TC02445

Appeal number: TC/2011/09590

INCOME TAX - CIS scheme; admitted compliance failures including PAYE/NI payments and corporation tax; whether discretion extending beyond consideration of "reasonable excuse" properly exercised under section 66(1) FA 2004 – yes;

FIRST-TIER TRIBUNAL
TAX CHAMBER

EAST MIDLANDS CONTRACTING LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE CHRISTOPHER HACKING

Sitting in public at City Exchange, Leeds on 1 March 2012

Mr A Magee counsel for the Appellant

Mrs K Newham a case presentation officer of HM Revenue and Customs, for the Respondents

Decision

1. This appeal concerns a decision made by the Revenue to cancel the Appellant's registration for gross payments under the Construction Industry Scheme (the scheme). That decision was notified by letter dated 10 August 2012 and confirmed following a review by another decision maker within the Revenue by letter dated 13 October 2011 sent to the Appellant (with a copy to its accountants).

2. The removal of registration under the scheme is a serious matter for a contracting company operating as a sub-contractor as it then receives a net payment from its employer (effectively on account of tax) rather than a gross sum. The receipt of gross payments whilst registered under the scheme materially assists the sub-contractor's cash flow. There is an added difficulty with the removal of the certificate which is that as sub-contractors do not always, for reasons of confidentiality and to maintain competitive pricing, disclose on their invoices a split between labour and items purchased for the contract this means that the deduction required will often extend beyond the taxable labour content to the non-taxable expense element. Whilst in due course this can be reclaimed the sub-contractor's cash flow will, in such circumstances, be further adversely affected to a degree not necessarily justified by the purpose of the scheme. A yet further problem which arises if the gross payments status is removed is that many employers using sub-contractors will simply not employ sub-contractors who are not registered with the Revenue for gross payments status as the requirement to deduct and account for tax places an additional burden on the employer.

In this appeal the Tribunal's attention was drawn by counsel for the Appellant to the first-tier decision of Judge Guy Brennan in *John Scofield and HMRC* [2011]UKFTT 199 (TC) in which case there is a very helpful summary of the legislative provisions concerning the conditions of eligibility for gross payments status under the scheme both on registration and continuing thereafter as well as the circumstances entitling the Revenue to withdraw such status. These provisions under the Finance Act 2004 are set out in some detail. For that reason they will not be here repeated save as may be necessary to address the matter to which this appeal gives rise.

3. Relevant to this appeal is the language of section 66 Finance Act 2004 which states:

> "Cancellation of registration for gross payment
>
> (1) the Board of Inland Revenue **may** *(emphasis added)* 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 to register him,
>
> (b) he has made an incorrect return or provided incorrect information (whether as a contractor or 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.

(2) Where the Board makes a determination under sub-section (1), the person's registration for gross payment is cancelled with effect from the end of a prescribed period after the making of the determination (but see section 67(5)).

4. Section 67(5) of the act provides for the cancellation of the registration to be delayed in the case of an appeal to the Tribunal or to the Upper Tribunal or a court until the latest date of disposal of the appeal.

The grounds for cancellation of the Appellant's gross payments registration.

5. Put simply it is the Appellant's case that the word "may" appearing in section 66 (1) indicates a discretion vested in the Revenue which enables it to either cancel the Appellant's gross payments status or not. The Revenue has, says the Appellant, acted as though no such discretion exists in deciding to cancel the registration as a matter of course.

6. The grounds for cancellation of the Appellant's registration are stated in the Revenue's review letter of 13 October 2011 to be the late payment to the Revenue of CIS payments, the Appellant's own PAYE tax and National Insurance payments and the Appellant's failure to maintain agreed payments under a Time to Pay (TTP) agreement relating to the Appellant's taxation liabilities. No reasonable excuse was found for these failures.

The CIS payments

It was agreed that these were "only very minor failures of 1 or 2 days". Of the payments questioned by the Appellant's accountants it was agreed that the only clearly late payments under the scheme were those for the months of August, November and December 2010.

PAYE/National Insurance payments

Payments for the months of May, July, August, October, November and December in 2010 were in each case late. The July and August payments were each only 2 days late but the May, October and November payments were 11 or 12 days late. The December payment was 15 days late. These dates are shown in the Revenue's letter to the Appellant dated 10 August 2011 as calculated from the latest date payable (22nd day of the month) which applies to electronic payments. In fact the Appellant made payments by cheque, a matter which led to some discussion with the Appellant's accountants as to the dates cleared. However such payments are due on the 19th of the month so that 3 days can be added to the above periods of delay.

Corporation Tax

The Appellant had also agreed a "Time to Pay" arrangement with the Revenue in respect of outstanding corporation tax relating to the accounting period ended 31 December 2009 which would in the ordinary course have become due on 1 October 2010. The Appellant had failed to maintain agreed payments under this arrangement As the Appellant had been late with each of the 6 payments covered by the TTP agreement that agreement was cancelled on 5 July 2011. The sum covered by this agreement was £51,583.05. A final payment had been made on 3 August 2011 and this cleared the liability of the Appellant to the Revenue on this account. It was accepted on the Appellant's behalf that this too was a matter to which the Revenue might properly look in determining whether or not to withdraw gross payments status.

Previous compliance history

7. This was not the first time that the Appellant had found itself in some difficulty in meeting its obligations to the Revenue.

8. The Revenue wrote to the Appellant on 24 March 2009 following late payment of monies due agreeing on that occasion not to cancel the Appellant's gross payments certificate. In doing so it expressed its willingness to give the Appellant "the benefit of the doubt". The "doubt" to which reference was made related to its concerns as to future compliance. There was no doubt on the part of the Revenue as to the Appellant's failure to meet its obligations.

9. Again on 14 September 2009 following further late payments and a yet further appeal against cancellation of registration under the scheme, a letter was written by the Revenue to the Appellant drawing attention to the critical need to comply with payment dates. Reference is made in that letter to the Appellant having "continually" made late payments and advising as to the need to approach the Revenue at an early date before payments became due if it seemed that a TTP agreement might be necessary. The appeal was allowed by the Revenue although it was made clear that the matters put forward by the Appellant's accountants in support of its appeal did not amount to "reasonable excuse" for the payment delays.

10. Yet further failures of compliance were recorded in a letter from the Revenue to the Appellant of 24 May 2010.

The Appellant's appeal

11. The grounds on which the Appellant now appeals are set out briefly at page 5 of the Appellant's Notice of Appeal. This states:

> "The appellant hereby appeals against HMRC's decision to cancel its gross payments status under the Construction Industry Scheme (CIS). The grounds for appeal are that there was no proper exercise of the power given to the Board by section 66 Finance Act 2004"

12. It was accepted by the Appellant that it had been in breach of its obligations as detailed above. The issue addressed at some length by Mr Magee of counsel on behalf of the Appellant company concerned the proper obligations of the Revenue under s.

66 FA 2004 and in particular the question whether the Revenue had exercised the general discretion conferred on it by the section

13. Mr Magee drew the attention of the Tribunal to the word "may" as it appears in s.66 (1) of the act before the words "at any time". That word was, said Mr Magee, a permissive word which gave rise to a discretion on the part of the Revenue. Had this not been so the words "must" or "shall" or some other words of compulsion such as to exclude the exercise of discretion would have been used.

14. Until the decision in *Scofield* (above) it had, said Mr Magee, been the practice of the Revenue to automatically cancel a company's gross payments registration when a failure in compliance was recorded. This was dealt with as a function of the computerised system employed. It was the distinction between this practice and the apparent discretion afforded the Revenue under S. 66 (1) which gave rise to the appeal in that case.

15. It was Mr Magee's contention that far from exercising its discretion the Revenue had in this instance acted as though it was obliged to cancel the Appellant's gross payments registration. Mr Magee took the Tribunal to a number of items of correspondence from the Revenue which he argued supported his client's position in this appeal.

16. In relation to the letter from the Revenue to the Appellant's accountants dated 24 March 2009 before the computerisation of the system it was said to be clear that discretion had been exercised in his clients favour. This was the letter which spoke of the Revenue giving the Appellant the *"benefit of the doubt"* (see paragraph 8 above).

17. Again the Revenue's letter of 14 September 2009 (see paragraph 9 above) was accepted by Mr Magee as indicative of the exercise of discretion in its use of the words: *"In strictness, the company has failed the compliance test as can be seen….."* and *"The reasons you give are not strictly allowable under the provisions contained within Section 118(2) Taxes Management Act 1970 for "reasonable excuse". Nevertheless, on this occasion, this is not deemed to be a case we would take to litigation, therefore I hereby determine your appeal under Section 54 Taxes Management Act 1970; your appeal is upheld and the company will continue to receive gross payment tax treatment"*.

18. On 16 July 2010, following the further instance of late payment referred to at paragraph 10 above, the Revenue again clearly exercised discretion in allowing an appeal as evidenced by the words *"However, one of the payments did occur whilst the previous appeal was being considered and therefore on this occasion I am prepared to overlook these failures"*

19. By way of contrast in relation to the compliance failures the subject of this appeal the Revenue's letter dated 25 May 2011 was said by Mr Magee to have "gone off the rails" in that it conveys to the reader the clear impression that if the Appellant is unable to establish a "reasonable excuse" for its failures then de-registration under the scheme will follow. Mr Magee contended that the Revenue ought properly to have

used words which in substance or effect indicated that the Appellant should either show a reasonable excuse for its failures **or some other reason** why its registration under the scheme should not be withdrawn**.** *(emphasis added)*

20. The material words actually used in that letter are as follows:

"Before I make a decision as to whether the company's gross payments status should be removed I am giving you this opportunity to provide an explanation as to why these failures have occurred or to advise whether you have entered into a formal Time to Pay arrangement with HMRC in respect of any outstanding or late paid liabilities identified above. I can then make an informed decision as to whether a "reasonable excuse" exists for some or all of the compliance failures. Documentary evidence must also be supplied at this stage if this supports your reasons for the apparent compliance failures.

Please send your reply using the reference and address at the top of this letter

I would advise you that if I do not receive a response within 30 days from the date of this letter, I will base my decision as to whether gross payment status should be removed on information outlined above. If the decision is that the company's gross payments status should be removed then you will receive a formal notice and, at this stage, you will be given the opportunity to appeal should you wish to do so"

20. Mr Magee drew the Tribunal's attention to further correspondence including a letter from the Appellant's accountants to the Revenue dated 15 June 2011 purporting to provide an explanation for apparent delays based on an examination of the Appellant's cheque stubs and stressing that the Appellant had not knowingly paid late. The letter ends by stating that it is hoped that the Revenue would allow the company to retain its gross payments status.

21. By way of reply to the letter above the Revenue wrote on 6 July stating:

"I have considered the information provided in that letter but am unable to accept your explanation for the compliance failures that we have identified"

Mr Magee says that this indicates that beyond the question of whether or not a "reasonable excuse" might exist for the failures, the Revenue has been unprepared to exercise the discretion vested in it by virtue of the use of the permissive word "may" in section 66 (1) Finance Act 2004.

22. Mr Magee took the Tribunal to a further exchange of correspondence between the Appellant's accountants and the Revenue dated 18 July 2011 and 10 August 2011 the latter enclosing a copy of the Revenue's decision letter of 10 August 2011. Materially, said Mr Magee, that letter should have included a reference to some other reason when using the words:

"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 necessary to meet the conditions for gross payment. Additionally, you must have taken action without unreasonable delay to rectify the position in relation to your outstanding obligations as soon as the circumstances surrounding the reasonable excuse had ceased to be present"

23. A letter in reply to the above was sent to the Revenue by the Appellant's accountants on 5 September 2011 couched in terms suggesting the existence of a reasonable excuse. It was conceded at the hearing of this appeal however that the Appellant does not in fact have what could properly be described as a reasonable excuse. This letter was in turn followed by the appeal review letter of 13 October 2011 to which reference has already been made.

24. It was the Appellant's contention that the way in which the Revenue had chosen to deal with its consideration of the Appellant's admitted failures of compliance as evidenced by the correspondence between the Appellant and his accountants on the one hand and the Revenue on the other was procedurally flawed so as to render the decision to withdraw the Appellant's gross payments registration unlawful. The Revenue had not, said Mr Magee, taken account of the discretion properly to be inferred by the use of the word "*may*" in section 66 (1) of the act. That was fatal to the validity of the decision made. The Tribunal's powers were limited to either allowing the appeal or dismissing it. In all the circumstances the proper course was to dismiss the appeal.

The Revenue's response

25. The Revenue represented by Mrs Newham rejected that argument. She said that contrary to the case advanced by Mr Magee for the Appellant the correspondence indicated that careful consideration had been given by the Revenue to the serious matter of withdrawal of the Appellant's registration for gross payment status.

26. The Appellant had failed 3 separate compliance tests. That was not in dispute. HMRC had looked at the Appellant's past compliance record when on 3 separate occasions appeals were allowed notwithstanding the existence of compliance failures. On this occasion the matter had been reviewed looking initially at the period from 20 April 2010 to 20 April 2011. A cancellation notice had not been sent out straight away as might be expected if, as suggested, the process was an automatic one. The Revenue had implicitly suggested in its review letter of 13 October 2011 that it would not have removed the registration for gross payment by reason only of the CIS compliance failures. What the Revenue had in fact done is to look much more widely at the Appellant's compliance record as a whole. It was by reason of the repeated instances of compliance failure that the decision was made.

27. Mrs Newham acknowledged that the Revenue had "felt they had no option but to withdraw the Gross Payments Status from the Appellant". It was not however the case as suggested by Mr Magee that those making the decision and reviewing it had acted other than in the knowledge of the discretion which existed. Mrs Newham asserted that the Revenue had in this respect acted "within the spirit" of section 66 (1) of the act.

The Tribunals consideration of the appeal and decision

28. The Tribunal does not accept that the correspondence referred to above indicates, as Mr Magee has contended that the Revenue has neglected to consider matters outside of the scope of "reasonable excuse" in coming to its decision in this matter.

29. The instances of compliance failures prior to those leading to the present appeal clearly show that the Revenue looks at these issues more widely than Mr Magee has suggested was the case before the decision in *Scofield.* To that extent *Scofield* is not perhaps the watershed in the law which he has proposed. The best that can be said is that if, as contended by Mr Magee, there had been a practice of automatically cancelling a contractor's gross payments certificate before *Scofield* it is clear that this was not in accordance with the provisions of section 66(1) and must be considered unsound as no proper opportunity would have been given to the contractor to advance a "reasonable excuse" for its failure(s). What is clear is that on 3 occasions prior to the present appeal the Revenue most certainly did exercise its discretion in the Appellant's favour notwithstanding compliance failures for which there was no reasonable excuse.

30. The Revenue's letter dealing with the present compliance failures dated 25 May 2011 (see paragraph 19 above) includes the clear statement:

"Before I make a decision as to whether the company's gross payment status should be removed I am going to give you the opportunity to provide an explanation as to why these failures have occurred or to advise whether you have entered into a formal Time to Pay arrangement with HMRC…… I can then make an informed decision as to whether a "reasonable excuse" exists for some or all of the compliance failures…"

This language suggests that the opportunity extended to the Appellant was not limited to the issue of "reasonable excuse". Indeed by its terms it was envisaged that there might be a situation in which some of the reasons advanced might amount to a "reasonable excuse" but some might not.

31. The identification of compliance failures which might and which might not be so excused is part of the decision making process. It is clear from the chain of correspondence that equally important in this process was the Appellant's previous compliance history. It was because there was no reasonable excuse for the instant occasions of non compliance and in light of the Appellant's previous history that the Revenue made its decision. That was not in the view of the Tribunal a flawed process. The Revenue decided on the facts before it that the Appellant had not established that it had a reasonable excuse for the admitted failures in compliance and that in all the circumstances the Appellant's Gross Payments Status would be cancelled. That was a decision it was entitled to make.

32. The Appellant could, even at the late stage of a hearing, have come forward with what it might have considered to be a "reasonable excuse" for one or more of the

compliance failures. It did not do so. More relevantly to the ground of appeal advanced, it was not suggested what other matter(s) it felt ought to have been taken into account in the decision making process, whether a reasonable excuse or some other matter, which might have led to a different decision being made. Even if the language of the Revenue's correspondence appears to focus unduly on the existence or otherwise of a "reasonable excuse" there is and was nothing to stop the Appellant contending for any ground which it considered reasonable that the Revenue should take into account. The Appellant did not in fact seek to advance any other matter in its cause. The reasonable conclusion which the Tribunal must draw from this is that there was nothing the Appellant could usefully add to what had been said by its accountants on its behalf in the various exchanges of correspondence with the Revenue. Accordingly the Appellant cannot be said to have been disadvantaged by the process even if (which the Tribunal finds was not the case) the process was flawed.

33. Once it has become clear that there has been a compliance failure the burden of establishing a "reasonable excuse" or some other reason for the exercise of discretion falls on the Appellant. That is a burden it has singularly failed to discharge. To complain about a process which appears not to involve the exercise of a discretion which goes wider than that which attaches to the statutory ground of "reasonable excuse" when no matter has been advanced to engage that discretion is in the view of the Tribunal a somewhat otiose exercise lacking in merit.

34. There was no evidence before the Tribunal which suggested that it did not take account of representations made by or on behalf of the Appellant. The process was one which clearly afforded the Appellant every opportunity to advance any reasons at all which it wished to do in support of its contention that its gross payments status under the scheme should not be removed. The Revenue's officers dealing with the matter reviewed the past record of compliance and will have noted the discretion previously exercised in the appellant's favour. Why it is suggested that they would feel themselves statutorily or otherwise inhibited from exercising a similar discretion, should it have been appropriate to do so, was not explained.

35. The Tribunal is satisfied that the consideration given to the Appellant's appeal by the Revenue was consistent with its obligations under section 66(1) Finance Act 2004. It finds as a fact, based on the evidence before it, that the Revenue officers making and reviewing the decision took fully into account all matters relevant to the decision making process. There is no evidence supporting the suggestion that they considered their discretion limited to a consideration of the existence or otherwise of a "reasonable excuse" for the Appellant's admitted compliance failures. For these reasons and as stated above the tribunal dismisses this appeal.

36. 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.

CHRISTOPHER HACKING
TRIBUNAL JUDGE

RELEASE DATE: 27 June 2012