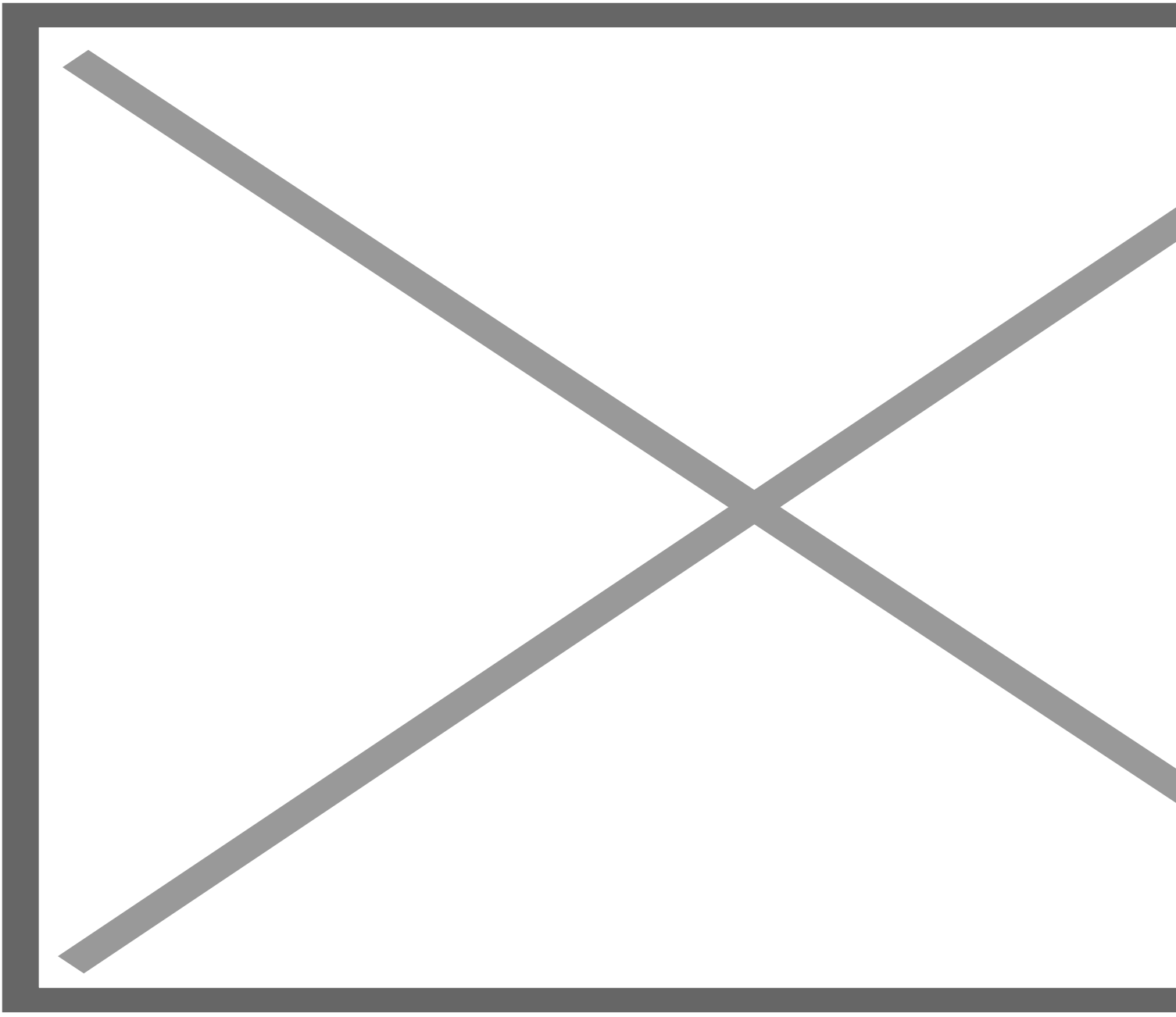
The twist

Management of taxes



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Keith Gordon considers a recent Tribunal case where an appeal against penalties for late tax returns yields an unexpected outcome

Key Points

What is the issue?

The decision will have potential repercussions on any situation where the appealable decision made by HMRC is dependent on a prior decision taken by HMRC which has not been the subject of an appeal, particularly in those cases where there are no statutory appeal rights.

What does it mean to me?

Given the fact that HMRC drafted in experienced Counsel to address the Judge's points, one can assume that they will not be happy with the outcome.

What can I take away?

If your client has such a case, then it is worth setting aside an hour to read the Goldsmith decision to see whether the client has a new argument which could be raised.

In previous articles (for example, 'The Rise and Fall of Christine Perrin' in August 2014 and 'La Peine Quotidienne' in February 2015), I have considered HMRC's relentless attack on taxpayers who have been late with their tax returns, incurring at a minimum £100 penalties, followed by up to £900 in daily penalties and then further penalties where returns have been even later, all such penalties being payable even if the taxpayer had no income to report.

On the whole, HMRC have won most of the legal arguments raised in such appeals although there has been a steady trickle of cases where HMRC's case preparation has been inadequate, meaning that the Tribunal is often faced with insufficient evidence to demonstrate that the notice to file was properly issued by HMRC, thereby obliging the Tribunal to allow the taxpayer's appeal.

Many (but not all) of these cases are dealt with by the Tribunal on the papers alone on the basis that the written documents will usually speak for themselves, although either party can insist upon an oral hearing. In fact, I would generally recommend an oral hearing in cases where reasonable excuse is being argued or if there is some other unusual fact which needs to be properly conveyed to the Judge.

In many ways, the *Goldsmith* case (*Goldsmith v HMRC* [2018] UKFTT 5 (TC)) looks as if it was going to be one such run-of-the-mill case, likely to be quickly forgotten by everyone other than the individuals involved. However, the Judge spotted an issue which he considered merited further consideration and requested submissions from the parties. Submissions were made on HMRC's behalf and, following a subsequent request by them, this led to an oral hearing at which HMRC were given the further opportunity to argue their position. In case anyone is concerned, Mr Goldsmith was of course given the same opportunity to make submissions (both on paper and to attend the oral hearing) but he declined on both occasions.

Facts of the case

Mr Goldsmith had two sources of taxable income in 2011/12: employment income and taxable Employment and Support Allowance paid by the Department for Work and Pensions. For reasons that are unclear, Mr Goldsmith's personal allowance was allocated to both sources of income through the PAYE code issued to each payer. As his total income for the year exceeded his personal allowance, the duplication of allowance in his code inevitably led to an under-deduction of tax. In fact, because the payments from each source were below the personal allowance,

no tax was paid by Mr Goldsmith during the year even though tax was clearly payable.

Remedying the shortcomings in the annual reconciliation process seen in earlier years, HMRC identified the under-collection of tax and issued a P800 to Mr Goldsmith in September 2012, showing a shortfall of £624. I personally would have expected this to have led automatically to a coding adjustment in later years, but this did not take place (although I cannot see why not). Instead a letter was apparently sent to Mr Goldsmith merely informing him of the duplicated allowances – the details of the letter, however, were not seen by the Tribunal.

No further action it seems was taken until May 2013 when a further letter was sent to Mr Goldsmith asserting (again, for reasons which are unclear) that a coding adjustment was not possible meaning that either Mr Goldsmith would be required to agree a repayment (sic) plan or HMRC would issue him with a tax return. A payment plan was agreed a few months later, under which Mr Goldsmith would make payments through 33 monthly instalments. However, after three instalments, Mr Goldsmith stopped making the payments.

In the meantime, Mr Goldsmith's income in 2012/13 was similarly undertaxed for the same reasons. The under-collection amounted to £289. Again, one might query why the situation was not remedied given that HMRC were clearly aware of the problem. Following several letters (the details of which are not discussed in the Tribunal's decision), HMRC issued Mr Goldsmith with a notice to file a 2012/13 tax return in March 2014. A notice to file a 2011/12 return was issued to Mr Goldsmith in May 2014. Mr Goldsmith eventually submitted his tax returns on 10 November 2014, by which time he had incurred two fixed £100 penalties and (in total) £450 in daily penalties. Although there is some confusion as to which of HMRC's various decisions were formally notified to the Tribunal, HMRC did not object to all the penalties being treated as within the Tribunal's jurisdiction.

The Tribunal's decision

The Tribunal (Judge Richard Thomas) appears to have accepted from the papers that the notices to issue the returns were sent, received and responded to late. Therefore, barring reasonable excuse and any procedural issues, it would have seemed that the appeals were likely to be dismissed. However, what triggered the Tribunal's particular interest was whether, as the penalty rules require, the notices issued by HMRC actually constituted a requirement to deliver a 'return under section 8(1)(a) of the TMA 1970'. Looking at the facts superficially, one would immediately say that that was precisely what the notices were. After all, what is the section number that governs personal tax returns for income tax? That is section 8 of the TMA. Furthermore, a return is (strictly) invalid unless it is made in response to a notice (see my article 'The Return of the Taxpayer' in the June 2016 issue of *Tax Adviser*). Therefore, one could say, the return was inevitably a return under section 8 and the preceding obligation derived from a notice to deliver such a return. However, Judge Thomas realised that the provisions require a more careful analysis.

His approach recognised that the complexities of the PAYE system are a consequence of a deliberate strategy to keep most taxpayers outside the Self Assessment regime. Central to this divide is the fact that the ordinary annual obligation to notify HMRC of chargeability (in the absence of a prior notice to submit a tax return) under TMA, section 7 has historically been disapplied in the case of taxpayers for whom the PAYE system is adequate to deal with the individual's tax affairs. Judge Thomas then proceeded to consider the provisions of section 8 which makes it clear that the notice and the subsequent return are 'for the purpose of establishing the amounts in which a person is chargeable to income tax and capital gains tax for a year of assessment, and the amount payable by him by way of income tax for that year'. As Judge Thomas correctly noted, that is precisely why most section 8 notices are sent: because HMRC need to be told how much income (and gains) an individual has enjoyed in any particular year.

However, that was not the case with respect to Mr Goldsmith. HMRC knew precisely how much money he had received and (indeed) how much tax was due in respect of that income. As Judge Thomas bluntly put it, 'HMRC's purpose in serving the notice in these circumstances is to create an enforceable debt to the Crown.' He therefore raised the question (and this is what led to the further submissions and the subsequent hearing) that the notice issued was not for the purpose as set out in section 8(1) and, therefore, there was not in fact a failure within the penalty code. HMRC expressed concern that the Judge was appearing to question HMRC's discretion as to whom they could issue section 8 notices. The Judge duly reassured them that this was not the case: he accepted that HMRC have an unfettered discretion in this regard and also that the First-tier does not generally have jurisdiction to challenge the exercise of such discretion.

HMRC's case, baldly stated, is that a notice was issued under section 8 and no further examination is required. As part of HMRC's arguments, it was suggested that the High Court decision in *PML Accounting Ltd v HMRC* [2017] EWHC 733 (Admin) dealt with similar issues. The *PML* case was a sequel to (rather than an appeal against) the First-tier's decision to allow an appeal against penalties for non-compliance with a Schedule 36 notice (i.e. under Finance Act 2008, Schedule 36) because of failings in the original Schedule 36 notice (see my article 'A little bit of this; a little bit of that' in December 2015). The High Court later decided that the First-tier had been wrong and that, in the absence of any appeal against the original information notice, the penalty appeal was not a further opportunity for the taxpayer to challenge the preceding notice.

However, Judge Thomas identified a fundamental distinction between the present case and that of *PML*. In *PML*, the taxpayer had (but did not fully exercise) the statutory right to appeal against the underlying Schedule 36 notice. As that statutory process was not followed, the taxpayer could not avail itself of the penalty proceedings to have a second bite of the cherry. However, there is no such statutory opportunity to challenge a decision to issue a notice under section 8(1), only the residual right to apply to the High Court for judicial review. Furthermore, Judge Thomas cited some earlier cases which considered the predecessor legislation to Schedule 36, where there had been no rights of appeal. Those cases indicated that a taxpayer was not obliged to issue judicial review proceedings and a collateral challenge to the underlying decision could be made in subsequent proceedings against a penalty for non-compliance. Judge Thomas therefore considered that he had jurisdiction to consider the validity of the notices purportedly issued under section 8(1). HMRC raised a number of objections to the Judge's proposed course of action. However, the Judge was not persuaded and concluded that HMRC were not permitted to use a notice to file a tax return in place of the alternative and (in his view) more appropriate methods of collecting the outstanding tax.

For these reasons, Judge Thomas allowed Mr Goldsmith's appeals.

Commentary

The first thing to note is that the Tribunal's decision contains so much more than I have been able to cover in this article. For example, between paragraphs [8] and [27], there is a fascinating history and overview of the PAYE system (now approaching its 75th anniversary); for me, this was a wonderful revision as I had been involved with the initial work on the rewrite of the PAYE regulations at the beginning of the millennium.

Given the fact that HMRC drafted in experienced Counsel to address the Judge's points, one can assume that they will not be happy with the outcome. In many ways, it would be appropriate for HMRC to appeal to the Upper Tribunal (on condition that they would not seek their costs should they succeed) so that a binding decision can be obtained so as to avoid uncertainty going forward. Indeed, Judge Thomas does raise issues of a wider relevance (being the extent of the First-tier's jurisdiction in statutory appeals) that is arising quite frequently (particularly in the context of APNs and the like). However, HMRC might feel discouraged from pursuing an appeal in the present case for the simple reason that Judge Thomas would, in any event, have cancelled the

penalties on the grounds of special circumstances.

What to do next

The decision will have potential repercussions on any situation where the appealable decision made by HMRC is dependent on a prior decision taken by HMRC which has not been the subject of an appeal, particularly in those cases where there are no statutory appeal rights. If your client has such a case, then it is worth setting aside an hour to read the *Goldsmith* decision to see whether the client has a new argument which could be raised. However, do be warned, HMRC are unlikely to take Judge Thomas's decision as the final word on the subject.