TC01966

Appeal number: TC/2012/00969

Construction Industry Scheme - Compliance failures – whether there was reasonable – whether HMRC exercised discretion – whether there was a breach of ECHR – intention of legislation – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

J P WHITTER (WATERWELL ENGINEERS) LIMITED — **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS — **Respondents**

TRIBUNAL: JUDGE J. BLEWITT

Sitting in public at Manchester on 11 April 2012

Mr J. Buchsbaum for the Appellant

Mr I. Birtles, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. By Notice dated 22 December 2011 the Appellant appealed against HMRC's decision to cancel its gross payment status under the Construction Industry Scheme (CIS). The grounds of appeal relied upon by the Appellant are stated as follows:

"HMRC are proposing to remove the client's gross status for a trivial compliance breach.

The effect of losing the gross status will mean that the Company's largest customer accounting for 75% of turnover over the last 18 months will not trade with them and the Company will have to cease trading with the loss of employment for its employees."

In support of its appeal, the Appellant relied on three authorities: *Schofield* [2011] TC 001068, *S Morris Groundwork Ltd* [2011] TC 00835 and *Bruns t/a Fabrications* [2010] TC 00371.

2. HMRC submitted that they may cancel gross payment status if there has been non compliance with obligations under the Taxes Acts and they rely on seven compliance failures by the Appellant as set out below:

- PAYE payment for the tax month ending 5 August 2010 was received late on 1 October 2010.
- PAYE payment for the tax month ending 5 February 2011 was received late on 31 March 2011.
- PAYE payment for the tax month ending 5 March 2011 was received late on 21 April 2011.
- PAYE payment for the tax month ending 5 September 2010 was received late on 6 October 2010.
- PAYE payment for the tax month ending 5 October 2010 was received late on 29 October 2010.
- PAYE payment for the tax month ending 5 November 2010 was received late on 26 November 2010.
- PAYE payment for the tax month ending 5 January 2011 was received late on 28 January 2011.

Legislation

3. There was no dispute between the parties as to the legislation applicable in this case. Chapter 3, part 3 Finance Act 2004 contains the provisions for the Construction

Industry scheme. Under the scheme certain payments to subcontractors must be made under deduction of tax unless the subcontractor is registered for gross payment. Schedule 11, part 3 of the Finance Act 2004 contains the conditions to be satisfied by a company in order to be registered for gross payment status. The conditions relevant to this appeal are set out in section 12; the compliance test.

4. The requirements are mitigated somewhat by provision in the Income Tax (Construction Industry Scheme) Regulation 2005 (the "CIS Regulation") which permit some failures to be ignored, and by paras 2(4) and 8(3) which require the disregard of a failure if the person who failed had a reasonable excuse for the failure.

5. Section 66 of the 2004 Act provides HMRC with the power to cancel gross payment status and section 118(2) of the Taxes Management Act 1970 ("TMA"), so far as is material to this appeal, provides as follows:

"…where a person had a reasonable excuse for not doing anything required to be done he shall be deemed not to have failed to do it unless the excuse ceased and, after the excuse ceased, he shall be deemed not to have failed to do it if he did it without unreasonable delay after the excuse had ceased."

Background

6. HMRC produced a bundle showing correspondence between it and the Appellant dating back to 2009. A letter from the Appellant's representative, Wilds, dated 2 October 2009 refers to a letter from HMRC to the Appellant dated 6 August 2009 which related to cancellation of the Appellant's gross payment status. The Appellant's representative accepted that late payments had been made but appealed against HMRC's decision on the basis that such a stringent penalty would lead to *"significant operational issues when tendering for longer contracts and hence jeopardising the livelihoods of the subcontractors the company engages."* The letter referred to the *"severe financial distress"* which would arise if gross payment status was removed and the fact that the Appellant had guaranteed that the issue would be addressed and all future payments made on time.

7. That letter was reviewed by the Hull Construction Industry Scheme Team and in a letter to the Appellant dated 12 November 2009, HMRC advised that they would overlook the compliance failures. The letter advised that the Appellant's tax treatment would be reviewed annually and included guidance as to the levels of compliance required and the issue of reasonable excuse.

8. The Appellant's representatives wrote to HMRC again on 8 July 2010 regarding a separate decision by HMRC to withdraw the Appellant's gross payment status as a result of late payments. The representatives accepted on behalf of their client that late payments had been made but asked HMRC to reconsider the issue as *"the withdrawal of the gross paying certificate will quite obviously put those contracts in jeopardy..."* and *"...will therefore severely hinder the company..."* and that the Appellant had agreed that all future PAYE would be paid on time.

9. By letter dated 20 August 2010 HMRC informed the Appellant's representatives that the compliance failures would be overlooked and the Appellant would, therefore, retain gross payment status.

10. By letter dated 20 June 2011 HMRC informed the Appellant that a review of the Company's gross payment status was due to be carried out and that seven compliance failures had been identified. The Appellant was asked to provide an explanation for the failures to HMRC before a decision was made as to whether the Company's status should be removed. The letter stated:

"...I can then make an informed decision as to whether a "reasonable" excuse exists for some or all of the compliance failures. Documentary evidence ***must*** *also be supplied at this stage if this supports your reasons for the apparent compliance failures."*

11. The Appellant responded to HMRC by letter dated 14 July 2011 in which the late payments were not disputed but Ms Whitter of the Appellant Company highlighted that four late payments were within 14 days and three over 14 days late. Ms Whitter apologised for the "*administrative oversights"* and stated that "*the August payment was overlooked and in catching this up there was a knock on effect causing the next two months to be slightly late. In addition, we omitted to make the February payment, so that although the subsequent months look late were in fact paid on time"* The letter stated that the loss of gross payment status would cause the Company to cease trading.

12. HMRC responded by letter dated 3 August 2011 in which it was stated that the explanation provided by Ms Whitter was not accepted because no documentary evidence was provided, as requested, in support of the claim and, in addition, HMRC noted that this was the Appellant's third failed review despite assurances previously given by the Company as to future compliance.

13. By letter dated 22 August 2011, the Appellant's representative wrote to HMRC appealing the decision and requesting a formal review. Mr Buchsbaum wrote:

"Whilst we accept that our client has made multiple compliance failures these are of a trivial nature...our client...promises to try harder in future to ensure that payments are made on time we feel that the punishment is disproportionate to the crime...if this status is removed from our clients they will lose that customer and consequently will not be able to carry on to trade...the removal of gross staus effectively prevents companies from trading and as such in our opinion represents a fundamental breach of human rights which is the ability to trade freely..."

14. On 15 September 2011 HMRC wrote to the Appellant upholding the decision to cancel gross payment status on the basis that no reasonable excuse was provided and that similar failure reasons were identified in respect of previous reviews failed by the Company.

15. Mr Buchsbaum wrote to HMRC on 23 September 2011 reiterating the points previously made on behalf of the Company and requesting an internal review. This

was carried out by Mr Sleight of HMRC's Appeals and Reviews Unit who informed the Appellant by letter dated 12 December 2011 that the decision to withdraw gross payment status was upheld.

The Appeal

16. No evidence was called by either party at the hearing. It was submitted by Mr Birtles that HMRC had complied with the *Scofield* case by providing the Appellant with an opportunity to explain the compliance failures prior to the decision about the Company's status being made and that the manual intervention of the CIS Team was evidence that HMRC had exercised discretion prior to reaching a decision. Mr Birtles contended that HMRC had a duty to act in a manner that was fair and equal to all and that by applying the legislation correctly in this case and that, in the absence of any reasonable excuse, the gross payment status was correctly withdrawn. Mr Birtles highlighted the previous compliance failures by the Company and the similar reasons given for those failures. He submitted that the Tribunal was not entitled to look at the issue of proportionality, citing *Hilton v Barnes Main Construction Ltd* EWHC 1355 (Ch) 2005 and *Enderby Properties v HMRC* UKFTT 85 (TC) 2010 in support.

17. Mr Buchsbaum relied upon five grounds in support of his client's appeal, which were put in the alternative and which I will summarise below:

(i) Reasonable excuse;

(ii) Consequences of loss of gross payment status;

(iii) Intention of the legislation;

(iv) Breach of the rights of European Union;

(v) HMRC's failure to follow the case of Schofield.

Reasonable Excuse

18. It was submitted that, in the absence of a statutory definition, reasonable excuse must include reference to the current economic climate. The largest default period was 6 weeks and that, looking at the compliance failures globally, the average default period was 12 days.

19. Mr Buchsbaum invited the Tribunal to consider how the reasonable businessman would behave in such a situation and bear in mind that banks no longer give customers credit or overdraft facilities to the extent they previously did. The Tribunal was referred to two newspaper articles contained in the bundle provided by Mr Buchsbaum; the first was entitled *"Bank of England loaned 1.6 billions pounds at 6.75%"* and detailed the facility for banks to borrow unlimited funds from the central bank, the second, entitled *"Bank of England takes new steps to ease money market paralysis"* detailed new rules under which the Bank would no longer publicise how much money it had loaned to commercial banks. Mr Buchsbaum relied on the articles

to support his contention that late payment is not necessarily a sign of poor business, but rather a reality of the current climate.

20. The Tribunal was referred to the cases of *Kincaid* [TC 01090] and *Mutch* [TC 00232] in support of the submission that cash flow shortages in the industry can justify late payments.

Consequences of loss of gross payment status

21. It was submitted that if gross payment status was cancelled, the Appellant would lose its largest customer which provides 50% of the Company's turnover. Mr Buchsbaum stated that further customers would also no doubt be lost with the consequence that the Company would cease trading causing unemployment and be unable to continue its research for Newcastle University.

22. The Tribunal was referred to the authorities of *Bruns t/a T K Fabrications* v *HMRC* [2010] TC 00371, *S Morris Groundwork Ltd v HMRC* [2011] TC 00835 and *Wood (t/a Propave) v HMRC* [2011] TC 01010 in support of the submission that the Tribunal is entitled to consider the issue of the consequences arising from HMRC's decision.

Intention of the legislation

23. Mr Buchsbaum submitted that the intention behind all legislation is to produce a fair outcome and that where the outcome is clearly perverse, the Tribunal should overrule such legislation. He contended that the legislation relating to the Construction Industry Scheme was introduced to prevent wilful defaulters, not willing taxpayers in breach of the legislation and that the outcome for the Appellant was unreasonable in the Wednesbury sense. In support of this contention Mr Buchsbaum referred the Tribunal to the case of *Scofield* (at para 127):

"It seems to us, therefore, quite understandable that Parliament intended that, before a subcontractor faced such serious consequences, some element of discretion might need to be applied. Indeed, we think that this is the thrust of the comments made by the Paymaster General to which we have already referred. At the very least, conferring a discretion on HMRC in these circumstances does not lead to an absurd or perverse result. On the contrary, as we have said, the result seems to us perfectly sensible. It does not reward non-compliance. In exercising their discretion HMRC may perfectly properly conclude that more serious or aggravated forms of non-compliance should lead to a cancellation of the registration. A discretion, however, allows HMRC to permit a subcontractor to retain the registration where the failure (assuming there is no reasonable excuse) falls in a grey area which exists between the failures permitted by Regulation 32 and the more serious forms of non-compliance"

Breach of the rights of European Union

24. It was submitted that larger companies refuse to work with companies not under the CIS regime and that, by its decision, HMRC are in breach of Article 15 of ECHR,

as the Appellant's will lose their freedom to choose an occupation and right to engage in work.

1. Everyone has the right to engage in work and to pursue a freely chosen or accepted occupation.

2. Every citizen of the Union has the freedom to seek employment, to work, to exercise the right of establishment and to provide services in any Member State.

3. Nationals of third countries who are authorised to work in the territories of the Member States are entitled to working conditions equivalent to those of citizens of the Union.

HMRC's failure to follow the case of Schofield

25. It was submitted that HMRC had failed to follow the case of *Scofield* and that as a result the decision was void. In support of this contention, Mr Buchsbaum referred the Tribunal to the case of *Cardiff Lift Company v HMRC* [UKFTT] TC 01470 in which it was stated:

"It seems to us that there was no proper exercise of the power given to the Board by section 66. Where a power is given a decision on whether or not to exercise it must be taken on the facts of the case. This the Board did not do."

This guidance was also followed in the case of *Piers Consulting Ltd v HMRC* [2011] TC 01456.

26. Mr Buchsbaum queried the "documentary evidence" requested by HMRC in their letter to the Appellant dated 20 June 2011. He submitted that there is no evidence to show that HMRC did in fact consider the information provided by the Appellant and that any consideration they may have given fell short of that envisaged by *Scofield*.

Discussion

27. I considered each of the arguments advanced on behalf of the Appellant carefully and I will address each in turn.

28. In the absence of a statutory definition of reasonable excuse, each case must turn on its own facts. The Appellant accepted that there had been seven compliance failures. I did not accept that the length of the periods of default assisted the Appellant in this case as the payments were, in my view, persistently and continually delayed. In such circumstances, given the large number of compliance failures and bearing in mind the Appellant's history of compliance failures, I did not accept that the delayed payments could be properly described as "trivial".

29. I did not find the articles referred to by Mr Buchsbaum of assistance in determining the issue of reasonable excuse; the accuracy of the articles is unknown and there was no evidence to link the articles to the specific facts of Appellant's case.

It may be in certain circumstances that late payment is not due to poor business on the part of a taxpayer and arises due to cash flow difficulties, however there was no evidence that such was the case in this appeal. To the contrary, the Appellant's letter to HMRC dated 14 July 2011 described the late payments as *"administrative oversights"*, that the *"August payment was overlooked"* and that the Appellant *"omitted to make the February payment"*.

30. In the absence of any evidence to support the contention that the compliance failures had resulted from cash flow difficulties, or indeed any evidence as to the reason for any such problems, I did not accept that the Appellant had a reasonable excuse. Even if this had been the cause of the compliance failures, in my view any reasonable person would have contacted HMRC to arrange time to pay, particularly given the background in this case of previous compliance failures. In the absence of any evidence to show that the Appellant had attempted to take steps to avoid delayed payments, I did not accept that the Appellant could be described as acting in a manner expected of a reasonable businessman and I found as a fact that there was no reasonable excuse.

31. As regards the consequences to the Appellant should its gross payment status be cancelled, I was referred to a number of authorities in which the disproportionate nature of the consequences of loss of status was considered to be a reasonable excuse. The authorities relied upon by the Appellant are not binding on this Tribunal and there are a number of (similarly not binding) authorities in which the Tribunal has held that the consequences of the loss of gross payment status is not relevant to the issue of reasonable excuse, for example *Grosvenor v HMRC* [2009] UKFTT 283 (TC). In my view, the consequences of the loss of status are not relevant to the issue of reasonable excuse which refers to the compliance failure in question and therefore is not a matter upon which this Tribunal can adjudicate. Even if I am incorrect in this view, there was no evidence to support the Appellant's contention that loss of status would result in closure of the Company; no one from the Company attended to give evidence and the Tribunal was not provided with an documentary evidence, such as accounts, to support the contention that the Appellant would lose its largest customer which provides 50% of the Company's turnover. I therefore did not accept that the potential unsubstantiated consequences to the Appellant amounted to a reasonable excuse.

32. I considered Mr Buchsbaum's submission as to the intention of Parliament; the legislation is stringent and no doubt the intention was to ensure that the rules and regulations carry a disincentive for those seeking deliberately not to comply whilst also recognising that genuine errors can be made. In my view, the background to the Appellant's case is relevant to this point; this was the third annual review failure arising from the Appellant's failure to comply with its statutory obligations. On the two previous occasions, HMRC agreed to overlook the compliance failures and in return were given assurances by the Appellant that payments would be met in a timely manner. This appeal arises out of no less than seven further compliance failures. There was no one present at the hearing from the Appellant Company and therefore no evidence upon which to assess whether the compliance failures were wilful or reckless but I considered that on either view, the compliance failures were not the actions of a Company seeking to comply with their statutory obligations and I found

as a fact that HMRC had properly treated this case as aggravated due to the previous compliance failures. In such circumstances, the legislation was correctly applied by HMRC in order to achieve fairness and balance with those who ensure that they meet their obligations and liabilities; to do otherwise would, in my view, reward the Appellant's non compliance. I therefore rejected Mr Buchsbaum's submission that HMRC's decision was perverse or Wednesbury unreasonable.

33. I rejected as misconceived Mr Buchsbaum's submission that HMRC have breached Article 15 of the ECHR, which provides for the freedom of a person to engage in work on the basis that there was no evidence to support the proposition that the Appellant could not work without gross payment status. Undoubtedly the granting of such status assists many in the industry, but there is no support for the contention that those without cannot engage in work.

34. I considered the cases of *Cardiff Lift Company v HMRC* and *Piers Consulting Ltd v HMRC*, which are not binding on this Tribunal. The cases both involved appeals in which HMRC offered no evidence of having exercised discretion in considering whether to invoke the powers conferred on it by section 66. The cases relevantly state:

"After we sought the parties representations in relation to the John Scofield decision, HMRC wrote to explain that they had now amended their procedures, but offered no new evidence in relation to this case."

35. The present appeal is distinguishable on the basis that Mr Birtles was able to evidence HMRC's use of discretion in the form of correspondence to the Appellant in which HMRC sought an explanation for the compliance failures in order to consider whether or not gross payment status should be cancelled. In my view, it cannot therefore be said that HMRC have failed to comply with the *Scofield* case. I found Mr Buchsbaum's question as to what "documentary evidence" should have been provided to HMRC did not assist me in determining the issues in this case; the fact was that the Appellant was provided with the opportunity to assist HMRC in reaching its decision, for example, it would no doubt occur to any reasonable businessman that had the compliance failures resulted from cash flow difficulties, the Company accounts or bank statements could be provided in support of this. I did not accept that there was any basis upon which HMRC had not considered the information provided by the Appellant in its letter dated 14 July 2011; to the contrary HMRC responded by noting that this was the third failed review and that assurances had been given in the past about future compliance, from which I inferred that Ms Hedley of the CIS Team had appraised herself of the Appellant's background and taken all matters into account, as it had on previous occasions, in deciding whether the Appellant's gross payment status should be cancelled.

Decision

36. For the reasons set out above the appeal is dismissed.

37. 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.

TRIBUNAL JUDGE

RELEASE DATE: 20 April 2012