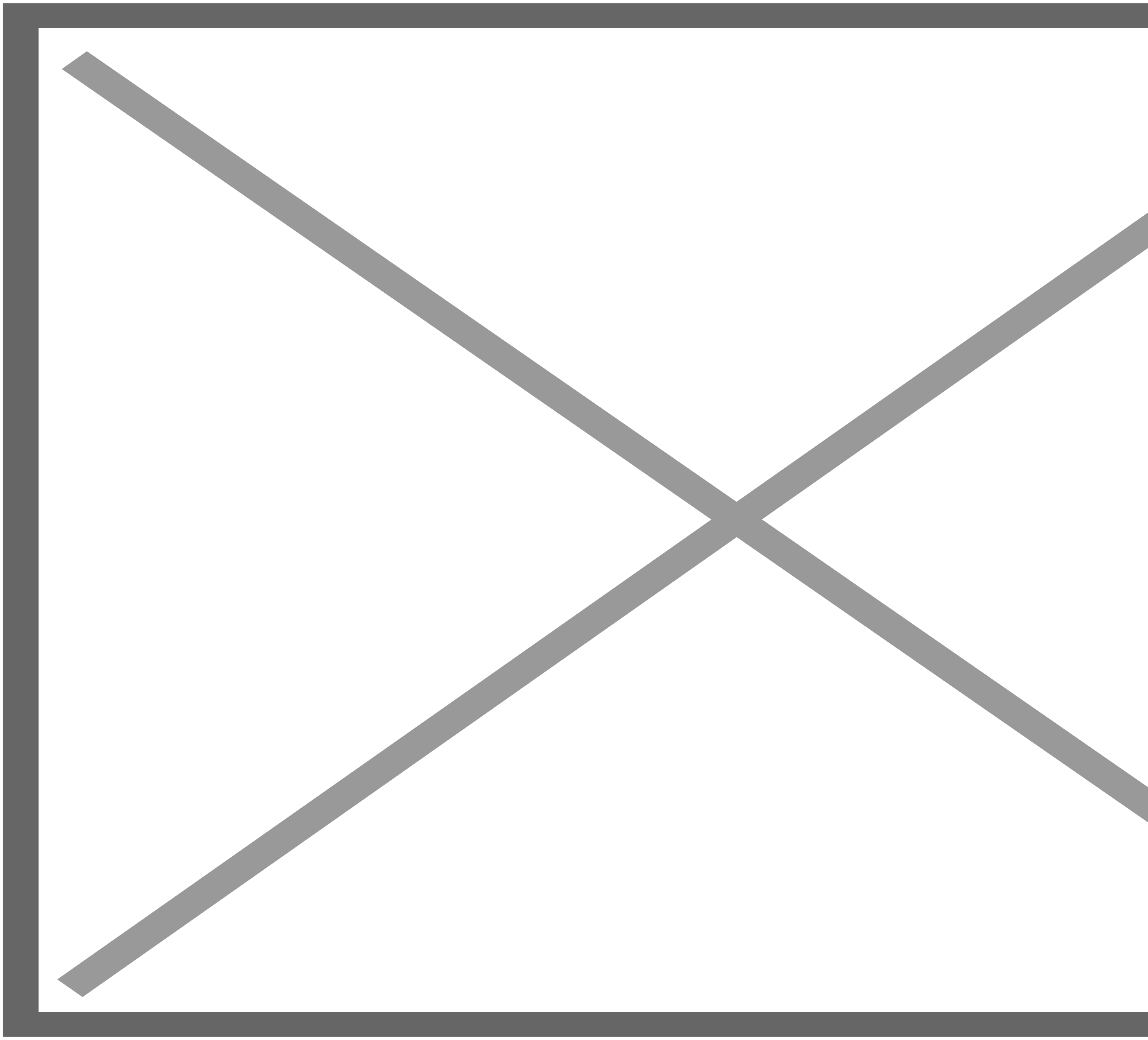
# Perils of an unauthorised payment

**Management of taxes**



01 July 2020

*Keith Gordon* looks at a case which considers the sanctions for making unauthorised payments from registered pension schemes

## Key Points

## What is the issue?

The company Bella Figura Ltd was both the sponsoring employer and scheme administrator of a registered pension scheme. The scheme had made a loan which, by the time of the Upper Tribunal, was agreed to be an unauthorised employer payment.

## What does it mean to me?

Under Finance Act 2004, only certain payments from pension pots are permitted under the legislation (authorised payments); while other (unauthorised) payments are subject to a scheme of charges of 40% (with some attracting a supplementary 15% surcharge).

## What can I take away?

The Upper Tribunal's decision on carelessness will have repercussions which are far wider than the context of the present case: indeed, it will be relevant to many discovery assessments, as well as cases involving penalties for errors on tax returns. Most importantly, it emphasises the need for the alleged carelessness to be the cause of the loss of tax complained of.

The taxation of pension schemes was thoroughly overhauled in the Finance Act 2004 with the new rules coming into force on 'A-Day' (though because of the extent of the changes this was postponed by a year to 6 April 2006). Although many of the provisions are undoubtedly complex, there is some advantage in having them in more or less one place.

The central tenet of the code is that funds can be transferred (tax efficiently) into a separate pot, with the proviso that those funds remain out of a worker's reach until pension age. This tenet will be undermined if funds within a pension pot can leak to the worker prior to the worker reaching the requisite age. Accordingly, only certain payments from pension pots are permitted under the legislation (authorised payments); while other (unauthorised) payments are subject to a scheme of charges of 40% (with some attracting a supplementary 15% surcharge).

Except where otherwise stated, all statutory references are to provisions in the Finance Act 2004.

## The facts of the case

In the case of *HMRC v Bella Figura Ltd* [2020] UKUT 120 (TCC), the company Bella Figura Ltd (Bella) was both the sponsoring employer and scheme administrator of a registered pension scheme. The scheme had made a loan which (by the time of the Upper Tribunal) was agreed to be an unauthorised employer payment. Bella was thus prima facie liable to both:

- as scheme administrator: a scheme sanction charge (under s 241); and
- as the sponsoring employer: an unauthorised payments charge (under s 208) and an unauthorised payments surcharge (under s 209).

HMRC issued assessments to Bella in respect of these charges. However, the First-tier Tribunal had set aside the assessment for the scheme sanction charge, saying that HMRC did not have the power to assess Bella for that charge. HMRC appealed against the First-tier Tribunal's conclusion in this respect.

Conversely, Bella appealed against the First-tier Tribunal's conclusion in relation to assessments for the unauthorised payments charge and surcharge. It challenged the First-tier Tribunal's view that the company's conduct was careless, therefore permitting the assessments to be made up to six years after the relevant tax year.

Finally, Bella challenged the First-tier Tribunal's refusal to allow it to be discharged under s 268 from some its liabilities. Section 268 permits unauthorised payments surcharges and scheme sanction charges to be discharged if 'it would not be just and reasonable for the person to be liable' to the respective charges. In cases concerning scheme sanction charges, there is a further condition to be met for a discharge: this is that the scheme administrator reasonably believed that the unauthorised payment was not a scheme chargeable payment.

## The Upper Tribunal's decision

The case came before Mr Justice Nugee and Upper Tribunal Judge Jonathan Richards.

### Issue 1: Statutory basis for assessment of the scheme sanction charge

The tribunal noted that scheme sanction charges are taken outside the ordinary self-assessment regime by the Taxes Management Act (TMA) 1970 s 9(1A). Accordingly, the starting point for any income tax assessment must be the discovery provisions in TMA 1970 s 29.

Bella, however, argued that s 29(1) is expressly limited to cases where HMRC is seeking to tax '*income* which ought to have been assessed to income tax *or chargeable gains* which ought to have been assessed to capital gains tax' (emphasis added); whereas a scheme sanction charge relates to neither income nor a chargeable gain, but is a stand-alone charge. Bella recognised that this would on its own render HMRC unable to assess for scheme sanction charges. However, as Bella also noted, Finance Act 2004 s 255 permits regulations to be issued so as to 'make provision for and in connection with the making of [such] assessments'.

The parties' cases then turned on the interpretation of regulations 4 and 9 of the Registered Pension Schemes (Accounting and Assessment) Regulations 2005. Regulation 4 provides a table identifying a number of scenarios (including an unauthorised payments charge, surcharge and scheme sanction charge) and, corresponding to each scenario, a description of the person to whom an HMRC officer 'must issue an assessment to tax'. In turn, regulation 9 modifies TMA 1970 s 29 so as to provide that unauthorised payments charges and surcharges are matters that can be assessed under that section (by extending the assessable scenarios beyond income and chargeable gains). However, regulation 9 makes no provision for scheme sanction charges.

Bella argued that, when read in combination, HMRC can use s 29 (as modified) in respect of unauthorised payments charges and surcharges, but not in respect of scheme sanction charges.

The Upper Tribunal, however, disagreed. It considered that regulation 4 provides a standalone power of assessment, so that recourse to TMA 1970 s 29 is not needed.

### Issue 2: Carelessness

It was common ground that the usual time limits conferred by TMA 1970 s 34 (as extended by TMA s 36) were applicable to the assessments for the unauthorised payments charge and surcharge. Because the assessments were made more than four (but fewer than six) years after the end of the relevant tax year, HMRC had to show that Bella's carelessness had caused a loss of tax.

In this regard, Bella was going to have an uphill struggle, as findings of carelessness are inherently ones of fact which are not susceptible to challenge on appeals against decisions of the First-tier Tribunal. The Upper Tribunal noted that the First-tier Tribunal had considered the steps that Bella's director had taken to check whether the loan gave rise to an unauthorised payment, comparing those with the steps which the hypothetically reasonable taxpayer in the same position would have taken. As the First-tier Tribunal's approach was the right one to follow, Bella's appeal on this point was very likely to fail. Indeed, the Upper Tribunal considered the First-tier Tribunal's conclusion on carelessness to have been 'tough' but not perverse. And only a perversity finding would allow a factual conclusion to be overturned.

Nevertheless, the Upper Tribunal considered that the First-tier Tribunal had made certain procedural errors. In particular, the First-tier Tribunal had observed that Bella had sought professional assistance in drawing up the loan documentation, yet failed to consider whether that professional assistance gave the company an implicit reassurance that there were no adverse tax consequences arising. Related to this, the First-tier Tribunal was held to have failed to consider whether the careless conduct it had identified (which was the lack of explicit advice) had *caused* the loss of tax. We must remember that the extended time limits operate when there is not mere carelessness, but only if that carelessness causes a loss of tax. In this case, there was a reasonable chance that the operative carelessness was inherent within the professionally drafted documentation, rather than the lack of advice obtained by Bella. Although HMRC argued that there were other possible outcomes, the Upper Tribunal noted that the burden of proof for carelessness lies on HMRC.

Accordingly, the Upper Tribunal concluded that the First-tier Tribunal's finding on this point was tainted by an error of law. This would ordinarily lead to the case being transferred back to the First-tier Tribunal for a fresh determination; though where the Upper Tribunal considers it has enough information to remake the decision itself, it can substitute its own decision.

Before explaining how it would proceed, however, the Upper Tribunal went on to consider the third issue.

**Issue 3: Discharge of the scheme sanction charge and the unauthorised payments surcharge**

This third issue turned on two matters:

- for the scheme sanction charge: whether Bella had a reasonable belief that the loan was authorised; and
- for both the sanction charge and the unauthorised payments surcharge: whether it was just and reasonable to set aside the charges.

In respect of the first matter, the Upper Tribunal considered that its prior conclusion on carelessness led to this point being similarly determined in Bella's favour. However, that led to the second point being critical. Indeed, as noted, for the unauthorised payments surcharge, it was the only live issue.

The Upper Tribunal held that the First-tier Tribunal had focused almost exclusively on what it considered to be Bella's carelessness and ignored the fact that Bella had at least tried to comply with the legislation and the fact that the unauthorised loan was fully repaid. As the First-tier Tribunal had failed to take into account these relevant considerations, the Upper Tribunal allowed the appeal on this ground as well. This led to the Upper Tribunal deciding how to dispose of the appeal.

## Disposal of the appeal

The Upper Tribunal felt that it had sufficient information to allow it to remake the First-tier Tribunal's decision and so avoid the costs and delay that a remittal would involve. In respect of the carelessness issue, it felt that the additional considerations which the First-tier Tribunal had overlooked meant that HMRC had not discharged the burden of proof. Thus, the unauthorised payments charge and surcharge were both set aside as having been assessed too late.

Had the scheme sanction charge been discharged as well, Bella would have had no adverse repercussions for making the unauthorised loan. The Upper Tribunal considered this to be contrary to the purposes of the legislation and, for this reason, declined to discharge the scheme sanction charge.

## Commentary

There are undoubtedly difficulties with the 2005 regulations, as the Upper Tribunal itself recognised. Notwithstanding its analysis, I think that the position in relation to issue 1 remains unclear. Had the Parliamentary intention been that all assessments be made under s 29, as argued for by Bella, then a number of provisions in the regulations would have been otiose. For one, the provision in regulation 4(2) determines when the assessed tax becomes payable (generally, 30 days after the notice of assessment). Furthermore, the wording in regulation 4(1) imposes an obligation on HMRC to make an assessment, and such wording would be inapposite if the regulation were merely facilitating the use of provisions elsewhere.

However, I recognise that in both cases it is possible to read the provisions differently. For example, the compulsion in regulation 4(1) could be said to reflect the fact that the 2004 code often makes more than one person liable for the various charges; and regulation 4(1) merely determines which of those various persons is to be assessed. As for the point about payment dates in regulation 4(2), one retort could be that the remainder of the regulation provides for exceptions to the general 30 day rule and, in the interests of clarity, all such payment dates are contained in a single provision.

On balance, I think that the tribunal reached the right conclusion. However, for me, the clincher is the wording of regulations 4(2) and 5 which both refer to assessments *under* regulation 4. Nevertheless, it is unsatisfactory that such a fundamental point can be determined only by looking for cryptic hints across the regulations, with judges having to decide which pointers positively determine the meaning of the regulations and which are of no more than anecdotal relevance. Indeed, the tribunal recognised that its conclusion led to the obvious question as to why regulation 9 (which modifies TMA 1970 s 29) would be needed at all, given that assessing power is given under regulation 4. It proceeded to suggest partial answers to this, and its conclusion was that 'regulation 9 does... give rise to difficulties for HMRC's interpretation of regulation 4'; however, the tribunal ultimately shied away from giving any formal determination of the matter, saying that its task was 'to construe regulation 4 and not to provide a comprehensive explanation for why regulation 9 is drafted as it is'.

Such a lack of clarity in the code is unhelpful and it would be sensible for these provisions (and the interface with the TMA 1970) to be the subject of a comprehensive review.

I found the tribunal's decision on whether or not to discharge the scheme sanction charge particularly interesting. As well as containing an eminently readable summary of the overall regime, it took the view that Bella ought to pay a 40% charge as a consequence of the transaction it had entered into. Because two assessments were set aside on grounds of delay, the tribunal felt that it was appropriate to maintain the scheme sanction charge. On the other hand, had the other assessments been upheld, the tribunal would have discharged the scheme sanction charge as otherwise the financial penalty on Bella would have been excessive.

I would not go so far as to say that the tribunal's approach was erroneous, but I think it definitely merits further consideration by the Court of Appeal and/or academic consideration. In particular, why should the incidence of a time limit which is there to protect taxpayers be a factor that mitigates against the exercise of a discretion in relation to a different (albeit related) tax charge? Furthermore, what would the situation be if, unlike the present case, the various charges were imposed on different persons?

## What to do next

The tribunal's decision on carelessness will have repercussions far wider than the context of the present case: indeed, it will be relevant to many discovery assessments, as well as cases involving penalties for errors on tax returns. Most importantly, it emphasises the need for the alleged carelessness to be the cause of the loss of tax complained of.

In the meantime, for anyone interested in pensions taxation, it is worth reading paras 72-74 of the tribunal's decision, which succinctly set out the Upper Tribunal's overview of the code.