



**TC01625**

**Appeal number: TC/2011/04910**

*PAYE – Penalties under Schedule 56 Finance Act 2009 – whether “special circumstances” reduction under para 9 or potential reasonable excuse under para 16 Schedule 56 must be considered by HMRC before assessing penalty – no – whether the penalty was disproportionate – no – whether penalty should be struck down due to perceived “unfairness” in its administration – held, no unfairness was involved – amount of penalty calculated by wrongly including default from following tax year – penalty confirmed, subject to reduction to take that default out of account*

**FIRST-TIER TRIBUNAL**

**TAX**

**AGAR LIMITED**

**Appellant**

**-and-**

**THE COMMISSIONERS FOR HER MAJESTY’S  
REVENUE AND CUSTOMS (Income Tax and NICs)**

**Respondents**

**TRIBUNAL: KEVIN POOLE (TRIBUNAL JUDGE)  
BEVERLEY TANNER**

**Sitting in public in Birmingham on 15 September 2011**

**Stephen Priddey of Harrison Priddey & Co, Chartered Accountants for the Appellant**

**Karen Powell, Presenting Officer for the Respondents**



## DECISION

### Introduction

1. This decision concerns penalties imposed by HMRC for late payment of PAYE.  
5 The penalties were imposed under schedule 56 Finance Act 2009 in respect of late payments of PAYE (and associated National Insurance Contributions) by the Appellant for the year 2010-11. This was the first year of operation of the new penalties.

2. The facts are undisputed in all significant respects. The appeal was based  
10 largely on legal argument about whether the penalty had been validly imposed in accordance with the legislation, and whether it should be struck down as disproportionate.

### Background facts

3. The Appellant's business is steel fabrication. It is not a large company, turning  
15 over £422,557 in its year ended 31 March 2010. Its turnover increased by some 50% the following year, and it moved back into profit (having made a loss of some £22,000 in the year to 31 March 2010).

4. From 6 April 2010, a new penalty regime was introduced by HMRC for late  
20 payment of monthly PAYE and NIC by employers. Previously, it was possible for employers to delay payments to HMRC of such sums for a period without incurring any material costs. Under schedule 56 Finance Act 2009, however, this possibility was removed. Schedule 56 imposes penalties for late payment of PAYE. The penalties also cover associated Class 1 National Insurance Contributions (by virtue of Regulation 67A of the Social Security (Contributions) Regulations 2001 (SI  
25 2001/1004).

5. The penalties under schedule 56 are structured on a sliding scale. The more late  
payments in a tax year, the larger the percentage penalty applied to the aggregate of the late payments. The first default in any year is disregarded altogether. The remaining defaults trigger a penalty of 1%, 2%, 3% or 4% depending on their number.  
30 A 4% penalty is payable if there are ten or more defaults during the tax year.

6. The Appellant was late in paying its monthly PAYE and NICs to HMRC for every month in the 2010-11 tax year. The amounts, due dates, actual payment dates and the penalty amounts charged are set out in the following table:

<b>PAYE and NIC Due</b>	<b>Due Date</b>	<b>Payment Date</b>	<b>Days Late</b>	<b>Penalty @ 4%</b>
£6,513.16	19.05.2010	17.06.2010	29	0
£5,219.85	19.06.2010	21.07.2010	32	£208.79

£5,680.32	19.07.2010	12.08.2010	24	£227.21
£7,834.62	19.08.2010	14.09.2010	26	£313.38
£6,297.32	19.09.2010	06.10.2010	17	£251.89
£5,678.23	19.10.2010	17.11.2010	29	£227.13
£7,209.00	19.11.2010	14.12.2010	25	£288.36
£5,759.58	19.12.2010	15.01.2011	27	£230.38
£6,906.69	19.01.2011	19.02.2011	31	£276.27
£5,824.97	19.02.2011	12.03.2011	18	£233.00
£6,273.95	19.03.2011	02.04.2011	14	£250.96
£7,114.79	19.04.2011	11.05.2011	22	£284.59
<b>£76,312.48</b>		<b>TOTALS</b>		<b>£2,791.96</b>

7. HMRC assessed a penalty at the 4% rate and notified it to the Appellant in a letter dated 15 June 2011. That letter in fact contained an error, in that one of the amounts of late paid PAYE and NIC was overstated by inadvertently including class 1A National Insurance contributions, which should not have been included. HMRC have subsequently accepted that the correct figures are as set out above.

### **The Appeal**

#### *The initial appeal and grounds*

8. The Appellant appealed to HMRC by letter dated 24 June 2011 from its accountants, Harrison Priddey & Co. HMRC refused to consider the appeal as they said it did not fall within any of the appeal provisions set out in schedule 56. This was an unfortunate response, as the Appellant was clearly appealing against HMRC's decision that a penalty was payable, which falls four square within the appeal provisions of the schedule. However, the Appellant immediately notified its appeal to this Tribunal as well.

9. In its initial appeal, the Appellant argued that the penalty should be set aside on the grounds that it was disproportionate to the default involved. Based on a rough calculation, it estimated that at an interest rate of 7%, HMRC had lost a little over £400 as a result of its late payments.

10. In addition to developing the proportionality argument a little more, it added two further grounds of appeal before the hearing.

11. First, it submitted that HMRC had wrongfully failed to consider the exercise of their discretion under paragraph 9 of schedule 56 (headed “Special Reduction”) before assessing the penalty, which was therefore void.

5 12. Second, it submitted that HMRC should have considered the issue of “reasonable excuse” under paragraph 16 of the schedule in conjunction with the Appellant before assessing the penalty. Their failure to do so, it was submitted, meant that they had not followed the correct procedure and the penalty was accordingly void.

10 13. At the hearing itself, Mr Priddey on behalf of the Appellant also argued that HMRC had not acted fairly in imposing the penalty which it had and the penalty should therefore be struck down under common law.

### *The appeal hearing*

#### The applicable legislation

15 14. As would be expected, HMRC brought copies of the relevant legislation with them to the hearing of the appeal (which was listed as a basic case, so proceeding straight to a hearing without any prior exchange of evidence or any statement of case from HMRC).

20 15. Unfortunately, however, it transpires that the legislation which they brought with them was not the up to date version. The provisions of schedule 56 were significantly amended by schedule 11 to the Finance (No 3) Act 2010 and the Finance (No 3) Act 2010, Schedule 11 (Appointed Day) Order 2011 (SI 2011/132) with effect from 25 January 2011 (which, it will be noticed, was part of the way through the tax year which is the subject matter of this appeal).

25 16. If the changes made by the Finance (No 3) Act 2010 had been relevant to the issues in this case, this could have been a crucial point. In fact, the changes made do not affect the issues in this appeal and it is therefore not necessary for us to decide the point. HMRC’s oversight is however unfortunate, and raises the question of how a taxpayer is supposed to remain fully informed of all current legislation when even HMRC seem unable to do so.

30 17. Therefore whilst the change to the legislation does not affect matters in this case, we would wish to send a clear message to HMRC and appellants that when they produce copies of legislation for hearings, they should produce copies showing all amendments which have been made over any relevant period.

#### The Appellant’s first submission – failure to exercise paragraph 9 discretion

35 18. Mr Priddey made the following points:

- (1) Paragraph 9 of schedule 56 confers a discretion on HMRC to reduce a penalty if there are “special circumstances”.

(2) The wording of paragraph 9 is, in all material respects, identical to the wording contained in paragraph 11, schedule 24 Finance Act 2007 (relating to the potential reduction, in “special circumstances”, of penalties for careless or deliberate inaccuracies in returns).

5 (3) As HMRC guidance on schedule 24 Finance Act 2007 makes clear, in cases where a special reduction is potentially relevant, they should consider it before reaching a decision on the penalty. He referred to *Scofield v HMRC* [2011] UKFTT 199, arguing that HMRC’s failure properly to consider the question of special reduction before assessing the penalty was a procedural  
10 flaw which rendered the penalty void.

19. Paragraph 9 of schedule 56 provides:

“(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 –

15 (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 –

20 (a) staying a penalty, and

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

20. Paragraph 11 of schedule 24 Finance Act 2007 provides:

25 “(1) If they think it right because of special circumstances, HMRC may reduce a penalty under paragraph 1 or 2.

(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.

30 (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.”

21. Mr Priddey is therefore clearly correct in his assertion that, for all practical purposes, the two provisions are identical.

22. The guidance that Mr Priddey referred to is contained in HMRC's Compliance Handbook Manual, paragraph CH82490, and includes the following passage:

5                               “Where a person requests a special reduction you should establish the facts and consider all of the relevant factors before reaching a decision.”

23. First, we note that HMRC's manuals may give an indication of their view of the law, but they are not always correct, indeed on a number of occasions they have been found to be wrong. We do not consider the manuals to give an authoritative guide to the meaning of legislation.

24. We also note that the above passage begins with the words “Where a person requests a special reduction...” ie. it does not assume that HMRC are under any obligation to consider the question of a special reduction unless and until the taxpayer requests one.

15 25. Mr Priddey also pointed us to the notice issued by HMRC on 7 April 2010, in which they summarised the new PAYE penalty regime for taxpayers. He pointed out that it made no mention of the possibility of a reduction in a penalty on account of “special circumstances”. It contains no clue for taxpayers as to the existence of such a possibility. He said this omission strengthened the duty on HMRC to exercise that discretion of its own volition.

26. Mr Priddey did not direct us to anything else in the wording of paragraph 9 or the context of schedule 56 generally which could be interpreted as laying down a requirement that HMRC must consider the question of “special circumstances” as an essential preliminary step before assessing a penalty.

25 27. So far as Mr Priddy's argument based on *Scofield* is concerned, we read that case as authority for the proposition that where HMRC are exercising a statutory discretion, they must consider all the issues that the statute requires them to consider before they can validly exercise that discretion. The crucial passage (at [144]) reads:

30                               “The statute requires that the issue of reasonable excuse is considered before the determination is issued and not afterwards.”

28. There is a key difference between the *Scofield* case and this appeal.

29. The *Scofield* case was concerned with a provision which conferred on HMRC a discretion to withdraw “gross payment” status under the construction industry scheme. HMRC had purported to withdraw that status from Mr Scofield on the basis that, if he were applying for gross payment status at the time, his application would be refused because he had made a late payment of tax; as a result, he would fail the “compliance test” set out in paragraph 4, schedule 11 Finance Act 2004; and because his application would be refused if he were a new applicant, they were required to withdraw his gross payment status. What *Scofield* said was that as the compliance

test itself allowed for a default to be ignored if there was a reasonable excuse for it, HMRC could not properly have applied the compliance test without enquiring into the question of reasonable excuse for that default. By simply issuing an automatically computer-generated notice cancelling his gross payment status, they had clearly not considered whether there might be a reasonable excuse for the default and had therefore not exercised their discretion as the statute required.

30. The situation under paragraph 9 of schedule 56 is not the same. In *Scofield* it was clear that the compliance test could not be properly carried out without investigating whether there was any reasonable excuse for the default. The compliance test was a fundamental statutory requirement. HMRC could not do what they had purported to do (withdraw gross payment status) without forming a proper view on the compliance test. In the present case, paragraph 9 allows a penalty to be reduced “if HMRC think it right because of special circumstances”. There is nothing in the existence of this “power to reduce” which is, in the same way, fundamental to the arising 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. For these reasons, we reject Mr Priddey’s submissions.

31. Mr Priddey submitted no further arguments in support of this particular limb of the appeal, though it is fair to say that some of the arguments he raised on the second limb of the appeal could apply also to this limb.

32. We consider those arguments no further here, as they are fully explored below and our comments on them would apply equally if they were advanced in relation to this limb.

25 The Appellant’s second submission – failure to consider reasonable excuse before imposing penalty

33. Mr Priddey referred again to *Scofield*. He argued that, as in that case, schedule 56 required HMRC to consider the question of potential reasonable excuse (which would necessarily involve raising the issue with the Appellant) before assessing the penalty.

34. His essential point was that paragraph 16 of schedule 56 stated that liability to a penalty did not “arise” if a reasonable excuse was established. He referred to the definition of “arise” in the Oxford English Dictionary:

“To spring up, come above ground, into the world, into existence”

35. Paragraph 16 of schedule 56, as originally enacted, provided as follows:

“(1) Liability to a penalty under any paragraph of this Schedule does not arise in relation to a failure to make a payment if P satisfies HMRC or (on appeal) the First-tier Tribunal or Upper Tribunal that there is a reasonable excuse for the failure.

(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,

5 (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

10 (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.”

36. As amended with effect from 25 January 2011, sub-paragraph (1) was amended to read as follows:

15 “(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.”

20 37. He submitted that, given the dictionary meaning of “arise”, the effect of paragraph 16 was that it was an essential precondition to the imposition of a penalty that there was no reasonable excuse. Until reasonable excuse had been considered and discounted, no penalty could “arise”. In procedural terms, he said, that meant that  
25 HMRC must confer first with the taxpayer to consider the question of reasonable excuse before they could impose a penalty. Any penalty imposed without doing so must be invalid, he submitted, on the basis of the reasoning in *Scofield*.

30 38. Mr Priddey noted that the language used in different parts of schedule 56 in relation to the imposition of penalties differed slightly and he sought to make sense of the differences in order to see if they supported his view of the significance of the wording in paragraph 16. In particular:

(1) Paragraph 1 says that a penalty is “payable” in the various circumstances, but that where the taxpayer’s failure falls under more than one provision, he is “liable to a penalty” under each provision.

35 (2) The various paragraphs which set out the calculations for the penalty amounts (including paragraph 6, the relevant paragraph in this appeal) all refer to the taxpayer being “liable to a penalty”.

(3) Paragraph 11(1) sets out the mechanism for assessment of the penalty. It starts with the words “Where P is liable for a penalty under any paragraph of this Schedule HMRC must – (a) assess the penalty.....”

(4) Paragraph 13 provides for a right of appeal “against a decision of HMRC that a penalty is payable” or as to “the amount of a penalty payable”

(5) As already mentioned above, paragraph 16 refers to “liability to a penalty” not “arising” where there is a reasonable excuse for the relevant failure.

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39. He thought that the slightly different language used must refer to slightly different underlying concepts. He sought to make sense of this by suggesting that “liability to a penalty” (in paragraph 16) was something which, conceptually, preceded being “liable for a penalty” (as in paragraph 11). Being “liable to” something, he argued, connoted an element of jeopardy or potential liability (as in “liable to a risk of a penalty”), whereas being “liable for” something connoted an actual existing liability (as in “liable for a debt”). If this was right, then “liability to” a penalty being imposed would necessarily precede “liability for” that penalty once it had been imposed. Accordingly, he argued, you could not reach the “liable for a penalty” stage of paragraph 11 (justifying the assessment of a penalty) until you had been through the “liability to a penalty arising” stage of paragraph 16. The logical sequence, which was consistent with the wording of each of the relevant provisions was as follows:

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(1) A late payment having occurred, the taxpayer became “liable to” a penalty under paragraphs 1 and 6.

(2) That penalty however cannot “arise” (or mature into an actual penalty) under paragraph 16 until the question of reasonable excuse had been dealt with.

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(3) Once any reasonable excuse argument has been discounted under paragraph 16, the penalty can “arise” and therefore the previous “liability to” a penalty matures into the taxpayer becoming “liable for” a penalty for the purposes of paragraph 11, so that an assessment may (indeed must) then be raised.

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(4) Once the assessment has been raised, the Appellant may appeal under paragraph 13 against either the decision that a penalty is “payable” or against the amount of that penalty.

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It followed, he said, that any attempt to raise an assessment under paragraph 11 was premature if HMRC had not previously considered the position in relation to reasonable excuse under paragraph 16. This supported his interpretation of paragraph 16 viewed in isolation at [37], he submitted.

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40. With respect to the detailed and subtle submissions made by Mr Priddey, we cannot agree with them. We consider the schedule has to be interpreted as a whole in line with its purpose. Unlike the construction industry scheme provisions considered in *Scofield*, we do not consider there is anything in the drafting or general scheme of schedule 56 which requires the question of reasonable excuse to be considered before any penalty can be assessed. Indeed, paragraph 16 specifically contemplates the First-

5 tier Tribunal or Upper Tribunal adjudicating on whether a reasonable excuse exists,  
and there is no mechanism set out in the schedule for how either of them might do so  
without a penalty having been assessed and appealed; it proceeds, it seems to us, on  
the tacit assumption that this Tribunal will be considering the issue of reasonable  
excuse in the context of an appeal against a penalty. That seems to us to be a  
perfectly sensible approach. If a Tribunal finds that a reasonable excuse existed, then  
it will be discovered, as a result of such finding, that the penalty (or the relevant part  
of it) never arose. That will result in an appropriate adjustment to the penalty under  
paragraph 15. We see no warrant, in the wording of the schedule, to import a whole  
extra stage of requiring HMRC to consider the question of reasonable excuse as a  
preliminary matter before assessing a penalty. With respect therefore, we consider  
that Mr Priddey's argument simply places too much weight on the use of the words  
"to" and "arise" in paragraph 16, and it cannot be sustained.

15 41. We acknowledge however that Mr Priddey's argument is not entirely without  
foundation. We do not agree with it, but if it were in fact correct it would have major  
implications for the way HMRC go about assessing penalties under schedule 56. We  
imagine that even if the Appellant does not wish to appeal on the point (and Mr  
Priddey indicated that this was unlikely, as he was not expecting to be paid by his  
client even for his appearance before this Tribunal), HMRC may wish the matter to be  
20 considered at a higher level in order to put the point beyond doubt, now that it has  
come up. With this in mind, we are prepared to confirm at this stage that we would  
give permission to appeal against our finding on this point if the Appellant were to  
apply for it. HMRC may wish to reach some arrangement with the Appellant as to  
costs to enable such an appeal to be made and determined.

25 The Appellant's third submission – proportionality

42. Mr Priddey submitted that we had power to strike down the penalty as  
disproportionate on the basis of the reasoning set out in *Energys Holdings UK Limited*  
*v HMRC* [2010] UKFTT 20. He asked that we do so.

30 43. He sought to persuade us that whilst the circumstances of the Appellant's cash  
flow were not sufficient to amount, on their own, to a reasonable excuse, they could  
be borne in mind when considering the question of proportionality. He pointed out  
the financial problems the Appellant had experienced (reflected in its accounts for  
2010). By reference to bank statements, he sought to persuade us that its cash flow  
was tight and it managed it as best it could, bearing in mind its reliance for a large  
35 part of its turnover on one key customer. He did not seek (rightly in our view) to  
argue that this could form the basis of a reasonable excuse for the defaults themselves,  
but he submitted it was relevant when considering proportionality.

40 44. He compared the Appellant with a notional taxpayer in a similar position who  
"played the system". He argued that by doing so, it could manipulate matters by  
withholding its first payment in the year, then allocating subsequent payments to  
current months (rather than running permanently one month in arrears, as the  
Appellant had done). With further manipulation of this nature, Mr Priddey calculated  
that the notional taxpayer could escape with penalties of just £72 rather than the

£2,791.96 suffered by the Appellant. He argued that this discrepancy of itself meant that the Appellant's penalty was disproportionate, as it penalised the Appellant forty times more than his other notional taxpayer with exactly the same payment profile.

45. We do not necessarily accept that the system could be manipulated as Mr Priddey contends, but in any event when we consider the penalty actually imposed in this case, we do not consider it to be "plainly unfair" in terms of the *Energysys* case.

46. Mr Priddey also asked us to find that the penalty imposed on this Appellant was disproportionate bearing in mind that many of his other 700 to 800 clients who had paid PAYE late had not received penalties. We do not consider that a general unsubstantiated assertion that HMRC are not imposing penalties even-handedly can found a proportionality argument. In any event, proportionality is concerned with the proportion between the default and the penalty, not with that between the taxpayer's penalty and any other person's penalty.

The Appellant's fourth argument – breach of common law duty of fairness

47. Mr Priddey referred to the First-tier Tribunal's decision in *HMD Response International v HMRC* [2011] UKFTT 472, in particular the statement at [18] that:

"...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."

48. Mr Priddey argued that good practice and fair conduct required either the early issue of penalty notices or, if that was not practicable, the early issue of reminders or warnings that penalties may be accruing. He pointed out that the system of schedule 56 allowed for penalties to be issued "in-year", but HMRC had simply decided not to do so, setting their computer to issue penalties automatically in one go at the end of the tax year. As such, he argued, they had set up a system which was incompatible with the principle set out in the *HMD* case and therefore any penalty notice issued in pursuance of that system was invalid.

49. We see many differences between the facts of this case and those of the *HMD* case. In that case, the Appellant genuinely and honestly believed that it had complied with its obligations. In fact, the Tribunal found out that HMRC had not shown that there had been any default, and therefore the comments made by the Tribunal about fairness are not relevant to its decision. In addition, of course, decisions of other panels of the First-tier Tribunal are not binding on us.

50. We express no view on the comments from *HMD* which Mr Priddey was seeking to rely on, but we observe that even if they were correct, we see nothing in the present case which would justify setting aside the penalty on the basis of them. The Appellant was very well aware of its obligations and of the fact that it was defaulting. What it really complains of is that it did not realise the full implications of its actions, in terms of the new penalties they would attract. Effectively Mr Priddey was arguing that the Appellant should be excused from the penalty by reason of its ignorance of the law. It is a long established principle of English law that this

argument is doomed to fail. In any event, we are satisfied that HMRC did send a letter to the Appellant on 28 May 2010 after its first default, warning of the possibility of penalties if there was any further default.

*The process followed by HMRC*

5 51. Whilst it is not strictly necessary in the light of the conclusions we have reached on the Appellant's arguments, we feel it appropriate to summarise the evidence we heard about the process followed by HMRC in imposing these penalties.

52. Oral evidence was given by Ms Louise Tarpay, who works in HMRC's Debt Management unit (the section of HMRC which administers these penalties). We  
10 accept her account.

53. Ms Tarpay explained that at the end of the tax year, information about PAYE defaulters is extracted from HMRC's system and a spreadsheet is produced of what she described as "the worst defaulters".

54. The individual records of the various employers on that list are then considered,  
15 especially with regard to their payment history, record of responses to chasing calls from Debt Management, and any "time to pay" arrangements. They seek to differentiate between employers who appear to be genuinely trying to pay, and those who do not.

55. In this case, there had been at least 18 unsuccessful attempts during the year to  
20 speak to the Director at the Appellant to chase up late payments. On occasion, the response was rude, or there was a straight refusal to pay. On many other occasions, calls were simply not returned. It may well be that by a more constructive engagement with HMRC during the year, the Appellant could have avoided the imposition of penalties at the end of the year. That is the crucial point that comes out  
25 of Ms Tarpay's evidence, rather than any suggestion that HMRC have simply issued computerised penalty demands to all defaulters without any care or consideration.

*Additional legal point*

56. In reviewing the papers in detail following the hearing, we have noted that the  
30 last of the defaults involved occurred when the Appellant failed to pay the NIC that was due no later than 19 April 2011 (slightly strangely, the April payment consisted entirely of NIC, with no PAYE involved at all). This default therefore occurred in the tax year 2011-12, not in the tax year 2010-11.

57. Paragraph 6 of schedule 56 sets out how the amount of the penalty is to be  
35 calculated. That paragraph was amended with effect from 25 January 2011. Both versions of paragraph 6 provide for the penalty to be calculated by reference to the defaults occurring during a tax year (both as to the number of defaults and as to their amount). It is clear that, in both versions of paragraph 6, a default occurs when the taxpayer fails to pay its PAYE in full by the due date. The due date for payment of PAYE and NIC is 14 days after the end of the tax month to which it applies (see  
40 Regulation 69 of the Income Tax (Pay as you Earn) Regulations 2003). No default

arises until the 15<sup>th</sup> day after the end of the tax month (or the 20<sup>th</sup>, where electronic payment is used).

58. The penalty notice issued by HMRC following their assessment of the penalty related to the tax year 2010-11. It specifically said so (as it was required to do by paragraph 11(1)(c) of schedule 56). It includes a penalty amount in respect of a default which occurred on 20 April 2011, in the following tax year. This is incorrect.

59. The first default in any tax year is disregarded for all purposes (paragraph 6(3), both versions). If the default which occurred on 20 April 2011 is also ignored (as it falls into a different tax year), there were ten defaults by the Appellant during the tax year 2010-11. That means that the applicable penalty rate remains at 4%.

60. However, no penalty can be levied in respect of the late payment of the NIC due by 19 April 2011. This is for two reasons. First, the penalty notice is specifically stated to apply to the period of the tax year 2010-11. Second, the late payment of the NIC due by 19 April 2011 represents the first default in the 2011-12 tax year and, as such, falls to be disregarded for all purposes in any event.

### **Decision**

61. We find that the Appellant did default in making the payments of PAYE and NIC set out in the table at [6] above.

62. We hold that the penalty should be calculated at a rate of 4% by reference to the amounts of those defaults but excluding the default which occurred when the Appellant failed to pay its NIC due on 19 April 2011 (see [59]).

63. We find that the penalty is not rendered invalid by HMRC's failure to consider whether to make a special reduction under paragraph 9 of schedule 56 before they assessed and notified it (see [30]).

64. We find that the penalty is not rendered invalid by HMRC's failure to consider the question of "reasonable excuse" under paragraph 16 of schedule 56 before they assessed and notified it (see [40]).

65. We consider that the penalty is not disproportionate (see [44] and [45]).

66. Even if the principle enunciated in *HMD* is applicable (about which we express no view) we find that the penalty in this case would not offend against it (see [49]).

67. It follows that the appeal is allowed, to the extent necessary to reduce the penalty from £2,791.96 to £2,507.37. Subject to that reduction, the penalty is confirmed.

68. 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.

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**KEVIN POOLE  
TRIBUNAL JUDGE  
RELEASE DATE: 6 DECEMBER 2011**