TC01955

Appeal number: TC/2011/03663

PAYE – Liability of employer – Non-deduction of tax from bonus paid to employee – Employee's self-assessment return of nil amount of tax in respect of bonus – Whether direction under Regulation 72E of PAYE regs should be made by HMRC – No

FIRST-TIER TRIBUNAL
TAX

DAVID A MARSHALL JEWELLER LTD **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

TRIBUNAL: SIR STEPHEN OLIVER QC
RICHARD THOMAS

Sitting in public in London on 6 February 2012

S J Askew FCA of Burns Waring, accountants, for the Appellant

J Lloyd, appeals and review unit of HMRC, for the Respondents

DECISION

1. David A Marshall Jeweller Ltd ("Limited") appeals against a determination made under Regulation 80 of the Income Tax (Pay as You Earn) Regulations (SI 2003/2682) ("the PAYE Regulations). The determination is that Limited is to pay £113,680 of tax that it failed to deduct and pay over in respect of –

(i) A bonus of £285,000 made in favour of Mr D. Marshall, the sole director of, and 50% shareholder in, Limited, in April 2006 and
(ii) Salary of £19,740 for the tax year 2006/07.

It also appeals against a penalty determined by HMRC at 10% of the tax of £113, 680 that HMRC say should have been deducted.

Facts

2. The following facts were not in dispute:

(a) Limited operated a PAYE scheme for its employees (including its officers)
(b) Limited had been given a code number for Mr. Marshall for the tax year 2006/07
(c) Limited accepted that the award of the bonus was within the scope of PAYE even though it was credited to Mr Marshall's loan account with Limited.
(d) Limited did not deduct income tax under PAYE or account for the tax to HM Revenue & Customs ("HMRC") on either the bonus or the salary.
(e) Mr Marshall made a tax return for 2006/-7 and the self-assessment included in that return for 2006/07 showed, the following entries:

Pay from all employments	£	304,740.00		
Foreign dividends	£	27.00		
UK dividends (plus credits)	£	33,357.00		
Total income received		£332,147.00		
Minus				
Losses	£	327,112.00		
Personal allowance	£	5,035.00		
Total		£332,147.00		
Total income on which tax is due			£	5,977.00
Dividends from companies	£5,977.00 @ 10% =		£	597.70
Minus Foreign tax credit relief			£	5.56
Income tax due after allowances & reliefs			£	592.14
Minus 10% tax credits on UK dividends (not repayable)			£	597.70
Income tax due after dividend tax credits			£	0.00

Accordingly the bonus and salary had been shown in the return, and the figure of income tax due was nil.

(f) In the return as originally submitted no entry had been shown in Box 1.11 of the Employment Pages for tax deducted under PAYE, but in an amended return filed in November 2010, an amount of £113,630.00 was shown in that Box, and that figure (in brackets) was shown at Box 18.3 of the main return as a "repayment due". Mr Marshall also ticked the "Yes" box to Question 19 (Do you want to claim a repayment if you have paid too much tax?) and to Question 19B (Do you want your repayment to be paid to you, or to your nominee?). No repayment has been made.

(g) the losses of £327,112 shown in the return and self-assessment were losses on the disposal of assets which would be allowable losses for the purposes of capital gains tax, but for a claim by Mr Marshall to treat them as income tax losses under section 573 of the Income And Corporation Taxes Act 1988 ("ICTA").

(h) the losses claimed arose in the course of a tax avoidance scheme which was disclosed to HMRC under Part 7 Finance Act 2004 (Disclosure of Tax Avoidance Schemes) and Mr Marshall had disclosed the scheme number in his returns and made white space entries describing some aspects of the scheme. The scheme is still under enquiry by HMRC.

(i) On 8 March 2011 HMRC issued a determination under regulation 80 of the PAYE Regulations for the tax year 2006-07 charging tax of £113,630.00 based on the use of tax code 503L.

(ii) On 26 July 2011 HMRC issued a penalty determination under section 100 of the Taxes Management Act 1970 ("TMA") charging a penalty in accordance with section 98A(4) TMA equal to 10% of the tax in the regulation 80 determination, on the basis that Limited's conduct in not deducting tax under PAYE was negligent. The maximum penalty that could have been charged is 100% of the tax.

Contentions

3. Limited claims that HMRC should direct that it is not liable to pay PAYE tax in respect of Mr Marshall's bonus and salary. That claim is made on the basis that Mr Marshall had disclosed the payments and had in effect accounted for all the tax due on them in his personal return and self-assessment for 2006/7. It says that the fact that losses reduce the tax due to nil is irrelevant. It relies on what was described in correspondence variously as the "Demibourne Concession" or just "Demibourne", but in the course of the hearing it accepted that the relevant question was whether Regulations 72E and 72F of the PAYE Regulations applied to it..
Limited also claims that no penalty should be charged as it acted on professional advice in not deducting tax, and that it was acting within the "Demibourne concession".

4. HMRC argued that income tax should have been deducted under PAYE from the bonus and salary payments and paid to HMRC at the relevant time shortly after the month when the bonus was credited (April 2006) or as the 2006/7 salary was paid to Mr Marshall. As Limited had failed to account for the tax at the appropriate time,

and had not entered the tax on its annual PAYE return (P35), HMRC was entitled to raise a determination under regulation 80 of the PAYE Regulations. It asked for the determination to be upheld. HMRC argues that the penalty is correctly charged. Acting on advice is not an excuse for failure to operate PAYE, and that Limited's conduct in not deducting tax under PAYE was negligent.

"Demibourne"

4A. Included in the bundle for the hearing is a document taken from HMRC's website entitled "Guidance on the Practical effect of the Demibourne case". This document ("the Guidance Note") is now incorporated into HMRC's Compliance Operational Guidance at paragraphs 915255 to 915340. As the Guidance Note shows, what the Special Commissioner (John Clark) decided in the case of *Demibourne Ltd v HMRC* (SpC 486) was:

> "Where an employment relationship exists, the employer is responsible for deducting tax from payments made to the employee in accordance with the PAYE Regulations
>
> Prior to the amendment to the PAYE Regulations [*in 2008 inserting regulations 72E and 72F*], HMRC did not have the discretion to choose whether to collect tax from the employer or the employee unless there has been a Direction to transfer PAYE to the employee under either Regulation 72 or Regulation 81 of the PAYE regulations
>
> An employee is always entitled under Regulation 185 of the PAYE Regulations, to treat as deducted any tax that the employer was liable to deduct whether or not that tax was actually deducted. However Regulation 185(5) provides a restriction on the amount of credit so that it cannot generate a repayment of tax that the employee didn't actually pay".

A point to note in *Demibourne* itself is that the employee concerned had been treated as self-employed and had made a return on that basis, and his self-assessment showed tax due (and paid) under Case I of Schedule D. In support of the determination made on the employer in that case HMRC pointed out that the employee could indeed get a credit for PAYE tax that had not been deducted or accounted for (under what is now regulation 185 of the PAYE regulations) and could make a claim under the "error or mistake" provisions then in section 33 Taxes Management Act 1970 to have the tax paid under Schedule D repaid on the grounds that it had been returned as such in error. These points were made to show that there was no double taxation if the employer was charged, and that failure to charge the employer would lead to no taxation at all. However in *Demibourne* the employee was out of time to claim error or mistake relief or to file an amended self-assessment return, so in that case there was actual double taxation.

4B This case differs from that in *Demibourne* in that no suggestion was made that Mr Marshall was self-employed. It seems that the amended return of November 2010 to include the tax that Limited should have deducted reflects a reading of the third paragraph from the Guidance Note cited above.

4C *Demibourne* was decided in 2005, and regulations 72E and 72F introduced in 2008. Between those dates HMRC operated a practice based on the suggestion made in the last paragraph of the *Demibourne* decision by the Special Commissioner. He indicated to HMRC that it would be appropriate to credit the tax paid by the employee, which would in a timely case be repayable, against the tax due under the determination on the employer. The "Demibourne concession" or "practice" in this period was to obtain a mandate from the employee under which any repayment due to them as part of an error or mistake claim or as a result of an amendment of a return and self-assessment could be set against the employer's liability. Rather oddly this practice would not have helped the employee in *Demibourne* as he was out of time to make a claim: yet it was only in the context of a claim being out of time that the Special Commissioner suggested the "mandate" procedure. What the mandate procedure avoids is the need for the employer to first pay the tax so as to generate a credit to the employee for PAYE tax which is capable of founding a repayment. (See the third paragraph of the Guidance Note which explains that regulation 185(5) of the PAYE regulations prevents a credit for tax that has not actually been accounted for being used to create a repayment).

4D In 2008 the Income Tax (Pay As You Earn) (Amendment) Regulations, SI 2008/782 inserted regulations 72E to 72G into the PAYE regulations with effect from 6 April 2008. The Explanatory Memorandum to SI 2008/782 says:

> Where an employer has failed to deduct or account for PAYE, the employee may nevertheless have included the payment in question in a tax return and self-assessed a liability to tax in relation to the payment. Or they may have paid tax in relation to the payment as a self-assessment payment on account, or suffered sub-contractors' deductions. The conditions which must be satisfied in order for HMRC to exercise the power to make a direction to transfer the PAYE liability to the employee will not normally be met, meaning that HMRC are obliged to seek recovery from the employer.
>
> 7.7 These Regulations introduce a new power to make a direction to transfer a PAYE liability from an employer to an employee which will apply to prevent tax being charged on the same income twice. Typically (but not always) the power is likely to become exercisable in cases where a worker's status has been recategorised from self-employment to employment following a status review by HMRC.

The regulations differ from the interim practice in that there is no mandating of a repayment to the employer as a result of an error or mistake claim etc. Instead the regulation short cuts that procedure by simply removing the liability from the employer leaving the tax shown as due by the employee in their return to stand. The liability that may relieved in this way is the amount of tax shown as payable in the employee's return etc (regulation 72F(2)).

4E There is an element of generosity in the regulations, in that the employer's liability is due very soon after the payment from which tax is deductible, whereas

self-assessment liabilities are paid by 31st January following the tax year of payment (or in some cases by two payments on account on 31st January in the year of payment and 1 July in the following year). The regulations also seem to apply in the actual circumstances of *Demibourne* where the employee is out of time to claim a repayment.

4F The Explanatory Memorandum also makes it clear that regulation 72F will not necessarily only apply in a case of incorrect status, where a person is wrongly treated as in self-employment. That was the case in *Demibourne*, but is not the case here.

Is relief under Regulation 72F available to Limited?

5. The documents put before the Tribunal show that HMRC had recognised that this might be a case where regulations 72E and 72F applied. Regulation 72F(1) is the operative rule and provides that "where this regulation applies, HMRC may direct that the employer is not liable to pay an amount of tax to them". Although regulation 72F give HMRC a discretion ("may direct"), no question of the Tribunal's jurisdiction to review HMRC's failure to make a direction was raised, the parties being content to let the appeal stand or fall by reference to the statutory conditions, which are found in regulation 72E.

6. Regulation 72E(1) directs that Regulation 72F applies where –

> "(a) An employee has received a relevant payment;
> (b) it appears to HMRC that an amount intended to represent tax on the payment … has been self-assessed …"

[There then follow three further conditions that are satisfied in the present circumstances.]

Regulation 72E(7) and (8) provides, for the purposes of Regulation 72E, that—

> "tax is self-assessed if –
>
> (a) it is included in a return under section 8 of TMA which includes a self-assessment; and
> (b) ignoring any relevant credit, the tax is or would be assessed as payable by way of income tax.
>
> (8) In paragraph (7), "relevant credit" means—
>
> (a) a payment made under section 59A of TMA (payments on account of income tax) or 59B (payment of income tax and capital gains tax); or
>
> (b) tax deducted at source or tax treated as deducted (within the meaning given by regulation 185(6))."

7. The key question is whether any amount representing tax on the bonus and salary payments has been self-assessed by being included in Mr Marshall's return and

is or would be assessed as payable by way of income tax. The answer, say HMRC, is no. This is because there is no self-assessment to any tax due in Mr Marshall's 2006/7 return as submitted, let alone to tax on the payments. For Limited it is said that, because Mr Marshall had included the entire amount of the bonus and salary in the self-assessment return for 2006/7, "an amount intended to represent tax on [those payments had] been self-assessed for purposes of" regulation 72E(1)(b).

8. We think HMRC are plainly correct. No "amount intended to represent tax on the payments" had been self-assessed. This is because the self-assessed amount of tax on the payments in Mr Marshall's self-assessment return was nil. There was a small amount of tax shown as due in the return, the £597.70. But that was tax on UK dividends (which must be treated as the highest part of a person's income – section 1A(5) of ICTA), not tax on the payments. And in any case the tax credits of the same amount represent credits falling within regulation 72E(8)(a) and must be deducted from the tax shown as due, so the result is still that no tax at all is self-assessed in the return.

8A The reason there is no self-assessed tax despite the substantial amounts of income is that Mr. Marshall has claimed to set losses of roughly the same amount as the payments against his income. That means that on the basis of his return Mr. Marshall cannot claim that there would be double taxation if Limited had to pay the tax, and so there is no element of unfairness. Whether it could be said that the result is consistent with the evident purpose of regulation 72F we rather doubt, because the background to the regulation as set out in the Guidance Note and in the *Demibourne* decision itself shows that double taxation would actually only be present if the employee was out of time to claim a repayment. The main purpose of regulation 72E cannot be to relieve that double taxation. Rather it could be said that the main purpose of the regulation was to avoid a rigmarole of repayment, amendment of returns and charging tax which has already been paid on a different person. But that rigmarole cannot or should not arise where the employee has not paid any tax, and so in this case there is no rigmarole to be avoided, and the purpose of the regulation has been fulfilled.

8A Thus, even if we had the authority to direct that HMRC should apply Regulation 72F to relieve Limited from its obligation to account for PAYE tax on the bonus and salary (which we doubt), it would not be proper for us to do so here.

8B We should add that if Mr. Marshall is unsuccessful in his claim for losses, and so becomes liable for tax, it may be that Limited could reapply to HMRC on the basis that the conditions in regulation 72E had been met. But we express no opinion on whether that application would succeed.

Is Limited liable to a penalty for non-compliance with its PAYE obligations?

9. On 26 July 2010 HMRC determined penalties due from Limited under section 98A(4) of TMA 1970. The penalty amount was based on 10% of the omitted PAYE

tax. The notice was resisted by Limited on the basis that it had received professional advice in failing to operate the PAYE regulations.

10. A 10% penalty is, in our opinion, justified. That level of penalty is in accordance with HMRC's own guidelines as to the credits to be given for various factors. Limited was aware that it should have applied PAYE in making the payments. The fact that the plan was for Mr Marshall to use losses to extinguish his own liability to tax on the payments is, we think, irrelevant, as was the fact that it may have been advised that it need not deduct tax. We were not given details of this advice (which we believe came from those associated with the tax avoidance scheme) but in any event we cannot imagine what advice could legitimately say that tax need not be deducted in the circumstances of this case. The PAYE regulations and the Guidance given to employers by HMRC are perfectly clear on tye requirement to deduct tax and account for it in circumstances such as those in this cvase, even where a payment is credited to a director's loan account.

Conclusions

11. For the reasons given above we dismiss the appeal against the Regulation 80 determination and against the penalty.

12. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

SIR STEPHEN OLIVER QC
TRIBUNAL JUDGE

RELEASE DATE: 18 April 2012