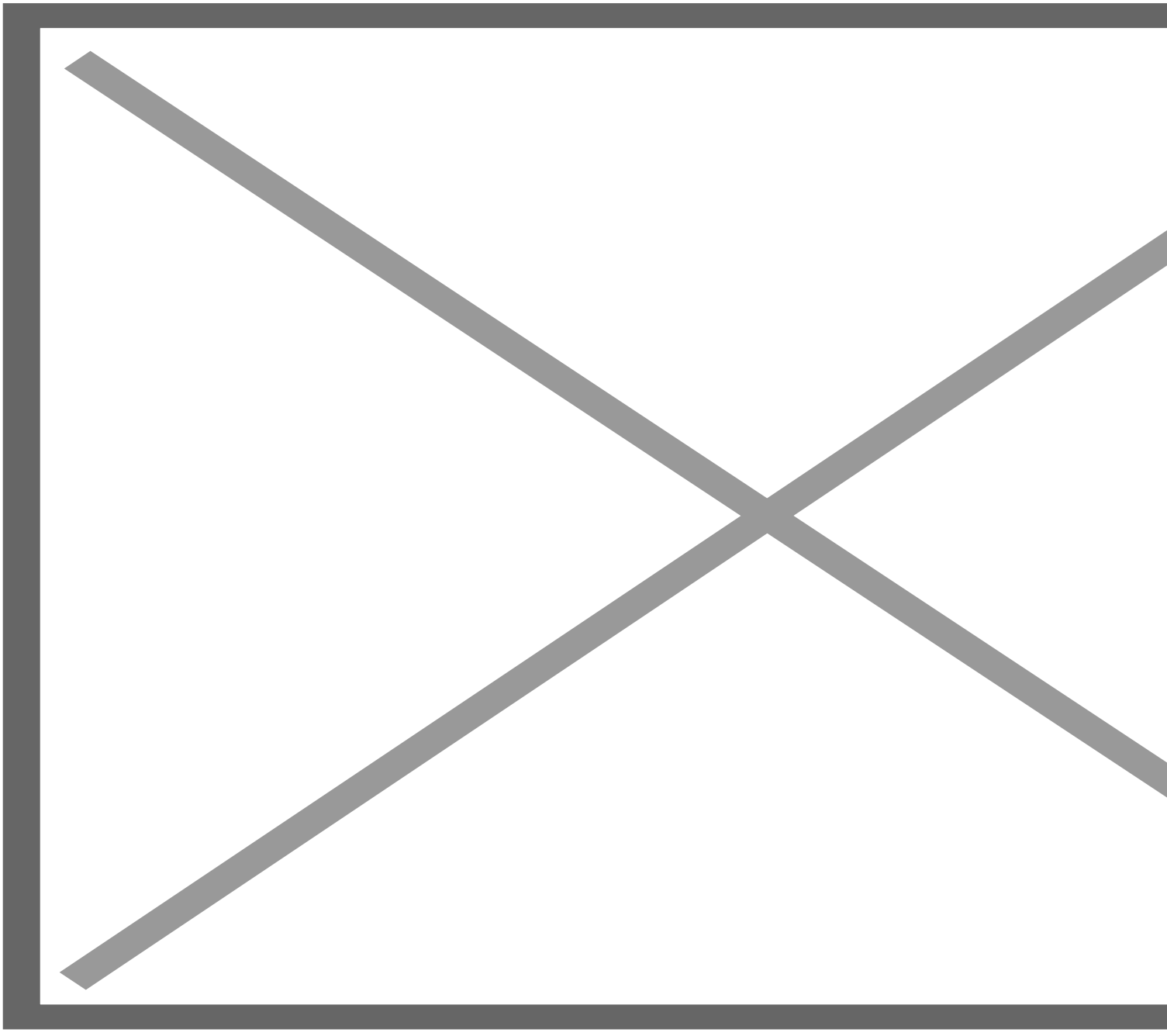
Steptoe & so on

Management of taxes



01 November 2015

Keith Gordon reviews the First-tier's decision in *Barrett v HMRC* [2015] UKFTT 0329 (TC)

Key Points

What is the issue?

Mr Barrett, a jobbing builder, took on casual labour on a subcontract basis but failed to apply for required construction industry scheme deductions. Under the statutory provisions then in place, the non-submission of the returns led to penalties totalling more than £128,000

What does it mean to me?

Mr Barrett argued that he had a reasonable excuse – being his reasonable reliance on his accountant

What can I take away?

The tribunal held that, having employed an accountant to deal with both accounting and tax, including PAYE, and having provided the accountant with all relevant business information, Mr Barrett was entitled to rely on that professional

It has been over a decade since I started writing a monthly case analysis for Tax Adviser. In that time, I have steadfastly avoided writing about a case in which I was instructed. However, I have chosen to make an exception in this month's article.

The facts of the case

From time to time, a jobbing builder subcontracted casual labour. Although the builder, Mr Barrett, had previous exposure to the construction industry scheme (CIS) when he worked on large construction sites and received his pay net of tax, he did not realise that the same rules applied to small building businesses that carried out works in private homes. More importantly, nor did Mr Barrett's accountant, a one-person practice based near Mr Barrett's home in Cardiff.

Subcontractors were taken on only occasionally. Between 6 April 2007 and 5 April 2011, for example, the under-deductions of tax were about £3,000 – of which some were waived because HMRC could recover the tax from the subcontractors themselves. This led to a net under-deduction of just over £2,000 – of which £1,800 was the subject of one of the grounds of appeal.

Of greater concern, however, was the imposition of penalties for non-submission of the annual CIS return for the 2006/07 tax year and the monthly returns thereafter. Under the statutory provisions then in place, the non-submission of the returns led to penalties totalling more than £128,000. It will be remembered that, before 6 April 2015, nil returns were required under the CIS rules.

Mr Barrett appealed against the imposition of the penalties, in part, on the basis that they were disproportionate (unsurprisingly). However, HMRC notified the taxpayer that, although there had been a then recent decision of the First-tier Tribunal allowing an appeal on such a ground, HMRC were appealing against that and suggested that Mr Barrett's appeal be stayed behind that other case. That other case, *HMRC v Bosher* [2013] UKUT 0579 (TCC), was eventually heard by the Upper Tribunal which concluded that the First-tier did not have the jurisdiction to consider arguments of proportionality in the context of direct tax penalties – the position for the VAT default surcharge being different.

Nevertheless, Mr Barrett had several arguments that were still available to him.

First, on the under-deducted tax, Mr Barrett argued that HMRC should be obliged to waive payments amounting to £1,800 in relation to one subcontractor whose affairs had been brought up to date belatedly. This would prevent HMRC earning a windfall by reference to the tax paid by the subcontractor and then a further payment from Mr Barrett.

The second centred on the penalties. Mr Barrett argued that the issue of the penalty determinations had been flawed from a procedural aspect and that, therefore, the determinations should be set aside.

Third, Mr Barrett argued that he had a reasonable excuse – being his reasonable reliance on his accountant. Thus, even if the penalties were not declared invalid, the appeal against them should still be allowed.

The tribunal's decision

The case came before Judge Berner.

Recovery of tax

As with the parallel provisions governing PAYE, HMRC are generally entitled to turn to the payer of 'wages' to recover any tax that should have been but has not been deducted under the CIS rules, even though in effect the sums have already been paid to the worker by way of gross payment. The rules, therefore, operate as an effective 100% penalty on contractors, subject to the contractor's right of recovery from the worker under the law of restitution.

Mr Barrett's appeal concerned one of the two exceptions to the normal rule, which is found in Income Tax (Construction Industry Scheme) Regulations 2005, SI 2005/2045, reg 9(4). If HMRC accept that the subcontractor has complied with their own obligations – to file a return reflecting the income on which the tax should have been deducted and to pay the correct amount – the contractor can be excused from also having to pay HMRC the tax.

In Mr Barrett's case, the subcontractor had fallen behind with his affairs, but caught up with them by the time of the hearing. In fact, the subcontractor had sent in his tax return late, too late even to displace a determination made by HMRC in the absence of a timely return.

The tribunal held that it did not have jurisdiction to require HMRC to revisit the earlier decision to seek the tax from Mr Barrett. It was also held that HRA 1998 could not be invoked to give the legislation a different interpretation in favour of Mr Barrett. Further, on the facts of the case, the tribunal considered that the subcontractor's late submission of his tax return precluded any opportunity for relief under reg 9(4).

Procedural deficiencies

The tribunal held that it did not have jurisdiction to consider the procedural deficiencies that, it was argued, tainted the penalty determinations. Therefore, Mr Barrett's appeal turned on whether he had a reasonable excuse for not submitting his CIS returns on time.

Reasonable excuse

The tribunal held that it was reasonable for Mr Barrett to rely on his accountant in this case. In particular, the accountant knew that Mr Barrett was engaging subcontractors. Although Mr Barrett was vaguely aware of the CIS, that knowledge had arisen in a different context and the tribunal held that this did not mean that Mr Barrett

should have been more alert to its wider implications.

As the tribunal held:

> ‘A reasonable taxpayer in Mr Barrett’s position, having employed an accountant to deal with both accounting and tax, including, PAYE, and having provided the accountant with all relevant information with respect to his business, would have been entitled to rely on that accountant to draw attention to any relevant filing obligation. It would also have been reasonable for such a taxpayer to have concluded, from his accountant’s silence, that there were no such obligations outstanding.’

For this reason, the appeal against the penalties was allowed.

Commentary

On the whole, I consider that the final result reached by the tribunal was the right one, although there are several aspects that could have been decided differently.

But the fact that this case proceeded at all demonstrates that there is something very wrong with the tax system these days. Although the former statutory provisions required penalties totalling more than £128,000 to be charged, HMRC recognised that this was excessive and were willing to reduce the penalties to just under £4,000, by retrospectively applying the rules that now apply under FA 2009 Sch 55. Nevertheless, even this seems excessive given the relatively modest extent of Mr Barrett’s defaults – the reduced penalties being about twice as much as the tax that had been under-deducted and would have amounted to a 200% penalty on top of the 100% penalty suffered by the obligation to account for the tax itself.

Although not recorded in the decision, Mr Barrett had offered to pay a penalty of £750 (as well as the tax), equating to roughly 30% of the under-deducted tax, which is at the kind of level that could often apply to a ‘prompted’ careless error. This offer was refused by HMRC. Further, apart from the fact that Mr Barrett thought the £4,000 sought by HMRC was unreasonable, full payment of this would have proved difficult to him and it was for this reason that the case proceeded to the tribunal. In the circumstances, HMRC’s refusal to accept that offer has cost the department dearly. Indeed, since it is our money that they spend, it has cost the general body of taxpayers dearly. Not only have HMRC squandered the £750 which Mr Barrett was offering them on a plate, but they also incurred the services of their solicitor’s office and counsel for a three-day hearing and the preparation necessary for such a case. Moreover, various HMRC officials were present throughout the proceedings, some of whom had had to travel from outside London and possibly needed hotel accommodation. Indeed, one could look at the wider cost to the public purse, given that the tribunal’s resources (personnel and space) were needed and the subsequent 38-page decision notice had to be prepared.

Mr Barrett was fortunate that, in advancing his case to the tribunal, he was offered the *pro bono* services of Mazars and counsel. Others are unlikely to be so lucky.

It is worth noting that, had tribunal proceedings been subject to fees, as they would be under the current proposals from the Ministry of Justice, Mr Barrett’s outlay would have been £1,200. This is because his case was allocated to the complex case category because of the issues that might have arisen in view of the ground of appeal concerning proportionality. It is highly unlikely that he would have paid this, given his difficulty in offering HMRC more than £750 in the first place.

On the judgment itself, I raise the following points.

The tribunal considered that the application of reg 9(4) depends on the subcontractor being meticulous with their tax affairs. In particular, it requires the subcontractor to have submitted a tax return 'in accordance with section 8 of TMA (personal return) or paragraph 3 of Schedule 18 to the Finance Act 1998 (company tax return)'. According to the tribunal, this means that the relief is available only if the tax return is submitted by the due date. If the subcontractor's return is one day late, without reasonable excuse, the contractor is unable to avoid liability for the tax, even if the subcontractor has properly accounted for the income and paid the tax on it. This seems unduly harsh and could lead to awkward questions on whether the subcontractor had a reasonable excuse for being late when submitting the tax return. It should be noted that the wording of reg 9(4) predates self assessment (see SI 1993/743 reg 10) when tax returns used to be due within 30 days of being issued. I believe that most returns missed that deadline – even those due from subcontractors in the construction industry. Yet, I am not aware of relief ever being denied on such grounds. On the assumption that the tribunal has reached the right interpretation of the legislation, it is my view that this merits a modest change in the law so as to allow a credit to be given in wider circumstances.

On the procedural deficiencies in the penalty determinations, the tribunal said it did not have jurisdiction to consider these. At issue was whether the officer in the case was properly authorised to issue a penalty determination. Until October 2011, officers had to be grade six or above. Since then, HMRC's board has directed that any officer may issue penalty determinations. The question for the tribunal was whether this board's direction was *ultra vires*. The tribunal considered that this question could be examined only by the High Court (or Upper Tribunal) in the course of judicial review proceedings. On behalf of Mr Barrett, it was suggested that litigants in civil proceedings were entitled to use public law arguments as part of their defence. (In tax cases, taxpayers – although called appellants – are in effect defendants in that they are generally responding to a demand issued by HMRC.) The tribunal acknowledged that this was the case in civil proceedings in the county court, say, but it did not extend to cases in the tribunal, where the jurisdiction is prescribed by statute. I am not sure that I agree – there again, I am of the view that the recent run of cases suggesting that the tribunal's jurisdiction seldom covers public law arguments is incorrect.

Finally, it is worth noting one aspect of the tribunal's decision where I agree completely with the judge. During the hearing, both sides referred the judge to various cases relating to reasonable excuse. One, *Turner v HMRC* [2014] UKFTT 1124 (TC) – concerning the provisions in FA 2009 Sch 55 – merited two additional comments from the judge. It will be noted that Sch 55 contains a specific rule about reliance on third parties: 'Where P relies on any other person to do anything, that is not a reasonable excuse unless P took reasonable care to avoid the failure' (para 23(2)(b)).

The judge's first comment was that *Turner* was incorrectly decided insofar as it concluded that para 23(2)(b) 'simply restate[d] the law as previously understood'. The judge's second comment was described as 'even more fundamental'. In *Turner*, the tribunal had accepted the HMRC argument that 'a reasonable excuse is normally an unexpected or unusual event that is either unforeseeable or beyond the person's control'. Not for the first time has the tribunal sought to eradicate this line of argument from HMRC's arsenal. In fact, it was at least the fourth I am aware of and, indeed, I referred to it in 'The Rise and Fall of Christine Perrin', *Tax Adviser*, August 2014.

The argument arises from the dissenting judgment of Scott LJ in the Court of Appeal case of *C & E Commrs v Steptoe* [1992] STC 757 and is expressly contradicted by the view of the majority. As Judge Berner said: 'It is inappropriate for HMRC to seek to rely on that formulation as representing the state of the law on reasonable excuse.'

As I noted in my August 2014 article, it was always possible that the fact that the argument was still found in HMRC's manuals, despite then at least two sharp criticisms from tribunal judges, was due to an unfortunate oversight. Indeed, I noted that HMRC's charter requires them to 'make decisions in accordance with the law'

and it would be a great cause for concern if HMRC were deliberately trying to confuse taxpayers and tribunals by retaining what was a clearly misleading report of a case in their published guidance. However, I also noted that the longer it takes them to correct their manuals, the less credible it would be that the error was there unintentionally.

It is now more than a year since I wrote my article on the *Perrin* case and two-and-a-half years since the tribunal expressed its concerns about HMRC's guidance. Yet the manuals have not been revised. I shall let readers draw their own conclusions.

Further information

Read Keith's article 'The Rise and Fall of Christine Perrin' from the July 2014 issue of Tax Adviser.