TC04300

Appeal number: TC/2014/02388

INCOME TAX – penalty for late payment of in-month PAYE – whether HMRC had advised of the risk of penalties – whether the case was "criminal" under the European Convention on Human Rights – whether the company had a reasonable excuse – the scope of HMRC's discretion to consider special circumstances – whether it must be exercised before the tribunal hearing –* Agar, Algarve Granite *and* Morgan & Donaldson *considered – whether penalties of £74,418.09 disproportionate – whether FA 2013 amendment to penalty provisions means original regime was disproportionate –* Bank Mellat v HM Treasury *and* Total Technology *considered and applied – appeal dismissed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

BLUU SOLUTIONS LTD — **Appellant**

- and -

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

TRIBUNAL: JUDGE ANNE REDSTON
MR DEREK SPELLER FCA

Sitting in public at the Tribunal Centre, Fox Court, Gray's Inn Road, London on 4 December 2014

The Appellant was not represented

Mrs Beverley Levy of HM Revenue & Customs' Appeals and Reviews Unit for the Respondents

DECISION

1. This was the appeal of Bluu Solutions Limited ("the company") against a penalty for late payment of monthly PAYE and Class 1 National Insurance Contributions[1] during the tax year 2012-13.

2. On 4 December 2014 the Tribunal heard and dismissed the company's appeal. We confirmed the penalty of £74,418.09. Shortly afterwards we issued a decision containing a summary of the facts and reasons.

3. By letter dated 22 December 2014, the company's representative, Francis Clark LLP ("Francis Clark"), requested full written findings of fact and reasons for our decision. This is that full decision.

4. The letter from Francis Clark also challenged some of the findings and conclusions contained in the summary decision and asked us "to further consider" certain points. We made our decision on 4 December 2014, and the reasons for that decision are now fully set out. If the company wishes to challenge this judgment, it must apply for permission to appeal as set out at the end of this decision notice.

The failure to attend

5. The hearing of the company's appeal was scheduled to begin at 10.00 am. Parties are asked to arrive at least 30 minutes beforehand. By 10.00am no one had arrived to represent the company. The tribunal clerk called Francis Clark and asked to speak to Mr Tom Roach, the partner who had communicated with HMRC and the tribunal on the company's behalf.

6. The tribunal clerk was initially told that Mr Roach was travelling, but was then called back and informed that (a) Mr Roach was not attending the hearing; (b) he had put forward all the company's arguments in writing and (c) he asked that the hearing proceed despite the absence of any representative from the company.

7. We considered Rules 2 and 33 of the Tribunal (First-tier Tribunal) (Tax Chamber) Rules 2009 ("the Tribunal Rules"). Rule 33 reads as follows:

> **Hearings in a party's absence**
>
> If a party fails to attend a hearing the Tribunal may proceed with the hearing if the Tribunal--
>
> (a) is satisfied that the party has been notified of the hearing or that reasonable steps have been taken to notify the party of the hearing; and
>
> (b) considers that it is in the interests of justice to proceed with the hearing.

8. The company had been notified of the hearing. We had received Mr Roach's submissions in writing and been told that the company was content for the hearing to

[1] References in this decision notice to PAYE should be read as including Class 1 National Insurance Contributions, unless the context otherwise requires.

proceed. HMRC had sent Mrs Levy to represent them at the hearing. We were satisfied that it was “in the interests of justice to proceed with the hearing.”

The issues in the case

9. The company did not dispute that PAYE had been paid late for each month of the tax year. The issues in the case were:

(1) whether the penalty was criminal for the purposes of Article 6 of the European Convention of Human Rights (“the Convention”);

(2) whether the company had a reasonable excuse for the late payments (a) because of financial, economic and cashflow difficulties; (b) on the basis that HMRC had not made it aware of the penalties; and/or (c) because of staff changes at the company;

(3) whether there were any “special circumstances”; and

(4) whether the penalty was disproportionate.

The legislation

10. The in-month PAYE penalty legislation is at Finance Act 2009, Schedule 56 (“Sch 56”). The relevant provisions as they applied in 2012-13 are set out as an Appendix to this decision.

11. Sch 56, para 6 provides for the method of calculating the penalty, which is as follows:

(1) if payments are late for one month in a tax year, there is no penalty;

(2) if two to four months’ payments are late, the penalty is 1% of the total PAYE paid late (excluding month 1);

(3) if five to seven months’ payments are late, the penalty rises to 2%;

(4) if eight to ten months’ payments are late, the penalty rises further to 3%;

(5) if eleven or twelve months’ payments are late, the penalty is 4%.

12. Sch 56, para 6(1) says that the penalty is determined by reference to “the number of defaults that [the person] has made during the tax year.” Since PAYE is due on the 19th day after the end of the calendar month (or the 22nd day if paid electronically), the PAYE payment for month 12 falls into the following tax year. Late payment of month 12’s PAYE is therefore not a default “made during the tax year.”

13. Following the identification of this point by the tribunal in *Agar v HMRC* [2011] UKFTT 773 (TC) (“*Agar*”) (Judge Poole and Ms Tanner) at [57], HMRC have not included month 12 defaults in Sch 56 PAYE penalty assessments, despite the fact that the month 12 default becomes the first default of the following tax year.

14. The Sch 56 PAYE penalty legislation was amended[2] with effect from the tax year 2014-15, although the start date was subsequently deferred by a year.[3] Under para 6(4) of the amended provisions:

(1) if payments are one month late, there is no penalty;

(2) if two or three months are late, the penalty is 1% of those late payments;

(3) if four to six month's payments are late, the penalty is 2%;

(4) if seven to nine months payments are late, the penalty is 3%; and

(5) if ten to twelve months payments are late, the penalty is 4%.

15. Unlike the penalties at issue in this appeal, which are based on the cumulative amount of late paid PAYE, the new penalties are calculated according to the amount paid late on each default. The amended provisions also changed the wording of para 6(1), so that a month 12 default is included in the calculation of that year's penalty.

16. Although the FA 2013 version of the penalties did not apply to the company's appeal, we refer to these provisions again in the context of proportionality at §189 below.

The evidence

17. The Tribunal was provided with the following:

(1) the correspondence between the parties and between the parties and the Tribunal;

(2) notes made by HMRC Officers working the Telephone Pursuit Unit ("TPU");

(3) a single page summary from the company's 2012-13 management accounts;

(4) extracts from HMRC's webpages;

(5) extracts from HMRC's Employer Bulletins 34, 35, 36, 37, 38 and 40;

(6) screenprints from the 2010-11 Employer CD Rom;

(7) Budget Note 90 ("BN90") issued in 2009, which announced the new penalty regime; and

(8) extracts from HMRC's computer records showing (a) the company's payment dates; (b) the date on which HMRC say that the 2012-13 penalty default warning letter was sent out and (c) the address to which HMRC say it was sent.

18. From that evidence, we found the facts set out in this decision. We first record the facts not in dispute and then make further findings.

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[2] FA 2013, s 230, Sch 50, para 10

[3] FA 2013, s 230, Sch 50 para 16(3), HMRC press release dated 12 February 2014

Facts not in dispute

19. The company is in the project management and office fit-out business. It operates mainly in the London area. During 2012-13 its turnover ranged from £1.7m to £3m per month, averaging around £2.5m. Its gross profit was relatively constant at approximately 20%. Overheads were around £500k. For eight months of the year, an amount called "other costs" was deducted from the gross profit. These "other costs" were not identified, but ranged from a low of £15,300 to a high of £151,085. For nine months of the year, the management accounts show a loss after overheads and "other costs." They also show that:

(1) the company had "connected company debts" of around £2m throughout the year; and

(2) the average time for which a trade debt was outstanding ranged from a low of 14.4 days to a high of 34.51 days; in five months of the year, the figure was less than 20 days.

20. The PAYE penalty regime was announced in Budget 2009 by way of a Budget Note (BN90) and was introduced from 6 April 2010. HMRC have not sought to charge the company penalties for 2010-11 or 2011-12, although it was common ground that PAYE was paid late on at least some occasions during those years.

21. In 2012-13 the company paid its PAYE late in every month of the tax year. The number of days late varied from 1 day to 19 days. On five occasions the payment was 10 or more days late.

22. The dates and amounts are set out in the table below.

Month	Due date	Date received	Payments	Days late
1.	22 May 2012	23 May 2012	£111,390	1
2.	22 June 2012	25 June 2012	£146,096	3
3.	22 July 2012	31 July 2012	£152,710	9
4.	22 August 2012	10 September 2012	£160,904	19
5.	22 September 2012	27 September 2012	£167,030	5
6.	22 October 2012	24 October 2012	£213,490	2
7.	22 November 2012	4 December 2012	£203,836	12
8.	22 December 2012	28 December 2012	£217,673	6
9.	22 January 2013	29 January 2013	£227,324	7
10.	22 February 2013	4 March 2013	£189,893	10
11.	22 March 2013	9 April 2013	£181,684	18
12.	22 April 2013	2 May 2013	£223,428	10
Total			£1,971,761	

23. The company and HMRC have both provided the tribunal with dates on which HMRC received the PAYE. For some months, the parties' dates differed. As the money was received in HMRC's bank account, and as HMRC's dates are more favourable to the company, we have used those dates.

24. It is clear from the TPU notes (some extracts from which are set out at §35) that the company was aware of the payment dates and knew it was paying late. Mr Roach has not suggested otherwise.

25. The penalty was charged for 10 months of the year, i.e., excluding month 1 (no penalty by statutory exception) and month 12 (because of the statutory wording and HMRC's practice following *Agar*).

26. From July 2013, the company began to pay its PAYE on time.

27. In December 2013, the company received the penalty notice. This was appealed on 22 January 2014 and subsequently notified to the Tribunal.

Contact between the company and HMRC about payments and penalties

28. The extent and nature of contact between the company and HMRC is disputed. In this section of the decision we set out the parties' contentions and their evidence, and then make further findings of fact.

Mr Roach's contentions on behalf of the company

29. In the letter of appeal dated 22 January 2014, Mr Roach submitted that the company "did not have any contact from HMRC indicating that payments had been late and that a penalty would potentially be due."

30. In his letter dated 27 February 2014, Mr Roach denied that the company had received an HMRC penalty warning letter issued in May 2012. Although he accepted that TPU had contacted the company, he said that:

> "while a telephone call had been made to our client, the matter was not communicated to management within the company. The financial controller, who is likely to be the person who took the phone call, has left the company."

31. In a further letter dated 24 July 2014, Mr Roach said "our client did not receive any warnings in the period that they were in default and therefore did not have any opportunity to modify their behaviour." He suggested that HMRC should have written a letter addressed to the directors explaining the penalty risk.

HMRC's contentions

32. HMRC say that they publicised the new late payment penalties extensively, including:

(1) in the employer pack which was mailed to employers in February 2012;

(2) on the PAYE pages of the HMRC website;

(3) by contact with agents and advisers;

(4) via over 100 pieces of media coverage in national, trade, regional and online publications; and

(5) in the following editions of Employer Bulletin, which were sent to all employers:

(a) Issue 33, dated September 2009, which included an article flagged "*Need to know.*" It spelled out how the penalties were calculated and where to find more information.

(b) Issue 34, dated January 2010, which contained a full page article with the following headline in emboldened large print: *Don't get a penalty – remember to pay on time.* The article explained that "the law is changing" and warned "don't get caught out".

(c) Issue 35, dated April 2010, had another full page article headlined "*Avoid late payment penalties – Pay on time and in full.*" It again explained how the penalties were calculated.

(d) Issue 36, dated August 2010, also devoted a full page to the new penalty regime, under a headline in large, bold print: "*Avoid late payment penalties – don't leave payment to the last minute!*"

(e) Issue 37, dated February 2011, contained an article headlined "*PAYE late payment penalties*" in which HMRC reiterated that the penalties are calculated based on the total amount outstanding and are charged at the end of the year. It also provided a link to more detailed information on the HMRC website.

(f) Issue 38, dated April 2011, contained an article setting out the payment dates for 2011-12 and gave further explanations about the penalties.

(g) Issue 40, dated February 2012, had a half-page article headed "*Avoid a late payment penalty – pay your PAYE on time.*" It explained that penalties are sent out after the end of the tax year because "it is only then that we are able to accurately calculate the penalty."

33. HMRC submit that not only was a late payment warning letter sent to the company on 30 May 2012 for the tax year 2012-13, but a letter in the same terms was sent on 29 July 2010 for the tax year 2010-11 and on 27 April 2011 for the tax year 2011-12 and "there is no evidence that these were not received."

34. Furthermore, HMRC say that they sent a P30B letter to the company on 8 January 2012 and that a warning about PAYE penalties was included in the letter. P30B letters are sent to employers who pay their PAYE electronically.

35. HMRC provided contemporaneous notes of contact between the company and the TPU, which record that:

(1) On 24 November 2010 (i.e., before the year in question), Mr Regan, who is identified in the TPU notes as the company's accountant, was telephoned by HMRC in relation to the 2010-11 month 7 late payment. The notes read:

> "late due to cash flow. Educated about in-year penalties and reminded of pyt dates, are waiting for money to come in from clients. WLAP [warning of legal action and penalties]."

(2) On 7 December 2010 TPU called the company chasing a late payment and was told that Mr Regan was unavailable because he was on holiday. Nigel Wilson, named in the notes as the company's Financial Director, called TPU back, said he knew about the PAYE arrears and asked if the payment could "wait until [Mr Regan's] return"

(3) On 30 July 2012 (i.e., during the tax year in question) TPU called the company about the late payment for month 3. The notes read:

> "Tele call to t/p [ref] 30/7/12 12.52 Pyt Promise - Richard (Dir) month 3 PYT on 31/7/12 for £146,000 by BACS/CHAPS. Late due to holidays. Educated about in-year penalties. Required additional authorisation to make a payment and FD on holiday until 31 July. WLA [Warning of Legal Action]."

(4) On 4 September 2012, TPU called the company about the late payment for month 4, and spoke to "Richard (authorised person)" and was told that the payment was "late due to holidays." The note ends by recording that another "Warning of Legal Action and Penalties" was given.

(5) On 27 September 2012, TPU spoke to a receptionist at the company about the late payment for Month 7. The receptionist said she was unable to take a message and that "Richard Pilgrim was on other call and didn't know how long call would take to finish."

(6) On 27 December 2012, TPU tried on three occasions to make contact with the company about the late payment for month 8; there was no reply on the first two attempts; on the third a message was left for a director to call back by 28 December 2012. There is no record of a call back but payment was made the following day.

(7) On 28 January 2013, TPU spoke to the company's finance manager "who advised that he wd try and make payment today; failing that it will be tomorrow, payment is just over £200,000 for month 9."

(8) On 27 February 2013, TPU spoke initially to an employee called Jenny. The call notes say that Jenny "will ask dir. to cb [call back]." Later the same day, the call notes read:

> "spoke to Mr Pilgrim (Dir) returning call earlier, regarding month 10; this will be sent this week and should be in the account within the week."

(9) On 27 March 2013, TPU left an answerphone message asking for a director to call back about the late Month 11 payment. There is no record of any response.

(10) On 9 April 2013 TPU called again, also about Month 11. The call record reads:

> "Tele call to t/p. [Ref] Large debt case. Mth 11 o/s. Tele co on [number] 1st name on record is a Richard Pilgrim. Asked for him, lady said no longer with co. I asked for dir she advised on holiday but she could pass me to a accounts dept. Spoke to a gent called Chetan Bhabra. I advised was tele from hmrc re paye, asked if he now dealt with [sic]. He said yes and paye payt for mnth 11 just made yesterday. He apologised for late pyt…"

(11) On 29 April 2013 TPU called the company and spoke to a person called "Amber" who said she would ask a director to call back. There is no record of any call back; payment for month 12 was received on 2 May 2013.

36. HMRC also provided evidence that they issued five enforcement warning letters, for months 3, 4, 7, 10 and 11. HMRC say that although these letters do not refer to penalties, "they did advise the company that they were paying late, giving them the opportunity to change their behaviour."

Further findings of fact: no dispute about receipt

37. HMRC have said, and Mr Roach has not disputed, that the company received the following, and we find as facts that they were received:

(1) the Employer Bulletins listed at §32(5) which contained guidance about the Sch 56 PAYE penalty regime;

(2) the employer pack sent out in February 2012, which included more information about the new rules;

(3) the P30B for 2012-13, which advised of the penalty regime; and

(4) the five enforcement warning letters issued during 2012-13.

38. Mr Roach has not explicitly disputed that any of the calls listed at §35 above were made, or the details of those calls, although he made the general statement that the company "did not receive any warnings in the period that they were in default."

39. We accept HMRC's contemporaneous evidence and find as a fact that these calls were made on the dates and in the terms set out by the HMRC officers working for TPU.

40. Mr Roach has also not disputed that the company received the late payment warning letters sent out on 29 July 2010 for the tax year 2010-11 and on 27 April 2011 for the tax year 2011-12 and we find as facts that these letters were sent by HMRC and received by the company.

Further findings of fact: the 2012-13 PAYE penalty warning letter

41. Mr Roach says that the company has "no record" of receiving the penalty warning letter dated 30 May 2012. HMRC have provided a screenprint headed "Actions for PAYE" along with the company's name. Next to the date of 30 May 2012 is a note stating "penalty default letter issued." HMRC also provided a screenprint showing the address to which they say the letter was sent; that address was entered onto the system on 30 October 2009 and is the same as that used for other

HMRC correspondence with the company, including the penalty at issue in this appeal.

42. We considered the Interpretation Act 1978, s 7, which is as follows:

> "Where an Act authorises or requires any document to be served by post (whether the expression "serve" or the expression "give" or "send" or any other expression is used) then, unless the contrary intention appears, the service is deemed to be effected by properly addressing, pre-paying and posting a letter containing the document and, unless the contrary is proved, to have been effected at the time at which the letter would be delivered in the ordinary course of post."

43. This means that a letter which has been properly addressed, pre-paid and posted is deemed to be delivered to the recipient unless that recipient proves that it has not been received.

44. Mr Roach has not argued that the penalty warning letter was (a) wrongly addressed; (b) not posted, or (c) that the postage was insufficient. Taking into account also HMRC's evidence, we find that the letter was properly addressed, pre-paid and posted.

45. In order to rebut the deemed delivery, the company must "prove" that the letter had not been delivered. We only have Mr Roach's statement that the company has no record of receipt. This is of course hearsay and lacks specificity: there is no information (for example) about how post is normally dealt with by the company; whether it is logged; on whose information Mr Roach was relying when he said that the letter had not been received; what checks were carried out by the company before Mr Roach was given this information; whether there is a procedure for reviewing, retaining, and acting on HMRC correspondence, and if so, whether everything received from HMRC is retained.

46. We find that the company has failed to prove that the penalty warning letter was not received. In reliance on the deeming rule provided by the Interpretation Act, we find as a fact that the PAYE penalty warning letter of 30 May 2012 was both sent by HMRC and received by the company.

Further findings of fact: communications to management

47. The final point for us to consider under this heading is whether the various communications between TPU and the company were not "communicated to management within the company," as Mr Roach asserts.

48. The company did not provide any witness evidence, or supply the Tribunal with any written material, such as records of phone calls. In contrast, HMRC's contemporaneous notes state that on 30 July 2012 "Richard" was "educated" about in-year penalties and warned of possible legal action and that on 4 September 2012 "Richard (authorised person)" was warned of "legal action and penalties." From the other references in the TPU notes we find that "Richard" is Mr Richard Pilgrim and

that on 30 July 2012 and 4 September 2012 he was specifically warned about PAYE penalties.

49. In the TPU call note dated 30 July 2012 Mr Pilgrim is referred to as a director. On 27 February 2013, an employee named Jenny said she would ask "a director" to call HMRC: Mr Pilgrim returned the call shortly afterwards. We find as a fact, in reliance on this evidence, that Mr Pilgrim was a director of the company.

50. We therefore do not understand the basis for Mr Roach's submission that the PAYE penalty warning was not "communicated to management within the company." Mr Pilgrim is a director and was explicitly advised about the risk of penalties. Mr Regan, the company accountant, was warned about PAYE penalties as far back as 24 November 2010.

51. Mr Roach also suggested that HMRC should have written a letter addressed to the directors to explain the penalty risk. We observe that not only had a TPU Officer twice spoken to Mr Pilgrim, but had also asked to speak to a director of the company on 28 November 2012 (about Month 7), 27 December 2012 (about Month 8) and 29 April 2013 (about Month 12), but these calls were not returned.

Whether the case was "criminal" for ECHR purposes

52. Mr Roach argued that the penalty was "criminal" and so came within the protection of the Convention. HMRC rejected this submission, relying on their understanding of the criteria set out in *Engel v. Netherlands (No. 1)* (1976) 1 EHRR 647 ("*Engel*"). It is HMRC's case that only penalties of 70% or more are "criminal" in nature and that this follows from *Han & Yau v HMRC* [2001] EWCA Civ 1048 ("*Han & Yau*"), and *King v Walden (No 2)* [2001] STC 822 ("*King v Walden*").

ECHR authorities

53. Our starting point is the three-fold *Engel* criteria, which are:

(1) the classification of the proceedings in domestic law, i.e., whether civil or criminal;

(2) the nature of the offence; and

(3) the nature and degree of severity of the penalty that the person concerned risked incurring.

54. In *Öztürk v. Germany* [1984] ECHR 8544/79 ("*Öztürk*"), Mr Öztürk had committed a breach of traffic regulations. He accepted that the resulting penalty was civil under German law, but objected to having to pay a fee for the use of an interpreter, saying that this was incompatible with Article 6(3) of the Convention. The German government submitted that the Convention did not apply. At [50] of their judgment, the European Court of Human Rights ("ECHR") repeated the *Engel* criteria, before holding at [53] that the penalty:

> "…retained a punitive character, which is the customary distinguishing feature of criminal penalties…It is a rule that is directed…towards all citizens in their capacity as road-users; it prescribes conduct of a

certain kind and makes the resultant requirement subject to a sanction that is punitive. Indeed, the sanction – and this the Government did not contest – seeks to punish as well as to deter…Above all, the general character of the rule and the purpose of the penalty, being both deterrent and punitive, suffice to show that the offence in question was, in terms of Article 6 of the Convention, criminal in nature. The fact that it was admittedly a minor offence hardly likely to harm the reputation of the offender does not take it outside the ambit of Article 6. There is in fact nothing to suggest that the criminal offence referred to in the Convention necessarily implies a certain degree of seriousness…"

55. In *Lutz v Germany* [1987] ECHR 9912/82 ("*Lutz*") the Court considered a regulatory penalty which was classified as civil by German law, and said at [55] that:

> "The Court points out that the second and third criteria adopted in the judgments in the *Engel and others* case and the *Öztürk* case are alternative and not cumulative ones: for Article 6 to apply in virtue of the words 'criminal charge,' it suffices that the offence in question should by its nature be "criminal" from the point of view of the Convention, as in the instant case, or should have made the person concerned liable to a sanction which, in its nature and degree of severity, belongs in general to the 'criminal' sphere."

56. In *Jussila v Finland* (2006) (A/73053/01) ("*Jussila*"), the appellant was subjected to ten VAT surcharges for book-keeping errors, totalling 308 euros, being 10% of the under-assessed VAT. The ECHR at [31] reiterated its decision in *Lutz*:

> "The second and third [*Engel*] criteria are alternative and not necessarily cumulative. It is enough that the offence in question is by its nature to be regarded as criminal or that the offence renders the person liable to a penalty which by its nature and degree of severity belongs in the general criminal sphere (see *Ezeh and Connors*, cited above, §86). The relative lack of seriousness of the penalty cannot divest an offence of its inherently criminal character (see *Öztürk v. Germany*, 21 February 1984, §54, Series A no. 73; see also *Lutz v. Germany*, 25 August 1987, §55, Series A no. 123)."

57. *Jussila* has been followed in a significant number of other ECHR judgments, the most recent of which is *Glantz v Finland* [2014] STC 2263 (App 37394/11) ("*Glantz*") where the Court said, at [50]:

> "The court has taken [a] stand on the criminal nature of tax surcharges, in the context of art 6 of the Convention, in the case *Jussila v Finland* (cited above). In that case the court found that, regarding the first criterion, it was apparent that the tax surcharges were not classified as criminal but as part of the fiscal regime. This was, however, not decisive but the second criterion, the nature of the offence, was more important. The court observed that the tax surcharges were imposed by general legal provisions applying to taxpayers generally. Further, under Finnish law, the tax surcharges were not intended as pecuniary

> compensation for damage but as a punishment to deter re-offending. The surcharges were thus imposed by a rule the purpose of which was deterrent and punitive. The court considered that this established the criminal nature of the offence. Regarding the third *Engel* criterion, the minor nature of the penalty did not remove the matter from the scope of art 6. Hence, art 6 applied under its criminal head notwithstanding the minor nature of the tax surcharge."

58. The ECHR have thus consistently held that the minor nature of a penalty does not prevent it from being "criminal" under the Convention, and that the classification under national law is not decisive. A penalty intended to punish and to deter, and which applies to taxpayers generally, is criminal in nature.

UK statute and case law

59. The Human Rights Act 1998 ("HRA") s 1 provides that the Convention rights set out in Schedule 1 to that Act are "to have effect for the purposes of this Act subject to any designated derogation or reservation." HRA s 2 provides that "a court or tribunal determining a question which has arisen in connection with a Convention right" must take ECHR judgments into account "so far as, in the opinion of the court or tribunal, it is relevant to the proceedings in which that question has arisen."

60. As we explain below, UK courts have taken the same approach as the ECHR to Article 6 and the criminal nature of even small tax penalties. Although HMRC seek to rely on *Han & Yau,* it is not clear why. It is true that in *Han & Yau* Nourse LJ considered *Öztürk* at [102] before expressing support for a dissenting judgment in that case at [104]. He went on to say that the first *Engel* criterion was more important and declined to follow *Öztürk*:

> "[109]…Everything seems to depend on whether it is open to us to attribute a greater importance to the first criterion than has been the tendency of the more recent Strasbourg decisions. In my judgment it is. We were consistently told by those who advocated the incorporation of the Convention in our law that it would enable our courts to make a beneficial contribution to its jurisprudence. In my opinion that contribution ought to start with a recognition of the widely differing traditions and institutions of the community States. What ought to be treated as a criminal charge in some of them may not need to be so treated in others. In this country we have, since 1689, developed a system of civil administration in which the executive, being subject to review by the courts, acts responsibly and fairly towards the individual citizen, the protection of whose rights is an integral part of the system.
>
> [110] The assessment and collection of revenues due to the Crown is an important part of our civil administration. The VAT penalty system is fair, beneficial to the taxpayer and in the public interest. The rights of the taxpayer are already adequately protected. It would be folly, in the name of an abstraction, to introduce a further unnecessary protection, whose practical consequence would be to impair the efficiency of the system at no advantage to the taxpayer. For my part, we decline to do so."

61. However, Nourse LJ was in the minority. The majority in *Han & Yao* (Potter LJ and Mance LJ) agreed with Stephen Oliver QC, who had heard the case at first instance, that the penalties were criminal within the meaning of Article 6 and that the approach of the ECHR should be applied in the UK. Mance LJ said:

> "[87] Under s 2 of the Act the Tribunal and this court are not bound by, but are obliged to take into account the Strasbourg case law, when determining such an issue. The effect of the case law is in my view to point unequivocally towards the answer given by the Tribunal below and by Potter LJ in his judgment. I refer in particular to the cases of *Ozturk* (a case, like the present, of a domestically 'de-criminalised offence), *Bendenoun, AP, MP and TP* and *Georgiou*, cited more fully in the judgment of Potter LJ. While I appreciate that there are contrary arguments which might have found favour in the Strasbourg Court, and did find favour in some minority judgments there, I do not consider that it is appropriate now to place this country's jurisprudence out on a limb in an area where the Strasbourg Court has sought explicitly to develop an autonomous international test."

62. There has also been no deviation from this "autonomous international test" in later judgments. In *R(oao McCann) v Kensington & Chelsea LBC* [2002] UKHL 39, Lord Steyn gave the judgment of the House. At [30] he said (emphasis added):

> "In *Engel v Netherlands* (*No 1*) [1976] ECHR 5100/71 at para 82, the European Court established three criteria for determining whether proceedings are 'criminal' within the meaning of the convention, namely (a) the domestic classification, (b) the nature of the offence, and (c) the severity of the potential penalty which the defendant risks incurring. The character and attributes of the proceedings for an anti-social behaviour order have been outlined. Domestically, they are properly classified as civil<u>. That is, however, only a starting point</u>. Turning to factor (b), the position is that the order under the first part of s 1 does not constitute a finding that an offence has been committed…It is right, however, to observe that <u>the third factor is the most important</u>..

63. Shortly afterwards, Lord Bingham gave the judgment in *R v H* [2003] UKHL 1, saying at [16]:

> "It is first necessary <u>to know how the issue is classified in domestic law. This test is far from decisive and rightly so</u>, since the convention seeks the achievement of broadly equivalent standards among the member states of the Council of Europe and <u>such aim would be defeated if domestic rules were determinative</u>. But this is the starting point…"

64. In *R(oao Mudie v Dover Magistrates Court* [2003] EWCA Civ 237 ("*Mudie*"). Laws J, giving the judgment of the Court, accepted in reliance on *Öztürk*, that the classification of proceedings in domestic law was "only a starting point and a factor of little weight." At [30] he said that "I accept that even a minor financial penalty may be consistent with the scheme being treated as criminal if in truth its purpose is deterrent and punitive."

65. The UK courts are therefore clear that a tax penalty, which is meant to be punitive and to deter, is "criminal" for the purposes of Article 6.

66. HMRC also rely on *King v Walden,* where the taxpayer had been charged a penalty of £58,600, which was 80% of the tax which would have been lost. Jacob J decided (against the submissions of HMRC) that the penalty for fraudulent or negligent conduct by a taxpayer was criminal for the purposes of the Convention. In so finding, Jacob J took into account the fact that "the amount of the fine is potentially very substantial." Possibly this is the source of HMRC's submission that only penalties which are at least 70% of the assessed amount come within the protection of the Convention.

67. If so, that submission cannot be accepted. Given the facts of *King v Walden,* the court did not consider the question of whether a small penalty would also gain the protection of the Convention; neither *Öztürk* nor *Lutz* were cited to the Court, and the decision predates *McCann, R v H* and *Mudie,* as well as *Jussila* and *Glantz.* Further, Jacob J referred to the overall quantum of the penalty as being "very substantial" and made no particular reference to the fact that it was 80% of the tax lost. *King v Walden* therefore does not provide support for HMRC's submission that only penalties of 70% or more are "criminal" for the purposes of the Convention.

68. On the basis of the analysis set out above, we agree with Mr Roach that tax penalties are normally "criminal" for the purposes of Article 6.

69. By way of footnote we also observe that the penalty charged on the company is not in any event a small sum. It is some 25% larger than the £58,600 described by Jacob J in *King v Walden* as "very substantial."

Whether the penalty is "punitive"

70. In their Statement of Case HMRC also argue that Sch 56 penalties are not "punitive" because:

> "the nature of the offence does not involve proof of any qualitative misconduct on the part of the taxpayer. Unlike the provisions in question in *Han* and *King v Walden*, there is no question of proving that the taxpayer is guilty of any fraudulent or negligent conduct. It is merely necessary to show that the taxpayer had not paid the relevant amount on time, and that they do not have a reasonable excuse or there are no special circumstances. The primary objective of the penalty is to change behaviour and to encourage future compliance with any element of punishment and deterrence playing a subordinate role."

71. Much of this submission appears to us to turn on semantics. A penalty which is designed to "change behaviour" is also one which aims to "deter" a person from his current behaviour. Negligence is the failure to behave in an objectively reasonable fashion. Although the concept of "reasonable excuse" is not identical to negligence, because it contains an element of subjectivity (see §81), a person who does not behave reasonably will not be able to rely on that defence.

72. HMRC's submissions also do not take into account ECHR case law. In *Jussila* the Court said at [38]:

> "the tax surcharges were not intended as pecuniary compensation for damage but as a punishment to deter re-offending. It may therefore be concluded that the surcharges were imposed by a rule whose purpose was deterrent and punitive. Without more, the court considers that this establishes the criminal nature of the offence."

73. In other words, ECHR case law contrasts penalties which simply seek "pecuniary compensation for damage" with those which are "a punishment to deter re-offending." The same dichotomy is evident in *Glantz* at [50], quoted at §57 above. Where a person has failed to pay a sum of money by a due date, the pecuniary compensation which would normally satisfy the payee would be a payment of interest.

74. Sch 56, para 6 imposes penalties of up to 4% of the total PAYE payable by a business for ten months of the tax year. Under para 7 a further 5% penalty (not at issue in this case) is chargeable if the delay is more than 6 months. The maximum period covered by the para 6 penalties is therefore 6 months.

75. Mr Roach calculated that if interest had been charged on the late payments at HMRC's rate of 3%, the company would have had to pay £1,564, whereas the actual penalty was £74,418.18. Even had the 3% rate been charged on the full amount paid late, for the maximum 6 month period, the interest would have been £29,576 (£1,971,761 x 3% x 6/12). The actual penalty is around 60% greater than that.

76. These calculations demonstrate that the Sch 56 PAYE in-month penalties are not the equivalent of interest. They very clearly fall on the "punitive" side of the line. As the ECHR says in *Jussila* "without more…this establishes the criminal nature of the offence."

Other points

77. There are several further points. The first is that appellant in this case is a company, and Mr Roach has made no submissions on whether a company is entitled to the protections of the Convention, the purpose of which is, after all, to protect "human" rights. We are nevertheless aware that in *OAO Neftyanaya Kompaniya Yukos v Russia* [2011] STC 1988 App. No 14902/04 ("*Yukos*") the ECHR found that the appellant company was entitled to the protection of Article 6.

78. Second, Mr Roach has not explained why it makes a difference to his client's case if the penalty is classified as criminal under the Convention. It is possible that he saw this as a precondition for making submissions on proportionality in the context of human rights law. However, as we explain at §163, a penalty is potentially a breach of Article 1, Protocol 1 ("A1P1") of the Convention, and proportionality is engaged irrespective of Article 6.

79. Third, because the case falls under Article 6, the burden of proof is on HMRC to show that the payments are late, i.e., that a penalty is due. However, the company has accepted that the payments were late, so HMRC have met this burden.

Reasonable excuse: approach

80. Sch 56, para 16(1) provides that if the company has "reasonable excuse" for a failure to make one or more of its PAYE payments by the due date, that (or those) failure(s) will not count as a default and the company will not be liable to a penalty in relation to that/those failure(s).

81. The term "reasonable excuse" is not defined in the legislation, but in *The Clean Car Co Ltd v C&E Commrs* [1991] VATTR 234 Judge Medd QC gave the following helpful guidance in the context of VAT default surcharges:

> "…the test of whether or not there is a reasonable excuse is an objective one. One must ask oneself: was what the taxpayer did a reasonable thing for a responsible trader conscious of and intending to comply with his obligations regarding tax, but having the experience and other relevant attributes of the taxpayer and placed in the situation that the taxpayer found himself at the relevant time, a reasonable thing to do?"

82. Although that decision related to VAT, it has been applied in other areas of tax law, see for example *Coales v HMRC* [2012] UKFTT 477(TC). In our judgment it is correct to take the same approach when considering whether a person has a reasonable excuse for failing to pay PAYE by the due dates.

83. Sch 56 includes two statutory exceptions to this general approach, one of which is relevant on the facts of this case. Para 16(2)(a) provides that "an insufficiency of funds is not a reasonable excuse unless attributable to events outside [the person's] control."

Reasonable excuse: financial and economic arguments

Mr Roach's arguments on behalf of the company

84. Mr Roach said that as the company is in the construction business, it suffered because of "general market factors" during the recession; it was making losses, and there were cash flow difficulties, in particular because of retentions held by customers. He relied on the management accounts, which showed that the company was loss-making in nine months of the tax year, and said that "these losses put pressure on the company finances [so that] from June 2012 the cash held was less than £50,000."

85. He also drew attention to two retentions. The first was for Company A, where the completion invoice was raised in November 2011, but the final retention amount was not billed until 25 July 2013. That invoice was paid on 28 August 2013. The second was for Company B. The completion invoice was raised in December 2011 but the final retention amount was not billed until 23 May 2013. The invoice was paid on 20 June 2013.

86. Mr Roach submits that "the length of delay in receiving these funds was exceptional in an exceptional period of trading" and that "late payments [of PAYE] were as a direct result of unforeseen poor trading and specifically two late receipts as noted" (i.e., Companies A and B).

Mrs Levy's arguments on behalf of HMRC

87. Mrs Levy said that an insufficiency of funds is precluded by statute from being a reasonable excuse "unless attributable to events outside [the company's] control." Retentions were a normal part of this company's business and the economic conditions it experienced were no different from those suffered by similar businesses; they were within the statutory exception and so could not provide a reasonable excuse.

Discussion

88. Mrs Levy is of course correct that "an insufficiency of funds is not a reasonable excuse unless attributable to events outside the person's control." That provision is, however, only relevant if an insufficiency has been shown to exist. Relevant evidence might include cashflow statements and bank accounts, together with information about attempts to obtain credit from financial institutions, and the outcome of any such efforts.

89. The company provided a single page of management accounts, which left many questions unanswered. In particular, what was the £2m debt owed by the connected company, and what were the "other costs" which were having such an impact on the profits?

90. Mr Roach said that "these losses put pressure on the company finances [so that] from June 2012 the cash held was less than £50,000." This too begged many questions. Was the cash held "less than £50,000" before or after payments due? Which payments? Were other creditors being paid on time? What steps were taken to reduce costs? How often was the cash below £50,000 over the course of the year?

91. In relation to the two particular retentions, we agree with Mrs Levy that retentions are a normal part of the company's operations. Furthermore, both invoices were paid a little over one month of being issued, which most businesses would regard as a good outcome.

92. One relevant fact that did emerge from the management accounts was that the average period for which a trade debt was outstanding ranged from a low of 14.4 days to a high of 34.51 days, and in five months of the year, the figure was less than 20 days. These figures do not indicate a problem with cashflow but rather the reverse.

93. It is for the company to make its case that (a) there was an insufficiency of funds, and (b) that this was caused by events outside its control. We find that the company has not proved that it had an insufficiency of funds at the time of each failure to pay its PAYE on time, still less that there was any event outside its control which led to an insufficiency. These financial/economic/cashflow arguments do not provide the company with a reasonable excuse.

Reasonable excuse: other submissions

Absence of warnings?

94. As we have seen, HMRC submitted in its Statement of Case that the purpose of the penalty provisions was to "change behaviour and encourage future compliance." In his Reply, Mr Roach contended that this purpose can only be achieved "if the client was made aware of the penalty regime," and that the company had not been warned of the penalty.

95. We have however found as facts that:

(1) HMRC issued a great deal of guidance, some of which was specifically sent to the company, including the many Employer Bulletins and the 2012 employer pack.

(2) The company received the late payment penalty warning letters for 2010-11, 2011-12 and 2012-13 as well as the P30B which included a warning about penalties.

(3) On 24 November 2010, Mr Regan, the company accountant, was verbally reminded about penalties and payment dates.

(4) Mr Richard Pilgrim, a director of the company, was specifically warned about the in-year penalties on 30 July 2012 and 4 September 2012.

96. The company was therefore not only told in writing about the risk of penalties, but its director and the company accountant were also told on the phone. Frequent, clear and timely warnings were provided via the Employer Bulletins.

97. Even had the company received no information from HMRC, that would not have provided it with a reasonable excuse. It is a well-established principle of this country's legal system that ignorance of the law is no defence. That principle applies just as much to a penalty system which is designed to change behaviour, as it does to other laws. As Judge Mosedale has recently explained, in *Spring Capital Ltd v HMRC* [2015] UKFTT 8 at [48]:

> "This is because otherwise the law would favour those who choose to remain in ignorance of it above those persons who choose to acquaint themselves with the law in order to abide by it."

Staff changes

98. Mr Roach said that the financial controller had left the company and that this had had "a detrimental effect on the internal control in the business which only came to light in the latter part of 2012/13." Mrs Levy's response was that it was the company's obligation to pay its PAYE on time and to ensure that its staff complied with that obligation.

99. We find Mr Roach's submission "unparticularised" – in other words, it lacks detail. When did the financial controller leave? Given that there were delays in previous years, did his departure make any difference to the company's approach to paying its PAYE on time? If the problem came to light in the latter part of 2012-13, why did the late payments continue until after the end of the tax year?

100. However, even if we had the answers to these questions, and even if they demonstrated that the financial controller's departure had a negative effect on the company's PAYE compliance, this would not avail the company. It has a statutory responsibility to pay its PAYE on time, and the reasonable taxpayer in the position of the company would have ensured that its staff fulfilled that obligation, whether or not it knew about the penalty regime.

Conclusion

101. We find that there is no reasonable excuse for the late payments.

Special circumstances

102. Sch 56, para 9 is headed "special reduction." It gives HMRC the power to reduce a penalty if they "think it right because of special circumstances."

103. The Court of Appeal in *Clarks of Hove v Bakers' Union* [1978] 1 WLR 1207 held (at page 1216) that in the context of "special circumstances, the word 'special' means "something out of the ordinary, something uncommon. In *Crabtree v Hinchcliffe* [1971] 3 All ER 967 Lord Reid said (at page 976) that "'special' must mean unusual or uncommon – perhaps the nearest word to it in this context is 'abnormal.'" In the same case, Viscount Dilhorne said (at page 983) that "for circumstances to be special they must be exceptional, abnormal or unusual…" The tribunal has generally accepted that these meanings apply to the same term used in Sch 56, para 9, and we take the same approach.

104. Mrs Levy told the Tribunal that she had considered whether there were any special circumstances in the company's case, but decided there were none. She said that none of the information put forward by Mr Roach, and nothing in the other information provided for the hearing, disclosed anything exceptional or abnormal, so as to allow a reduction for special circumstances. She reminded the tribunal that under Sch 56, para 9(2) "ability to pay" could not be considered as a special circumstance.

105. However, the HMRC penalty assessment, the review letter and the Statement of Case do not refer to special circumstances. That question was first considered by Mrs Levy at the hearing.

106. Several previous tribunals have already considered how the special circumstances provisions apply when HMRC have either not considered para 9 at all, or have considered it only after issuing the penalty. We discuss these earlier decisions at §130ff, but first we analyse the legislation.

The special reduction provision: Sch 56, para 9

107. Sch 56, para 9(1) says that "If HMRC think it right because of special circumstances, they may reduce a penalty under any paragraph of this Schedule." Para 9(3) reads:

> "In sub-paragraph (1) the reference to reducing a penalty includes a reference to –

(a) staying a penalty, and

(b) agreeing a compromise in relation to proceedings for a penalty."

108. The use of the word "may" in para 9(1) shows that HMRC have been given a discretion. It can be used to reduce a penalty, to delay the effect of a penalty by staying it, or to settle tribunal or court proceedings in relation to a penalty.

109. Para 9 does not stipulate that HMRC must exercise this discretion at any specific time. In particular, it does not require HMRC to consider special circumstances (a) before issuing a penalty assessment; (b) before providing the conclusions of a statutory review under Taxes Management Act 1970 s 49B or s 49C ("a review decision"), or (c) before the notification of an appeal to the tribunal.

110. Instead, the provision points clearly in the opposite direction. Para 9(3)(b) says that the reference in para 9(1) to reducing a penalty "includes a reference to…agreeing a compromise in relation to proceedings for a penalty." HMRC can therefore exercise their discretion at the time they settle a case which is under appeal to the tribunal, i.e., when there are "proceedings for a penalty." Furthermore, since compromises can be made to settle appeal proceedings even after a tribunal hearing has begun, it seems to us that para 9(3)(b) allows HMRC to exercise their discretion at any point up to the conclusion of the hearing.

111. In all three references in para 9 to the use of the discretion, it operates to reduce "a penalty." In other words, "a penalty" first exists and is then reduced, stayed or compromised. Although not relevant to this appeal, we think it would also be possible for HMRC to use their general care and management powers to reduce a penalty under para 9 before assessment. If HMRC were aware of special circumstances, it would be unnecessarily legalistic for them to have to assess the penalty and then immediately reduce it.[4] But the statutory position is that the para 9 discretion allows HMRC to reduce a penalty after it has been assessed.

112. Having considered para 9 in isolation, we next discuss how it fits with the tribunal's jurisdiction over appeals.

Appeals and the tribunal's jurisdiction

113. If a person is liable for a penalty, para 11(1) requires HMRC to assess that penalty and notify the person. Para 13(2) allows the person to appeal "against a decision of HMRC as to the amount of a penalty payable by P." That "amount" is the figure shown in the penalty assessment, which may have be amended as the result of a statutory review.

114. Para 15(2) says that "on an appeal under paragraph 13(2) that is notified to the tribunal, the tribunal may (a) affirm HMRC's decision, or (b) substitute for HMRC's decision another decision that HMRC had power to make."

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[4] See for example *Sam Smith t/a Heliops UK v HMRC* [2015] UKFTT 0024 at [20] which says that HMRC sent the taxpayer "a penalty explanation" telling him about the VAT penalty they intended to charge and how they had calculated it.

115. Reading para 13(2) together with para 15(2), the tribunal can either (a) affirm HMRC's decision as to the amount of a penalty payable by P or (b) substitute HMRC's decision as to the amount of the penalty with another decision which HMRC could have made. In both (a) and (b) the "decision as to the amount of the penalty" is the decision appealed to the tribunal, i.e., the original penalty assessment, unless amended as a result of a statutory review.

116. Para 15(3) says that if the tribunal substitutes its decision for HMRC's decision as to the amount of the penalty, the tribunal may rely on para 9 to a different extent from HMRC "only if the tribunal thinks that HMRC's decision in respect of the application of paragraph 9 was flawed." Para 15(4) says that "flawed" means "flawed when considered in the light of the principles applicable in proceedings for judicial review."

117. We found para 15(3) difficult. If "HMRC's decision" means "HMRC's decision as to the amount of the penalty" then. as we have seen, it refers back to the original assessment, unless amended as the result of the statutory review. That meaning would be the same as its usage in paras 15(1) and (2), and this consistency has an obvious attraction. However, it causes difficulties when more fully explored.

118. First, it limits the tribunal to considering how HMRC exercised the para 9 discretion at the time they made the penalty assessment or review decision. That cannot be reconciled with para 9(3)(b), which explicitly allows the discretion to be exercised by "agreeing a compromise in relation to proceedings for a penalty." In other words, Parliament has explicitly provided that para 9 can be used to settle proceedings *after* the appeal has been notified to the tribunal, i.e., after the assessment or review decision.

119. Second, where there is no statutory review, the decision appealed to the tribunal is the original penalty assessment. However, para 9 operates after the penalty has been assessed, see §111. As a result, HMRC will never have exercised their para 9 discretion in relation to the assessment, unless they have done so using their care and management powers. Given that appealing penalties directly to the tribunal is commonplace, Parliament is unlikely to have granted a discretion which is so fettered, without at least including any reference to that limitation in para 9.

120. Third, if HMRC do consider special circumstances at the time of the statutory review, the result is less extreme because the penalty has by then been issued and HMRC have had an opportunity to reduce it under para 9. But the discretion is still fettered: if HMRC fail to consider special circumstances at this point, they have no later opportunity. Yet again there is no indication in para 9 that Parliament intended to limit HMRC's discretion in this way. Instead, the contrary is the case: para 9 does not contain any restrictions as to the time when the discretion can be exercised.

121. We prefer an alternative reading of para 15(3), which we find wholly consistent with the broad discretion given by para 9. We read "HMRC's decision" in the sentence "HMRC's decision in respect of the application of paragraph 9 was flawed" as meaning *HMRC's decision about the application of para 9* and not HMRC's

decision as to the amount of the penalty. In other words, we think that the statute envisages two decisions, one “as to the amount of penalty payable by P” and a second decision “in respect of the application of para 9.”

122. Reading para 15(3) in this way allows HMRC to exercise the para 9 discretion at any time before the tribunal makes its decision. This is in accordance with the discretion granted by Parliament under para 9, allowing HMRC to “reduce a penalty” including staying a penalty, without limit as to time, and agreeing a compromise in relation to proceedings for a penalty. HMRC can therefore consider special circumstances at the time of the statutory review, when drafting the statement of case, or during the tribunal proceedings.

123. For example, if HMRC consider special circumstances at the time of the Statement of Case, and decide there are no special circumstances, HMRC’s decision as to the amount of the penalty is unchanged: it is the figure on the original penalty assessment, or in the review decision. When the tribunal decides the appeal, it can substitute HMRC’s decision about the amount of the penalty with another sum, but in making that substitute decision the tribunal can only take special circumstances into account if the decision made by HMRC when preparing the Statement of Case was flawed.

124. We also think that our reading of para 15(3) is linguistically correct, because words which follow a noun usually qualify that noun. In the phrase “if the tribunal thinks that HMRC's decision *in respect of the application of paragraph 9* was flawed,” the words in italics qualify “decision,” they do not qualify “flawed.” In other words, para 15(3) does not mean “HMRC’s decision about the penalty assessment was flawed because of the way HMRC applied paragraph 9 when making that assessment.”

125. We recognise that other tribunals have read Sch 56 differently, holding that HMRC is required to consider special circumstances before making the penalty assessment, or before making a review decision, and that a failure to do so flaws its decision as to the amount of the penalty, allowing the tribunal to make its own special circumstances decision. We consider their arguments in more detail at §130ff below.

No special circumstances decision

126. If HMRC have failed to consider para 9 at all, so that they make no decision on special circumstances, they have failed to exercise their discretion. Although para 6(3)(b) gives the tribunal the jurisdiction to make a new decision on special circumstances only if “HMRC’s decision in respect of the application of paragraph 9” was flawed, it seems to us that the tribunal must also have jurisdiction to make a decision where HMRC have failed to exercise their discretion, so that they have made no decision about the application of para 9.

127. Certainly, such a failure would be challengeable under the normal principles of judicial review, see for example the recent case of *R (Thapa) v SSHD* [2014] EWHC 659 (Admin), where the judge (Ms Mountfield QC) said at [48] that there was “nothing which indicates that the Defendant's officer was even aware that she was

exercising a discretion" and she could not therefore have exercised it "properly and fairly."

Powers of a tribunal following a special circumstances decision

128. If HMRC have made a special circumstances decision, then para 15(4) provides that the tribunal must assess it in the light of the principles applicable during judicial review proceedings. These were helpfully set out in *Collis v HMRC* [2011] UKFTT 588(TC) (Judge Berner and Mr Adams):

> "[36] … Judicial review may be pursued in relation to decisions of public bodies on a number of grounds. Included amongst these are the grounds of illegality and fairness. In the context of a decision of HMRC as to whether a reduction in a penalty should be made on account of special circumstances, the general test will be whether the decision is so demonstrably unreasonable as to be irrational or perverse, such that no reasonable authority could ever have come to it (*Associated Provincial Picture Houses Ltd v Wednesbury Corporation* [1948] 1 KB 223, HL).
>
> [37] …The tribunal should also consider whether HMRC have erred on a point of law (see *Customs & Excise Commissioners v J H Corbitt (Numismatists) Ltd* [1980] STC 231; *John Dee Ltd v Customs & Excise Commissioners* [1995] STC 941). This will also include considering whether any internal HMRC policy on the application of the special circumstances rule is being applied too rigidly so as to amount to a fetter on HMRC's discretion."

129. At §151 below we apply our analysis to the facts of this case. First, however, we consider how other tribunals have approached these special circumstances provisions.

Agar and Algarve Granite

130. In *Agar*, the tribunal considered and rejected the appellant's submission that HMRC had to consider special circumstances before issuing a penalty notice. At [30] they say:

> "There is nothing in the existence of this 'power to reduce' which is…fundamental to the arisal of the penalty in the first place. Indeed, the use of the phrase 'they may reduce a penalty' implies that a perfectly valid penalty may exist before the question of reducing it, by reason of 'special circumstances', arises."

131. In other words, special circumstances do not have to be taken into account before the penalty is issued. We agree, see §122 above.

132. In *Algarve Granite v HMRC* [2012] UKFTT 463 (TC) ("*Algarve*") the tribunal (Judge Brannan and Mr Howard) say at [51]:

> "…when Parliament confers a discretion on a statutory body, such as HMRC, that statutory body must consider whether it is appropriate to exercise that discretion. It cannot fail to take account of its discretion

> eg by applying over-rigid policies or by simply ignoring the fact that it has a discretion."

133. We agree, see §126.

134. However, that tribunal also decided that HMRC was required to consider special circumstances before issuing the penalty, and that a failure to do so meant that the penalty decision was flawed. In coming to this conclusion, they relied on the position of para 9 in the Schedule: they say that there is "a logical sequence to these provisions" so that para 9 comes immediately after the calculation provisions at paras 5-8 and is itself followed by the assessment procedures at paras 10 and 11, see [53] of their judgment.

135. With respect, we think this places too much weight on the location of para 9 within Sch 56. Although we agree that there is a natural progression, from liability through assessment to appeal, that structure does not override the words of para 9 itself. Furthermore, if the paragraph numbering dictated the ordering of actions, then para 16 (which deals with reasonable excuse) would precede the paragraphs dealing with appeals. Instead, the reverse is the case: the reasonable excuse provision follows the appeal provisions, which are at paras 13-15. We find that the placing of a provision within the Schedule does not govern the order in which matters must be considered.

136. At §111 we said that our analysis on this point was supported by the fact that para 9(1) says "if HMRC think it right because of special circumstances, they may *reduce a penalty*" and from that, together with the references to staying *a penalty* and compromising proceedings for *a penalty*, we found that the penalty assessment precedes the "special circumstances" decision. The tribunal in *Algarve* took a different view:

> "the fact that para 9 states that HMRC 'may reduce a penalty' does not, in our view, imply that a valid penalty may exist without HMRC considering whether a reduction on account of 'special circumstances' should be made. In our view, these words refer to the calculation of the penalty to which the taxpayer would otherwise be liable – absent 'special circumstances' – pursuant to the provisions of the immediately preceding paras 6-8."

137. We respectfully disagree: in our judgment the wording of the paragraph is plain. The paragraph does not say "if HMRC think it right because of special circumstances, they may reduce *the calculation of a penalty to which the taxpayer would otherwise be liable*" but simply "they may reduce *a penalty*." And, as we have already said, if the discretion could only be exercised before assessment, HMRC would be unable to use para 9 to stay a penalty, or compromise a penalty, so those paragraphs would be otiose. Finally, "compromising proceedings for a penalty" clearly refers to HMRC's exercise of the para 9 discretion after an appeal has been lodged with the tribunal: in other words, it operates at the end of the penalty process rather than at the beginning.

138. At [50] of their decision, the tribunal in *Algarve* gave a further reason for their conclusion that HMRC must consider special circumstances before issuing the penalty assessment, saying:

> "In quantifying the penalty HMRC must apply the mandatory quantification provisions of paras 5 and 6 of Sch 56 but in order to reach a final quantification of the penalty, for the purposes of the penalty assessment notification, HMRC must also consider whether a reduction under para 9 of special circumstances should be made. Whether to make a reduction in the penalty because of special circumstances goes directly to the quantum of the penalty which is then assessed."

139. Although the special circumstances decision can only take effect by reducing (or not reducing) a penalty, there is, as we have already said no requirement that consideration of special circumstances precede assessment. Para 9 is not fettered in that way. It is not only perfectly possible, but in our analysis more consistent with para 9(1), para 9(3) and para 15(3), for there to be two decisions, the first to assess the penalty and the second to decide whether there are special circumstances.

Morgan & Donaldson

140. In *Morgan & Donaldson* [2013] UKFTT 317 (Judge Mosedale and Mr Thomas) ("*Morgan & Donaldson*")[5] the tribunal noted at [114] that HMRC automate the issuance of penalty assessments, and so never consider special circumstances before a penalty is issued.

141. At [115] the tribunal discussed this automation of penalty assessments in the context of the *Algarve* approach, namely that special circumstances must be considered before assessment. They said:

> "By limiting the Tribunal's ability to consider special circumstances only to those decisions of HMRC which are flawed, it was clearly not Parliament's intent that *all* decisions should be seen as flawed. And therefore the legislation should not be interpreted as meaning all penalty decisions are flawed simply because the assessments are issued automatically, when, as we have said, automation must have been intended as there is no requirement for an individual officer to issue the assessment to a penalty, in contrast to other assessments."

142. We agree that "it was clearly not Parliament's intent that *all* decisions should be seen as flawed." On our reading, the legislation does not require HMRC to consider special circumstances before assessing a penalty. Assuming we are right, the practical problems arising from automatic penalty assessment referred to in this paragraph disappear.

143. The *Morgan & Donaldson* tribunal continues at [117]:

[5] Mr Donaldson's case was appealed to the Upper Tribunal as *Donaldson v HMRC* [2014] UKUT 536(TCC) but the "special circumstances" provisions were not considered on appeal, see [2] and [3] of the Upper Tribunal decision.

> "…if special circumstances are not considered until the hearing, then that is too late because it is clear that Parliament intended special circumstances to be considered by HMRC before the taxpayer lodged an appeal with the Tribunal."

144. Unfortunately, the tribunal does not develop this point, so we do not know why they thought Parliament intended that special circumstances should be considered before an appeal is notified to the tribunal. As already explained, we take a different view: the reference in para 9(3)(c) to "agreeing a compromise in relation to proceedings for a penalty" demonstrates that Parliament intended HMRC to be able to decide on special circumstances after the appeal has been notified to the Tribunal.

Other tribunal decisions

145. We considered a number of other cases which considered these special circumstances provisions, or the similar paragraphs in other penalty statutes. In *Hardy v HMRC* [2011] UKFTT 592 (TC) and *Rodney Warren & Co v HMRC* [2012] UKFTT 57 (TC) HMRC never considered the special circumstances provisions, so the tribunals found that the decision was "flawed." We agree with that approach, see §126. In *Roche v HMRC* [2012] UKFTT 333 (TC) and *Collis v HMRC* [2011] UKFTT 588 (TC) HMRC made decisions on special circumstances, but the tribunals considered that these were flawed on judicial review grounds: again, we concur with that approach, see §128.

146. In *Pendle v HMRC* [2015] UKFTT 0027 at [111] Judge Redston followed the analysis in *Morgan & Donaldson.* Her understanding of the statutory provisions has now changed and is as set out in this decision. However, had the new analysis been applied in *Pendle*, the outcome in that case would have remained the same: there would still have been no reduction of the penalty for special circumstances.

147. In *White v HMRC* [2012] UKFTT 364 (TC) (Judge Brannan and Mr Williams) ("*White*") the review officer had considered special circumstances. However, the tribunal said that this "*ex post facto* consideration" of special circumstances did not prevent the original penalty assessment from being flawed, see [66] of that judgment. As already explained, we disagree. In our analysis, a decision on whether or not there are special circumstances is separate from the penalty decision and can be made at any stage up to the conclusion of the tribunal hearing.

148. However, the tribunal in *White* went on to say at [67] that if they were wrong in this, the decision was flawed because of an absence of reasons. The decision continues:

> "[68] It is true that the common law, 'at present', does not recognise a general duty to give reasons for administrative decisions (*R v Home Secretary ex p. Doody* [1994] 1 AC 531 per Lord Mustill at page 564). However, in many cases if a public body, such as HMRC, fails to give reasons for its decision it will be found to have acted unlawfully. As explained in 'Administrative Law' (10th edition) Wade & Forsyth, there is no closed list of circumstances in which fairness will require reasons to be given.

> [69] In this case, [the relevant statutory provision] envisages this Tribunal having to decide whether HMRC's decision is flawed, in the judicial review sense of that term. A failure to give reasons for a decision makes this task almost impossible. It would not then be possible to determine whether the decision-maker applied the correct legal test, whether he took account of all relevant factors or whether he took account of irrelevant factors. In short, a failure to give reasons makes it almost impossible for the Tribunal to determine the issue of *Wednesbury* unreasonableness. Parliament must have envisaged that an officer of HMRC deciding whether to exercise the discretion in paragraph 11 would give reasons for the decision."

149. We respectfully agree that a decision of HMRC in relation to special circumstances requires reasons: otherwise the tribunal cannot know whether the decision was flawed, and so cannot fulfil its obligations under para 15(3)(b).

150. The reasons do not need to be lengthy. Lord Brown's summary of the correct approach in *South Bucks DC v Porter* [2004] 1 WLR 1953 at [36] is accepted as authoritative and includes the following guidance:

> "The reasons for a decision must be intelligible and they must be adequate. They must enable the reader to understand why the matter was decided as it was and what conclusions were reached on the 'principal important controversial issues', disclosing how any issue of law or fact was resolved. Reasons can be briefly stated, the degree of particularity required depending entirely on the nature of the issues falling for decision. The reasoning must not give rise to a substantial doubt as to whether the decision-maker erred in law, for example by misunderstanding some relevant policy or some other important matter or by failing to reach a rational decision on relevant grounds. But such adverse inferences will not readily be drawn. The reasons need refer only to the main issues in the dispute, not to every material consideration…"

Application to this case

151. What is the position where, as here, it is HMRC's presenting officer who has made the special circumstances decision? We know from our own experience that presenting officers can and do make concessions during the hearing: for instance, to reduce the amount under appeal or even to withdraw assessments entirely. Presenting officers are not only advocates, but representatives who have authority to make compromises and settlements on HMRC's behalf. We see no reason why a presenting officer should be unable to exercise the discretion contained in para 9. Indeed, that she should be able to do so is entirely consistent with the reference in para 9(3)(b) to the special circumstances discretion including "agreeing a compromise in relation to proceedings for a penalty."

152. We therefore find that Mrs Levy was exercising the discretion given to HMRC under para 9, and that there was no failure by HMRC to consider the exercise of that discretion.

153. Where it is the presenting officer who makes the decision, she must give her reasons orally to the tribunal, as Mrs Levy has done. Our task is therefore to consider whether her decision was "flawed" according to the principles of judicial review. As we have already recorded, she reviewed each of Mr Roach's submissions to see if, while not constituting a reasonable excuse, one or more might fall within the special circumstances provision, but found that none did. She also considered the other material available to her, but again, found nothing that caused her to reduce the penalty under appeal.

154. It cannot be unreasonable for HMRC to find that the company's financial and economic difficulties were not "exceptional" or "abnormal": they resulted from a general recession affecting many businesses. It is also entirely reasonable to conclude that retentions are a normal part of the company's business. There is also no basis on which we can interfere with her decision that neither the departure of the financial controller nor the communications between the company and HMRC were exceptional or unusual.

155. There were no other matters which we considered should have been taken into account, and no matters taken into account which should have been omitted from consideration. The lack of ability to pay is, as Mrs Levy said, precluded by statute from coming within the special circumstances provisions. There was no error of law in her approach.

156. As a result, HMRC's decision in respect of the application of the special circumstances provision in para 9 was not flawed.

157. In view of the different interpretations of the scope of HMRC's discretion, see §130ff, we confirm that, had the tribunal exercised its own discretion under para 9, we would also have concluded that there were no special circumstances.

Proportionality

The parties' submissions

158. Mr Roach submitted that the penalty was disproportionate, because:

(1) it does not take into account that the maximum delay in payment was only 19 days;

(2) it does not take into account that the company made losses in nine months of the tax year; and

(3) the overall quantum is too high.

159. HMRC's Statement of Case said that "the tribunal jurisdiction does not extend to proportionality." Mrs Levy wisely withdrew from that submission, and relied instead on *Total Technology (Engineering) v HMRC* [2012] UKUT 418 (TC) ("*Total Technology*") (Warren J and Judge Bishopp), where the Upper Tribunal decided at [100] that:

> "there is nothing in the VAT default surcharge which leads us to the conclusion that its architecture is fatally flawed. There are, however,

> some aspects of it which may lead to the conclusion that, on the facts of a particular case, the penalty is disproportionate. But in assessing whether the penalty in any particular case is disproportionate, the tribunal must be astute not to substitute its own view of what is fair for the penalty which Parliament has imposed."

160. Mrs Levy said that there was nothing in the architecture of the PAYE in-month penalty rules to suggest that they were "fatally flawed." On the contrary, the penalty was proportionate to the amount of earnings paid in the month, and to the number of months in default. The facts of the company's case were not such as to mean that the penalty was so extreme as to be disproportionate.

The law

161. The concept of proportionality forms part of European Union law, and is also a fundamental principle of the Convention. Some taxes, such as VAT, engage both EU law and the Convention. This is a direct tax case and does not engage EU law, so we consider only the Convention.

162. A1P1 reads as follows:

> "Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.
>
> The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."

163. Both "natural and legal persons" are encompassed within A1P1, so there is no issue about whether it extends to companies. A penalty is an interference with a person's rights under the first paragraph of A1P1, because it deprives him of possessions. However, the second paragraph of A1P1 provides that the right to peaceful enjoyment of possessions does not prevent the levying of "taxes or other contributions or penalties."

164. Nevertheless, the State must not act disproportionately. The Supreme Court recently considered A1P1 and proportionality in *R v Waya* [2012] UKSC 51, in the context of whether a confiscation order made following Mr Waya's false declaration for mortgage purposes was compatible with A1P1. The facts are obviously different to the present case but the principles considered by the Court are essentially the same.

165. The judgment in *Waya* was given by Lord Walker and Hughes LJ. At [12] they said:

> "It is clear law, and was common ground between the parties, that [A1P1] imports, via the rule of fair balance, the requirement that there must be a reasonable relationship of proportionality between the means employed by the state in, *inter alia*, the deprivation of property as a form of penalty, and the legitimate aim which is sought to be realised

> by the deprivation. That rule has consistently been stated by the European Court of Human Rights."

166. They then cited *Jahn v Germany* (2006) 42 EHRR 1084 at [93], describing it as setting out a principle "gathered from established Strasbourg jurisprudence in terms often repeated and generally applied":

> "The court reiterates that an interference with the peaceful enjoyment of possessions must strike a 'fair balance' between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights: see, among other authorities, *Sporrong and Lönnroth v Sweden* (1982) EHRR 35, para 69. The concern to achieve this balance is reflected in the structure of article 1 of Protocol No 1 as a whole, including therefore the second sentence, which is to be read in the light of the general principle enunciated in the first sentence. In particular, there must be a reasonable relationship of proportionality between the means employed and the aim sought to be realised by any measure depriving a person of his possessions: see *Pressos Cia Naviera SA v Belgium* (1995) 21 EHRR 301, para 38.
>
> In determining whether this requirement is met, the court recognises that the state enjoys a wide margin of appreciation with regard both to choosing the means of enforcement and to ascertaining whether the consequences of enforcement are justified in the general interest for the purpose of achieving the object of the law in question: see *Chassagnou v France* (1999) 29 EHRR 615, para 75."

167. It is a settled principle of ECHR case law that in matters of general social and economic policy, on which opinions within a democratic society may reasonably differ widely, the domestic policy-maker should be afforded a particularly broad margin of appreciation, see *Stec v UK* [2006] 20 BHRC 348 at [52]. It is also well established that states are afforded additional deference and latitude in the exercise of their fiscal functions, see *National & Provincial Building Society v UK* [1997] STC 1466 at [75] to [83] and *Yukos* at [559].

168. As we have already seen at §59, HRA s 1 gives effect to Convention rights, and HRA s 2 requires UK courts and tribunals to "take into account" ECHR judgments.

169. In *Bank Mellat v HM Treasury (No 2)* [2013] UKSC 39 ("*Bank Mellat*") the Supreme Court recently considered the principle of proportionality in the context of Convention rights. The issue in *Bank Mellat* was whether a direction issued by the Treasury under powers given by a statutory instrument was proportionate. Although there was no consensus on whether the Bank's appeal should be allowed – Lord Sumption gave the leading judgment, with which Lady Hale, Lord Kerr and Lord Clarke agreed in whole, but from which Lords Reed and Hope dissented and Lords Neuberger, Dyson and Carnwarth agreed with the majority only in part – there was agreement on Lord Reed's formulation of the concept of proportionality, see Lord Sumption at [20].

170. At [70] Lord Reed said:

> "One important factor in relation to the Convention is that the Strasbourg court recognises that it may be less well placed than a national court to decide whether an appropriate balance has been struck in the particular national context. For that reason, in the Convention case law the principle of proportionality is indissolubly linked to the concept of the margin of appreciation. That concept does not apply in the same way at the national level, where the degree of restraint practised by courts in applying the principle of proportionality, and the extent to which they will respect the judgment of the primary decision maker, will depend upon the context, and will in part reflect national traditions and institutional culture. For these reasons, the approach adopted to proportionality at the national level cannot simply mirror that of the Strasbourg court."

171. He went on to say that:

> "The approach to proportionality adopted in our domestic case law under the Human Rights Act has not generally mirrored that of the Strasbourg court. In accordance with the analytical approach to legal reasoning characteristic of the common law, a more clearly structured approach has generally been adopted."

172. At [74] he echoes the summary of the approach set out by Lord Sumption at [20], who said that it requires:

> "an exacting analysis of the factual case advanced in defence of the measure, in order to determine:
>
> (i) whether its objective is sufficiently important to justify the limitation of a fundamental right;
>
> (ii) whether it is rationally connected to the objective;
>
> (iii) whether a less intrusive measure could have been used; and
>
> (iv) whether, having regard to these matters and to the severity of the consequences, a fair balance has been struck between the rights of the individual and the interests of the community."

173. At [20] Lord Sumption said that "these four requirements are logically separate, but in practice they inevitably overlap because the same facts are likely to be relevant to more than one of them." We respectfully agree: in particular, it seems to us that points (i) and (ii) are linked, as are (iii) and (iv).

174. The third criterion – whether a less intrusive measure could be used – is sometimes referred to as the "least restrictive means" test or the "least intrusive means" test. In that context, Lord Reed at [75] endorsed Dickson CJ's dictum in the Canadian case of *R v Edwards Books and Art Ltd* [1986] 2 SCR 713 at pages 781-782 that the court is "not called upon to substitute judicial opinions for legislative ones as to the place at which to draw a precise line." He also cited with approval the words of Blackmun J, in the US case of *Illinois Elections Bd v Socialist Workers Party* (1979) 440 US 173 ("*Illinois Elections*") at 188-189:

> "a judge would be unimaginative indeed if he could not come up with something a little less drastic or a little less restrictive in almost any situation, and thereby enable himself to vote to strike legislation down."

175. In *R (Sinclair Collis) v Secretary of State for Health* [2011] EWCA Civ 437 ("*Sinclair Collis*") the Court of Appeal considered the proportionality of primary legislation, being section 3A of the Children and Young Persons (Protection from Tobacco) Act 1991, as well as of the regulations made under that provision. It assessed proportionality by considering EU law, but held that in the context of the particular EU provisions in issue, the identity and weight of the relevant factors were "sufficiently similar" to those requiring consideration under the second paragraph of A1P1, so that separate review was not needed, see [54] [147] and [192]-[194]. *Sinclair Collis* is therefore significant in the context of both EU law and A1P1.

176. The proportionality challenge in *Sinclair Collis* was to primary as well as secondary legislation, in contrast to *Bank Mellat*, where the Supreme Court considered the proportionality of a direction given by the Treasury under the delegated powers of a statutory instrument.

177. In relation to the "least restrictive means" test, Lord Neuberger said at [204] of *Sinclair Collis*:

> "…that factor should not be applied by a court in such a way as to usurp the role of the primary decision-maker. So, where there is an alternative possible measure, there may be a difference of view as to which measure would be less onerous, and, unless the view of the Member State's government that its measure is the more appropriate is manifestly wrong, the court should not substitute its own view for that of the government. This is, I think, what the Court of Justice had in mind, when it said in *National Federation of Fishermen* [1995] ECR I-3115, para 59, that a measure could not be challenged as disproportionate 'merely because other kinds of measures could have been adopted, since the selection of measures to be taken is a political decision falling within the purview of the Member State concerned, within the limits set by Decision 92/593'."

178. In the same case, Arden LJ said that when considering primary legislation, the "least intrusive means" test either did not apply at all, or applied at a lower level of intensity, so that the proper test was that the law would only be disproportionate if "manifestly inappropriate," see [137] and [151]-[155].

179. In *Kennedy v Charity Commission* [2014] UKSC 20 at [54], Lord Mance, giving the leading judgment with which Lords Neuberger and Clarke agreed[6], endorsed these *dicta* of Lord Neuberger and Arden LJ, saying that the "proportionality review may itself be limited in context to examining whether the exercise of a power involved some manifest error or a clear excess of the bounds of discretion."

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[6] Lord Toulson and Lord Sumption agreed with Lord Mance's conclusions, see [150] and [152], Lord Wilson and Lord Carnwarth dissented, see in particular [246]-[247].

180. In the recent case of *Gibraltar Betting & Gaming Association Ltd v Secretary of State for Culture, Media & Sport* [2014] EWHC 3236 (Admin) ("*Gibraltar Betting*"), Green J first considered the case law, including *Sinclair Collis,* and then summarised the position:

> "All of the case law underscores the point that an Act of Parliament is at the apex of the exercise of the democratic decision making process. A court should only interfere with the [the Act in question] if there are fundamental errors or where the policy choices adopted are wholly unsupported by evidence or unconnected with any lawful policy objective and cannot on any logical or sensible basis be said to be consistent with the various limbs of the proportionality test."

Application to the Sch 56 penalty regime.

181. The Sch 56 PAYE late payment penalty regime is part of a tax statute. If this appeal were being heard before the ECHR, it would be subject to the higher margin of appreciation given to fiscal measures. As the appeal is being heard in a UK tribunal, we have considered proportionality by using the four criteria set out by Lords Sumption and Reed in *Bank Mellat*, taking into account ECHR case law.

182. The first criterion is whether the objective "is sufficiently important to justify the limitation of a fundamental right." BN90, the Budget Press release included in HMRC's Bundle, refers to the consultations which preceded the introduction of the Sch 56 penalty provisions. These included "*Meeting the Obligations to File Returns and Pay Tax on Time: Consultation Responses and Refined Models*" published in June 2008 ("the Consultation").

183. The Consultation set out a number of objectives for reforming the penalty provisions so that people pay their taxes on time, and said that:

(1) It is crucial to the effective operation of Government and the management of public finances that there is a regular and predictable flow of funds to the Exchequer (para 2.13).

(2) Around 60% of small and medium employers pay their PAYE on time. This contrasts with of larger employers, whose compliance has increased to over 90% since the introduction of surcharges (para 8.23 and page 54).

(3) Employers who delay payment of PAYE are putting their employees at risk of not receiving their appropriate benefits and entitlements and receiving a significant commercial advantage over employers who pay on time (para 8.23).

184. The Consultation was preceded by the 49th Report of the Public Accounts Committee ("PAC") during the 2002-03 parliamentary session, entitled "*The Recovery of Debt by the Inland Revenue.*" At [21] of the Report the PAC recorded:

> "Between 1999-2000 and 2002-03 the Department wrote off £789 million in National Insurance contributions debt, mainly owed by businesses that had become insolvent. Although the employer's debt is written off, the individual employee's contributions are deemed to be paid so the write-off does not reduce their entitlement to related welfare benefits."

185. From the Consultation and the Report we find that the purpose of the PAYE in-month penalty provisions is to improve the timely collection of PAYE and NICs, so as to (a) provide a predictable flow of funds to the Exchequer; (b) as to reduce the risk that the PAYE will not be collected at all (for instance, because of insolvency) and so (c) to help to protect the welfare benefits of employees.

186. There is no doubt that these purposes meet the first criterion in *Bank Mellat*: the objective is sufficiently important to justify interference with the employer's A1P1 rights. The second criterion is that the penalties be rationally connected to that objective. The necessary linkage is demonstrated by the increased PAYE compliance of larger employers after the introduction of late payment surcharges.

187. We next consider the fourth criterion, before returning to the third. The fourth criterion is whether the infringement of the company's rights is disproportionate to the likely benefit accruing to the state. The following elements of the design of the Sch 56 PAYE in-month penalty regime indicate proportionality[7]:

(1) No penalty at all is charged if the employer is late in one month of the tax year, so a single error is not penalised at all.

(2) The penalty percentage increases with the number of defaults. This also makes the penalty proportionate to the seriousness of the failure, given that two late payments are less serious than ten late payments.

(3) The percentage is directly related to the amount of PAYE unpaid, and so proportionate to the money not remitted to HMRC by the due date. This could also be regarded as a rough proxy for the size of the business, in that a micro-enterprise will have a lower PAYE bill than a larger company.

(4) The penalty can be reduced, or even eliminated entirely, if there are special circumstances and/or a reasonable excuse; the latter provisions can be applied to each "failure to make a payment", see Sch 56 para 16(1). Taken together, reasonable excuse and special circumstances allow the scheme to accommodate the particular exculpatory facts of each case.

188. There are, however, a number of areas where the scheme could be said to be disproportionate:

(1) The penalties do not correlate with the company's profitability, so that it is possible for a business to have a large payroll but make a loss for the tax year in question or for part of that year. But the tax which is being paid late is PAYE, so it is the prompt payment of those funds which are being denied to the Exchequer. It is therefore proportionate for the penalty to be linked to that amount, rather than to the overall profitability of the business.

(2) The penalty does not change if the PAYE is paid one day late, or after the end of the tax year. However, adding this further complexity would make the system even more complicated. And, as the Upper Tribunal said at [88] of

[7] In making these findings we gratefully acknowledge the similar analysis carried out by the Upper Tribunal in *Total Technology*

Total Technology when they considered similar concerns in relation to the VAT default surcharge:

> "This, as we see it, is a reflection of the aim of the legislation which, as we have explained, is to ensure compliance with the obligation to file and pay by the due date. The issue is not, in our view, whether the absence of a different treatment depending on the extent of the delay in filing the return undermines the system; the issue is whether the amount of the penalty is proportionate to the breach of duty in being a single day late."

(3) The Sch 56 provisions do not distinguish between deliberate withholding of money, lack of care, and accidental error. But to include all these factors would amount to a bespoke penalty system, which would be significantly more complex to administer. Again, we respectfully agree with the Upper Tribunal at [86] of *Total Technology:*

> "Although it might be possible to identify cases at either end of the spectrum, and although it would be possible to design a system which imposed penalties according to some scale of culpability, placing a particular case in a scale of culpability would…require a judgment to be made in each case, placing a huge and disproportionate (to use the word again) burden on HMRC and no doubt leading to a multitude of appeals. Accordingly, viewing the regime as a whole, the principle of proportionality is not breached."

(4) Penalty notices were not issued during the year, but only afterwards. We find this to be a consequence of the design of the system. Unlike VAT default surcharges, where the higher percentages (2%, 5%, 10%, 15%) apply to the second and subsequent late payments, in the case of Sch 56 penalties, the higher rate is applied to all late PAYE for 10 months of the tax year. It is therefore not possible to know, for example, at the end of month 2, whether the penalty will be 1% of the late paid PAYE for that month (the rate applied if there are no further defaults) or 4% (the rate applied if months 3-11 are also paid late). Although HMRC could send out penalty notices in-year, the amount assessed would not be final until after the end of the year. The amended scheme, introduced by FA 2013 and due to take effect from April 2015, takes a different approach, being based on the PAYE paid late each month rather than on the cumulative late paid PAYE over the year, see §14. The new provisions will allow final penalty notices to be sent out in-year rather than waiting until the year end.

189. We considered the FA 2013 amendments in the context of the third *Bank Mellat* criterion: in other words, do they demonstrate that "a less intrusive measure could have been used."

190. We began by asking whether the new provisions result in a lower maximum penalty. The answer is generally yes: 4% of the total PAYE paid late for 10 months is usually more than charging 11 late monthly amount at an increasing percentage. However, this is not invariably the position: there may be employers where large

bonuses are paid in April, so the PAYE for that month would be significantly higher than that for other months. Under the original provisions, the 4% penalty was not applied to the April late payment.

191. Even though the reformulated provisions will normally give rise to a lower tax bill than the paragraphs they replace, and so are "less intrusive," Sch 56 is primary legislation, only to be interfered with by a court or tribunal if "manifestly wrong" or "manifestly inappropriate," i.e., where "there are fundamental errors or where the policy choices are wholly unsupported by evidence or unconnected with any lawful policy objective…" see *Sinclair Collis* and *Gibraltar Betting.* Adjusting the Sch 56 provisions so as to remove cumulation does not come close to that threshold.

192. We have already considered at §188 whether any other elements in the penalty provisions might make them disproportionate. We did not find anything, let alone some factor which would make them "manifestly wrong." To borrow the words of the Upper Tribunal in *Total Technology,* "there is nothing in the [regime] which leads us to the conclusion that its architecture is fatally flawed." While we could doubtless "come up with something a little less drastic or a little less restrictive," as Blackmun J said in *Illinois Elections*, in the absence of some manifest error, it is not for us to replace one statutory framework with another.

193. We therefore find that the Sch 56 PAYE in-month penalty regime is not disproportionate.

The company's case.

194. Notwithstanding that conclusion, we must also consider the company's particular facts. Lord Sumption said in *Bank Mellat* at [26] that "every case turns on its own facts, and analogies with other decided cases can be misleading." The Upper Tribunal in *Total Technology* stated that "it remains necessary that the resulting penalty in a particular case is proportionate to the gravity of the infringement," see [77]-[78] of that judgment.

195. As we have seen, Mr Roach submits that the penalty levied on the company is disproportionate because (a) the maximum delay was only 19 days, (b) the company made losses in nine months of the tax year, and (c) the overall quantum is too high.

196. His first two submissions are a consequence of the architecture of the regime, which we have already considered. In relation to the third submission, we acknowledge that a penalty of £74,418.09 is significant. But it came about, not because of a single default, but after 11 consecutive failures to pay on time. The statutory scheme is specifically designed to levy a heavy penalty on those who repeatedly do not comply.

197. Taking into account that starting point, and bearing in mind the high threshold before a court or tribunal can "substitute its own view for of what is fair for the penalty which Parliament has imposed," as the Upper Tribunal put it in *Total Technology,* we went on to consider the particular facts of the company's case.

198. The business is of some size, with an annual payroll of nearly £2m, with monthly PAYE payments ranging from £111,390 to £223,428. Monthly turnover also averaged £2m. The TPU call records show that the company was casual about compliance with its statutory responsibilities, for example by failing to ensure that arrangements were made for PAYE payment when the person responsible was on holiday. Many of the company's defaults caused extra work to HMRC, in terms of enforcement warning letters and frequent phone contact. Taking all relevant factors into account, we find that this penalty is not disproportionate.

Decision and appeal rights

199. There is no reasonable excuse for the company's failures to pay on time, there are no special circumstances and the penalty is not disproportionate. The appeal is dismissed and the penalty confirmed.

200. 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 Rules. 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.

ANNE REDSTON
TRIBUNAL JUDGE

RELEASE DATE: 20 February 2015

Amended pursuant to rule 37 of the Tribunal Rules on 8 March 2015

APPENDIX: LEGISLATION

FA 2009, Schedule 56: Penalty for Failure to Make Payments on Time

Penalty for failure to pay tax

1.

(1) A penalty is payable by a person ("P") where P fails to pay an amount of tax specified in column 3 of the Table below on or before the date specified in column 4.

(2) Paragraphs 3 to 8 set out—

(a) the circumstances in which a penalty is payable, and

(b) subject to paragraph 9, the amount of the penalty.

(3) If P's failure falls within more than one provision of this Schedule, P is liable to a penalty under each of those provisions.

(4) In the following provisions of this Schedule, the "penalty date", in relation to an amount of tax, means the date on which a penalty is first payable for failing to pay the amount (that is to say, the day after the date specified in or for the purposes of column 4 of the Table).

	Tax to which payment relates	*Amount of tax payable*	*Date after which penalty incurred*
2	Income tax	Amount payable under PAYE regulation	The date determined by or under PAYE regulations as the date by which the amount must be paid

2-4 …

Amount of penalty: PAYE and CIS amounts

5.

(1) Paragraphs 6 to 8 apply in the case of a payment of tax falling within item 2 or 4 in the Table

(2) But those paragraphs do not apply in the case of a payment mentioned in paragraph 3(1)(b) or (c).

6.

(1) P is liable to a penalty, in relation to each tax, of an amount determined by reference to:

(a) the number of defaults that P has made during the tax year (see sub-paragraphs (2) and (3)), and

(b) the amount of that tax comprised in the total of those defaults (see sub-paragraphs (4) to (7)).

(2) For the purposes of this paragraph, P makes a default when P fails to make one of the following payments (or to pay an amount comprising two or more of those payments) in full on or before the date on which it becomes due and payable--

(a) a payment under PAYE regulations;

(b) a payment of earnings-related contributions within the meaning of the Social Security (Contributions) Regulations 2001 (SI 2001/1004);…

(3) But the first failure during a tax year to make one of those payments (or to pay an amount comprising two or more of those payments) does not count as a default for that tax year.

(4) If P makes 1, 2 or 3 defaults during the tax year, the amount of the penalty is 1% of the amount of the tax comprised in the total of those defaults.

(5) If P makes 4, 5 or 6 defaults during the tax year, the amount of the penalty is 2% of the amount of the tax comprised in the total of those defaults.

(6) If P makes 7, 8 or 9 defaults during the tax year, the amount of the penalty is 3% of the amount of the tax comprised in the total of those defaults.

(7) If P makes 10 or more defaults during the tax year, the amount of the penalty is 4% of the amount of the tax comprised in the total of those defaults.

(8) For the purposes of this paragraph--

(a) the amount of a tax comprised in a default is the amount of that tax comprised in the payment which P fails to make;

(b) a default counts for the purposes of sub-paragraphs (4) to (7) even if it is remedied before the end of the tax year.

(9) …

7

If any amount of the tax is unpaid after the end of the period of 6 months beginning with the penalty date, P is liable to a penalty of 5% of that amount.

8

If any amount of the tax is unpaid after the end of the period of 12 months beginning with the penalty date, P is liable to a penalty of 5% of that amount.

Special reduction

9.

(1) If HMRC think it right because of special circumstances, they may reduce a penalty under any paragraph of this Schedule.

(2) In sub-paragraph (1) "special circumstances" does not include—

(a) ability to pay, or

(b) the fact that a potential loss of revenue from one taxpayer is balanced by a potential over-payment by another.

(3) In sub-paragraph (1) the reference to reducing a penalty includes a reference to—

(a) staying a penalty, and

(b) agreeing a compromise in relation to proceedings for a penalty.

10 ….

Assessment

11.

(1) Where P is liable for a penalty under any paragraph of this Schedule HMRC must—

(a) assess the penalty,

(b) notify P, and

(c) state in the notice the period in respect of which the penalty is assessed.

(2) A penalty under any paragraph of this Schedule must be paid before the end of the period of 30 days beginning with the day on which notice of the assessment of the penalty is issued.

(3) An assessment of a penalty under any paragraph of this Schedule—

(a) is to be treated for procedural purposes in the same way as an assessment to tax (except in respect of a matter expressly provided for by this Schedule),

(b) may be enforced as if it were an assessment to tax, and

(c) may be combined with an assessment to tax.

(4) A supplementary assessment may be made in respect of a penalty if an earlier assessment operated by reference to an underestimate of an amount of tax which was due or payable…

12. …

Appeal

13.

(1) P may appeal against a decision of HMRC that a penalty is payable by P.

(2) P may appeal against a decision of HMRC as to the amount of a penalty payable by P

14.

(1) An appeal under paragraph 13 is to be treated in the same way as an appeal against an assessment to the tax concerned (including by the application of any provision about bringing the appeal by notice to HMRC, about HMRC review of the decision or about determination of the appeal by the First-tier Tribunal or Upper Tribunal).

(2) Sub-paragraph (1) does not apply—

(a) so as to require P to pay a penalty before an appeal against the assessment of the penalty is determined, or

(b) in respect of any other matter expressly provided for by this Act

15.

(1) On an appeal under paragraph 13(1) that is notified to the tribunal, the tribunal may affirm or cancel HMRC's decision.

(2) On an appeal under paragraph 13(2) that is notified to the tribunal, the tribunal may—

(a) affirm HMRC's decision, or

(b) substitute for HMRC's decision another decision that HMRC had power to make.

(3) If the tribunal substitutes its decision for HMRC's, the tribunal may rely on paragraph 9—

(a) to the same extent as HMRC (which may mean applying the same percentage reduction as HMRC to a different starting point), or

(b) to a different extent, but only if the tribunal thinks that HMRC's decision in respect of the application of paragraph 9 was flawed.

(4) In sub-paragraph (3)(b) "flawed" means flawed when considered in the light of the principles applicable in proceedings for judicial review.

(5) In this paragraph "tribunal" means the First-tier Tribunal or Upper Tribunal (as appropriate by virtue of paragraph 14(1)).

Reasonable excuse

16.

(1) If P satisfies HMRC or (on appeal) the First-tier Tribunal or Upper Tribunal that there is a reasonable excuse for a failure to make a payment--

(a) liability to a penalty under any paragraph of this Schedule does not arise in relation to that failure, and

(b) the failure does not count as a default for the purposes of paragraphs 6, 8B, 8C, 8G and 8H.]

(2) For the purposes of sub-paragraph (1)--

(a) an insufficiency of funds is not a reasonable excuse unless attributable to events outside P's control,

(b) where P relies on any other person to do anything, that is not a reasonable excuse unless P took reasonable care to avoid the failure, and

(c) where P had a reasonable excuse for the failure but the excuse has ceased, P is to be treated as having continued to have the excuse if the failure is remedied without unreasonable delay after the excuse ceased.