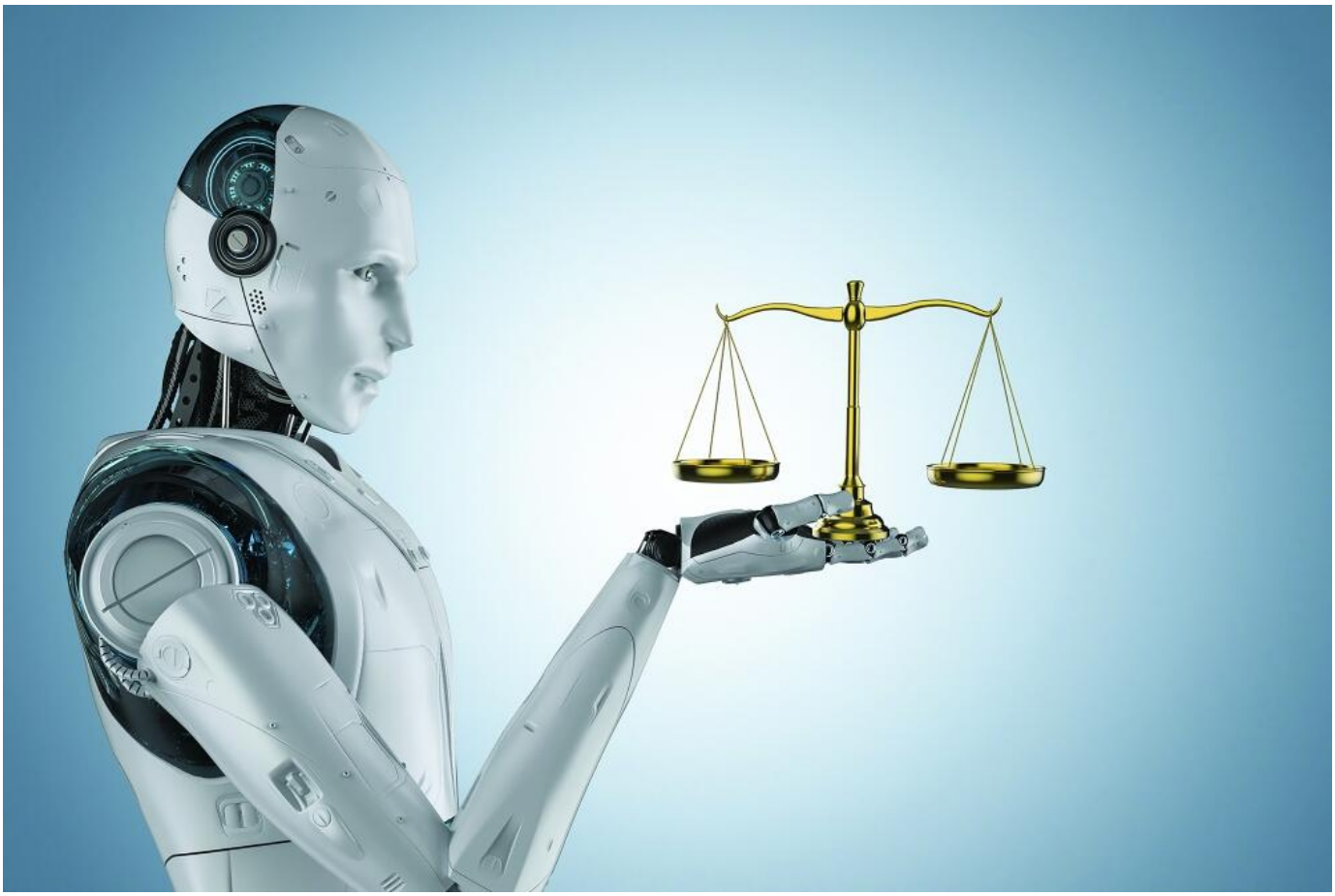
An officer and an automaton

Management of taxes | Personal tax



01 March 2020

Keith Gordon looks at HMRC's appeal in two cases where the First-tier Tribunal held that HMRC had failed to prove that an officer had issued a notice to file a tax return

Key Points

What is the issue?

A penalty for the late submission of tax returns will be payable only if there has been a failure to comply with a notice under TMA 1970 s 8, and s 8 itself states that such a notice is one issued by an officer. The provisions that require an officer to carry out

this functi on have increasingly been automated.

What can I take away?

In the joint case of Rogers & Shaw, the Upper Tribunal sought evidence from HMRC as to the process that leads to the HMRC computer issuing notices requiring a tax return. The tribunal concluded that this satisfied the minimum requirements of s 8.

What does it mean to me?

The Upper Tribunal's decision was keenly awaited because a number of other cases were also challenging the validity of automation of the s 8 process. HMRC will no doubt be delighted by the result.

Over the past few years, doubts have been raised about whether the Taxes Management Act (TMA) 1970 has kept up with HMRC's practices. In particular, the provisions that require an officer to carry out a particular routine function have, increasingly, been automated. HMRC's first public defeat on this matter came in the case of Khan Properties Ltd [2017] UKFTT 830 (TC), involving penalties under TMA 1970 s 100 (although I had previously had a string of successes in similar cases when HMRC suddenly decided to withdraw the penalties prior to the case reaching a tribunal).

The relevance of s 100 has reduced in recent years in the light of the more up to date penalty provisions (particularly in the Finance Act 2009). However, this issue has not gone away completely. Although the rules imposing penalties for late tax returns (Finance Act 2009 Sch 55) are drafted differently, they are still in part dependent on the provisions in TMA 1970. In particular, a penalty will be payable only if there has been a failure to comply with a notice under TMA 1970 s 8, and s 8 itself states that such a notice is one issued by an officer.

The facts of the case

In the (previously separate) cases of Rogers v HMRC [2018] UKFTT 312 and Shaw v HMRC [2018] UKFTT 381, HMRC issued the taxpayers with a penalty for the late submission of their tax returns. The taxpayers appealed, citing a reasonable excuse, and the cases proceeded to the tribunal. As is typical for such cases, they were allocated to the 'default paper' category, meaning that the tribunal would consider the written materials before it and decide the cases without an actual hearing.

The tribunal judge (the same in both cases) considered that before considering the question of reasonable excuse, it was necessary first for HMRC to demonstrate that the conditions for a penalty had in fact been met. One of those conditions was that there had been a s 8 notice which the taxpayers had failed to comply with. In both cases, the judge felt that the paperwork before him was inadequate to demonstrate that there had indeed been a notice issued by an officer requiring the submission of the tax return. He therefore summarily allowed both appeals.

HMRC was dissatisfied. It appealed against both decisions to the Upper Tribunal which heard the two cases together (HMRC v Rogers & Shaw [2019] UKUT 406 (TCC)).

The tribunal's decision

The case was heard by Mr Justice Zacaroli (President of the Upper Tribunal's Tax and Chancery Chamber) and Judge Jonathan Richards. HMRC had four grounds of appeal. The first was to argue that the tribunal could not even consider the validity of a s 8 notice. This argument amounted to the suggestion that as long as HMRC claims to have issued a s 8 notice, then (unless the taxpayer successfully argued otherwise in the course of judicial review proceedings, for which there is a very tight timetable) the validity of such a notice could not be questioned. The Upper Tribunal rejected that argument, and the tribunal was required to address HMRC's next three grounds of appeal.

Grounds 2 and 3 were addressed together. HMRC argued that the statutory words 'issued by an officer' could be satisfied by the actions of a computer. Furthermore, addressing one of the steps of the FTT's reasoning, HMRC argued that it was not necessary for the officer to be specifically identified on the s 8 notice.

Formally, the Upper Tribunal allowed the appeal on both of those grounds. However, the tribunal's explanations make it clear that the words 'issued by an officer' did not permit a fully automated process. In particular, the tribunal put it beyond doubt that 'the requirement is that whoever requires the notice to be given, whether identified or not, has the status of an officer'. Nevertheless, it remains the case that 'the giving of a notice must have been under the authority of an officer of HMRC'.

Validity of s 8 notices

The point then becomes clearer when one considers HMRC's fourth and final ground of appeal: that the FTT had deprived HMRC of the opportunity for a fair trial, as it was not under notice that it was required to demonstrate the validity of the s 8 notices.

In due course, the Upper Tribunal concluded that HMRC had indeed been denied this opportunity. This meant that the Upper Tribunal allowed HMRC's appeal and then had to decide whether to remit the cases back to the FTT or remake the decisions itself. The latter course of action, however, would require the Upper Tribunal to give HMRC a full opportunity to demonstrate the validity of the s 8 notices (so as not to repeat the FTT's error).

Anticipating this as a possible outcome, the tribunal had sought evidence from HMRC as to the process behind the scenes that leads to the HMRC computer issuing notices requiring a tax return. The tribunal was duly furnished with four witness statements which proceeded to explain:

- how HMRC officers choose criteria as to which taxpayers ought to be asked to prepare tax returns;
- how computers then scan the HMRC records to identify which taxpayers satisfy the chosen criteria;
- how the computers' output is then checked by using a sample of 200 taxpayers so identified; and
- how the actual sending function is then subcontracted to an external provider.

This evidence was not challenged by the taxpayers and the Upper Tribunal concluded that it satisfied the minimum requirements of s 8. Having concluded that the taxpayers had been issued with s 8 notices, the tribunal then considered whether the taxpayers had a reasonable excuse for their late filing. In both cases, however, the tribunal concluded that no such excuse existed.

Accordingly, when remaking the decisions, the Upper Tribunal considered that the taxpayers' appeals would be dismissed.

Commentary

The Upper Tribunal's decision was keenly awaited because a number of other cases were also challenging the validity of automation of the s 8 process. HMRC will no doubt be delighted by the result; otherwise we would have had the rather

embarrassing situation of HMRC failing to observe its own legislation over a number of years. As to whether HMRC's actual adherence to the TMA 1970 was by design or by chance, we will perhaps never know.

In many ways, it is easy to see why the Upper Tribunal allowed HMRC's appeal. The FTT had unilaterally identified an argument (the validity of the s 8 notices) and failed to give HMRC the opportunity to respond. However, it is equally easy to understand why the FTT did not give HMRC the opportunity to respond.

In the context of discovery assessments, the Upper Tribunal has expressly ruled that HMRC is required to prove every component of the statutory tests, even if the taxpayer has not raised a challenge in relation to them; and also that the FTT is not required to give HMRC a second chance to put forward the appropriate evidence. It is not immediately obvious how these two decisions can be reconciled, although perhaps one can simply say that discovery assessments and penalties are different.

I must, however, express some concern about the Upper Tribunal's approach to reasonable excuse on the facts of the two cases. As tax professionals, I think it is too easy for us to think that everyone must act with tax constantly on our minds. In the case of Mr Rogers, it appears that he had not fully appreciated the distinction between income tax and tax credits and the fact that they required the completion of separate forms (albeit containing very similar information being sent to the same organisation). Is it reasonable to expect the typical taxpayer to be aware of these distinctions?

Mr Shaw's principal error, it seems, was that he attempted to submit his tax return online long before the filing deadline of 31 January 2017 but did not appreciate that the final submission would require him to reconfirm his login details. Accordingly, his return remained in a draft state. Subsequent warning notices were detected as spam by his email system and went unread. The Upper Tribunal considered that the failure to enter his login details at the final submission stage was not reasonable on the basis that he had used online filing in the previous ten years. However, is it reasonable to expect individuals to remember precisely how HMRC software operates? Indeed, it is not clear to me whether the process has changed over the ten year period in question (or why this particular step in the process is something that the average taxpayer is expected to recall). Furthermore, Mr Shaw may have used different software (or an agent) in earlier years, meaning that he would not have had the relevant experience to guide him in relation to his 2016 return.

The tribunal was similarly unimpressed by Mr Shaw's failure to check his computer's spam settings. However, spam settings are often changed by external providers and HMRC often communicates using a range of different email addresses. Indeed, when signing up for MTD last year, I received an email purporting to be from HMRC but from a spurious looking address. When I queried it (on Twitter), HMRC responded by sending me a link to a webpage listing its legitimate addresses. I responded by pointing out that the address used by the MTD system did not feature on that list. It was only as a result of my tweets that the list was updated!

In my view, it is easy to say after the event what went wrong, but I am not sure that it is so easy to revisit what Mr Shaw actually did and where his actions or omissions meant that his excuse for late filing ceased to be reasonable.

Ultimately, each case will turn on its own specific facts. However, my concern is that the Upper Tribunal's decision might encourage the FTT to take a harsher line with taxpayers in similar cases.

What to do next

It should be noted that the Upper Tribunal was able to reach its findings on the s 8 process based on the unchallenged evidence latterly provided by HMRC, the details of which were not rehearsed in the Upper Tribunal's decision. Furthermore, it is well known that evidence in one case cannot be relied upon in litigation involving another party. This means that it is theoretically open for other taxpayers to continue to challenge the validity of s 8 notices and seek to challenge the evidence provided. Whilst that might prove to be administratively inconvenient, I am not sure (at least at present) that any adviser can confidently suggest to a client to do otherwise (at least without seeing the evidence at first hand).

In late October 2019, HMRC announced that it was seeking a change in the law so as to provide that the role of an officer can be delegated to a computer in order to avoid this kind of challenge. It is unclear whether the result of the Rogers & Shaw case means that it is less likely to do so. However, it is my firm view that the potential administrative difficulties of proving compliance with the law mean that a change in the law remains as appropriate as ever (although I remain uncomfortable about the idea of computers automatically issuing penalty notices without proper human supervision). However, because of the impact upon taxpayers' human rights, I would strongly urge any change in the law to be prospective (i.e. limited to notices issued after the change in the law).