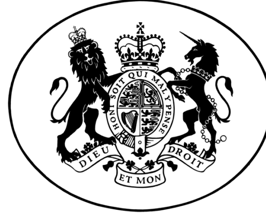
[2014] UKFTT 823 (TC)



TC03940

Appeal number: TC/2012/10023

Appeal against direction notice – PAYE – under-deduction – did employer take reasonable care and did under payment arise from error made in good faith – no—reasonable care not taken – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

TED SPARREY	**Appellant**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS	**Respondents**

TRIBUNAL: JUDGE JUDITH POWELL
MS ELIZABETH BRIDGE

Sitting in public at Bedford Square, London on 27 May 2014

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DECISION

The Appeal

1. The Appellant was present in person and Mr Donnelly, presenting officer, represented the Respondents. The appeal is against a direction of the Respondents under Regulation 72(5) Condition A Income Tax (Pay As You Earn) Regulations 2003 made on 12 July 2012 that Adra Match Ltd was not liable to pay £5033.60 under-deducted by them from payments they had made to the Appellant. The result of the direction is that the Appellant is liable to pay this amount. The reason for the Respondents making the direction is that they were satisfied that Adra Match took reasonable care to deduct the correct amount of tax from the payments but failed to do so due to an error made in good faith.

Background

2. The background facts are as follows. On 24 October 2008 the Appellant left his employment with Trintech. Upon leaving he was provided with a P45 which stated his tax code was 375L and contained a Month 1 indicator. On 1 November 2008 the Appellant commenced employment with Adra Match and provided them with a copy of his P45. Adra Match passed the P45 to a company called Goodwille which Adra Match used to process the P45 and manage payroll matters. The Appellant received his first pay slip from Adra Match on 28 November 2008 and the calculation of his net pay was incorrect. Essentially the pay had been calculated as if the Appellant had no previous earnings in the year of assessment 2008/2009. This was not correct as he had also been paid by Trintech in that year. The effect of the error meant that Adra Match failed to make sufficient deductions from the payments they made to the Appellant for the rest of that year and this gave rise to the under deduction which is the subject of the disputed direction. (In fact it appears the under deduction would have been greater but for an over deduction by Trintech from payments made by them).

Facts found or agreed

3. It was agreed that parts 2 and 3 of the P45 did not contain details of the income paid to the Appellant by Trintech as it should have done. We were satisfied that the Appellant first heard of the underpayment when he received a Form P800T. It is not clear when he received this but he acknowledged receipt of it on 1 March 2011 and told us he received it in "late February 2011" and this was not disputed by the Respondents. In the Appellant's letter of 1 March 2011 he expressed his belief that "my former employer has been negligent in their administration of Income Tax collection and should be held solely accountable for this amount". Adra Match was the former employer mentioned in his letter since his employment with them had come to an end by March 2011.

4. The 1 March 2011 letter was acknowledged by HMRC on 5 May 2011 who said the matter was still under enquiry. On the same day HMRC wrote to Adra Match and told them it was their obligation to operate PAYE and to pay any amounts due and that £5033.60 was still due. HMRC followed up this letter with a reminder on 14 November 2011 requesting payment. They referred to the possibility of making a

determination under regulation 80 of the amount payable and also of charging a penalty for sending an incorrect P35 (end of year) return as well as interest.

5. Goodwille, as agents for Adra Match, responded to the 14 November letter from HMRC by letter on 30 November 2011 having apparently tried to establish details of the underpayment in a telephone call made to HMRC on 24 November. Goodwille said in their letter "Please provide a copy of the original letter so that we can look into this matter further. In the meantime we have investigated and our records for tax year 2008/2009 show that the employee named T Sparrey was on a tax code 375L, earned £49,799.50 and paid tax of £11,456.00 which is correct". On 19 December HMRC provided a copy of their original letter to Goodwille. Goodwille replied on 19 January 2012 saying that the P45 did not state any previous pay or tax and so it was not possible to include those details in the tax calculations they performed. They acknowledged that although they used the correct tax code they omitted to mark it appropriately to ensure it was operated on a week1/month 1 basis but that the error "was made in good faith". Goodwille went on to say that the P45 details were submitted electronically to HMRC on 10 November 2008 and that the error might have been avoided if HMRC had spotted the issue earlier. They finished by asking HMRC to confirm they would seek the tax owed directly from the employee.

6. What happened after Goodwille wrote their 19 January 2012 letter is not completely clear but it seems there was an internal reference by HMRC to its PAYE Errors Unit which that Unit received on 5 March 2012. The Unit were extremely busy and asked not to be contacted for progress within 90 days. They did take action within that period. The Unit wrote to Goodwille on 23 May 2012 referring to the possibility that Regulation 72(5) Condition A might apply and if it did then a Direction pursuant to that regulation would transfer the liability to the employee. The Unit told Goodwille that this regulation permits employers to be relieved from the obligation to pay the under-deduction if they can show they took reasonable care to comply with the regulations and the failure to deduct the correct amount of tax was an error made in good faith. The Unit asked Goodwille to provide a detailed explanation of why the error occurred. The person writing on behalf of the Unit stated in that letter "to enable me to consider the "reasonable care" aspect of the legislation I need details of the checks you have on your payroll to identify errors." In the letter they asked a series of questions which were presumably designed to establish those matters. The questions asked why Goodwille had failed to ensure the P45 details were operated correctly, why the code was operated on a cumulative basis, what percentage of employee records are reviewed, who conducted the reviews, and how often, and an estimation of numbers of people on the payroll, numbers of amendments and the number of P6 and P9 coding notices dealt with each year.

7. On 21 June 2012 Goodwille wrote a detailed response to the Unit's 23 May letter in which they gave answers to each of the questions. In particular the author of the letter from Goodwille said the P45 details are checked for accuracy, entered onto the payroll software and filed online with HMRC shortly afterwards and "It failed on this occasion due to human error". The letter said that code 375L was operated on a cumulative basis by an administrative error because the non-cumulative marker was overlooked. The letter contained further details of the other review procedures followed by Goodwille.

8. We were shown a record of a telephone report made on 28 June 2012 by George Higgins at HMRC. This was a record of his telephone conversation with the author of

the Goodwille letter of 21 June 2012 who explained to Mr Higgins that she had started working for Goodwille in March 2012 and that the answers about checks and processes reflect the position when she wrote the letter and that the person who had operated the payroll in 2008/09 had left the company and this was not mentioned in the letter at the request of her manager. The author of the letter specifically asked Mr Higgins not to mention the conversation in any correspondence and he said he would mark the file accordingly.

9. On 12 July 2012 HMRC wrote to Adra Match saying they had made a direction under Regulation 72(5) Condition A of the Income Tax (Pay as you earn) Regulations 2003 that they were not liable to pay the tax under-deducted because HMRC were satisfied that they took reasonable care to deduct the correct amount of tax from the relevant payments. On the same day they issued a Direction to the Appellant saying they were satisfied Adra Match "took reasonable care and had sufficient checks and balances in place but due to an error made in good faith failed to deduct the correct amount of tax due". The direction they issued is the subject of Mr Sparrey's appeal.

10. Prior to hearing from HMRC in July 2012 with the outcome of their enquiries, Mr Sparrey had written to HMRC on 25 June 2012 with a complaint about the lack of progress in dealing with his case. On 26 July 2012 HMRC acknowledged his complaint letter and said they would be unable to reply immediately but promised to reply within 30 days. By then, of course, Mr Sparrey had heard from HMRC with the direction and had also written a letter on 26 July expressing surprise that they were satisfied Adra Match took reasonable care and had sufficient checks and balances in place.

11. On 16 August 2012 HMRC responded and effectively upheld the contents of the letter of 12 July and the direction. They did add a couple of further points particularly noting that Adra Match was a small employer. They repeated that they were satisfied with the checks and balances in place. The Appellant responded on 9 August disagreeing with the conclusion why the incorrect tax was deducted (the explanation being that the Appellant was given a duplicate personal allowance) and with the assertion that Adra Match was a small employer.

12. HMRC treated the Appellant's 9 August letter as a request for a review by HMRC and they wrote on 24 September to say they had conducted a review and their view as expressed in the letter of 16 August remained the same but the letter would be sent to an independent review team. The instructions to the review team included mention of the telephone conversation that HMRC had with the author of the letter from Goodwille and an explanation to the review team that this conversation had been discounted since the officer was not in a position to challenge the employer. The same letter mentioned that in 2008/09 the company had only 3 employees.

13. The outcome of the review was communicated to Mr Sparrey on 4 October 2012. The independent review team upheld the decision on the basis that whilst there was a mistake in the operation of the payroll reasonable care was taken and this was an isolated error. There was no mention made of any checks and balances in place. The October letter explained that Adra Match had operated the correct tax code but through oversight failed to operate this on a non-cumulative basis which resulted in the under-payment.

14. Mr Sparrey appealed to this tribunal on 30 October 2012.

Submissions

15. Mr Sparrey submitted that Adra Match failed to administer PAYE correctly, failed to exercise proper care and attention, failed to have the necessary controls, checks and balances in place to prevent the incorrect administration of PAYE and has failed to provide an accurate explanation of how they failed to exercise their duty to the Appellant and to HMRC. He argued that they have a number of employees worldwide – maybe 100 – and that the size of their workforce is irrelevant to the obligation to exercise proper care. They also claim the underpayment did not result entirely from the failure to operate the Tax Code on a week 1/month 1 basis but was a consequence of Adra Match making two specific payments of commission in two separate months without deducting tax from those payments. He said that when he was headhunted to join Adra Match he had provided pay slips to them and so they would have been aware of his previous employment as well as the fact he had earned income in the year.

16. Mr Donnelly very helpfully took us through the way in which the underpayment had been calculated. This involved looking separately at the two employments in the 2008/09 tax year. In his employment with Trintech the Appellant received payments of £58,870 from which £18,514.40 tax was deducted. Mr Donnelly told us that the tax from this employment was calculated on the basis of reducing the amount received by a proportion of the then current personal allowance (£1880) to £56,990. Using the rates then current, £34,800 of this was chargeable at 20% (giving tax due of £6960) and the balance was chargeable at 40% (giving further tax due of £8876). The total tax due was £15836 but £18514.40 had been deducted giving an overpayment of £2678.40. In his employment with Adra Match the Appellant's total pay was £49,799 from which tax of £11,456 was deducted. Mr Donnelly told us that this was an underpayment because although the chargeable amount should be reduced by the unused balance of the personal allowance (£1875) to £47,924 all of this is chargeable at 40% because the 20% band was used to calculate the tax due on the Trintech payments. The tax due on this basis is £19,169.60 resulting in an underpayment of £7713.60 which was reduced (by the overpayment of £2678.40 from the Trintech payments) to £5035.20. The difference between this figure and the amount used in the direction (£1.60) is apparently thought to be due to some discrepancy in the tax tables used in this period.

17. Mr Donnelly submitted to us that the P45 itself was deficient because it did not contain details of the Appellant's previous income for the year. He said that HMRC tried to ascertain how the errors resulting from this and from the oversight that the Tax Code should have been operated on a week1/month 1 basis had occurred. He said that the error appears to have been isolated, that the taxpayer has some responsibility for his tax affairs and he was obviously aware that he had earned income prior to starting his new employment. He felt that the conclusion this was an error made in good faith was justified and so was the conclusion the employer had taken reasonable care.

18. Mr Donnelly explained that he had considered whether extra statutory concession A19 might apply to the Appellant. This concession applies where the taxpayer could reasonably have believed his tax affairs were in order and was notified more than 12 months after the end of the tax years in which HMRC received the information indicating that more tax was due. He explained that in this case the underpayment arose in the 2008/09 tax year and was notified to the taxpayer in March

2011 but HMRC did not receive the information indicating more tax was due until it received the annual return from his employer in 2009/10. This year ended on 5 April 2010 which was less than 12 months before the taxpayer was notified of the underpayment in March 2011. Accordingly, he submitted that the concession could not apply in this case. The taxpayer must have been aware of the underpayment in March 2011 since his own letter written on 1 March 2011 referred to the P800 which contained details of the underpayment. No point was taken on this by the Appellant and we do not mention it further.

Decision

19. We did not explore in detail the way in which PAYE operates where there are two employments in the same year but we accept that the under deduction of tax resulted from Adra Match assuming that the payments they made were the only payments the taxpayer received in the relevant year. We also accept that the result of this assumption is that tax was calculated as if the full personal allowance for the year was available to reduce the chargeable amount and that the full 20% rate was available to calculate the tax due on that amount. The first consequence was developed in the correspondence and was mentioned in the review letter but the second consequence (the use of the 20% rate) was not really developed.

20. We understand that HMRC were unable to challenge Goodwille about their responses to the enquiry how the error arose because the author of the letter asked them not to do so. It is apparent they did not ask any further questions and the first review refers to HMRC being satisfied that the necessary checks and balances were in place. However we are surprised that the explanation about the P45 did not receive further enquiry. The explanation was that when a P45 is received it is checked and details are entered onto payroll software and filed online shortly afterwards and "it failed on this occasion due to human error". There is no explanation of what failed nor why the error arose. Goodwille explained that they had operated the tax code on a cumulative basis because an administrative error meant that the non-cumulative marker on the P45 was overlooked and this resulted in the incorrect operation and underpayment. The explanation about the coding reveals a misunderstanding about why the total under deduction occurred. Part of it occurred because the entire personal allowance was used to reduce the chargeable amount but the other part occurred because no account was taken of the previous payments to the Appellant.

21. HMRC seem to have proceeded with their enquiries on the basis that if Goodwille had taken reasonable care then so had Adra Match. They seem to have focussed entirely on what Goodwille told them about how the error had occurred and the background to how they operated PAYE. However they also appear to have taken into account that Adra Match had only a small number of employees; we did not see the relevance of this when Adra Match had engaged Goodwille to look after the PAYE matters. it might have been more relevant to enquire whether Goodwille had the necessary experience to deal with PAYE. the answer to this might also have answered whether it was reasonable for Adra Match to engage them to deal with its PAYE – it might be reasonable to Adra Match to rely on Goodwille but if it is to do so it must be relevant to know whether they checked what expertise Goodwille possessed.

22. We accept that the Appellant would have been aware of his previous income. We also accept that he was settling into a new job and relied upon his employer to

calculate his tax correctly. We can see it is reasonable for an employer to employ an agent to deal with its tax compliance but it cannot abandon these matters to the agent without enquiry or without liaison. We have no idea whether there was enquiry or liaison since neither the employer or Adra Match were at the hearing but there is also no evidence of HMRC asking about this and they seem to have taken the view that if Goodwille took reasonable care then so did the employer. If Goodwille took all reasonable care then that is certainly helpful but they cannot act in isolation and it is surprising if they as an agent dealing with tax affairs routinely did not query whether a new employee starting employment mid-way through a tax year really had no previous payments in that year. The Appellant received significant payments and it is surprising if this did not trigger an enquiry about his previous position. We believed the Appellant when he told us he had provided payslips to Adra Match when he was engaged by them and so this is information that the employer would have had if Goodwille had checked his previous pay position.

23. We conclude that the employer did not take reasonable care either itself or through its agent Goodwille and we allow the appeal.

24. 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.

JUDITH POWELL
TRIBUNAL JUDGE

RELEASE DATE: 20 August 2014