TC01972

Appeal number:TC/2010/09276

INCOME TAX – Construction Industry Scheme – Appellant paid sub-contractor gross –appellant liable for amount that ought to have been deducted – appeal against HMRC's refusal to make direction relieving appellant under Regulation 9 of the Income Tax (Construction Industry Scheme) Regulations 2005 ("CIS Regulations") because HMRC not satisfied sub-contractor had paid tax - whether Tribunal had jurisdiction on this point – no – whether HMRC wrong to refuse relief under Regulation 9(3) of CIS Regulations (reasonable care to comply, error made in good faith, genuine belief deduction obligation did not apply) - no - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MR STEVEN HOSKINS **Appellant**

- and -

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

TRIBUNAL: JUDGE SWAMI RAGHAVAN
PHILIP GILLETT

Sitting in public at City Gate House, Brighton on 16 February 2012

Mr Hoskins in person

Mrs Gardiner of HM Revenue and Customs, for the Respondents

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DECISION

Introduction

1. The Appellant is a contractor in the construction industry who was liable to make deductions of a tax on payments he made to a sub-contractor, Mr Fletcher.

2. Under Regulation 9(5) of the Income Tax (Construction Industry Scheme) Regulations 2005 ("CIS Regulations") HMRC are able to direct that the appellant be relieved of the liability on the payments if two alternative conditions are met. The first is set out in Regulation 9(3) and covers the situation where the contractor took reasonable care to comply, and the error was made in good faith, or the contractor held a genuine belief the deduction obligation did not apply. The second is set out in Regulation 9(4) and includes the situation where HMRC are satisfied the subcontractor had taken account of the payments in his own tax return and had paid the tax.

3. Following HMRC's refusal to make a direction under either of these conditions the appellant appeals against the refusals on the grounds that the subcontractor has paid the tax.

4. HMRC argue that there is no appeal route to this Tribunal on the second condition (whether the subcontractor had made a return and paid the tax). In relation to the appeal against their refusal to make a direction under the first condition, while this is within the Tribunal's jurisdiction, they argue that none of the available grounds of appeal apply to the payments in question.

5. The amounts liable to deduction and which we do not understand to be in dispute are £6,340 in 2005/6 and £4,100 in 2006/7. The deductions due on those amounts are £1,141.20 and £738.00 respectively.

Previous hearing

6. This hearing was adjourned from a previous hearing on the matter before a differently constituted panel which took place on 27 June 2011. The panel at that hearing had considered the matter of what evidence was available as to whether the sub-contractor, Mr Fletcher had declared and paid the tax in issue. It was directed that HMRC should correspond with Mr Fletcher to see whether he would consent to his tax affairs being referred to in the context of this hearing, and that the hearing be relisted once it was clear whether or not evidence of Mr Fletcher's tax affairs would be available.

Evidence

7. We had before us a document bundle produced by HMRC. This contained the letters setting out HMRC's refusals to make a direction under Regulation 9 and the appellant's notices of appeal. It also contained correspondence and notes of telephone conversations in the period 22 September 2008 through to 6 April 2011 between HMRC on the one hand and the appellant and his accountants on the other. In addition the bundle contained copies of two letters dated 10 April 2009 and 3 August 2010 from the sub-contractor, Mr Fletcher, to HMRC, stating respectively that tax had been paid to HMRC by Mr Fletcher on the payments received from the appellant and that Mr Fletcher had included the payment amounts in his tax returns for the relevant years. We also heard evidence from the appellant in the course of his submissions

which was not cross-examined.

Law

8. The statutory provisions applicable during the relevant years of assessment were as follows:

9. Section 61 of Finance Act 2004

"Deductions on account of tax from contract payments

(1) On making a contract payment the contractor (see section 57(3)) must deduct from it a sum equal to the relevant percentage of so much of the payment as is not shown to represent the direct cost to any other person of materials used or to be used in carrying out the construction operations to which the contract under which the payment is to be made relates.

(2) In subsection (1) "the relevant percentage" means such percentage as the Treasury may by order determine.

(3) That percentage must not exceed—

(*a*) if the person for whose labour (or for whose employees' or officers' labour) the payment in question is made is registered for payment under deduction, the percentage which is the basic rate for the year of assessment in which the payment is made, or

(*b*) if that person is not so registered, the percentage which is the higher rate for that year of assessment."

10. The Income Tax (Construction Industry Scheme) Regulations 2005

Regulation 9—

(1) This regulation applies if—

(*a*) it appears to an officer of Revenue and Customs that the deductible amount exceeds the amount actually deducted, and

(*b*) condition A or B is met.

(2) In this regulation—

"the deductible amount" is the amount which a contractor was liable to deduct on account of tax from a contract payment under section 61 of the Act in a tax period;

"the amount actually deducted" is the amount actually deducted by the contractor on account of tax from a contract payment under section 61 of the Act during that tax period;

"the excess" means the amount by which the deductible amount exceeds the amount actually deducted.

(3) Condition A is that the contractor satisfies an officer of Revenue and Customs—

(*a*) that he took reasonable care to comply with section 61 of the Act and these Regulations, and

(*b*) that—

(i) the failure to deduct the excess was due to an error made in good faith, or

(ii) he held a genuine belief that section 61 of the Act did not apply to the payment.

(4) Condition B is that—

(*a*) an officer of Revenue and Customs is satisfied that the person to whom the contractor made the contract payments to which section 61 of the Act applies either—

(i) was not chargeable to income tax or corporation tax in respect of those payments, or

(ii) has made a return of his income or profits in accordance with section 8 of TMA (personal return) or paragraph 3 of Schedule 18 to the Finance Act 1998(*a*) (company tax return), in which those payments were taken into account, and paid the income tax and Class 4 contributions due or corporation tax due in respect of such income or profits; and

(*b*) the contractor requests that the Commissioners for Her Majesty's Revenue and Customs make a direction under paragraph (5).

(5) An officer of Revenue and Customs may direct that the contractor is not liable to pay the excess to the Commissioners for Her Majesty's Revenue and Customs.

(6) If condition A is not met an officer of Revenue and Customs may refuse to make a direction under paragraph (5) by giving notice to the contractor ("the refusal notice") stating—

(*a*) the grounds for the refusal, and

(*b*) the date on which the refusal notice was issued.

(7) A contractor may appeal against the refusal notice—

(*a*) by notice to an officer of Revenue and Customs,

(*b*) within 30 days of the refusal notice,

(*c*) specifying the grounds of the appeal.

(8) For the purpose of paragraph (7) the grounds of appeal are that—

(*a*) that the contractor took reasonable care to comply with section 61 of the Act and these Regulations, and

(*b*) that—

(i) the failure to deduct the excess was due to an error made in good faith, or

(ii) the contractor held a genuine belief that section 61 of the Act did not apply to the payment.

(9) If on an appeal under paragraph (7) it appears to the tax appeal Commissioners that the refusal notice should not have been issued they may direct that an officer of Revenue and Customs make a direction under paragraph (5) in an amount the tax appeal Commissioners determine is the excess for one or more tax periods falling within the relevant year

(10)… "

Regulation 13—

(1) This regulation applies if—

(*a*) there is a dispute between a contractor and a sub-contractor as to—

(i) whether a payment is made under a construction contract, or

(ii) the amount, if any, deductible by the contractor under section 61 of the Act from a contract payment to a sub-contractor or his nominee, or

(*b*) an officer of Revenue and Customs has reason to believe, as a result of an inspection under regulation 51 or otherwise, that there may be an amount payable for a tax year under these Regulations by a contractor that has not been paid to them, or

(*c*) an officer of Revenue and Customs considers it necessary in the circumstances.

(2) An officer of Revenue and Customs may determine the amount which to the best of his judgment a contractor is liable to pay under these Regulations, and serve notice of his determination on the contractor.

(3) A determination under this regulation must not include amounts in respect of which a direction under regulation 9(5) has been made and directions under that regulation do not apply to amounts determined under this regulation.

(4) …

(5) A determination under this regulation is subject to Parts 4, 5 and 6 of TMA (assessment, appeals, collection and recovery) as if—

(*a*) the determination were an assessment, and

(*b*) the amount determined were income tax charged on the contractor,

and those Parts of that Act apply accordingly with any necessary modifications, except that the amount determined is due and payable 14 days after the determination is made.

(6) If paragraph (1)(*a*) applies and an officer of Revenue and Customs does not make a determination under paragraph (2), either the contractor or the sub-contractor may on giving notice to an officer of Revenue and Customs, apply to the General Commissioners to determine the matter…."

Does the Tribunal have jurisdiction to hear an appeal by a contractor against a refusal by HMRC to make a direction relieving liability on the grounds the sub-contractor took account of payments in his return and paid the income tax due (Regulation 9(4))?

11. The appellant wants to appeal against HMRC's refusal to make a direction under Regulation 9(4) because he argues the tax due on the payment has been paid by the sub-contractor, Mr Fletcher, and Mr Fletcher has confirmed this in writing. Before we can hear argument on that we must first determine whether the Tribunal has jurisdiction on this aspect of the appeal.

12. HMRC argue that the specific provisions setting out what can be appealed to this Tribunal do not give us jurisdiction to hear an appeal on whether Condition B as set out in Regulation 9(4) is correct.

Discussion

13. The provisions setting out HMRC's ability to make a direction relieving liability, their refusal to make such direction, and appeals against such refusals are set out in Regulation 9 of the CIS Regulations. The two alternative conditions for making a direction are referred to as Conditions A (Regulation 9(3) and Condition B (Regulation 9(4)).

14. Regulation 9(5) permits HMRC to direct that the contractor is not liable to pay the amount the contractor would otherwise be liable to deduct. Regulation 9(6) provides for HMRC to give a "refusal notice" but this is predicated on Condition A not having been met. Regulation 9(7) goes on to give the contractor a right of appeal against the refusal notice. Regulation 9(8) makes specific provision as to the grounds of appeal for the purposes of Regulation 9(7). These are the matters referred to in Condition A, namely that the contractor took reasonable care to comply and the failure to deduct was due to an error made in good faith, or that the contractor held a genuine belief that section 61 of Finance Act 2004 (Deductions on account of tax from contract payments) did not apply to the payment.

15. Nothing at all is said about whether a refusal notice can be given by HMRC if condition B is not met. We consider that the lack of specific mention in relation to condition B coupled with the specific mention of grounds of appeal which reflect the content of only condition A point to there being no appeal right in relation to a refusal on the grounds that condition B is not met.

16. We did consider whether the words "refusal notice" in Regulation 9(7) could be read as being broader than refusal notice in Regulation 9(6) but would have difficulty doing this given the term "the refusal notice" is specifically defined in Regulation 9(6) as being tied to situations where Condition A is met. Further we also considered whether Regulation 9(8) when it refers to "the grounds of appeal are.." could admit of other grounds of appeal rather than being exhaustive, but we see no justification for reading the provisions in that way. On the contrary the fact the regulation has gone to the trouble of specifying grounds of appeal but then in those grounds only specifying a more limited subset of the reasons why a direction might be made, namely reasons related to Condition A, suggest to us that the intention of the provisions is that there should be no appeal right in respect of Condition B.

17. We note that the provisions of Regulation 9 have a similar structure and similar wording to Regulations 72 to 72C in the Income tax (PAYE) Regulations 2003 which deal with recovery from an employee of tax not deducted by an employer. There too there are two different conditions A and B which can relieve the person paying from the liability to the deductions they ought to have made. But, in contrast to the provisions before us, separate and specific appeal rights are provided in respect of each condition.

18. Having said that the outcome that there is no appeal right does seem odd to us given that on the one hand the matter of whether a sub-contractor has or has not taken account of payments in his return and has or has not paid the tax due must be a relatively black or white issue that would be straightforward for a tribunal to make a finding of fact on. For different reasons the lack of appeal right in relation to the alternative ground of relief in Condition A (namely that the person to whom the contractor made the payment to "was not chargeable to income tax or corporation tax in respect of those payments") also seems surprising given that could throw up issues of fact and law which are not straightforward and which might usefully warrant independent review by the tribunal.

19. Be that as it may our disquiet at the lack of obvious reasons for the restricted scope of appeal does not alter the fact that that is the position the words of the legislation leave us in. It seems rather unsatisfactory to us, and no doubt to the appellant, that having had the facts and circumstances of the payments before us, the appellant, if he wants to pursue the point further as a legal matter, will have to resort to an action for judicial review in the High Court of HMRC's refusal to make a direction with all that entails in terms of being at risk on costs. In that regard the appellant understandably is waiting for the outcome of this Tribunal's decision on jurisdiction before considering his further options in relation to judicial review.

20. In addition we also understand that the appellant has referred the matter to the Adjudicator but that the adjudicator's review is pending the outcome of this appeal.

21. We have considered for the sake of completeness whether any avenue of appeal is afforded through HMRC making a determination under Regulation 13 of the CIS Regulations. This enables an officer of HMRC to the best of his judgement to determine the amount which the contractor is liable to pay. That determination is then appealable to this tribunal under Regulation 13(5) as if it were an assessment and the amount determined were income tax charged on the contractor.

22. We note though that even if there was a dispute as to the amount, and a Regulation 13 direction is made, the amounts covered by Regulation 9(5) and Regulation 13 are mutually exclusive. Regulation 13(3) requires any amounts relieved under Regulation 9(5) to be left out of account. We considered whether it might be arguable that if a Regulation 13 determination is made but there is no Regulation 9(5) determination, whether the appellant can then bring before the tribunal the issue of whether the subcontractor has paid the tax or not. The separate and mutually exclusive provisions of regulations 9 and 13 suggest however that this is not what was is intended. In addition, the reference to "may determine" in Regulation 13(2) shows the direction is within HMRC's discretion. It would be odd if an appellant's ability to dispute whether HMRC ought to have been satisfied tax was paid by the sub-contractor was dependent on HMRC making a direction which within their discretion.

23. On the other hand if we were wrong on this interpretation and regulation 9(3) could be considered in the context of an appeal against a Regulation 13 determination this might suggest to us that this is the sort of situation where a Regulation 13 determination ought to seriously be considered. A refusal to make a Regulation 13 determination giving rise to an appeal right would not itself be appealable to this tribunal but on the face of it would be able to be judicially reviewed.

24. Given the conclusions on the jurisdiction point we are unable to consider further evidence and submissions around the way Mr Fletcher dealt with the payments received for the purposes of his tax. We would note that following the direction made by this Tribunal at the earlier hearing on 27 June 2011, HMRC informed the tribunal that they did write to Mr Fletcher at the address given in his letter of 3 August 2010 and that no reply was received.

Facts

25. On the evidence we were referred to we found the following:

(1) The appellant had been a self-employed sub-contractor since the year 2002 working within the construction industry.

(2) The appellant had in 2002 been a sub-contractor who had had tax deducted at source from payments made to him by his contractor.

(3) The appellant engaged Mr Fletcher as a sub-contractor during the years ended 5 April 2006 and 5 April 2007.

(4) In engaging Mr Fletcher, the appellant was doing a favour to a friend whose business had failed.

(5) Mr Fletcher helped the appellant out on a casual labour basis van-driving and doing odd bits of labouring.

(6) The appellant paid Mr Fletcher £6,340 in the year ended 5 April 2006 and £4,100 in the year ended 5 April 2007.

(7) The payments were made without deduction of income tax

(8) The appellant was under the impression Mr Fletcher would declare and pay tax on the payments.

(9) When the payments were made to Mr Fletcher the appellant was not registered on the HMRC Construction Industry Scheme as a contractor.

(10) The appellant did not ascertain whether Mr Fletcher held a valid exemption certificate issued prior to making any payments to him

(11) On 25 February 2010 HMRC refused to make a direction relieving the appellant of liability on the payments.

(12) As the appellant was pursuing a complaint on an associated matter HMRC wrote to the appellant on 28 July 2010 to say they were prepared to accept that he had a reasonable excuse for pursuing a late appeal.

(13) The appellant asked HMRC for a review of their refusal to make a direction, the result of which communicated to him in a letter dated 4 November 2010.

(14) The review letter confirmed the reviewing officer had seen the correspondence from Mr Fletcher. The review did not alter HMRC's position on the refusal.

(15) The appellant completed his Notice of Appeal on 30 November 2011 and filed this with the tribunal.

Appellant's arguments

26. The appellant argues Mr Fletcher has returned his income to HMRC and paid the relevant tax due and that therefore there is double taxation if he is assessed and this should be covered by CIS Regulation 9(4) and a direction should be issued under CIS Regulation 9(5).

27. The appellant was frank about the fact that his main complaint was that he was being asked to the foot the bill for tax which according to correspondence from Mr Fletcher had already been paid.

28. At no point had he set out to avoid paying tax. The circumstances of the contract were that he had been trying to help out a friend's son out by giving him some work.

29. The appellant did not typically use subcontractors and his accountant had not highlighted the issue and had been putting the amounts down as casual labour in the accounts.

30. At the time the appellant was a single parent trying to keep a business going and not deducting was simply an oversight.

Respondent's arguments

31. The appellant was responsible for the operation of the Construction Industry Scheme and should have made himself aware of his obligations as a contractor.

32. He did not take reasonable care to comply with section 61 Finance Act 2004.

33. Our attention was drawn to statement made in correspondence with HMRC on 25 September 2008 where the appellant said "I realise I was foolish to work in this manner…" and an HMRC note of a telephone conversation HMRC had with the appellant on the same date in which was stated to have accepted he was going to be "hit with a bill as he has not dealt with this correctly". HMRC submits he knew he should have deducted tax but chose not to do so.

34. The appellant had been registered within the CIS scheme since 2002 and had suffered tax deducted from payments received by him. He would have been sufficiently aware of the existence of the scheme and of the requirement to make deductions from payments made to subcontractors.

35. The previous scheme had been in operation since 1999 and to the extent there was any argument that the processes in the scheme had changed this was irrelevant / incorrect.

Decision

36. We must first consider whether the appellant took reasonable care to comply with his obligation to deduct. In doing this we were wary of putting too much weight on the statements made by the appellant in the subsequent correspondence and telephone call notes which we were referred to. We were of the view that any concessions he had made, when viewed in context were more by way of seeking to focus attention on his main complaint which was around HMRC's refusal to make a direction under Regulation 9(4).

37. But, we do find that the fact that the appellant was previously a sub-contractor within the predecessor construction industry scheme which was in existence at the time to be of relevance. Having known that a scheme existed under which payments to subcontractors suffered deduction we would have expected the appellant to have considered the matter further before paying Mr Fletcher gross and to have made further enquiries of HMRC or his accountant if he was unsure as to his obligations.

38. While we have no reason not to believe that the appellant was under the impression that Mr Fletcher would be declaring and paying the relevant tax we do not think that can be of assistance in showing how the appellant took reasonable care to comply with his own obligation to make a deduction.

39. Similarly we believed the appellant when he said he did not regularly use sub-contractors, the personal circumstances he was in at the relevant time, and that his accountant had not subsequently raised an issue but we do not think those matters get him over the point that he ought to have known, or at least taken steps to investigate what his deduction obligations were.

40. We also considered whether the changes and delays to the new versions of the Construction Industry Scheme were relevant. The timing and complexity of the various iterations of the scheme were certainly not straightforward and we have some sympathy with the position that it would take some effort to establish where a contractor stood in relation to his obligations. While it may be easier to say with the benefit of hindsight that the processes in the new scheme were the same as previously it would not necessarily have been wholly apparent at a given point in time when the regime was in flux.

41. The point remains though that given the appellant had been aware of a scheme in the construction industry under which the contractor made deductions, albeit from his role as a sub-contractor before, and ought to have been on notice of the need to take steps to investigate what his deduction obligations were. Given the evidence before us about the level of care the appellant did in fact take we cannot come to the conclusion that he took reasonable care to comply for the purposes of Regulation 9(3).

42. That conclusion means we do not for the purposes of this decision need to go on to consider the further two matters in Regulation 9(3)(b)(i) and (ii) which set out two alternative second legs to the reasonable care test but for the sake of completeness we will briefly record our views on those.

43. The first matter is whether the failure to deduct was due to an error made in good faith. Having heard the appellant's evidence on the circumstances of the payment and having had no qualms about his credibility we would note that if we had had to go on to consider this point we would have found that any error was made in good faith.

44. The second matter is whether the appellant had a genuine belief that section 61 of the Finance Act 2004 did not apply to the payment. That seems to us to imply that the contractor must first have appreciated that there might be an obligation to deduct but then to have genuinely believed that this was not applicable to the payments in question. If it had been necessary to consider this point we would have had difficulty in finding this test to be satisfied because from the documents and evidence before us it appeared that this was a case where the appellant had not turned his mind to his obligation to deduct rather than one where a contractor had been aware of it but then had genuinely believed it did not apply.

Conclusion

45. For the reasons above the appellant's appeal against the HMRC refusal fails and payment amounts liable to deduction stand as £6,340 in respect of payments made in 2005/6 and £4,100 in respect of payments made in 2006/7.

46. 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.

SWAMI RAGHAVAN

TRIBUNAL JUDGE

RELEASE DATE: 20 April 2012