A little bit of this; a little bit of that

Management of taxes

04 December 2015

Keith Gordon reviews the First-tier Tribunal's decision in *PML Accounting Ltd v HMRC* [2015] UKFTT 040 (TC)

Key Points

What is the issue?

The case concerned an appeal against a penalty charged for an alleged failure to comply with a Sch 36 notice

What does it mean to me?

This case shows that where there is a defect, it is not always necessary to challenge the initial notice in order to escape the consequences of non-compliance

What can I take away?

The tribunal concluded that, since the Sch 36 notice was held to be invalid – it was issued under the wrong provision and breached the human rights of PML's clients – there could be no penalty for non-compliance

Most tax cases concern just a single issue or, occasionally, two distinct issues. The PML case, however, deals with a wide range of topics – rather like an exam question or, depending on your taste, either a *smörgåsbord* or a bumper Christmas assortment box of chocolates.

PML was appealing against a penalty (issue 1) charged for an alleged failure to comply with a Sch 36 notice (issue 2). However, the factual background was an investigation under the managed service companies legislation (issue 3) with human rights questions (issue 4) arising too.

The facts of the case

PML Accounting Ltd (PML) provides accounting, tax and corporate services to between 700 and 800 contractors and consultants at any one time. Company formation, bookkeeping, accounts preparation, tax computations and tax return preparation are among its services.

On 6 August 2012, an HMRC officer wrote to PML suggesting that it was a managed service company (MSC) provider under ITEPA 2003 Pt 2 Ch 9. PML denied this. The letter requested informal discussions, but, in the absence of any agreement to proceed informally, included a threat to use HMRC's formal information powers. This was later followed by a three-and-a-half page request for information. Although PML responded, suggesting that the investigation would be less costly if HMRC detailed the information and documents required, the Revenue simply followed this with a formal information notice issued under their powers in FA 2008 Sch 36 para 1. This requested the information by 11 January 2013.

On 7 December 2012, PML wrote back to request additional time to comply with the information request. HMRC agreed to allow PML until 28 February 2013 to comply, but made it clear that no more time would be granted. PML's principal, Mr Hazell, worked through the night of 27 February to meet the deadline, intending to courier the information to HMRC on the due date. However, the widespread use of PO boxes by HMRC made this difficult. Further, the HMRC officer contacted claimed to be unable to give a street address. So the information had to be posted, although Mr Hazell's record of the conversation suggested that an address in Sheffield was given.

In the meantime, Mr Hazell's two-year-old daughter was badly injured in an accident at home and had been taken to A&E in Southampton where she was put under 24-hour observation. Moreover, he had missed calls and messages from his wife while he was phoning HMRC. A letter was sent to HMRC explaining the circumstances and stating that the information should be ready in the next week.

Mr Hazell considered that he was now working to a deadline of 8 March for when he arranged for a courier to collect and deliver 16 boxes of documents. However, the courier failed to arrive due to a mistake with the booking. Consequently, Mr Hazell drove to Sheffield, arriving at the tax office just before 5pm. Although the office was closed, a security guard accepted the boxes.

The HMRC officer considered that some of the items he was seeking were missing and duly raised a £300 penalty for non-compliance with the Sch 36 notice.

The issues before the tribunal

The tribunal (Judge Nicholas Aleksander and Rebecca Newns) considered that it had to address six matters:

1. Had PML appealed against the information notice?
2. Had PML complied with the information notice?
3. If PML had not complied with the information notice, did it have reasonable excuse for its failure?
4. Was the information notice valid?
5. Was there a breach of PML's or its clients' rights to privacy under article 8 of the European Convention on Human Rights?
6. If the information notice was invalid, was it now too late to challenge it?

The tribunal’s decisions

Was there an appeal against the information notice?

Although the 7 December 2012 letter from PML did, on the face of it, seem to challenge the information notice itself, subsequent correspondence between HMRC and the business clarified that the only issue between the parties was the timing for compliance; and it was agreed to extend this until the end of February 2013.

One could say that there was no actual appeal against the information request itself. However, the tribunal – probably correctly – concluded that there was initially an appeal against the request, but this was quickly settled. Under TMA 1970 s 54, there ceased to be a live appeal in this regard.

In the absence of any live appeal against the substantive requests, the tribunal had to consider whether the notice had been complied with.

Had the information notice been complied with?

HMRC raised two grounds for complaint. First, they considered that PML had not supplied all the information the notice had sought. Second, they considered that PML had not provided all the documents requested by the notice.

The tribunal disagreed with HMRC about the alleged lack of information. Although the officer felt the need to clarify the answer given by PML, that did not of itself mean that the original response had failed to answer the question. However, the tribunal did agree with HMRC that there appeared to be gaps in the documents sought by HMRC.

Although PML suggested that it had produced additional documents later, there was insufficient evidence to substantiate this. In any event, the tribunal appears to have considered that the principal question concerned a shortfall in the documents that PML had provided by the extended deadline of 8 March 2013. This was answered in the affirmative and (absent any reasonable excuse defence) could not be overcome by documents being provided later.

Did PML have a reasonable excuse for its failure?

The tribunal considered that PML did not have a reasonable excuse. In essence, it considered that the full set of information ought to have been more or less ready by 27 February when Mr Hazell was first notified of his daughter's condition. Therefore, by the time that the boxes were delivered to HMRC on 8 March, they ought to have been complete.

It is possible that the tribunal might have taken a more lenient view had there been some omissions from those boxes that were remedied relatively quickly afterwards. However, since some documents had yet to be provided to HMRC by the time of the hearing (8 July 2014), the tribunal could not take such a relaxed view.

It is noteworthy that HMRC argued that PML should have engaged its other shareholders or some of its more senior staff to undertake some of the work to assemble the documents the department had wanted. The tribunal accepted this argument so far as the staff were concerned, but not in relation to the other shareholders who had no management obligations.

Was the information notice valid?

It was here that PML's luck started to turn for the better. Although the tribunal considered that the requests within the notice were reasonable, it considered that there was an error in the issue of it.

The notice was issued under FA 2008 Sch 36 para 1 in order to 'check the company's ITEPA 2003 Ch 9 position to give proper consideration to the application of the Managed Service Company Legislation'.

The tribunal noted that the MSC legislation provides that managed service companies are deemed to be workers' employers for the purposes of the employment income and PAYE provisions. However, HMRC's concern was that PML was an MSC provider. Such companies have no tax liability themselves under the MSC rules, except in cases in which there has been a default by the relevant managed service company. In this case a default had not been proven (or even alleged) so it was premature to suggest that any investigation under the MSC legislation would lead to a charge on PML. As a result, it was not correct to suggest that the information notice related to PML's own tax position and, therefore, it should have been issued under paragraph 2 (third-party notices) instead of paragraph 1.

Human rights

The tribunal considered that the notice did not breach PML's rights under human rights law. However, it did consider that the notice breached the rights of PML's clients. On the facts of the case, the tribunal's reasoning was linked to the fact that the officer should have issued his notice(s) under the provisions of paragraph 2, which permits a level of safeguard for the taxpayers involved. In particular, third-party notices may not be issued without either the taxpayer's prior consent or the tribunal's approval.

Was it too late to challenge the notice?

Although the Sch 36 notice was not the subject of any live appeal, the tribunal felt – in my view, correctly – that the shortcomings in the notice itself did have ongoing relevance.

The proceedings before the tribunal concerned a challenge against a penalty imposed for non-compliance with the Sch 36 notice. The tribunal concluded that, since that notice was held to be invalid – having been issued under the wrong provision and breaching the human rights of PML's clients – there could be no penalty for non-compliance. In other words, a penalty could follow only if the underlying notice were valid.

Therefore, despite the tribunal's other findings about non-compliance with the notice, the penalty was set aside.

Commentary

The tribunal's decision, with which I agree, is that a defective notice at one stage in a statutory process will render invalid all subsequent stages that depend on it. This has wider consequences and will cover, say, defective enquiry notices and defective payment notices under the accelerated payment notice rules introduced in FA 2014.

This case shows that, where there is a defect, it is not always necessary to challenge the initial notice to escape the consequences of non-compliance. (In cases involving defective enquiry notices, it is not possible to challenge the initial notice.) However, it should be noted that inaction is not usually recommended. In particular, what might be thought to be a fatal defect could turn out to be remediable or not even a

defect in the first place.

In the circumstances, I consider that PML was lucky to escape without having to pay the penalty, given the tribunal's finding of non-compliance with the notice. However, reading the case did give me cause for concern about HMRC's conduct in investigations such as this.

It could just have been an accident of timing, but I felt that the officer seemed a little keen to issue the Sch 36 notice in the first place. Further, it is remarkable that, as soon as a shortcoming was perceived in the information produced, the officer felt that a penalty should be issued.

Although I have no reason to deny HMRC's use of their penalty powers in cases of non-compliance, it does not strike me overall as helpful for penalties to be issued at the earliest opportunity, especially when the case will require co-operation between the taxpayer and HMRC. A little flexibility would have been better and, in the long term, probably far more effective. My concern is particularly acute given the officer's willingness to issue a penalty in part because he required a clarification of an answer given to him.

The provisions in Sch 36 have the effect of making it far easier than it was previously for HMRC officers (particularly the more junior ones) to seek information from taxpayers. In my experience, these powers are sometimes abused. For example, HMRC officers will often use these powers when they are not entitled to do so or seek information to which they are not entitled. It is only if a taxpayer is willing to risk the cost of standing up to HMRC that these excesses can ever be scrutinised.

A cynic might say that that is precisely HMRC's approach. It is now official policy for HMRC to seek to maximise revenue rather than to focus on seeking that taxpayers pay the correct tax. In the same way, HMRC seem to take the attitude that, if they do not ask for information they might not get it. After all, so it seems, it is not HMRC's fault if taxpayers are either unwilling to rock the boat or not savvy enough to know when a challenge might be appropriate. This is a worrying trend but consistent with HMRC's attitudes elsewhere.

HMRC officers now regularly point to their statutory responsibilities for the 'collection and management of revenue'. This phrase does sound far more ominous than the previous phrase 'care and management'. However, what is often forgotten is that CRCA 2005 s 51(3) expressly provides that, notwithstanding the words actually

used, the actual meaning of the phrase ‘collection and management’ is ‘care and management’.

It is about time that HMRC stop focusing only on collecting and start to care.