TC07704

CONSTRUCTION INDUSTRY SCHEME – property development – property owned by five persons – appellant company specially formed to facilitate property development – were payments by appellant to building contractors made under "construction contracts"? – was appellant a person to whom s59 applied? – was it carrying on a business which included construction operations? – yes – was there a reasonable excuse for failure to make CIS returns? – no – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2019/02682

BETWEEN

HART ST INVESTMENTS LTD **Appellant**

-and-

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

TRIBUNAL: JUDGE ZACHARY CITRON
MR CHARLES BAKER

Sitting in public at Taylor House London EC1 on 6 February 2020

Mr P Springett, director of the Appellant, for the Appellant

Mr J Kruyer of HM Revenue and Customs for the Respondents

DECISION

INTRODUCTION

1. This appeal was about whether payments to third party builders by the appellant, a company specially formed to facilitate development of a property by the two individuals and three (related) companies which owned the property, were liable to deduction under the construction industry scheme ("CIS"); and, if so, whether there was a reasonable excuse for the appellant company's failure to submit CIS returns.

THE APPEAL

2. HMRC sent the appellant company a determination notice under regulation 13 Income Tax (Construction Industry Scheme) Regulations 2005 (the "CIS regulations") dated 17 October 2018 for the 2017-18 tax year in the amount of £16,801; the appellant company notified its appeal to HMRC in a letter dated 15 October 2018. On 10 December 2018 HMRC raised a Schedule 55 Finance Act 2009 penalty notice on the appellant company for failure to make CIS returns in the period 6 October 2015 to 5 November 2017, in the amount of £12,457.45; the appellant company notified HMRC of its appeal in a letter dated 8 January 2019.

3. HMRC's review conclusion letter of 4 April 2019 upheld the original HMRC decisions.

4. The appellant company notified its appeal to the Tribunal on 30 April 2019.

EVIDENCE

5. We had a document bundle with correspondence between the parties and copies of a number of agreements (referred to in our findings of fact below). We also had further documents, including financial statements for the year ended 31 May 2018, provided by the appellant company two weeks before the hearing. We heard oral evidence from Mr Springett as well as from Mr D Ord, the officer of HMRC who dealt with the appellant company's compliance with CIS. We largely accepted Mr Springett's evidence as to matters of fact; where we have not entirely accepted his version of the facts, we have indicated this in what follows.

FINDINGS OF FACT

6. The appellant company was formed in connection with the development of a historic property at 16-18 Hart Street, Henley (the "property").

7. For historical and planning-related reasons, ownership of the property was in five separate parts:

(1) One part, which was residential, was owned by Mr Springett;

(2) another part, also residential, was owned by Mr Mackie;

(3) the other three parts were owned by three private companies, each of which was owned by Mr Springett and Mr Mackie (who were also the directors).

8. Mr Springett was a property development consultant of many years' standing – he became involved with the property in 2015. Except for the residential parts held by them personally, Mr Springett and Mr Mackie wanted to develop part of the property for office use, and part as flats for residential use, all with a view to sale or letting. They utilised the appellant, a recently formed company with themselves as shareholders and directors, so that:

(1) third parties (like the building contractor) could contract with a single legal entity;

(2) expenditure on the project could be pooled in (and funded by bank loans to) a single legal entity, and then allocated out the five owners, proportionately, when the project was finished; and

(3) VAT incurred on supplies received as part of the development project could be recovered by a single legal entity (presumably on the grounds that such entity was itself making taxable supplies for VAT purposes).

9. On 17 August 2015, the appellant company and the five property owners entered into a 20-page development agreement in relation to the property (apart from those parts owned personally by Mr Springett and Mr Mackie). The objects of the "joint development" created by the agreement were to carry out the property development, fund its expenditure and then dispose of it.

10. The appellant company was referred to a handful of times in the development agreement - these are summarised below.

(1) Clause 2.1 provided that the five property owners would "through" the appellant company "together control the management of" the property development, determine policy to attain its objects, and make decisions on matters of principle in relation to it. Clause 2.2 set out a non-exhaustive list of "matters of principle": valuing the property, financial appraisal and budget estimates, method of selecting the "professional team", approval of a purchaser and terms of sale, financial assistance to fund expenditure on the project, and anything else not within the day to day management of the development or already decided as a matter of principle. Clause 2.3 provided for meetings of the five property owners; clause 2.4 provided for the five property owners to engage the services of professional advisers.

(2) Clause 3 set out Mr Springett's responsibilities. From this it appeared that he was to manage the property development. His duties included the terms of employment of the building contractor and termination of the building contract. He also had supervision and control of the appellant company's bank account for the purposes of paying project expenditure; and at clause 3.3.2 it was provided that he would ensure that the appellant company would prepare and maintain up to date accounts of project expenditure, keep records of income and expenditure, and provide Mr Springett with information, cost reports and budget estimates.

(3) Clause 4 set out the duties of the five property owners. These included (where mention is made of the appellant company):

(a) entering into agreements as may be required to enable the appellant company and Mr Springett to complete certain arrangements in Schedule 2 to the agreement (relating to obtaining consents for the development)

(b) permitting the appellant company and those authorised by it to enter the property with all necessary vehicles, plant equipment and apparatus:

(i) to inspect, survey and measure any part of the property

(ii) to carry out planning surveys

(iii) to effect hedging or tree planting

(iv) for any other reasonable purpose in connection with the agreement and/or the attainment of the objects of the joint development

(c) ensuring the property was vacant to ensure that the appellant company "can carry out its development obligations" and the units of the property can be constructed and sold with full vacant possession

(d) a bar on the property owners disposing of the property in any way during the subsistence of the agreement without the appellant company's prior consent (and agreement to a registration of such restriction on the title to the property)

(4) Clause 9 provided that the appellant company use its reasonable endeavours to negotiate a sale of the property or part of it.

(5) Under clause 7, the property owners were to observe and perform their respective obligations and the conditions set out in Schedule 2 ("Development obligations"). The appellant company is mentioned in that schedule:

(a) as having appointed RA Shayler & Son as "their" building contractor;

(b) in the context of Mr Springett, "through" the appellant company, assuming all obligations for the purposes of the Construction (Design and Management) Regulations 2015 (made under the Health and Safety at Work, etc Act 1974); using all reasonable endeavours to ensure that execution of the building works complied with those regulations; and Mr Springett was "through" the appellant company to make a declaration to the Health and Safety Executive in accordance with those regulations that the appellant company was the only client in respect of the building works;

(c) the property owners were either to insure the relevant structures, or to cause them to be insured by the appellant company (in the event, it was the appellant company that took out this insurance).

11. There were aspects of the relationship between the appellant company and the property owners which were not set out in the development agreement: for example, the agreement that, by the end the project, the property owners would reimburse the appellant company for its costs (we find this was agreed, based on Mr Springett's oral evidence).

12. Also on 17 August 2015, Mr Springett and Mr Mackie (only) entered into a supplemental agreement to the development agreement, relating to the two parts of the property to be retained by them for residential purposes. Clause 3 of this agreement provided that the parties would instruct the "Development Company" (which appears from the context to mean the appellant company) to construct two residential properties in accordance with certain specifications. Mr Springett's oral evidence was that there was no expectation that the appellant company would itself do such construction work.

13. On 31 August 2015 the appellant company entered into a Joint Contracts Tribunal ("JCT") standard contract with a third party building contractor ("Shayler") for the "conversion of buildings to residential and office use" at the property. The "contract sum" was cost plus 10%. Shayler went on to invoice the appellant company monthly. This contract covered the bulk of expenditure incurred for the development. The appellant company in addition incurred small amounts of expenditure for the services of a tree surgeon and an expert in wooden beams in listed buildings. (Of the £16,801 payable under the regulation 13 determination, £15,412 related to payment to Shayler, £672 to payments to the tree surgeon (Roderick Baird Ltd) and £717 to payments to the wooden beams expert (Love Old Buildings).

14. A loan agreement with National Westminster Bank Plc dated 28 August 2015 showed the appellant company, along with four of the five property owners in a "partnership" or "joint venture arrangements", as the "customer". The 18-month loan of up to £1,832,000 was to assist with the development of the property. Each of the "customer" parties was jointly and severally liable. Another loan with NatWest, for up to £2,282,204 and due for repayment on 13 May 2017, was entered into around the end of September 2016: the "customer" was described as "the partnership of" the appellant company and the same four property owners.

15. The balance sheet in the appellant company's financial statements for the year ended 31 May 2018 showed that its "stocks" had reduced from £2,674,421 in 2017 to £1,055,286. "Stocks" were the costs of the property development. The fall was because those costs had been partly reimbursed by the property owners. At 31 May 2018, the appellant company had an accumulated deficiency on the profit and loss account of £11,924. This represented the accumulated general administrative expenses of the company, mainly accountancy costs.

16. On 13 June 2018 HMRC made a direction under regulation 9 of the CIS regulations that, for the 2015-16 and 2016-7 tax years, the appellant company was not liable to pay amounts due under CIS, based on Shayler's tax compliance for those years.

THE LAW

17. CIS, as set out in Chapter 3 Part 3 Finance Act ("FA") 2004, provides for certain payments under construction contracts to be made under deduction of sums on account of tax.

18. To be a construction contract, a contract must:

(1) relate to construction operations; and

(2) be a contract where

(a) one party is a sub-contractor; and

(b) another party (the "contractor") either

(i) is a person to whom s59 FA 2004 applies, or

(ii) is a sub-contractor under another such construction contract relating to all or any of the construction operations.

19. A party to a contract relating to construction operations is a sub-contractor if, under the contract –

(1) he is under a duty to the contractor to carry out the operation, or to furnish his own labour (in the case of a company, the labour of employees or directors of the company) or the labour of others in the carrying out of the operations or to arrange for the labour of others to be furnished in the carrying out of the operations; or

(2) he is answerable to the contractor for the carrying out of the operations by others, whether under a contract or under other arrangements made or to be made by him.

20. Section 59 FA 2004, as relevant here, applies to:

(1) any person carrying on a business which includes construction operations; and

(2) a person carrying on a business at any time if certain financial thresholds as regards expenditure on construction operations are exceeded (see s59(1)(l)(i) and (ii))

21. Construction operations are defined in s74 FA 2004 and include construction and alteration of buildings (sub-section (2)(a)), as well as operations for rendering complete, including site restoration and landscaping (sub-section (2)(f)).

22. The CIS regulations provide for the making of CIS returns by contractors making payment subject to CIS in certain circumstances.

23. Under regulation 13 of those regulations, an officer of HMRC may in certain circumstances determine the amount which to the best of his judgement a contractor is liable to pay under the regulations. Such determination is subject to Parts 4, 5, 5A and 6 Taxes Management Act 1970 as if the determination were an assessment and the amount determined were income tax charged on the contractor.

24. Under Schedule 55 FA 2009, penalties are payable by a person who fails to make a CIS return on or before the filing date. If HMRC think it right because of special circumstances, they may reduce a penalty (the "special circumstances" power). Liability to a penalty does not arise in relation to a failure to make a return if the party satisfies the Tribunal (on appeal) that there is a reasonable excuse for the failure. On an appeal that is notified to the Tribunal, the Tribunal may affirm or cancel HMRC's decision that penalties are payable. If the Tribunal substitutes its own decision for HMRC's, it may rely on "special circumstances" to a different extent than HMRC did, but only if HMRC's decision is respect of "special circumstances" was flawed.

25. In *The Clean Car Co Ltd v C&E Comrs* [1991] VATTR 234 Judge Medd QC set out his understanding of "reasonable excuse":

> "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?...
>
> It seems to me that Parliament in passing this legislation must have intended that the question of whether a particular trader had a reasonable excuse should be judged by the standards of reasonableness which one would expect to be exhibited by a taxpayer who had a responsible attitude to his duties as a taxpayer, but who in other respects shared such attributes of the particular appellant as the tribunal considered relevant to the situation being considered. Thus though such a taxpayer would give a reasonable priority to complying with his duties in regard to tax and would conscientiously seek to ensure that his returns were accurate and made timeously, his age and experience, his health or the incidence of some particular difficulty or misfortune and, doubtless, many other facts, may all have a bearing on whether, in acting as he did, he acted reasonably and so had a reasonable excuse."

29. That this is the correct test was confirmed by the Upper Tribunal in *Perrin v HMRC* [2018] UKUT 156. At [81] of that judgment, the Upper Tribunal also set out a recommended process for this Tribunal when considering whether a person has a reasonable excuse:

> "(1) First, establish what facts the taxpayer asserts give rise to a reasonable excuse (this may include the belief, acts or omissions of the taxpayer or any other person, the taxpayer's own experience or relevant attributes, the situation of the taxpayer at any relevant time and any other relevant external facts).
>
> (2) Second, decide which of those facts are proven.
>
> (3) Third, decide whether, viewed objectively, those proven facts do indeed amount to an objectively reasonable excuse for the default….In doing so, the Tribunal should take into account the experience and other relevant attributes of the taxpayer and the situation in which the taxpayer found himself at the relevant time or times. It might assist the Tribunal, in this context, to ask itself the question "was what the taxpayer did (or omitted to do or believed) objectively reasonable for this taxpayer in those circumstances?"
>
> (4) Fourth, having decided when any reasonable excuse ceased, decide whether the taxpayer remedied the failure without reasonable delay after that time (unless, exceptionally, the failure was remedied before the reasonable excuse ceased). In doing so, the FTT should again decide the matter objectively, but taking into account the experience and other relevant attributes of the taxpayer and the situation in which the taxpayer found himself at the relevant time or times."

BURDEN OF PROOF

26. As regards the regulation 13 determination, the burden of proof was on the appellant company to show that the amount charged was excessive. As regards the penalty assessment, the burden of proof was on HMRC to show the appellant company was prima facie liable. The burden of establishing that it should not be liable for the penalty because, for example, there was a reasonable excuse, lay with the appellant company. The standard of proof was the normal civil standard: on the balance of probabilities.

PARTIES' SUBMISSIONS

27. The parties' arguments focused on the point of whether the appellant company was a company to which s59 FA 2004 applied; and, in particular, whether it was carrying on a business which included construction operations.

28. Mr Springett submitted that

(1) the appellant company's purpose was to

(a) fairly apportion costs between the parties, break even and arrive at a "nett zero tax position";

(b) to act as agent for the property owners and administer the overall development on behalf of the property owners and act as a single source to funnel bank development funds coming in, VAT compliance and contract payments going out, having entered into the JCT contract with a main contractor, Shayler, as agent of those parties;

(2) the appellant company did not own any property or assets and was not a trading business. There was never any intention to make profit or loss;

(3) Mr Springett himself acted independently as project manager and service administrator for the development project;

(4) since the appellant company was not a business and had no financial interest in the result of the development, it was not within s59 FA 2004;

(5) advice was taken from accountants that CIS did not apply to payments by the appellant company.

29. HMRC submitted the appellant company was carrying on a business which included construction operations, as it managed the property development.

DISCUSSION

The regulation 13 determination

30. The key issue here is whether the JCT contract and the contracts (for very small amounts) with the tree surgeon and the expert in wooden beams were construction contracts: if so, then on making payments under them to the sub-contractor, the appellant company, assuming it was the contractor under those contracts, had an obligation to deduct under CIS.

31. It is clear that the JCT contract was a contract relating to construction operations. It is also clear that Shayler, as one of the parties to the JCT contract, was a sub-contractor (under the JCT contract, Shayler was under a duty to carry out construction operations). Given this, the JCT contract would fall to be a construction contract if the appellant company was a person to whom s59 FA 2004 applies.

32. The same holds true for the contracts with the wooden beams expert and the tree surgeon (the latter coming within construction operations as site restoration or landscaping).

Was the appellant company a person to whom s59 FA 2004 applies?

33. As the appellant company did not meet the financial thresholds in s59(1)(l) FA 2004 (this was an agreed fact between the parties), it would only have been a person to whom s59 FA 2004 applies if it was carrying on a business which includes construction operations.

34. We would summarise the activity of the appellant company thus. Five legal persons – two individuals, Mr Springett and Mr Mackie, and three companies owned by those individuals 50-50 – wished to carry out a property development project. The appellant company was a specially formed corporate "vehicle" for execution of that project from the point of view of the property owners. Hence, it contracted with the builders, borrowed money from the bank to pay them, and was the vehicle for keeping track of the financial side of the project. The appellant company performed these tasks without having employees: the underlying decisions were taken by the two property-owning individuals who were its directors and shareholders. The appellant company was also the vehicle for protecting the joint venture against any individual property owner acting against the collective interest: hence, none of the underlying properties could be sold during the course of the project without the appellant company's consent (even though the appellant company itself was not a property owner); and the property-owners committed contractually to allowing the appellant company access to carry on the building work – even though it was not the appellant company itself that carried on the construction.

35. The appellant company was not, however, the day-to-day project manager – that role was allocated to Mr Springett under the development agreement, and he was paid for it (by the appellant company). Nor was the appellant company, in legal terms, the agent of the five property-owners: nowhere in the documentation with third parties (Shayler or NatWest) does the appellant company hold itself out as an agent; and the documentation between the property-owners and the appellant company (the development agreement) does not appoint the appellant as a their "undisclosed" agent, either. The clause in Schedule 2 to the development agreement requiring a statement under certain health and safety regulations that the appellant company was the "only client" in respect of the building works, is also consistent with our finding that the appellant company was not acting as agent in a legal sense. It is equally clear to us that the appellant company was not in partnership with the property owners: it had no share of the profits from the development project.

36. The concept of "carrying on a business" is found in a number of places in tax legislation but is nowhere defined. It is for us as the fact-finding tribunal to make a realistic, common-sensical assessment of whether the appellant company was "carrying on a business", based on the facts as found. There are a number of indicators that the appellant company was carrying on a business:

(1) It entered into substantive business-like contractual relationships with third parties – Shayler and NatWest – under which it had obligations, amongst other things, to pay Shayler for their work and repay loans of over a million pounds.

(2) In doing so, it took business-like risks – principally, the risk that the property owners would reimburse it in due course.

(3) It had significant business-like legal rights under the development agreement – it could stop parts of the property being sold, and was given access rights over the property for the purposes of the development.

(4) As a company, its activities were, by definition, not carried on for "personal" reasons.

37. The one indicator that the appellant company was not carrying on business was the fact that it was reimbursed at the end of the project by the property-owners, such that it was not

expected to make a substantial profit or loss. However, we are inclined to afford this less weight as an indicator of whether it was "carrying on a business", as the appellant and those for whom it was providing a service (the property owners) were related parties, and it seems likely to us that if they were not related, the appellant company would have charged for its services. In our view, balancing the different indicators, the appellant company was carrying on a business

38. As to whether that business included construction operations: we are bound by *Mundial Invest SA Ltd v Moore* [2006] STC 412 – a decision of the High Court on the CIS provisions we are concerned with here – to the effect that a company that owned properties, and carried out construction operations on them by engaging other enterprises to perform them, was itself carrying on a business which included construction operations. This indicates that a business "includes" construction operations even where it involves engaging other persons to perform those operations. The facts here are different from *Mundial*, in that the appellant company did not itself own the property on which the construction operations were carried out. However, the important fact, in our understanding of *Mundial*, is that both in that case, and here, construction operations are a component of the business of the taxpayer in question – which means they are "included" in it for the purposes of s59 FA 2004.

39. We further note that in *Thornton Heath LLP v HMRC [2018] UKFTT 0685 (TC)*, the Tribunal distinguished the facts before it from those in *Mundial* and decided that a taxpayer which held property as an investment (rather than as a property developer, which was the case in *Mundial*) was not "carrying on a business which included construction operations". The decision placed weight on statements in HMRC's manuals to the effect that property "investment" companies did not normally carry on a business which included construction operations. The facts before us here are altogether different, as the appellant company was neither a property-investor nor a property-developer – we therefore do not find the *Thornton Heath* decision of assistance in deciding this case (and in any case, as a decision of the Tribunal, it is not binding on us).

40. It follows from our conclusion that the appellant company was carrying on a business which included construction operations, that it was a company to which s59 FA 2004 applies, and so its payments were subject to the obligation to deduct under CIS.

The penalties for failure to make CIS returns

41. It is not in dispute that the appellant company failed to make CIS returns. The excuse given is that the appellant company had received advice from accountants to the effect that it was not a contractor for CIS purposes and so payments could be made to Shayler and others without deduction. As for whether the facts giving rise to that excuse are proven: no copy of such advice was adduced in evidence; and Mr Springett's oral evidence did not provide details of the factual background given to the adviser, whether the adviser had made assumptions or qualified the advice given, and the level of the adviser's expertise in, and experience of, CIS. Whilst we accept that Mr Springett received advice on CIS from an accountant, we find that it is not proven that

(1) the advice was ever delivered in writing;

(2) the adviser had a detailed understanding of the arrangements, including the legal documentation;

(3) the advice was given without assumptions or disclaimers which could affect its applicability to the arrangements; or

(4) the adviser held itself out as expert in CIS.

42. As to whether having taken "informal" advice of this kind is, objectively, a "reasonable" excuse for the appellant company's failure to make CIS returns: the appellant company's affairs were controlled by its directors; Mr Springett, both as director and as the project manager, was particularly involved with the appellant company's tax affairs. He was a seasoned property development consultant and so familiar with the practical workings of CIS. In our view a company under the direction of someone with Mr Springett's experience, and wishing to be responsible and compliant as regards its tax affairs, would not have been satisfied with "informal" advice on a question like this. Rather, it would have wanted advice set out in writing from an adviser with CIS expertise – or perhaps consulted in advance with HMRC - before proceeding on the assumption that payments to Shayler and others could be made free of deduction under CIS. It was not, in our view, objectively reasonable for the appellant company to have relied on informal, unwritten advice about the application of CIS to its circumstances.

43. We therefore conclude that there was no reasonable excuse for the appellant company's failure to make CIS returns.

44. There is no evidence to suggest that HMRC's decision that there were no special circumstances here, was flawed.

CONCLUSION

45. The appeal is dismissed: the regulation 13 determination stands good and the penalties are confirmed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

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

ZACHARY CITRON
TRIBUNAL JUDGE

Release date: 13 May 2020