taking action at the date of the hearing to recover the NICs for that period. In addition, HMRC’s request at the hearing to increase that amount without having given any prior notice to PDG was tantamount to ambushing PDG with new evidence.

GROUND OFS OF APPEAL

26. PDG have appealed on the following grounds:

- (1) wages paid to the sole shareholder and director of PDG, Mr Singh Johal, and his wife, Mrs Johal, should be excluded from the calculations of PAYE and NICs as those payments could have been switched to dividends. Alternatively, Mrs Johal’s wages should be excluded from the calculations as a semi-fixed cost;
- (2) payroll costs should be calculated as 13% of turnover and not the 20% of turnover applied by HMRC. The 20% rate has not been achieved by the business in the years since the operation of the PAYE scheme;
- (3) failure to differentiate between fixed, semi- fixed and variable costs distorted the results. Small businesses in their early years have to employ temporary work on a needs basis and Mr Singh Johal worked many unpaid hours in production, delivery and fitting of PDG’s products in its early years;
- (4) actual wages paid for the accounting period ended 31 May 2012 prior to the introduction of the PAYE scheme were not taken into account by HMRC;
- (5) PAYE registration was not compulsory if all of the employees were paid below PAYE and NIC thresholds;
- (6) most of the workers were on minimum wage with their annual earnings falling below the tax threshold and therefore there were no PAYE tax implications;
- (7) there is no evidence of any off-record workers;
- (8) HMRC’s approach had been “very confrontational, prejudicial, non-reconciliatory, unreasonable, unequitable, irrational and very damaging to the long run prospects of an otherwise successful business”.

APPEAL RIGHTS AND BURDEN OF PROOF

27. Regulation 80 of the PAYE Regs provides that where it appears to HMRC that there may be tax payable by an employer (either under the Real-Time Information Regulations or otherwise) which has not been paid, HMRC may determine the amount of that tax to the best of their judgment. That determination is then treated as if it was an assessment for the purposes of identifying appeal rights.

28. Section 11 SSCA provides a right of appeal to the tribunal against a NICs decision made under Section 8 SSCA.

29. Regulation 7 of the Social Security Contributions (Decisions and Appeals) Regulations 1999 (“the 1999 Regs”) states that Sections 49A-49I of the Taxes Management Act 1970 (“TMA”) apply to appeals under the SSCA.

30. The appeal rights are therefore provided in the same way as for other tax assessments by the provisions contained in the Taxes Management Act 1970.

31. In an appeal against an assessment for tax (including NICs), the burden is on the appellant to show that the sums charged to tax by the assessment are excessive. That was confirmed by Mustill LJ in *Brady (Inspector of Taxes) v Group Lotus Car Companies plc* [1987] STC 635, at 642, as follows:

“The starting point is an ordinary appeal before the [Tribunal]. Here, however unacceptable the idea may be to the ordinary member of the public, it has been clear law binding on this court for sixty years that an inspector of taxes has only to raise an assessment to impose on the taxpayer the burden of proving that it is wrong: *Haythornthwaite & Sons Ltd v Kelly (Inspector of Taxes)* (1927) 11 TC 657.”

32. In this case HMRC have applied a best judgment assessment and in doing so have relied on the presumption of continuity. Once HMRC show that there was a basis to make a best judgment assessment – in this case that there may be tax payable by PDG as employer which has not been paid, as explained below – and that the best judgment was based on reasonable inferences, the burden of proof remains with the taxpayer as more fully described later in this decision.

33. In relation to the penalties, the appeal rights are set out in paragraph 15 of Schedule 24 FA 2007 which states:

“(1) A person may appeal against a decision of HMRC that a penalty is payable by the person.

(2) A person may appeal against a decision of HMRC as to the amount of a penalty payable by the person.

(3) A person may appeal against a decision of HMRC not to suspend a penalty payable by the person...

34. Paragraph 17 provides that:

(1) On an appeal under paragraph 15(1) the tribunal may affirm or cancel HMRC's decision.

(2) On an appeal under paragraph 15(2) the tribunal may—

(a) affirm HMRC's decision, or

(b) substitute for HMRC's decision another decision that HMRC had power to make.

35. The tribunal may reach a different conclusion about the application of “special circumstances” or not to suspend a penalty only if HMRC’s decision on either of those matters was “flawed”. “Flawed” means flawed when considered in the light of the principles applicable in proceedings for judicial review.”

36. The burden is on HMRC to show that the penalties have been correctly imposed in accordance with the legislation.

37. The standard of proof in each case is the ordinary civil standard, which is the balance of probabilities.

THE STATUTORY FRAMEWORK

The requirement to apply PAYE

38. Section 684 Income Tax Earnings and Pensions Act (“ITEPA”) provides for regulations to be made with respect to the assessment, charge, collection and recovery of income tax in respect of all “PAYE income”. Those regulations are the PAYE Regs. PAYE income is defined in Section 683 ITEPA and includes PAYE employment income which is in turn defined as:

- (a) any taxable earnings from an employment in the year (determined in accordance with section 10(2)), and
- (b) any taxable specific income from an employment for the year (determined in accordance with section 10(3)).

39. Under Section 6 ITEPA there is a charge to tax on general earnings and specific employment income.

40. Regulation 21 of the PAYE Regs states that

“On making a relevant payment to an employee during a tax year, an employer must deduct or repay tax in accordance with these Regulations by reference to the employee’s code, if the employer has one for the employee.”

41. Regulation 4 of the PAYE Regs defines a “relevant payment” by reference to “Net PAYE Income” which in turn is defined in Regulation 3 as

“PAYE income less any—

- (a) allowable pension contributions, and
- (b) allowable donations to charity.”

42. For the non-RTI years, 2011-12 and 2012-13, an employer is required under Regulation 68 to pay to HMRC an amount which is broadly speaking the excess of the amounts deducted from payments made to employees over the amounts the employer is liable to repay to its employees. Regulation 69 sets out the payment dates.

43. For the RTI years, 2013-14 and 2014-15, Regulation 67G sets out the requirement to make payments to HMRC. Regulation 69 applies the same payment dates.

44. Where it appears to HMRC that there may be tax payable by an employer which has not been paid, HMRC is given the power under Regulation 80(2) to determine the amount of that tax to the “best of their judgment” and serve notice of their determination on the employer.

45. The notice of determination under Regulation 80 must satisfy statutory requirements. It may cover any one or more periods in a tax year and extend to the whole of the amount of tax determined by HMRC under paragraph 80(2), or such part of it as is payable in respect of a class or classes of employees specified in the determination, or one or more named employees.

46. The phrase “best of their judgment” is used elsewhere in tax legislation and has been considered in various cases. In the case of *Johnson v Scott* [1978] STC 48 it was recognised that where insufficient evidence to make an accurate assessment is provided, any resulting estimates will be unsatisfactory “But what the Crown has to do in such a situation is, on the known facts, to make reasonable inferences...Where...figures have to be inferred, what has to be made is a “fair” inference as to what such figures may have been.”

47. It was confirmed in *Bi-Flex Caribbean Ltd v Board of Inland Revenue (Trinidad and Tobago)* [1990] 63 TC 515 that such best judgment assessments are “prima facie right and remain right until the taxpayer shows that they are wrong and also shows positively what corrections should be made in order to make the assessments right or more nearly right.” That description of the burden of proof being on the taxpayer was confirmed by the Court of Appeal in *Customs and Excise Commissioners v Pegasus Birds Ltd* [2000] All ER (D) 34 where guidance to the tribunal when considering a best of judgment assessment was given which included the following at paragraph 38:

“i) The Tribunal should remember that its primary task is to find the correct amount of tax, so far as possible on the material properly available to it, the burden resting on the taxpayer. In all but very exceptional cases, that should be the focus of the hearing, and the Tribunal should not allow it to be diverted into an attack on the Commissioners' exercise of judgment at the time of the assessment.

48. In this case HMRC have relied upon the presumption of continuity when making the best judgment assessment. HMRC have relied on the case of *Jonas v Bamford* (1973-1978) 51 TC 1 and that case was commented on by the First Tier Tribunal in *Guide Dogs for the Blind Association* [2012] UKFTT 687 (TC). The Tribunal said:

“In *Jonas v Bamford* 1973 51 TC 1, 1973 STC 519 Walton J observed, at page 25, that once an inspector comes to the conclusion that, on the facts which he has discovered, the taxpayer has additional income beyond that which he has so far declared, then the usual presumption of continuity will apply. The situation will be presumed to go on until there is some change in the situation, the onus of proof of which is clearly on the taxpayer. Such a presumption is not the exclusive preserve of HMRC but is also available to taxpayers. It is, however, only a presumption and may be rebutted. We agree with the observations of the Tribunal in *Dr I Syed v HMRC* [2011] UKFTT 315 (TC) on this point at paragraph 38 that:

“In our view this quotation [from *Jonas v Bamford*] expresses no legal principle. It seems to us that it would be quite wrong as a matter of law to say that because X happened in Year A, it must be assumed that it happened in the prior year. An officer is not bound by law and in the absence of some change to make or to be treated as making a discovery in relation to last year merely because he makes one for this year. This tribunal is not bound to conclude that what happened this year will happen next year. It seems to us that Walton J is instead expressing a common sense view of what the evidence will show. In practice it will generally be reasonable and sensible to conclude that if there was a pattern of behaviour this year then the same behaviour will have been followed last year. Sometimes however that will not be a proper inference: there will be occasions when the behaviour related to a one off situation, perhaps a particular disposal, or particular expenses; in those circumstances continuity is unlikely to be present.”

49. In other words, the presumption is just that – a presumption – and it is rebuttable. It can be displaced by sufficient evidence of material change in the taxpayer’s situation.

50. This means that in this case when considering HMRC's best judgment assessments the burden is on the taxpayer to show what corrections should be made and, so far as the presumption of continuity has been applied, to show that there were material changes in circumstances which rebut that presumption.

PAYE Record Keeping

51. Chapter 2 of the PAYE Regs sets out the requirements which apply to employers when new employees start work. Those requirements are detailed and vary according to the employee's employment history in particular. It is not necessary for this decision to set out the requirements in full, but key provisions relevant to PDG can be summarised as follows.

52. Prior to the introduction of RTI reporting requirements from 6 April 2012, the employer was required to send the P45 or P46 for each employee to HMRC once completed by the employee and employer. Those requirements were modified after the introduction of RTI for employers operating RTI, unless notified by HMRC.

53. The employer is also required under the PAYE Regs to operate a deductions working sheet for each employee using the tax code shown on a P45 where that form is provided.

54. If the employee provides a P46 and states that he or she does not have another continuing employment and he or she is not in receipt of a pension, the employer is required by Regulation 47 of the PAYE Regs to apply the emergency tax code once a payment made to an employee equals or exceeds the lower earnings limit for Class 1 contributions. Prior to 6 April 2008 the threshold for deduction was the PAYE threshold, but this was changed by the Amendment of the Income Tax (Pay As You Earn) Regulations 2003 SI 2007/2969. If the employee has another employment (which is continuing) or is in receipt of a pension the employer must initially deduct tax using a basic rate code regardless of whether the payments made exceed the lower earnings threshold for NICs.

55. Where the employee has no P45 and does not complete a P46 or since RTI has not provided the relevant information, then from 6 April 2011, the employer must operate code 0T on a cumulative basis. Under this code the tax is deducted at the basic, higher or additional rate, as appropriate, but without the benefit of personal allowances.

56. On receipt of the relevant information, HMRC fix a new code for the new employee concerned and notify it to his or her employer. On receipt of that notification, the employer must operate that code in respect of subsequent relevant payments. Regulation 66 provides that deduction working sheets must be maintained for each employee for whom HMRC have issued a code or whose pay exceeds the PAYE threshold.

57. For the non-RTI tax years 2011/12 and 2012/13 Regulation 73 of the PAYE Regs required that before 20 May after each tax year employers should deliver a return to HMRC setting out the amounts paid to each employee and the amount of tax deducted, together with further details about the employees. Common practice was to submit a P35 setting out the aggregate amounts of the payments and deductions and a separate form, known as P14, providing the requisite details for each employee. Both the P35 and the P14 were forms provided by HMRC for the purpose.

58. For the tax years 2013/14 and 2014/15 RTI reporting rules applied. There was a temporary relaxation of reporting requirements for small businesses with fewer than 50 employees. Until April 2014, such employers who found it difficult to report every payment to employees at the time it was made could send information to HMRC no later than the end of the tax month in which the payments were made. From 6 April 2014, this relaxation was replaced with a relaxation for 2014/15 and 2015/16, only, applying to employers with a PAYE reference at 5 April 2014 and no more than nine employees at the start of the year. Such

employers could make returns of relevant payments for a tax month delivered on or before making the last relevant payment in that month. Although the timing of reporting requirements was relaxed, the requirements to report information remained.

59. Under RTI, any PAYE scheme with one or more employees earning above the lower earnings threshold for NICs must include all employees in the RTI reports, irrespective of whether they earn above the NICs threshold or not. Regulation 67B provides the reporting requirements for employers and Regulation 67G provides that the total net tax deducted in relation to the total payments to date in the employments must be paid by the employer to HMRC. Regulations 67B and 67BA requires reporting of relevant payments for all employees.

60. Regulation 97 of the PAYE Regs requires employers to keep PAYE records for 3 years after the end of the tax year to which they relate. Those records include all documents and records relating to payments made to employees.

61. In addition, paragraph 21 of Schedule 18 of the Finance Act 1998 requires companies which may be required to deliver a tax return to keep records, including records of all expenses in the course of the company's activities.

NICs

62. The obligation to apply NICs to payments made by an employer is set out in Section 6(1) of the Social Security Contributions and Benefits Act 1992 which states:

(1) Where in any tax week earnings are paid to or for the benefit of an earner over the age of 16 in respect of any one employment of his which is employed earner's employment—

(a) a primary Class 1 contribution shall be payable in accordance with this section and section 8 below if the amount paid exceeds the current primary threshold (or the prescribed equivalent); and

(b) a secondary Class 1 contribution shall be payable in accordance with this section and section 9 below if the amount paid exceeds the current secondary threshold (or the prescribed equivalent).

63. Primary Class 1 contributions are paid by employed earners; and secondary Class 1 contributions are paid by employers and other persons paying earnings (Section 2 SSCBA).

64. Provision is made in Schedule 1 for the employer to be liable for paying both the primary and secondary Class 1 contributions. The employer may recover the amount of the primary Class 1 contributions by deduction from the employee's earnings.

3(1) Where earnings are paid to an employed earner and in respect of that payment liability arises for primary and secondary Class 1 contributions, the secondary contributor shall (except in prescribed circumstances), as well as being liable for any secondary contribution of his own, be liable in the first instance to pay also the earner's primary contribution or a prescribed part of the earner's primary contribution, on behalf of and to the exclusion of the earner; and for the purposes of this Act and the Administration Act contributions paid by the secondary contributor on behalf of the earner shall be taken to be contributions paid by the earner...

(3) A secondary contributor shall be entitled, subject to and in accordance with regulations, to recover from an earner the amount of any primary Class 1 contribution paid or to be paid by him on behalf of the earner; and, subject to sub-paragraphs (3A) to (5) below but notwithstanding any other provision in any enactment regulations under this sub-paragraph shall provide for recovery to be made by deduction from the earner's earnings, and for it not to be made in any other way.

65. Section 8 SSCTFA provides the power for an officer of the Board of HMRC to make decisions about whether a person is or was liable to pay contributions of any particular class and, if so, the amount that he is or was liable to pay.

66. Regulation 3 of the Social Security Contributions (Decisions and Appeals) Regulations 1999 requires the Section 8 notice of decision to state the period for which it has effect.

67. The tribunal has a broad power to vary the Section 8 decision which is provided by Regulation 10 of the 1999 Regulations which states:

If, on an appeal ... under Part II of the Transfer Act that is notified to the tribunal, it appears to the tribunal that the decision should be varied in a particular manner, the decision shall be varied in that manner, but otherwise shall stand good.

Penalties

68. Penalties can be imposed under Schedule 24 FA 2007 where a taxpayer provides one of a list of specified documents and the document contains inaccuracies. Paragraph 1 of Schedule 24 states:

- (1) A penalty is payable by a person (P) where—
 - (a) P gives HMRC a document of a kind listed in the Table below, and
 - (b) Conditions 1 and 2 are satisfied.
- (2) Condition 1 is that the document contains an inaccuracy which amounts to, or leads to—
 - (a) an understatement of a liability to tax,
 - (b) a false or inflated statement of a loss ..., or
 - (c) a false or inflated claim to repayment of tax.
- (3) Condition 2 is that the inaccuracy was careless (within the meaning of paragraph 3) or deliberate on P's part.

69. The documents in the table include a return for the purposes of the PAYE Regs.

70. In this case the penalties have been imposed on the basis of “careless” inaccuracies. Paragraph 3 of Schedule 24 provides that an inaccuracy is careless where it is due to failure by the person to take reasonable care.

71. Paragraph 13 of Schedule 24 provides that:

- (1) Where a person becomes liable for a penalty under paragraph 1, 1A or 2 HMRC shall—
 - (a) assess the penalty,
 - (b) notify the person, and
 - (c) state in the notice a tax period in respect of which the penalty is assessed (subject to sub-paragraph (1ZB)).
- (1ZA) Sub-paragraph (1ZB) applies where—
 - (a) a person is at any time liable for two or more penalties relating to PAYE returns...and
 - (b) the penalties (“the relevant penalties”) are assessed in respect of more than one tax period (“the relevant tax periods”).
- (1ZB) A notice under sub-paragraph (1) in respect of any of the relevant penalties may, instead of stating the tax period in respect of which the penalty

is assessed, state the tax year or the part of a tax year to which the penalty relates...

(3) An assessment of a penalty under paragraph 1...must be made before the end of the period of 12 months beginning with—

(a) the end of the appeal period for the decision correcting the inaccuracy, or

(b) if there is no assessment to the tax concerned within paragraph (a), the date on which the inaccuracy is corrected.

72. The starting point for calculating the amount of the penalty for careless inaccuracy is 30% of the potential lost revenue. “The potential lost revenue” in respect of an inaccuracy in a document is defined as the additional amount due or payable in respect of tax as a result of correcting the inaccuracy or assessment in paragraph 5 of Schedule 24.

73. However, that can be reduced under paragraph 9 where a taxpayer tells HMRC about the inaccuracy, gives HMRC reasonable help in quantifying the inaccuracy, or allows HMRC access to records for the purpose of ensuring that the inaccuracy is fully corrected. A distinction is drawn between “prompted” and “unprompted” disclosures. In the case of prompted disclosures the standard penalty of 30% cannot be reduced below 15% (Paragraph 10 Schedule 24).

74. If they think it right because of special circumstances, HMRC have the power under paragraph 11 to reduce a penalty under paragraph 1 of Schedule 24. “Special circumstances” are stated not to include the ability to pay, or the fact that a potential loss of revenue from one taxpayer is balanced by a potential over-payment by another.

75. The term “special circumstances” is not defined but has been found to involve something which is unusual or exceptional, or where the application of the penalty rules would run counter to their policy, or produce an arbitrary result.

76. HMRC is given power in paragraph 14 of Schedule 24 to suspend penalties payable by a person. Paragraph 14 (3) states that

“HMRC may suspend all or part of a penalty only if compliance with a condition of suspension would help [the person] to avoid becoming liable to further penalties under paragraph 1 for careless inaccuracy.

77. In HMRC’s guidance it is stated that:

“We can only suspend penalties for careless inaccuracies in returns or documents if we’re able to set at least one suspension condition that will help you avoid penalties for similar inaccuracies in the future. Each condition must be ‘SMART’. SMART means:

☐ specific - it must be directly related to the cause of the inaccuracy

☐ measurable - you’ll need to be able to show us whether you have met the condition

☐ achievable - you’ll need to show us that you are able to meet the condition

☐ realistic - we can realistically expect that you’ll meet the condition

☐ time bound - you must meet the condition by the end of the suspension period.”

78. In this case HMRC has decided not to suspend the penalties.

EVIDENCE

79. The evidence consists of the agreed bundle of documentary evidence running to 743 pages as set out in the index, with the replacement of the bundle version of Mrs Lakhani's Witness Statement with an updated Witness Statement, as well as the oral evidence of Mr Singh Johal, Mrs Johal, Mr Attwal and Mrs Lakhani. Although Mr Attwal has been appointed as PDG's representative and appeared at the hearing as such, we permitted Mr Attwal to give evidence regarding his role in the operation of PDG's payroll system.

HMRC'S CASE

80. HMRC maintains that:

- (1) the PDG workforce was larger than that declared and as a consequence PAYE has not been correctly applied by PDG;
- (2) in particular, PDG failed to comply with its obligations under Regulations 46, 49 and 66 of the PAYE Regs when dealing with new employees. As some tax and NICs were deducted it is clear that not all of the employees of PDG were paid below the lower earnings threshold;
- (3) PDG has failed to provide accurate information to HMRC as required by the PAYE Regs;
- (4) PDG operates without written employment contracts and pays its employees in cash. The company had acknowledged its uncertainty over its record keeping duties and that "big mistakes" had been made. At the hearing it had been accepted that PDG had not kept the records required by legislation. Even diaries, which were described as the only evidence of employees' hours, had not been kept. As a result PDG cannot say what hours were worked by its employees;
- (5) PDG is heavily reliant on its workforce to generate income and HMRC consider that there should be a relationship between the wages and the turnover. In February 2015 PDG described a workforce which was inconsistent with the declared turnover. That was accepted by PDG and in a meeting a year later a different and more realistic workforce was described. Prior to the opening of the enquiry the wages costs were only 3%-5% of turnover, whereas after the enquiry those costs increased to 20% of turnover. HMRC concluded that the intervention had led to improved record-keeping and compliance with PDG's PAYE obligations;
- (6) PDG has acknowledged that it failed in its PAYE obligations but asserts that HMRC's figures are not correct without putting forward and substantiating its own figures. PDG says that Mrs Johal should be excluded from the calculations, but this is not accepted by HMRC. Similarly, PDG argues both that Mr Singh Johal's salary should not be included when calculating the expected payroll cost, and the salary payment to him should be offset against the liability for the tax year ended 5 April 2012, without any evidence to support the assertion that PAYE should not have been operated on payments made to him;
- (7) A suggested 13% of turnover for the PAYE cost is problematic as evidence from PDG shows that the cost was at least 17.5%.
- (8) HMRC rely on the cases of *Johnson v Scott* [1978] STC 48 and *BI-Flex Caribbean Ltd v Board of Inland Revenue (Trinidad and Tobago)* [1990] BTC 452 in relation to the best judgement assessment;
- (9) *Jonas v Bamford (HM Inspector of taxes)* (1973-1978) 51 TC 1 is relied on in applying the presumption of continuity in making the assessment;

(10) in determining whether PDG's behaviour was careless, HMRC relies on the judgement of *Collis* [2011] TC 01431. PDG failed to take prudent and reasonable measures to prevent the errors in its PAYE reporting occurring. The disclosure was prompted because it was HMRC's investigation that uncovered the inaccuracy and a reduction for disclosure has left a penalty charge of 18% of the assessed PAYE;

(11) HMRC has decided not to suspend the penalty as a result of a number of factors, in particular the fact that increased reporting of payroll costs had taken place and therefore there were no SMART conditions that could be put in place. In addition, in the case of *Dr David Atkinson v HMRC* [2016] UKFTT 387 (TC) it was stated that suspension, which might result in the lifting of a penalty, was for the less serious end of careless penalties. That was not the case in this appeal;

(12) Officer Lakhani's Witness Statement was not challenged;

(13) it was not plausible that PDG had four vehicles operating in the business for the number of employees working the small number of hours claimed by the company.

PDG'S CASE

81. PDG maintains that:

(1) Mr Singh Johal worked numerous unpaid hours in building up his business and this has been misconstrued as undisclosed payments to off record staff and unrecorded payments to existing staff. On an average basis he worked up to 15 hours a day mostly for 6 days a week (occasionally 7 days) mostly unpaid. He gradually introduced paid staff as business started improving;

(2) there were inadvertent trivial lapses and delays due to Mr Singh Johal's lack of understanding and time commitment to his business;

(3) recognition by Mr Singh Johal and Mrs Johal of PDG having incomplete records did not mean records were missing, but simply that they were not following a transaction by transaction, double entry accounting system. The records were sufficient to produce reasonable and accurate accounts with debtors/creditors being balanced thorough director's loan account balances;

(4) temporary staff were employed on a needs only basis and paid the national minimum wage. Before RTI was introduced payroll registration was not compulsory for all paid staff, especially if they were paid below the PAYE threshold and the lower earnings limit for NICs;

(5) there were major disruptions in the business during the company's financial year's 2010-11 and 2011-12 due to the relocation of business operations from Slough to Hayes;

(6) an alternative calculation produced by Mr Attwal is more accurate. Mr Singh Johal's and Mrs Johal's payroll costs and casual ad hoc administrative staff should be excluded from the turnover-related payroll costs calculations. Payroll costs should more accurately be calculated on the basis of 13% of turnover. The gap between actual payroll costs and the 13% estimate is accounted for by Mr Singh Johal's unpaid work;

(7) HMRC's approach has been very heavy-handed;

(8) There is no evidence to suggest that PAYE returns submitted since the operation of the payroll scheme were erroneous;

(9) HMRC assessments are based on very convenient assumptions rather than proven facts;

(10) Mr Singh Johal and Mrs Johal had explained at the hearing that diaries were kept and these were the basis of figures provided to Mr Attwal for preparation of accounts and operation of the payroll;

(11) PDG relied on the evidence from the payroll reports.

82. PDG accepts the description of the law as set out by HMRC in its statement of case and skeleton argument.

FINDINGS OF FACT

83. These findings of fact relate to the tax years in dispute – 2011-12 to 2014-15 – unless otherwise stated.

84. The following matters are not in dispute:

(1) PDG was incorporated in May 2009 with a sole shareholder and director, Mr Jaskaren Singh Johal. Its original name was changed from Shelter Building & Roofing Ltd to PDG in August 2010.

(2) Mr Singh Johal remains the sole director and shareholder of PDG. He received dividends from PDG from 2015 onwards.

(3) PDG has operated a business of the manufacture, supply and fitting of double glazing windows and doors and fittings since August 2010. PDG conducts its own sales and marketing activities.

(4) The premises of PDG were in Slough until March 2011 and were moved to Hayes in June 2011.

(5) The following figures are shown in PDG's accounts for the accounting periods ended on 31 May for each year 2012-2016 inclusive.

| | 30.5.12 | 30.5.13 | 30.5.14 | 30.5.15 | 30.5.16 |
|--|---------|---------|---------|---------|---------|
| Turnover (£) | 209,865 | 329,999 | 357,792 | 357,792 | 441,289 |
| Mr Singh Johal's salary (£) | 5000 | 6,000 | 7,603 | 8,560 | 10,200 |
| Other wages (£) | 10,400 | 11,091 | 40,864 | 51,170 | 90,351 |
| Dividends to Mr Singh Johal (£) | | | | 25,000 | 14000 |

However, the evidence casts doubt on the reliability of the figures in the company accounts for the reasons explained later in this decision.

(6) There were no written employment contracts for any of PDG's employees.

(7) PDG paid its employees wholly in cash. It still pays half of its payroll in cash.

(8) PDG started to operate a PAYE scheme in March 2013. PDG did not inform HMRC when employees started work and did not obtain any tax codes to apply to employees' wages prior to establishing that PAYE scheme.

(9) PDG has not kept any underlying records such as work sheets or deductions sheets to show who was employed at what time, the hours worked by employees, or what amounts were paid to employees in the relevant tax years, although PDG started to provide RTI reports in April 2013.

(10) For the tax year 2012-2013 end of year summaries of payments (P14s) for Mrs Johal and four other employees were submitted by PDG to HMRC showing payments of £5,551.62 only. No P14 was provided for Mr Singh Johal although he was paid employment income for that year as shown by the company accounts. A P35 for the same tax year shows total tax and NICs paid by PDG of £478.32. The amounts in the P14s and P35 are reflected in a summary of employee pay prepared by Mr Attwal, but do not account for additional wages shown by PDG's accounts to have been paid to Mr Singh Johal and other employees.

(11) No P14 forms or other records have been provided for employees for the tax year 2011-12.

(12) PDG owned four motor vehicles: two cars and two vans. Three of them were purchased by PDG in 2011, 2013 and 2014.

(13) No travel records have been kept to show the use of the vehicles for the purposes of the PDG business.

(14) In a meeting with HMRC in February 2015 it was said that cheques from PDG of £5000 per month to Mr Singh Johal represented dividends to Mr Singh Johal which at that time had not been declared by Mr Singh Johal through self-assessment. In March 2015 Mr Attwal corrected that description of the payments to repayments of a loan by PDG. Mr Singh Johal has subsequently declared employment income and dividends received from PDG on his tax returns.

(15) PDG did not issue invoices for most of its supplies in the relevant tax years.

(16) Mrs Johal, the wife of Mr Singh Johal, has been responsible for PDG's book keeping since the company's formation and would liaise with Mr Attwal for advice. She gave up another job in December 2012 and worked full-time for PDG from 21 January 2013.

(17) Mrs Johal was paid wages for her work for PDG from January 2013.

(18) A VAT investigation is also ongoing in relation to PDG's operation and VAT compliance.

Further findings and evidential issues

85. The RTI summary sheets show new employees starting to work for PDG, yet in each case they are given the standard code for basic rate taxation with the personal allowance, even though there is no evidence that PDG informed HMRC of the new starters or was provided with a P46 by new starters. PDG should have been applying the OT code (with no personal allowance given) in those circumstances and has not provided a reason for failing to do so.

86. Turning to the varying evidence about employee records, Mrs Johal explained at the hearing that she would note down hours worked by employees in a diary, but the diaries have not been retained. Mr Singh Johal explained at the hearing that PDG's employees in the relevant tax years were not available to provide evidence as they had been in the UK on temporary visas and had since left the country.

87. Mr Attwal's evidence at the hearing about the existence of underlying records such as wages sheets was somewhat confused. He confirmed that he was told that there were no records for any of the employees. When asked about items such as wages sheets Mr Attwal said that those had been produced at a meeting with HMRC and had been taken by HMRC, although Mr Attwal then became unclear as to what was meant by reference to wages sheets.

88. Given the clear evidence of Mrs Johal, who has been responsible for administration and bookkeeping throughout the relevant tax years, we are satisfied that there are no underlying records to show employees' work history at PDG.

89. Mr Attwal has explained in meetings with HMRC and at the hearing that PDG's accounts have been prepared by Mr Attwal on the basis of the incomplete records provided to him and using his best judgment. The Director's loan/current account is used as the item which balances the accounts. The company accounts for the accounting periods ended 31 May 2010 and 31 May 2011 show no pay to Mr Singh Johal and no pay to employees but subsequently Mr Attwal has provided a schedule showing wages paid in those periods to employees and, in the latter year, to Mr Singh Johal. For these reasons we therefore find that the accounts are not reliable evidence of PDG's payments to employees.

90. At the hearing it was confirmed that Mrs Johal's Witness Statement contains inaccuracies. For example, Mrs Johal confirmed at the hearing that she could not explain the figures stated in her Witness Statement for wages paid prior to the introduction of PAYE by PDG. She said that they had been provided by Mr Attwal, but did not know how they were calculated and recognised that there are no records which could have been used by Mr Attwal to produce such figures. Given the inaccuracies and the lack of basis for the stated causal labour figures we have reduced the weight given to Mrs Johal's Witness Statement.

91. It was also confirmed at the hearing that Mr Singh Johal's Witness Statement was prepared for him by Mrs Johal. It is written in the same terms as Mrs Johal's and therefore contains the same inaccuracies and has the same issues with references to matters which cannot be explained by Mr Singh Johal. We have therefore also reduced the weight given to Mr Singh Johal's Witness Statement.

92. We have not reduced the evidence provided by Mr Singh Johal at the hearing about the following matters concerned with the production of quotations as the evidence is consistent and plausible. That evidence leads us to the following findings about PDG's business:

(1) Much of its work is generated by customer referral, but it also uses a van with a logo to advertise. Around 75% of its business is generated by orders from builders. The rest is from private homeowners.

(2) Around 15-20% of the business requires attendance at a property or site to produce quotations. Other business is handled by builders sending measurements to PDG. PDG then produces a quotation.

(3) Mr Singh Johal has been the only person conducting quotations at properties or sites. Mr Singh Johal would go out to prepare quotations on average 2 to 3 times per week. Each trip would take about 1½ hours – 2 hours on average. Other quotations were prepared from details provided by builders and did not require Mr Singh Johal to attend the site to prepare the quotation.

93. The evidence regarding the number of quotations prepared for PDG each month is less consistent. Mr Singh Johal said at the hearing that PDG would provide approximately 15-20 quotations per week throughout the relevant years, whereas the evidence from previous meetings with HMRC was that PDG produced 3 quotations for every job and in October 2016, for example, 71 invoices were issued (recognising that an invoice is not issued for every job). The meeting evidence shows a much higher number of quotations per month. The disparity has not been explained.

94. Much of PDG's case turns upon the claim that Mr Singh Johal devoted a large amount of unpaid time to developing the business and this accounted for the low payroll costs. Both Mr Singh Johal and Mrs Johal said that he worked long unpaid hours for the business,

especially in its early years. While we recognise that establishing a business will often involve a very significant time commitment with little remuneration, the evidence overall does not support a conclusion that Mr Singh Johal was doing the bulk of the manufacture of PDG's products for the following reasons.

95. Mr Singh Johal originally conducted a roofing business through PDG before changing to the window and door business. At the hearing Mr Singh Johal described the hiring of workers, explaining that he was able to hire people who had experience in the manufacture of PDG's products in other factories. They therefore knew what to do. Yet there is little evidence of Mr Singh Johal himself having any background or experience in the manufacture of PDG's products. Mr Singh Johal previously worked as a lorry driver and before that had tried to set up a building works business prior to starting the PDG business.

96. In the meeting between HMRC, Mrs Johal and Mr Singh Johal in February 2015, it was said that Mr Singh Johal's involvement in the production of goods was mainly limited to finishing off or "glossing". Other employees were described as the people who manufactured the goods and carried out the fitting. Specific details were provided about each employee's role. The meeting note was prepared by HMRC and sent to PDG for comment. Mr Attwal responded on behalf of the company and, whilst there were some minor clarifications and amendments, the description of the employees and their roles was not altered.

97. A second meeting was held a year later and was also attended by Mr Attwal. In that meeting as in the first Mrs Johal described a system where she would input measurements onto a computer system and produce a jobs sheet. In that second meeting she again described giving the job sheets to the "boys". Again Mr Singh Johal's role was described as mainly meeting customers and obtaining orders and a description of five full-time employees' roles as fitters and manufacturers was given. Again Mr Attwal responded to the meeting note with some comments. Although these were more substantive, particularly in relation to vehicles owned by PDG, the description of the operation of the business was not challenged.

98. A third unannounced meeting took place in October 2016 and the same description of the process of producing job sheets which were handed to the "boys" was provided at that meeting. Mr Attwal telephoned HMRC to discuss the meeting and in particular document requests, but the note of meeting was not challenged.

99. At the hearing it was confirmed that the notes of meetings were accepted.

100. We have therefore concluded that there has been a consistent description provided by Mr Singh Johal and Mrs Johal of the operation of PDG's business during three meetings over the course of more than 18 months which is not consistent with the claim that Mr Singh Johal – a man of no apparent experience in the production and fitting of PDG's goods – was effectively the principal maker and fitter of them. We find that others were employed to carry out the manufacture and fitting of the products.

101. The evidence in meetings, correspondence and at the hearing has often been vague or inconsistent about who was employed, on what basis and for how long.

102. For example, in the first meeting with HMRC on 12 February 2015 five workers working varying hours were identified by Mr Singh Johal and Mrs Johal. None of them were said to be full-time. In a meeting on 5 February 2016 five workers were identified in addition to Mr Singh Johal and Mrs Johal, but all five of the workers were said to work 35 hours per week. The payroll costs identified by PDG in a "Master Schedule" provided by Mr Attwal, and the hours described in 2016, were more than double the hours described in 2015 even though turnover had increased by just under 18%. The difference is not accounted for by Mr Singh Johal's unpaid work in production for the reasons explained above.

103. At the hearing Mr Singh Johal said his orders had remained fairly constant since 2012 until a recent downturn this year and said that he worked 15-16 hours per day until 2014 making the products with only one or two people occasionally helping him for 2-4 hours per day. However, PDG's turnover figures do not reflect a fairly constant level of orders. Turnover in 2015/16 is more than double that in 2011/12.

DISCUSSION

PAYE and NICS

104. PDG has not challenged the form of the Regulation 80 or Section 8 notices or the process for their issue. We are satisfied that the notices comply with the statutory requirements regarding form and process. In particular, the Regulation 80 notices have identified the relevant tax periods and the class of employees covered by the notices. The Section 8 notice also states the period for which it has effect.

105. PDG have challenged the best judgment basis upon which HMRC have made the Regulation 80 assessments. We are satisfied that HMRC was entitled to make a best judgment assessment in the circumstances that this case for the following reasons.

106. PDG has conceded that records have not been kept. Indeed, there has been an extraordinary lack of record keeping. Employees have been paid in cash and so it has not been possible to trace back through bank statements to show what payments were made. Mrs Johal referred to diaries being used to record hours worked by employees, but the diaries have not been provided and Mrs Johal confirmed at the hearing that they no longer exist. There are no written employment contracts.

107. We do not accept Mr Attwal's submission that this is standard practice for small businesses. It is practice which fails to comply with statutory obligations for companies and directors of companies.

108. The evidence shows that there have been inaccuracies:

(1) In the meeting in February 2016 Mrs Johal said that there were five full-time employees working for PDG (in addition to herself and Mr Singh Johal) each of whom was earning more than £12,000 per annum, above both the income tax personal allowance and the lower earnings threshold for NICs. However, the PAYE summaries produced by Mr Attwal to show the payments made and deductions made for employees in each relevant year do not reflect this. None of the employees (apart from Mrs Johal) in that schedule is shown to have earned over £12,000. Two of the named full-time employees are shown on the PAYE summaries to have earned just over £4000 and just under £5000. It is therefore clear that the amounts said by Mr Attwal's summaries to have been reported through the payroll system do not reflect the payments to workforce described by Mrs Johal in the meeting;

(2) On 18 April 2015 Mr Attwal set out the number of hours worked by employees in the tax year 2013/14. He listed 5 employees, but his summary of employee pay produced in April 2018 shows that Mr Singh Johal and Mrs Johal were also paid wages in that year. The question asked by HMRC did not ask for information for employees other than Mr Singh Johal and Mrs Johal, but for all employees. Even if Mr Singh Johal was excluded as a director there was no reason to exclude Mrs Johal;

(3) The company accounts for the accounting periods ended 31 May 2010 and 31 May 2011 show turnover of £31,485 and £64,500 with no employee costs and no director's remuneration. Mr Attwal has provided a schedule showing £8,800 of wages paid other than to Mr Singh Johal and his wife in the accounting period ended 31 May 2010. The schedule shows £5,000 paid to Mr Singh Johal as salary and £5200 as wages paid to other

employees in the accounting period ended 31 May 2011. None of those payments were reported to HMRC although it is recognised that the amounts paid in 2010 arose prior to the years in dispute;

(4) PDG has not challenged HMRC's conclusion that the P14s for the tax year 2011-12 did not reflect the total amounts shown in the accounts as having been paid to employees in that year;

(5) PDG has conceded that there have been errors and lapses although disputes the extent of them.

109. Considering all the evidence, it is clear that HMRC were left with little option but to make a best judgment assessment about the amount of wages paid by PDG in the relevant years and the consequent PAYE and NICs which should have been paid.

110. We find that the best judgment assessment was based on reasonable inferences for the following reasons. HMRC have explained that the calculation of the wages costs was originally based on the meeting in February 2016 and the percentage wages costs shown by the figures described at that meeting, i.e. 17.5%. It was later increased to 20% to take account of the fact that the reporting of wages had notably increased in the accounting period ended 31 May 2016, after the effects of HMRC's initial meeting in February 2015 had had time to generate improved reporting. The presumption of continuity was applied and therefore 20% was applied to the earlier periods. HMRC explained that any effect of relocation of premises in 2011 would be reflected in the turnover figures and PDG has not provided any reason why this would not be the case.

111. Having decided that HMRC were entitled to make a best judgment assessment and that it was based on reasonable inferences, the burden of proof falls on PDG to show that the assessment is wrong and also to show positively what corrections should be made in order to make the assessments right or more nearly right. Mr Attwal submits that HMRC have not proved that their assessment of amounts paid to employees is correct, but it is not for HMRC to do so. It is also not for HMRC to identify off-record workers.

112. Mr Attwal submits that the payroll costs should be calculated on the basis of 13% of turnover as that is the percentage reflected in the three years ended 31 May 2016 – 31 May 2018 inclusive when the pay of Mr Singh Johal, Mrs Johal and administrative staff is excluded. He then goes on to submit that the difference between the 13% figure and the actual wages paid reflects unpaid hours worked by Mr Singh Johal.

113. Taking the second of those points first, we refer to the finding made earlier that Mr Singh Johal was not working as claimed as the maker and fitter of the PDG products. We therefore do not accept that the difference between the expected wage costs and the actual wage costs is explained by Mr Singh Johal's work.

114. We also find that there is insufficient evidence to show that Mr Attwal's 13% figure should be used in preference to HMRC's 20% figure for the following reasons.

115. Using the relatively basic information provided by Mrs Johal in the meeting of February 2016 describing five full-time employees working 35 hours per week at the rate of £7 or £7.50 per hour, the wages cost for those employees was £64,610 as shown by the evidence from HMRC. (In fact, HMRC have provided evidence from the Office for National Statistics which has not been challenged by PDG showing that glaziers would be expected to earn an average hourly rate of £9.68 in 2013, but we have proceeded with the £7 or £7.50 figures used otherwise by HMRC.) When the wages of £64,610 are added to those of the administrative staff the wage costs are more than 15% of the turnover for the year ending 31 May 2016.

116. At the time of the meeting, prior to production of the 2016 accounts, the wages cost for the five full-time production employees was by itself 17.5% of the latest turnover figures (i.e. for the 2015 accounting period). If the wages costs for Mr Singh Johal and Mrs Johal for the 2015 accounting period were also taken into account the percentage for the wages costs reached more than 25%.

117. When the increased turnover shown by the 2016 accounts is taken into account the wages costs (including Mrs Johal and Mr Singh Johal's) for the accounting period ended 31 May 2016 is nearly 23%. If Mr Singh Johal's wages are excluded as a shareholder who could alternatively receive dividends, the wages costs are 20.47% of turnover. If only the wages costs for the 5 employees are taken into account the percentage is nearly 15%.

118. These percentages do not support the use of 13% proposed by Mr Attwal. He has used a figure of £57,058 as the amount reported as having been paid to employees other than Mrs Johal, Mr Singh Johal and administrative staff, in the accounting period ended 31 May 2016, but that does not reflect Mrs Johal's description of the workforce in February and no explanation of the disparity has been given. Even Mrs Johal's description of the 5 full time employees is not reflected in the payroll summary provide by Mr Attwal for 2015-16 which shows 10 employees. Mrs Johal is included in that summary, but the evidence is not clear that Mr Singh Johal is. That is because the RTI reports taken together with his tax identification details show that payments to him are reported as made to Jaskaran Singh and there is no reference to J Singh in Mr Attwal's summary. However, even if we assume that another name was used in Mr Attwal's summary for Mr Singh Johal that leaves 8 employees in addition to Mr Singh Johal and his wife.

119. Therefore the issues with the reliability of Mrs Johal's' description of the workers mean that HMRC may in fact have been generous to rely on those figures for the basis of their assessments. The evidence has also shown that the figures in the statutory accounts prepared for PDG are not reliable and PDG continue to maintain incorrectly that employees paid below the NICs lower earnings threshold and income tax personal allowance need not be reported.

120. Mr Attwal has claimed that the wages costs for Mr Singh Johal, Mrs Johal and admin staff should be excluded from the calculations because they are "exceptional items being fixed payroll costs determined more by the liquidity and profitability of the business than the increase in turnover". While they could have been fixed costs in fact the schedule produced by Mr Attwal shows that they were not, but we recognise that the wages paid to Mr Singh Johal and his wife will in practice depend on liquidity and profitability. Even if those wage costs are excluded however, the claim that the 13% rate should be applied to the years in question is not supported by the evidence as explained above.

121. PDG has therefore not shown that HMRC's assessment is wrong in using 20% to calculate the wages and have not shown that 13% is a more accurate best judgement percentage to apply.

122. HMRC have applied the presumption of continuity. PDG says that the presumption does not take into account the impact of relocation, but HMRC maintains that calculating the wages costs as a percentage of turnover automatically takes into account its effect. We agree that the turnover figure should reflect the impact of relocation. PDG have not identified any other circumstances which lead to a rebuttal of the presumption. The start-up period in 2010-11 is not covered by HMRC's assessments.

123. HMRC's assessments correctly deduct the amounts which were in fact reported by PDG as wages (including the wages of Mr Singh Johal and his wife). PDG has not challenged the allocation of the wages costs and resulting application of the income tax and NICs rules.

124. Therefore for all these reasons we conclude that PDG has not shown that the best judgment assessments should be amended and we confirm those assessments.

Penalties

Does the penalty notice comply with the statutory requirements?

125. The validity of the penalty notice has not been challenged by PDG. It is not disputed that it was received by PDG. The penalty notice complies with the requirements of Paragraph 13 of Schedule 24 in stating the tax years to which it relates. It was issued on 22 October 2018 which was before the end of the period of 12 months beginning with the end of the appeal period for the decisions correcting the inaccuracies, as those decisions were made on 28 March 2018 and 8 May 2018.

Were the PAYE returns and RTI returns inaccurate?

126. This is not a situation as in the case of *Fab Cleaning Management Ltd v HMRC* [2016] UKFTT 31 (TC) where the returns correctly state the amounts in fact paid, but the amounts of tax have been incorrectly deducted. Instead, in this case HMRC have imposed penalties because HMRC has decided that the returns did not reflect the payments made to employees. For the following reasons we are satisfied that HMRC have shown that there were inaccuracies:

- (1) As we have decided that PDG has not shown that HMRC's best judgment figures are wrong, the PAYE returns and RTI returns must be found to be inaccurate;
- (2) The evidence of Mrs Johal in meetings with HMRC about the number of employees and their hours is not consistent with the evidence in Mr Attwal's summaries of the payroll;
- (3) Prior to RTI, unless PDG had evidence in a P46 or P45 which meant that an employee could be treated otherwise, all payments of employment income should have been subject to the PAYE deductions and reporting system. After RTI there was at least one employee earning above the NIC lower earnings threshold and PDG should have reported payments made to all employees regardless of whether their earnings were above the lower earnings threshold. (It is of some concern that even at this stage Mr Attwal, Mr Singh Johal and Mrs Johal maintained that it is not necessary to report payments made to those earning below the PAYE or NICs thresholds.)

Were the inaccuracies careless?

127. HMRC have applied the penalties on the basis of "careless" behaviour rather than "deliberate" behaviour. HMRC has relied on the cases of *Dr David Atkinson v HMRC* [2016] UKFTT 387 (TC) and *David Collis v HMRC* [2011] UKFTT 588 (TC). Those cases identify the test for determining whether behaviour is careless as being whether the taxpayer acted as a prudent and reasonable taxpayer in the position of the taxpayer in question would have acted. PDG has not challenged this and we agree that it is the correct approach.

128. We consider that the extraordinary lack of record keeping is not an action of a prudent and reasonable taxpayer running a small business. PDG has shown scant regard for producing reliable figures for any reporting. The behaviour in this case is a prime example of careless behaviour.

Should the reduction in the penalty for disclosure be varied?

129. The careless reporting was identified in the course of HMRC's investigations. The disclosures were therefore prompted.

130. HMRC have reduced the penalty to take account of co-operation and disclosures. The legislation provides details of factors which should be taken into account in that process:

timing, nature and extent. The minimum percentage after reductions is 15% and the maximum is 30%. The reductions for PDG's co-operation and disclosures result in an 18% penalty. PDG have not challenged the reductions and we are satisfied that HMRC's reduction in the penalties for the prompted disclosures is appropriate and, if anything, at the more generous end of the range of appropriate reductions given the inconsistencies in the disclosures and the need to issue two information notices.

Is HMRC's decision that there are no special circumstances "flawed"?

131. We are satisfied that HMRC's decision that there are no special circumstances in PDG's case is not "flawed". Flawed in this context is defined to have the narrow meaning when considered in the light of the principles applicable in proceedings for judicial review. HMRC have addressed whether special circumstances exist and state that PDG have not raised any circumstances which could fall under that heading. PDG has not raised any matter which would lead us to conclude that this decision made by HMRC is flawed.

The decision not to suspend the penalties

132. Again this can only be changed by us if we decide that the decision is, when considered in the light of the principles applicable in proceedings for judicial review "flawed". Initially the independent review concluded that insufficient consideration had been given to the question of whether the penalties should be suspended. After further consideration and issue of the appealed new notice of decision HMRC have set out various reasons for not suspending the decision in the revised penalty notice. In particular, Mr Moore identifies in HMRC's statement of case that setting conditions to ensure future compliance was not appropriate as payroll costs are already being reported on a more accurate basis.

133. Suspension is designed to enable conditions leading to improved compliance and we are therefore satisfied that this is not a flawed decision.

CONCLUSION

134. The decisions by HMRC to:

- (1) assess £31,372 under the PAYE Regs for the tax years 2011/12, 2012/13, 2013/14, 2014/15;
- (2) assess £19,758 under the SSCA for the period 6 April 2012 to 5 April 2015; and
- (3) impose penalties totalling £7692.48 under FA 2007 in respect of the tax years 2012/13, 2013/14 and 2014/15

are affirmed and PDG's appeal is dismissed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

135. 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.

TRACEY BOWLER

TRIBUNAL JUDGE

RELEASE DATE: 30 JUNE 2020