TC02316

Appeal number: TC/2012/00969

INCOME TAX – construction industry scheme – cancellation of gross payment status – s66 Finance Act 2004 – HMRC discretion – whether properly exercised - Failure to take into account effect of cancellation on appellant – Barnes v Hilton Main Construction considered and distinguished – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

J P WHITTER (WATERWELL ENGINEERS) LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE JONATHAN CANNAN
MR PETER WHITEHEAD

Sitting in public at Manchester on 9 August 2012

Mr Ian Whalley, Solicitor for the Appellant

Mr Ian Birtles of HMRC for the Respondents

DECISION

Background

1. The appellant challenges a decision of HMRC to cancel its registration for gross payments for the purposes of the construction industry scheme. The appeal was originally heard on 11 April 2012 and a decision dismissing the appeal was released on 20 April 2012. Following that hearing the appellant appointed a new representative and made an application to set aside the decision. That application was granted and the appeal was re-listed to be heard on 9 August 2012. The hearing before us was a fresh hearing and we have had no regard to the findings and reasons given in the original decision.

2. We heard evidence from Ms Sally Whitter on behalf of the appellant. We also had documentary evidence before us in the form of correspondence between the appellant's representative and various officers of HMRC. We make our findings of fact based on this evidence, although it is fair to say that there was little dispute as to the underlying facts. The real issue between the parties is the inferences we can draw from those facts and the extent to which they are relevant in considering the decision to cancel the registration.

3. The decision under appeal is a decision dated 3 August 2011 cancelling the appellant's registration for gross payments. It was confirmed by HMRC following a statutory review dated 12 December 2011. Before dealing with the facts surrounding the decision, we set out the relevant statutory provisions in relation to the construction industry scheme.

Statutory Provisions and Authorities

4. The law regarding the construction industry scheme is contained in *sections 57-77 Finance Act 2004*, *Schedules 11 and 12* of that Act and the *Income Tax (Construction Industry Scheme) Regulations 2005*. Section 64 of the FA 2004 sets out the requirements for registration for gross payment. In particular section 64(4) provides that where a company is applying for registration it must comply with the three statutory tests set out in *Part 3 of Schedule 11*. These are generally described as the business test, the turnover test and the compliance test. Paragraph 12 deals with the compliance test:

5. Paragraph 12(1) specifies the criteria for the compliance test:

> "*The company must, subject to sub-paragraphs (2) and (3), have complied with –*
>
> *(a) all obligations imposed on it in the qualifying period...by or under the Tax Acts or the Taxes Management Act 1970, and*
>
> *(b) all requests made in the qualifying period to supply to the Inland Revenue accounts of, or other information about, its business.*"

6. For these purposes the qualifying period is defined by paragraph 14 as "*the period of 12 months ending with the date of the application in question*". The application referred to is an application for registration for gross payments.

7. Paragraphs 12(2) and (3) deal with non-compliance which is to be excused for the purposes of the compliance test. This may be because the non-compliance is of a kind specified in regulations or because the applicant has a reasonable excuse for failing to comply. The provisions state as follows:

> *"(2) A company that has failed to comply with such an obligation or request as –*
>
> *(a) is referred to in sub-paragraph (1) and,*
>
> *(b) is of a kind prescribed by regulations made by the Board of Inland Revenue,*
>
> *is, in such circumstances as may be prescribed by the regulations, to be treated as satisfying the condition in that sub-paragraph as regards that obligation or request.*
>
> *(3) A company that has failed to comply with such an obligation or request as is referred to in sub-paragraph (1) is to be treated as satisfying the condition in that sub-paragraph as regards that obligation or request if the Board of Inland Revenue are of the opinion that*
>
> > *a) the company had a reasonable excuse for the failure to comply, and*
> >
> > *b) if the excuse ceased, it complied with the obligation or request without unreasonable delay after the excuse had ceased."*

8. At the time of the decision to cancel the appellant's registration the regulations for the purposes of paragraph 12(2)(b) were the *Income Tax (Construction Industry Scheme) Regulations 2005 (SI2005/2045). Reg 32* sets out the prescribed obligations which include the obligation to pay tax deducted under PAYE. The prescribed circumstances in which a breach may still be treated as satisfying the compliance test are, for present purposes:

> "*(1) Payment is made not later than 14 days after the due date, and*
>
> *(2) the applicant or company—*
>
> > *(a) has not otherwise failed to comply with this obligation within the previous 12 months, or*
> > *(b) has failed to comply with this obligation on not more than two occasions within the previous 12 months.*"

9. Paragraph 12(7) provides, effectively as part of the compliance test, that:

> "*There must be reason to expect that the company will, in respect of periods after the qualifying period, comply with –*
>
> *a) all such obligations as are referred to in paragraphs (10) and (11) and sub-paragraphs (1) to (6), and*
>
> *b) such requests as are referred to in sub-paragraph (1)*"

10. *Section 66(1) FA 2004* makes provision for HMRC to cancel a persons registration for gross payments:

> "*The Board of Inland Revenue may at any time make a determination cancelling a person's registration for gross payment if it appears to them that-*
>
> *(a) if an application to register the person for gross payment were to be made at that time, the Board would refuse so to register him,*
>
> *(b) he had made an incorrect return or provided incorrect information (whether as a contractor or as a sub-contractor) under any provision of this Chapter or of regulations made under it, or*
>
> *(c) he has failed to comply (whether as a contractor or as a sub-contractor) with any such provision.*"

11. The provisions introduced by *FA 2004* with effect from 6 April 2007 replaced a similar scheme under the *Income and Corporation Taxes Act 1988*. The previous scheme required a contractor to hold a certificate issued by the Inland Revenue before the contractor could receive gross payments. There were similar obligations and compliance tests before a contractor could receive a gross payment certificate, together with a system whereby the Inland Revenue could refuse to renew a certificate if the holder failed the compliance tests. *Section 565(3) ICTA 1988* provided that:

> "*A company which has failed to comply with such an obligation … shall nevertheless be treated as satisfying this condition … if the Board are of the opinion that the failure is minor and technical …*"

12. The previous regime was considered by Ferris J in *Shaw v Vicky Construction [2002] STC 1544*. That case was concerned with a refusal by the Inland Revenue to issue a certificate and whether the refusal was a disproportionate interference with the taxpayer's right to peaceful enjoyment of a possession. In substance the original appeal to the General Commissioners by *Vicky Construction* was against the opinion of the Board that the non-compliance was not minor and technical. The case

proceeded on the basis that the General Commissioners were entitled to substitute their own view for that of the Board of Inland Revenue. Ferris J raised an issue as to the nature of the jurisdiction of the General Commissioners hearing the appeal but for procedural reasons he expressed no view on the matter.

13. Ferris J held that the General Commissioners in that case had erred in law in finding that the non-compliance was minor and technical as that term is properly construed according to conventional principles of construction. He also found that there was no need to read the provisions in a modified sense in order to avoid an infringement of convention rights. The scheme of the Act was not a disproportionate interference with the right to peaceful enjoyment of a possession.

14. Under *section 561 ICTA 1988* the Board was not exercising any discretion in deciding whether to grant a certificate. If the Board was satisfied that the conditions for the issue of a certificate were satisfied they were bound to issue a certificate. If the conditions were not satisfied they had no power to issue a certificate.

15. It is now well established in the First-tier Tribunal that in cancelling a registration pursuant to the power in *section 66 FA 2004*, HMRC are exercising a discretion – see *Scofield v HMRC [2011] UKFTT 199 (TC)* which has been applied on a number of occasions since. Mr Birtles did not invite us to depart from that approach.

16. There is a significant issue between the parties as to the extent to which we can take into account the financial effect on the appellant of cancelling its registration for gross payment. We consider this issue below when giving reasons for our decision on this appeal.

Jurisdiction of the Tribunal

17. In *Hudson v JDC Services Limited [2004] STC 834* Lightman J referred to the decision of Ferris J in *Vicky Construction*, and in particular that the nature of the jurisdiction of the old General Commissioners on such appeals had been left open. That case also concerned an appeal against refusal to issue a certificate. Having considered the context of the provisions in *ICTA 1988* he held that the General Commissioners had a full appellate jurisdiction and were free to substitute their own decision for that of the Board. Part of his reasoning for doing so was that the decision under appeal, the granting of a certificate, did not involve any exercise of discretion by the Inland Revenue.

18. Whether the statutory context in FA 2004 gives rise to the same result has been considered by the First-tier Tribunal on a number of occasions. In *Piers Consulting Limited v HMRC [2011] UKFTT 613 (TC)* and *Cardiff Lift Company v HMRC [2011] UKFTT 628 (TC)* the Tribunal held that it did not have jurisdiction to substitute its own decision for that of HMRC. Effectively the Tribunal has a supervisory jurisdiction which is what might be expected in a case where HMRC are exercising discretion, in this case discretion to cancel a registration. In each of those cases the appeal was allowed, but the Tribunal did not substitute its own decision.

19. In *Scofield v HMRC*, referred to above, HMRC accepted and the Tribunal found that it had a full appellate jurisdiction and could substitute its own view for that of HMRC. The point however does not appear to have been argued and we prefer the view in *Piers Consulting* and *Cardiff Lift Company* for the reasons given in those decisions that we have a supervisory jurisdiction.

20. The test of reasonableness in a supervisory jurisdiction involves consideration of whether HMRC have taken into account some irrelevant matter, have disregarded something to which they should have given weight or have reached a decision which no reasonable decision maker could have reached. If the decision maker has not taken into account material facts which he or she should have taken into account then the decision will not be reasonable for these purposes.

21. In *John Dee v CCE [1995] STC 941* the Court of Appeal considered the jurisdiction of the VAT Tribunal in security appeals. Both parties in that case accepted that the tribunal had a supervisory jurisdiction rather than a full appellate jurisdiction. However if it was shown that the Commissioners had failed to take into account relevant material a tribunal could nevertheless dismiss an appeal if a decision taking into account that material would inevitably have been the same.

Findings of Fact

22. The appellant carries on business, as its name implies, as water well engineers. It drills boreholes and wells for water companies, commercial and agricultural businesses and the domestic market. It operates on a UK wide basis with 25 employees. It is very much in the nature of a family business started by Philip Whitter in 1972 and was later incorporated in the 1980's.

23. Prior to incorporation, and at all material times since, Mr Whitter and the appellant have used the services of Wilds Chartered Accountants. Their services have included operating the appellant's payroll system.

24. The business has grown steadily and presently has about 25 employees, including a number of family members on the administration side. Sally Whitter, who gave evidence, is a daughter of Philip Whitter. She is the company secretary and has worked for the appellant for more than 20 years. Her sister Lucy is responsible amongst other things for making payments authorised by the directors. In the three years to 2011 the business had a turnover of approximately £4.4 million making a net profit over the same period of about £180,000. Approximately £1.9 million of that turnover derived from contracts with United Utilities. Other major well known customers accounted for a further £900,000.

25. Employees of the appellant are paid weekly. Each Monday time sheets are collected and sent to Wilds who prepare pay slips and payments are made by BACS transfer on the Wednesday. On or shortly after the 5th of each month Wilds send details to the appellant of amounts due to be paid to HMRC in relation to PAYE and national insurance contributions. Historically payments have been made to HMRC

either by BACS transfer or by cheque. Often payments have been late. This is because of the procedure operated for paying suppliers rather than any particular cashflow shortage. Having said that Ms Whitter accepted that cashflow was a struggle in 2008 and 2009 and they had to prioritise suppliers. The officers of the appellant would look at the cashflow at the end of each month before deciding which suppliers should be paid. Payments to HMRC in respect of PAYE were dealt with as part of the same system.

26. It was inevitable that the system would cause payments to HMRC which fell due either on the 19th or 22nd of each month to be made late. That had been the position for many years and HMRC had never chased payment or indeed expressed any concern that PAYE payments were late. There are various other family business interests including a leisure park business which has 5 employees and which complies with its PAYE obligations. Historically it has had its own systems which work well and have not been changed. Unfortunately those systems were not introduced into the appellant's business.

27. The appellant's registration for gross payments as with other registered taxpayers was subject to ongoing review by HMRC to ensure compliance with the conditions described above. We understand that such reviews were generally carried out by computer on an annual basis. In August 2008 a review was performed and the results were satisfactory. On 29 July 2009 a review was performed and the appellant failed. Although we had no direct evidence as to the reason for this failure we infer and find as a fact that it was because of late payment of PAYE. The failure led to cancellation of the appellant's registration by letter dated 6 August 2009.

28. Wilds responded to HMRC on behalf of the appellant by letter dated 2 October 2009. They appealed the decision in a letter written by Janice Hyde of Wilds stating as follows:

> "*Whilst we can agree that our client has been late in making payments the company has never failed to make such payments and to penalise this business in a stringent manner is we fear only going to lead to significant operational issues when tendering for longer contracts and hence jeopardising the livelihoods of the sub-contractors the company engages.*
>
> …
>
> *We have drawn our client's failings to their attention and the company has guaranteed that they will address this issue and that all future payments will be made on time. If they are unable to fulfil their obligations they will contact the Business Payment Support Team immediately…* "

29. Janice Hyde was an accountant responsible for the appellant's tax returns. She was not very senior and whilst Ms Whitter knew her she had never had a meeting with her. She acted as an assistant to Ken Nash who was a more senior accountant.

30. Ms Whitter gave evidence that when the HMRC letter dated 6 August 2009 was received she would have rung the tax department of Wilds and probably spoke to Ken Nash. We accept that evidence. She also stated that she never realised the seriousness of the position and no steps were taken to improve compliance at that time. Ms Whitter's recollection of her discussions following this letter was vague. We find as a fact that Mr Nash did make her aware of the matters referred to in Janice Hyde's letter dated 2 October 2009. In particular that the appellant was not complying with its PAYE obligations and that future payments must be made on time. Whilst we accept that Ms Whitter did not realise the seriousness of the matter, we consider that she ought to have done. It was unreasonable not to have taken steps to improve compliance in 2009.

31. On 12 November 2009 HMRC wrote to Wilds to say that their appeal had been upheld. At the same time however HMRC made clear that the company had responsibility to make payments on time whilst recognising that it had taken steps to improve compliance. The letter stated that the rules would in future be applied strictly and that there was no scope to allow for "minor and technical" failures. The letter identified the "reasonable excuse" provisions and the possibility of seeking a time to pay arrangement which if granted would not affect registration.

32. It is likely and we find as a fact that Mr Nash would have discussed the contents of this letter with Ms Whitter.

33. On 29 June 2010 there was another annual review which the appellant failed due to late payment of PAYE. The appellant's registration was again cancelled. Wilds appealed by letter dated 8 July 2010 stating as follows:

> "*This business has been grown meticulously by the Whitter family to a position where it can now confidently apply for tenders from United Utilities and indeed have just obtained two very large contracts with them. The withdrawal of the gross paying certificate will quite obviously put those contracts in jeopardy as United Utilities will not deal with companies who do not have a gross paying certificate…The withdrawal of the certificate will therefore severely hinder the company who have managed to survive over a very difficult last eighteen months to two years.*
>
> *… our clients have on their part agreed that all future PAYE will be paid on time.*"

34. References to a certificate are clearly intended to be references to registration for gross payment. Ms Whitter was not copied in with this letter nor shown a copy in draft prior to it being sent. However Ms Whitter did fairly accept that Mr Nash would have discussed the position with her. We find that he did so, and in particular the appellant agreed to make future PAYE payments on time. Again, however the appellant failed to take any steps to improve compliance at this stage.

35. There was some confusion on the part of HMRC whether this appeal had been lodged in time. It clearly was in time. By letter dated 20 August 2010 HMRC replied apologising for their earlier confusion and stated:

> "*On this occasion I am prepared to overlook these failures, your appeal is upheld and the company will retain gross payment status.*"

36. Again the letter included a warning about future compliance, and also about the PAYE penalty regime that had been introduced in tax year 2010-11. At this stage we note that there was no evidence before us as to whether penalties pursuant to *Sch 56 FA 2009* were ever assessed on the appellant. Nor was it suggested that in the exercise of its discretion HMRC ought to have considered that the imposition of a penalty was a more appropriate sanction than cancellation of the appellant's registration.

37. On 30 May 2011 there was another annual review which the appellant again failed due to late payment of PAYE. On this occasion, prior to cancellation of the registration, HMRC wrote to the appellant identifying the defaults and giving the appellant an opportunity to advise whether it had entered into a formal time to pay arrangement or to produce evidence in support of a reasonable excuse.

38. We find as a fact that the following late payments of PAYE had been made:

Due Date	Date Paid	Period Late
22 Aug 2010	1 Oct 2010	40 days
22 Sept 2010	6 Oct 2010	14 days
22 Oct 2010	29 Oct 2010	7 days
22 Nov 2010	26 Nov 2010	4 days
22 Jan 2011	28 Jan 2011	6 days
22 Feb 2011	After 20 June 2011	At least 118 days
22 Mar 2011	31 Mar 2011	9 days

39. The reason the date of payment for the sum due on 22 February 2011 cannot be identified is that Ms Whitter, in her reply dated 14 July 2011, stated that the appellant had omitted to make the February payment but that it had now caught up. The point was not addressed directly in evidence by either party but we infer that the February payment was made some time after the HMRC letter on 20 June 2011 but before Ms Whitter's reply dated 14 July 2011. In any event the extent to which that payment was late does not in itself have any impact on our decision.

40. In her reply Ms Whitter apologised for the late payments which she said were due to "administrative oversights". She continued:

> "*Whilst admitting to these oversights, which we will endeavour to prevent in future, we would point out that losing our gross status would prevent us tendering for contract work and thus cause the company to cease trading. I am sure you will agree that removing gross status will cause great hardship which is disproportionate to the level of the oversights discussed above.*"

41. We do not accept that the PAYE non-compliance in late 2010 and 2011 can fairly be described as an "administrative oversight". The appellant was well aware of the non-compliance drawn to its attention in 2009 and 2010. It must have chosen, for whatever reason, not to address the matter and did not improve the system for making payment to HMRC until after July 2011. Ms Whitter gave evidence that Wilds had been lax in dealing with the appellant's affairs in connection with this correspondence and had constantly re-assured her that there was no problem. She identified Mr Buchsbaum as the most senior person she dealt with and said that he had not alerted her to the seriousness of the issue. We have not heard any evidence from Wilds, however we do have the correspondence referred to above. That correspondence is certainly not consistent with a firm being lax in its dealings and we are unable to accept Ms Whitter's evidence in this regard. She may well have underestimated the significance of the issues but we are not satisfied this was because of any failure on the part of Wilds.

42. After July 2011 the appellant significantly changed its systems to ensure that PAYE was paid on time. As soon as information as to the amount of the monthly PAYE payment is received from Wilds a BACS payment is set up to be made on the 17th of the month. Since then PAYE payments have always been made on time.

43. HMRC wrote to the appellant on 3 August 2011 stating that they were unable to accept the explanation for compliance failures. The letter also noted that this was the third failed review and that assurances as to future compliance had previously been given. This is the letter which effectively evidences HMRC's decision to cancel the appellant's registration.

44. Wilds appealed the decision in the following terms:

> "*Whilst we accept that our client has made multiple compliance failures these are of a trivial nature with payments being an average three weeks late … we feel that the punishment is disproportionate to the crime.*
>
> *The situation is that our clients major customer will only deal with businesses which have a gross status and if this status is removed from our clients they will lose that customer and consequently will not be able to carry on to trade with the results that several people will have to be made redundant and redundancy costs arising out of that.*

We would also point out that as a result of ongoing pressure from the Inland Revenue there is now a growing trend among larger businesses to refuse to deal with anybody who does not have gross status and therefore the removal of gross status effectively prevents companies from trading and as such in our opinion represents a fundamental breach of human rights which is the ability to trade freely especially where it arises out of trivial failures.

We should therefore be obliged if you could reconsider your decision in light of the disproportionate effect it will have on our clients business as against the … failures which are quite clearly not malicious but merely administrative errors."

45. By letter dated 15 September 2011 HMRC refused the appellant's appeal on the following basis:

"*For your appeal to succeed, you need to demonstrate a 'reasonable excuse' for the failures to meet obligations which have prevented you retaining gross payment status. Our view is that a reasonable excuse is where exceptional circumstances beyond your control have prevented you fulfilling the obligations …*

I have considered your appeal but no reasonable excuse has been provided for the failures. Also the company have failed previous tax treatment reviews where the same failure reasons had been identified, and warnings regarding future compliance were issued by HMRC…"

46. Wilds replied by letter dated 23 September 2011 and noted that whilst HMRC did not accept reasonable excuse they were aware of other cases where gross status had been allowed to continue on the basis of disproportionate hardship. They asked for a statutory review of the decision. That review was concluded on 12 December 2011 and the decision was upheld. The reviewing officer clearly considered that there was no reasonable excuse for the defaults. He noted Wild's arguments that the decision was disproportionate and dealt with those arguments in the following terms (sic):

"*In your appeal you have made the point that the withdrawal of gross payment status is disproportionate to the offence. Please note that the issue of proportionality has been considered in the High Court case in Hilton v Barnes Main Construction Ltd EWHC 1355 (Ch) 2005 and endorsed in the Enderby Properties v HMRC UKFTT 85 (TC) 2010 case.*

The findings were that Tribunal has no discretion in the scenario where a plea made by an appellant on the basis of a loss of status might put a Company out of business, nor can Tribunal or HMRC consider proportionality as the High Court rules that Human Rights Act did not require the UK Courts to read in a test of proportionality in the gross payment status rules and the 'reasonable excuse' exemption provision so

provided so as not to make the rules disproportionate, that and given the fact that a person could then recover GPS in the future."

47. Ms Whitter said that United Utilities and other major customers would be likely to withdraw work from the appellant if it lost its gross status registration. We accept that evidence, indeed Mr Birtles accepted that large contractors do refuse to deal with sub-contractors who do not have gross payment status. The effect of losing such customers would be a fall of some 63% in turnover and profits. The company would likely shrink to some 5 or 6 employees from the current 25. It would not be able to tender for any utility or large commercial work. Even if the registration was lost and regained 12 months later the nature of the work was so specialised they would not be able to recruit suitable employees. It would take the appellant 10 years or so to get back to where it is now.

48. Mr Birtles did not challenge this evidence and we accept it.

Reasons

49. The appellant lodged its notice of appeal with the Tribunal on 22 December 2011. The grounds of appeal are essentially that the decision is disproportionate and cites the First-tier Tribunal cases of *Scofield, S Morris Groundwork Ltd* and *Bruns t/a Fabrications* where the tribunal had considered the proportionality of the decision.

50. *Section 66(1) FA 2004* gives HMRC a discretion to cancel registration for gross payment where the trader, if he had been applying for registration at that time, would have been refused registration. For present purposes that involves focussing on the compliance test. Both parties agreed before us that the correct approach to the question of cancellation of registration is essentially as follows:

(1) Has the company complied with its obligations under the *Tax Act* and the *Taxes Management Act 1970* during the qualifying period?

(2) If not, does any failure to comply fall within regulations made under *para 12(2) Sch 11* such that the company is to be treated as having complied?

(3) If not is HMRC of the opinion that the company had a reasonable excuse for non-compliance so that it is to be treated as compliant?

(4) In any event, even if the company has complied with its obligations, or is to be treated as complying with its obligations, is there reason to expect that the company will in future comply with its obligations.

(5) Where a company has not complied with its obligations and is not to be treated as complying with its obligations, or if there is not reason to expect that it will comply in future, then HMRC has discretion to cancel the registration.

51. The primary issue between the parties is whether or not the officer should have taken into account the financial effect of the company losing its registration for gross payments. Both parties described this as a proportionality argument which is useful as a shorthand but we are not sure that is an entirely apt description in the present

context. Mr Whalley's principal submission was that by failing to take into account the financial effect on the appellant the decision was flawed and unreasonable.

52. Mr Birtles submitted that this was not a factor that could or should be taken into account. In support of that submission he relied upon the decision of Lewison J as he then was in *Barnes (HMIT) v Hilton Main Construction [2005] EWHC 1355 (Ch)*. That case was concerned with the same regime as Ferris J had considered in *Vicky Construction*. The taxpayer in *Hilton Main Construction* had an annual certificate which had expired. In broad terms *Reg 26 Income Tax (Sub-contractors in the Construction Industry) Regulations 1993 (SI 1993/743)* made provision for a certificate to be valid for periods of one year or three years subject to satisfying certain tests. *Reg* 27 made provision for renewals in the 6 months prior to expiry. On an application for renewal the provisions of section 561 were expressed to apply in the same was as they apply to an application. The Inland Revenue refused to renew on the grounds of non-compliance. Again, pursuant to section 561 the Inland Revenue had no discretion in the matter.

53. The taxpayer appealed and the General Commissioners found that whilst the late payments were not minor and technical the consequences of the decision not to renew, namely the likely closure of the taxpayer's business, were disproportionate and inequitable. The Inland Revenue appealed on the basis that the taxpayer was not entitled to a certificate and no question of proportionality arose in addition to that which was inherent in the scheme itself.

54. Lewison J applied the decision of Lightman J in *Hudson v JDC Services Ltd* referred to above. In particular where past failures are not minor and technical then whatever the prognosis for future compliance the taxpayer is not entitled to a certificate. In *Hilton Main Construction* the taxpayer argued that *Hudson* should not be followed because Lightman J had not considered arguments based on the Human Rights Act 1988. In particular that the construction given to the statutory provisions in *Hudson* infringed the taxpayer's convention rights because the consequences of non-renewal were disproportionate.

55. It is notable that there was no discretion in relation to the granting of a certificate under *ICTA 1988*. The position is the same under *section 63 FA 2004*. Pursuant to section 561(8) ICTA 1988 the Board "… *may at any time cancel a certificate* … " where, if an application were to be made at that time the Board would refuse to issue a certificate. Again the position is the same under *section 66 FA 2004*.

56. In *Hilton Main Construction* and *Hudson* the courts were not concerned with cancellation of a certificate. They were concerned with non-renewal of a certificate. In each of those cases the tests to be applied were the same and pursuant to *section 561(2)* on the grant of a certificate the Board had no discretion. If the conditions are satisfied they "*shall*" grant a certificate.

57. It was the absence of any discretion on the part of the Inland Revenue that led the taxpayers in those cases to argue a breach of convention rights, just as the taxpayer had done in *Vicky Construction*. Hence, at [21] Lewison J states:

> "*the taxpayer's broad argument based on proportionality has to have as its starting point a Convention right that has been infringed. If there is no such right, then there is no peg on which to hang the argument based on proportionality. Since I consider that no Convention right has been infringed there is no occasion to resort to section 3 of the Human Rights Act.*"

58. The provisions for cancellation of an existing registration under *FA 2004* are quite different to the provisions for the grant of a certificate under *ICTA 1988*. In particular HMRC has a discretion as to cancellation even where there is a breach of the compliance test for which there is no reasonable excuse. In our view it is the existence of such discretion which gives a peg on which to hang arguments that the effect on the appellant of cancellation is a relevant factor. Indeed reasonableness, including proportionality type arguments, might be expected to be at the very heart of such discretion. Having said that, when HMRC is exercising its discretion it will no doubt have well in mind the mischief that the construction industry scheme is designed to combat.

59. Lewison J gave as one reason for not importing a test of proportionality the difficulty officers of HMRC would have in applying it. At [22] he stated:

> "*If the legislation were to incorporate a general test of proportionality that would place a heavy burden on tax inspectors to conduct a prospective review or forecast of the potential effect of refusal of a certificate on individual businesses. Moreover, it is not said that it will always be disproportionate to refuse a certificate if the result would be that the taxpayer would be put out of business. So there would require to be a judgment by the inspector not only whether a refusal would have that effect, but also whether that effect is proportionate to the failures.*"

60. Leaving aside issues of proportionality, it seems to us that the general unfettered discretion given to HMRC in considering whether to cancel an existing registration does at least involve taking into account the effect on a business of losing its registration for gross payments.

61. It is clear that in fact HMRC have already exercised discretion when previously deciding not to cancel the appellant's registration. HMRC allowed appeals against two earlier cancellations in November 2009 and August 2010. Neither of the letters sent out at that time indicate on what basis the discretion was exercised. For example there is no indication whether the loss of business with United Utilities was taken into account. We would be surprised if it wasn't because the only other factors relied upon in the appeals were that PAYE whilst paid late was always eventually paid and that the appellant had agreed all future PAYE would be paid on time. In August 2010 this was the appellant's second compliance failure and we think it unlikely that those assurances on their own would have been sufficient for HMRC to exercise its discretion not to cancel the registration.

62. It is easy to see why Parliament might choose to distinguish the position of a taxpayer applying for registration and a taxpayer who is registered but whose registration is liable to be cancelled. In the former case HMRC must simply ascertain whether the taxpayer satisfies the conditions laid down in *FA 2004*. If so then HMRC must grant registration. In the latter case, if the conditions are not satisfied then HMRC has discretion because cancellation of registration can clearly have serious implications for an existing business. In exercising such discretion HMRC have a wide margin of appreciation. It will only be if they have failed to take into account a relevant factor, have taken into account irrelevant factors or have reached a wholly unreasonable decision that the Tribunal will intervene.

63. It seems to us that the officer who made the review decision in the present case misunderstood the basis upon which HMRC must exercise discretion in cancelling a registration. His reliance on *Barnes v Hilton Main Construction* as authority for the proposition that he could not take into account matters of proportionality and reasonableness was misplaced. We make no criticism in this regard because it is not an easy point of law. Indeed he also relied upon a decision of the First-tier Tribunal in *Enderbey Properties Limited v HMRC [2010] UKFTT 85 (TC)* in which the tribunal stated (sic):

> "*The Appellants are pleading that the loss of their status might put the company out of business. However, our understanding of the law is that we have no discretion to take such a factor into account. The High Court has ruled in a decision, which is binding upon us, that neither HMRC nor we the Tribunal can consider proportionality: Barnsley v Hilton Main Construction [2005] EWHC 1355 (CH). In that case, the judge considered the Human Rights Act and concluded that it did not require the UK courts to read in a test of proportionality in the gross payments status rules.*"

64. For the reasons given above we do not consider that the statement of law set out in *Enderbey Properties Limited* is correct. The effect on a business of losing its registration for gross payment will often be a factor to be taken into account. The weight to be attached to that factor is a separate matter. Previous tribunal decisions illustrate the tension apparent in the existence of discretion as to cancellation if such a factor cannot be placed in the balance. They have canvassed the possibility of resolving that tension by treating it as a factor which can be taken into account in determining whether there is a reasonable excuse for non-compliance with a condition. See for example *Bruns t/a TK Fabrications v HMRC [2010] UKFTT 58 (TC) at [32]* and *S Morris Groundwork Ltd v HMRC [2010] UKFTT 585 (TC).* In our view that is not the correct approach.

65. We now turn to the particular facts of the present appeal. The appellant did not dispute that there was a compliance failure, although Mr Whalley did contend that the review officer had wrongly considered matters outside the relevant period.

66. It is necessary for us to consider whether there was a failure to comply with PAYE obligations in the "qualifying period". That period is 12 months ending with

the date of the application for registration. For present purposes the period ends on the date on which the decision to cancel was made. Both parties suggested that the qualifying period is July 2010 to June 2011. However there was no decision on cancellation in June 2011. The decision to cancel was made on 3 August 2011. In our view therefore the qualifying period is 4 August 2010 to 3 August 2011.

67. We have found as a fact that the appellant failed to comply with the monthly obligation to pay PAYE on 7 occasions in that period. On the basis of our findings of fact it is clear that there was no reasonable excuse for those failures. Nor do they fall within the prescribed circumstances in the 2005 Regulation.

68. Mr Whalley submitted that HMRC in carrying out a review of the decision to cancel had taken into account matters which they should not have taken into account. Namely facts and matters which occurred prior to 4 August 2010. In particular on review HMRC expressly referred to the fact that there had been 3 failed compliance reviews.

69. We do not accept that submission. The qualifying period is relevant to whether there has been a compliance failure and whether there is reason to expect the company to comply in the future. If there is non-compliance then it would appear to HMRC that an application would be refused. For the reasons given above it is the non-compliance which triggers HMRC's discretion. Once the discretion is triggered, HMRC can and must take into account all relevant factors. Previous compliance history and its context, whether it is inside or outside the qualifying period, is plainly relevant to that discretion.

70. Mr Birtles contended that the correspondence demonstrated that from August 2009 the appellant was aware of the need for compliance and of the risk it could lose its gross payment status. It knew the consequences and yet it did not improve its compliance systems. On two occasions the registration was cancelled but reinstated partly on the strength of an undertaking to improve compliance in the future. On each occasion the undertaking was broken so that on the third occasion it was not unreasonable for HMRC to cancel the registration. HMRC has to be fair to all other taxpayers who pay their tax on time. It could not be said that the failures to comply were trivial. The appellant was aware of the possibility of seeking a time to pay arrangement and had not done so. Nor had it improved its compliance record as promised. To uphold the appeal he said would be to reward non-compliance. There is considerable force in Mr Birtles' submissions.

71. Mr Birtles accepted that large contractors do refuse to deal with sub-contractors who do not have gross payment status. However he submitted that could not be taken into account in the decision under appeal. We have already rejected that submission.

72. Mr Birtles submitted that even if the effect on the business could be taken into account then the evidence was not that the business would be lost, as suggested in correspondence from Wilds, but something less than that. We accept that submission which is consistent with the evidence of Ms Whitter.

73. Having found that the decision to cancel the appellant's registration was made without taking into account the financial effect on the company we are satisfied that HMRC failed to take into account a relevant factor. As such the decision was wrong in law and susceptible to review by this Tribunal. We do not have power pursuant to our supervisory jurisdiction to substitute our own view based on the facts found and all relevant factors. In the circumstances we should therefore allow the appeal unless we are satisfied that even if HMRC had taken into account the effect on the business it would inevitably have come to the same decision. We cannot be satisfied that is the case. It may be likely that HMRC would reach the same decision but on the authority of *John Dee* such a finding is not sufficient for us to dismiss the appeal. In the circumstances we must allow the appeal.

74. Finally we should note that the appellant has previously relied upon an argument based on *Article 15* of the *Charter of Fundamental Rights of the European Union* which provides for "*… the right to engage in work and to pursue a freely chosen or accepted occupation*". Mr Whalley did not make any submissions in relation to *Article 15* and we have not considered it for the purposes of this decision.

75. 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.

JONATHAN CANNAN
TRIBUNAL JUDGE

RELEASE DATE: 18 October 2012