TC01322

Appeal number TC/2011/02979

Penalty; late filing; fairness; s98A(2)(a) TMA 1970. Common law fairness. Conscionable conduct. Jusilla v Finland. "Reasonable excuse" does not necessarily involve any exceptional circumstance. Honest and genuine belief amounts to "reasonable excuse". Burden of proof.

FIRST-TIER TRIBUNAL

TAX

HMD RESPONSE INTERNATIONAL **Appellant**

- and -

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

TRIBUNAL: GERAINT JONES Q.C. (TRIBUNAL JUDGE)
ANTHONY HUGHES ESQ. (TRIBUNAL MEMBER)

Sitting in public at 45 Bedford Square, London WC1 on 07 July 2011.

Mr. Williams for the Appellant

Miss Weare, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction.

1. HMD Response International, the appellant, is a small charity which has some employees. In those circumstances it is required to supply an employer's end of year return (P35) to HMRC by 19 May in each year. It retained Mr John Williams, a chartered accountant, to undertake that task, along with several other accountancy related tasks, on its behalf.

2. HMRC contends that the appellant failed to file its P35 for the fiscal year ended 5 April 2010 by 19 May 2010. The appellant says that the first that it knew of that situation was when it received a penalty notice in the sum of £400 on 27 September 2010. However, as that penalty notice was not sent in sufficient time for a P35 to be filed prior to the 19 September 2010, HMRC levied a further £100 penalty on the basis that it levies a penalty at the rate of £100 for each month or part of a month during which the filing remains outstanding. Thus, the total penalty demanded was £500, the P35 having been successfully filed online on the 12 October 2010.

3. The appellant sought a Review of the penalties, by its agent Mr Williams' letter of 8 October 2010. HMRC eventually replied to that request for a Review by its letter of 30 March 2011. It upheld the penalties.

4. Inexplicably, on the 21 February 2011, whilst the Review was being considered by HMRC and well before all the appellant's appeal avenues had been exhausted, HMRC sent a threatening letter to the appellant alleging, quite wrongly, that the appellant had been ignoring *"our efforts to resolve the matter of your outstanding liability."* We have seen no evidence of any efforts made by HMRC to resolve the outstanding liability. By the date of that letter HMRC had not even dealt with the Review, which was not concluded until the 30 March 2011. In those circumstances it was, in our judgement, quite wrong of HMRC to send a letter which threatened, in its second paragraph, to levy distraint by sending somebody to the appellant's premises to seize goods to be sold at public auction. Such high-handed threatening action was not justified. It smacks more of the conduct of a disreputable debt collector than of responsible conduct by an organ of the state. It might have been better if HMRC had concentrated its efforts on dealing with the outstanding Review, rather than taking almost six months to deal with it.

5. After the Review had been concluded, the appellant submitted an appeal to this Tribunal.

The Grounds of the Appeal.

6. The appellant's appeal is put on the basis that its P35 was sent to and filed with HMRC on 16 May 2010. HMRC denies that it was received. Alternatively, says the appellant, the fact that it, by its agent Mr Williams, honestly and genuinely believed that the P35 had been filed by the due date amounts to a reasonable excuse for the

default thereafter (if default there was) at least until such time as it was put on notice that the honest and genuine belief was incorrect.

The Law.

7. Before we turn to the facts of this appeal and to our conclusions in respect of it, it is appropriate that we set out the law as we now perceive it to be. In G. Deacon & Sons v Commissioners of Inland Revenue 33TC 66 Mr Justice Donovan dismissed a request for a case to be stated in respect of conclusions drawn by General Commissioners, holding that from the primary facts adduced in evidence, they were entitled to draw the inferences that they drew against the then appellant, Mr Deacon.

8. In Johnson v Scott (1987) STC 476 Mr Justice Walton expressly considered where the onus of proof lay in a case where an appellant was challenging amended assessments that had been upheld by the Commissioners. He observed that counsel for the Crown had correctly accepted that where, as in that case, neglect on the part of the taxpayer had to be established, the onus of establishing such neglect lay with the Crown. He went on to hold that if a finding of neglect is made, and justified on the evidence, that enabled the Crown to make assessments for the purpose of making good any tax lost as a result of such neglect. He went on to observe that if that stage was reached, then the onus would pass to the taxpayer to adduce evidence to show that the assessment is too large.

9. His Lordship desisted from indicating whether the onus that then shifted to the taxpayer was a legal burden or an evidential burden, but usually a reference to a party then having a burden to adduce evidence, refers to an evidential rather than a legal burden. It is also relevant to observe that in that case the learned judge was considering section 50(6) of the Taxes Management Act 1970 in its original, unamended, form. The learned judge also emphasised that where the Crown's case was based upon inferences drawn from primary facts, such inferences had to be "fair" inferences. One would not have expected otherwise. The Court of Appeal upheld that judgment. It was a case in which the taxpayer failed, by adducing acceptable or probative evidence, to discharge the evidential burden upon him of showing that the inferences drawn by the Crown were not fair or appropriate.

10. I set out the foregoing because it is often stated, incorrectly, that once an assessment is raised or a surcharge demanded, the burden of proving that it is incorrect rests upon the taxpayer. That may be an approximation of the *de facto* position in respect of an assessment (but not a surcharge or penalty) but it fails to analyse the true legal position.

11. In our judgment the true legal position now has to be considered bearing in mind the amendments to section 50 of the Taxes Management Act 1970, the most recent having come into effect on 1 April 2009, but more importantly having in mind the decision of the European Court in the **Jussila v Finland (2009) STC 29** where, in the context of default penalties and surcharges being levied against a taxpayer, the Court determined that Article 6 of the European Convention on Human Rights was applicable, as such penalties and surcharges, despite being regarded by the Finnish

authorities as civil penalties, nonetheless amounted to criminal penalties despite them being levied without the involvement of a criminal court. At paragraph 31 of its judgment the court said that if the default or offence renders a person liable to a penalty which by its nature and degree of severity belongs in the general criminal sphere, article 6 ECHR is engaged. It went on to say that the relative lack of seriousness of the penalty would not divest an offence of it inherently criminal character. It specifically pointed out, at paragraph 36 in the judgment, that a tax surcharge or penalty does not fall outside article 6 ECHR.

12. This is a case involving penalties. The European Court has recognised that in certain circumstances a reversal of the burden of proof may be compatible with Article 6 ECHR, but did not go on to deal with the issue of whether a reversal of the burden of proof is compatible in a case involving penalties or surcharges. This is important because a penalty or surcharge can only be levied if there has been a relevant default. If it is for HMRC to prove that a penalty or surcharge is justified, then it follows that it must first prove the relevant default, which is the trigger for any such penalty or surcharge to be levied.

13. In our judgement there can be no good reason for there to be a reverse burden of proof in a surcharge or penalty case. A surcharge or penalty is normally levied where a specified default has taken place. The default might be the failure to file a document or category of documents or it may be a failure to pay a sum of money. In such circumstances there is no good reason why the normal position should not prevail, that is, that the person alleging the default should bear the onus of proving the allegation made. In such a case HMRC would have to prove facts within its own knowledge; not facts peculiarly within the knowledge of the taxpayer.

14. It is for HMRC to prove that a penalty is due. That involves HMRC proving, on the balance of probabilities, that the required end of year filing did not take place by 19 May 2010. In our judgment it has produced no, or insufficient, evidence to that effect and, for that reason alone, this appeal must succeed.

15. Section 98A(2)(a) Taxes Management Act 1970 provides that any person who fails to make a return in accordance with the relevant provisions *"shall be liable to a penalty or penalties of the relevant monthly amount for each month (or part of a month) during which the failure continues ....."*.

16. So far as the State and its several manifestations are concerned (HMRC being one such manifestation), there is a common law duty of fairness. In R v S. S. Home Department [2003] EWCA Civ 364 at paragraph 69 the Court of Appeal expounded the principle as related to the decision making process under scrutiny in that appeal. In S. S. Home Department v Thakur [2011] UKUT 151 the Upper Tribunal, in paragraph 12 of its Decision, also recognised that principle, again in the context of a decision making process.

17. Thus, the issue arises whether that common law principle has any application where a statutory provision renders a person "liable" to a specified penalty. It must be noted that the statute does not provide that the penalty or any part of it must be levied.

It does no more than to indicate that a person is “liable” to the penalty which means not that the specified penalty must apply, but may apply and may be demanded. If we take a criminal analogy it is that, for a specified offence, a statute might provide that a convicted person is liable to a fine not exceeding £500. In our judgement the words "not exceeding" make little, if any, difference. They are not words which import discretion but simply make it clear that the fine cannot exceed £500. The discretion of a court to impose a fine below the specified maximum does not arise by reason of the words "not exceeding" but by the use of the expression that a person is "liable" to a fine, capped at £500. Similarly a person may be “liable” to a given penalty upon conviction for a specified offence, but that does not mean that prosecution for that offence, once detected, must take place. The decision whether to prosecute involves the use of discretion, usually involving a consideration of policy matters often including the wider public interest.

18. Thus, in our judgement, the appellant is entitled to rely upon the common law duty of a public body to act fairly not just in its decision-making process but also in administering its statutory powers. We are in no doubt that such a body does not act fairly when it deliberately desists from sending a penalty notice, for four months or more, knowing that the effect will be to impose a minimum penalty of £500 upon somebody whose sin may amount to no more than oversight or forgetfulness.

19. We should also add that when HMRC sent the result of its Review to the appellant on 30 March 2011 it made it clear that it had undertaken the Review process on the basis that for the appellant to show that it had a "reasonable excuse" for failing to file its P35, it needed to demonstrate that there had been some exceptional event beyond its control that had prevented it from sending its return on time. As a matter of law, that is not the correct test and is totally misleading. Thus HMRC misdirected itself in law. Parliament has said that an appellant must demonstrate that it has a "reasonable excuse”. Those are ordinary English words in everyday use. They must be given their ordinary and natural meaning. If Parliament had intended to say that an appellant must prove some exceptional circumstance, it could and should have said so. It did not choose to say so. Instead, it used the expression "reasonable excuse" which HMRC has quite wrongly sought to elevate to something more onerous than the test specified by Parliament. The fact that section 118 Taxes Management Act 1970 (the definition section) does not contain a statutory definition of "reasonable excuse" is sufficient to indicate that those words or that expression must be given the plain and ordinary meaning that they bear in everyday usage. That meaning cannot be said to extend to demanding that an appellant demonstrates that there were exceptional circumstances or some exceptional event beyond its control before a "reasonable excuse" can be established.

The Facts and Findings.

20. HMRC did not adduce any witness evidence. Miss Weare sought to rely upon a bundle, containing several documents, without there being any witness evidence speaking to the provenance, content or relevance of any such documents. Whilst computer generated documents are admissible in evidence, the meaning of such documents and/or their import will often need to be put in evidence unless they are

obviously self explanatory. Where they contain codes, shorthand expressions and/or jargon, they will need to be explained.

21. The appellant had not submitted any witness statements. However, Mr Williams orally told us that his position was that on the 16 May 2010 he filed the appellant's P35 electronically, or so he genuinely and honestly believed. He produced a copy of his office diary bearing the date 31 March 2010 where he had written the names of various clients and their pass-codes, which were needed to make an online filing. Alongside the appellant's reference he has noted "16/5".

22. HMRC relies on the fact, without adducing any evidence to support it, that its system provides a notification, either a receipt or notice of rejection, when an online filing is attempted.

23. It is beyond doubt that Mr Williams was on line on Sunday 16 May 2010 as HMRC's own system has informed him of that fact. Mr Williams told us that, in mid-2010, it was not his practice to check what might be voluminous incoming e-mails to see whether a receipt had been sent by HMRC. In the light of this present experience he has altered his practice.

24. HMRC bears the onus of proving that the annual return was not filed. If it is to discharge that onus it must adduce some evidence upon which we can act. It is no good HMRC simply relying upon computer-generated documents without there being any evidence relating to their provenance, content, relevance or meaning. It is not for us to divine what they mean, or might demonstrate, absent evidence from somebody conversant with the system.

25. This is not to require HMRC to prove a negative. It would probably be sufficient for HMRC, by a responsible officer, to provide a statement explaining precisely how its online filing system works (or is supposed to work) and stating that the witness has examined the relevant appellant's account to check whether any relevant on line filing took place; and then giving the result of that check. If the evidence is to the effect that no such online filing took place or is recorded as having taken place, it is at that stage that an evidential burden would shift to the appellant.

26. When Mr Williams gave evidence, he said that, quite candidly, he could not be sure whether the submission he made on 16 May 2010 had or had not been successful. He did not try to overplay his hand. In our judgement, he was a candid and honest witness. He said that he genuinely and honestly believed that the filing had successfully taken place.

27. We asked Miss Weare whether she accepted that if a person genuinely and honestly believes that a successful online filing has been completed, that might amount to a reasonable excuse, at least until such time as that person is informed that that belief is incorrect. She agreed that such circumstances would amount to a reasonable excuse. We take the view that she was entirely correct to do so. We are equally sure that those circumstances could not possibly be described as exceptional.

That is a simple illustration of why the exceptionality test propounded by HMRC is, as a matter of law, wrong.

28. We should also add that HMRC sets out that it runs a *"structured programme to enable penalties to be issued regularly throughout the year, rather than waiting for the late return to be submitted and then issue a final penalty. These penalties, although aimed at encouraging compliance and having the effect of reminding are not designed to be reminders for the outstanding return."*

29. Thus, HMRC deliberately waits until four months have gone by and does not issue the first interim penalty notice until, as in this case, September of the year of default. By that time a penalty of £400, being four times £100 per month, is said to be due. In fact, if the penalty notice *de facto* operates as a reminder and the taxpayer undertakes the necessary filing forthwith, a further one month penalty must arise because the *de facto* reminder is received only after it is too late to avoid a further £100 penalty. Thus, the effect of HMRC desisting from sending out a penalty liability notice very soon after 19 May of the relevant year, and choosing deliberately to delay that penalty notice until four months has gone by, is to result in the taxpayer facing a minimum penalty of £500. We appreciate that HMRC takes the stance that it is the responsibility of the taxpayer to make the necessary filing and that it is its stance that it has no obligation to issue any reminder. However, we have no doubt that any right thinking and fair minded member of society would consider that to be unfair and falling very far below the standard of fair dealing and conscionable conduct to be expected of a manifestation of the State that is empowered to issue penalties, as a means of ensuring compliance.

30. There can be no logical reason whatsoever for HMRC to delay sending out a penalty notice for four months so that, in effect, a minimum penalty of £500 will be levied unless the taxpayer has unilaterally realised that it has failed to undertake the necessary filing. Its computers could be set to issue a penalty notice at any time after 19 May in each year; but it chooses to wait until mid/late September in each year.

31. HMRC is a manifestation of the State. It is no function of the State to use the penalty system as a cash generating scheme. The penalty system has a legitimate aim, which is to ensure that appropriate filings take place in good time and to discourage default. Given that that is the legitimate aim, it is inexplicable why HMRC deliberately delays sending out a penalty notice for four months, with the effect that a penalty for five months becomes payable, that is, £500. In our judgement it would be a very simple matter for HMRC to set its computer settings so that a default or penalty notice is sent out soon after 19 May in any year, instead of some four months later. That fair approach might generate less penalty cash for the State, but it would be fair and conscionable as between the taxpayer and the State (acting by HMRC).

32. HMRC makes the point that it is not under an obligation to remind a taxpayer of its obligation to file documents. It is true that it is under no obligation to do so, but that does not mean that good practice and conscionable conduct does not require it either (i) to send a reminder soon after 19 May in each year when it knows that a default has taken place or, more likely (ii) soon after 19 May each year to issue a

£100 penalty notice which would levy the penalty then due and also have the effect of acting as a reminder before further monthly penalties are incurred.

33. It has long been part of the common law of this country that manifestations of the State must act fairly and in good conscience with its citizens. In our judgement there is nothing fair or reasonable in setting a computer system so that it does not generate a penalty notice until four months have gone by from the date of default, thereby ensuring that a penalty of not less than £500 will be due. We are in no doubt that the computer system could easily be set to generate a single £100 penalty notice soon after the 19 May in each year. That is the course that a fair manifestation of the State, acting in good conscience towards the citizens of the State, would adopt.

34. As, in our judgement, HMRC has neither acted fairly nor in good conscience, in the manner described above, we do not consider that any penalty would be recoverable over and above the £100 penalty for the first month, unless HMRC proves (the onus being upon it) that even if such a penalty notice, which would have acted as a reminder, had been issued, the default would nonetheless have continued. It has proved no such thing.

35. It follows from the foregoing that we find as follows:

(1) HMRC has not proved the alleged default.

(2) Even if the alleged default had been proved, the appellant has established a reasonable excuse for the entire period of the default given that its agent, Mr Williams, honestly and genuinely believed that the filing had taken place on the 16 May 2010.

(3) Even if there had been no reasonable excuse, the penalty would have been reduced from £500 to £100 given that HMRC deliberately desisted from sending out a penalty notice until September 2010, by which time it could demand a penalty of £500

(4) This appeal must be allowed in full. The £500 penalty is set aside.

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

TRIBUNAL JUDGE
RELEASE DATE: 15 JULY 2011