



**TC01626**

**Appeal number: TC/2011/06567**

*PAYE and NICs – late payment of amounts due during 2010-11 – penalty under Schedule 56 Finance Act 2009 – reasonable excuse – held that for period up to 1 June 2010, Appellant had reasonable excuse – insufficiency of funds attributable to events outside the Appellant’s control – penalty also imposed by reference to late payment of 2010-11 PAYE and NIC due on 19 April 2011 – this late payment not to be taken into account as the default was outside the 2010-11 tax year and was the first default in the following year – applicable penalty rate reduced to 3% and penalty reduced from £7,418.10 to £5,494.60 – appeal allowed in part*

**FIRST-TIER TRIBUNAL**

**TAX**

**STONE MANOR HOTELS LIMITED**

**Appellant**

**-and-**

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

**Respondents**

**TRIBUNAL: KEVIN POOLE (TRIBUNAL JUDGE)  
CHRISTOPHER JENKINS**

**Sitting in public in Reading on 15 November 2011**

**Christopher Harlow of Harlow Consulting for the Appellant**

**Karen Evans, Senior Officer for the Respondents**

## DECISION

### Introduction

1. This decision concerns penalties imposed by HMRC for late payment of  
5 PAYE. 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 appeal was mainly based on “reasonable excuse”. The Appellant argued  
10 that although the reason for late payment was insufficiency of funds, that  
insufficiency was attributable to events outside its control.

3. A further point arose, concerning the correctness of including penalties for late  
payment of amounts which related the tax year in question but which only fell due for  
payment in the following tax year.

### 15 The Appeal

4. From 6 April 2010, a new penalty regime was introduced by HMRC for late  
payment of monthly PAYE and NIC by employers. Previously, it was possible for  
employers to delay payments to HMRC of such sums for a short period without  
incurring any material costs. Under schedule 56 Finance Act 2009 (“Schedule 56”),  
20 however, this possibility was removed. Schedule 56 imposes penalties for late  
payment of PAYE. The penalties also cover associated national insurance  
contributions.

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  
25 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.  
A 4% penalty is payable if there are ten or more defaults during the tax year.

6. The Appellant was late in making payment of all but one of its monthly PAYE  
30 payments in respect of the year 2010-11. The amounts paid late, the due dates and the  
penalty amounts subsequently charged are set out in the following table:

<b>PAYE and NIC paid late</b>	<b>Due Date</b>	<b>Penalty @ 4%</b>
£25,024.65	19.05.2010	£0
£4,545.91	19.06.2010	£181.84
£24,434.36	19.07.2010	£977.37
£23,340.08	19.08.2010	£933.60

£26,662.62	19.09.2010	£1,066.50
£15,153.17	19.10.2010	£606.13
£18,386.86	19.11.2010	£735.47
£14,171.66	19.12.2010	£566.87
£14,946.68	19.01.2011	£597.87
£16,487.51	19.02.2011	£659.50
£Nil	19.03.2011	£0
£27,323.31	19.04.2011	£1,092.94
<b>£210,476.81</b>	<b>Totals</b>	<b>£7,418.10</b>

7. HMRC assessed a penalty for the late payments, which they notified to the Appellant in a letter dated 9 June 2010. As required by the legislation, they disregarded the first default of the year, but imposed a penalty at the appropriate percentage rate in respect of what they regarded as the other 10 defaults. The appropriate percentage rate was 4% (as the Appellant had paid late more than 9 times during the year). The penalty totalled £7,418.10.

8. In passing, we would note that HMRC appear to have used a slightly inaccurate method of calculation. Schedule 56 imposes a penalty at the appropriate rate on the total amount of the defaults during the year, whereas HMRC appear to have calculated the penalty by reference to each individual amount and then added them up. This leads to a slight rounding error which, in this case, has overstated the penalty by two pence. They should correct their method of calculation so that it conforms properly to the provisions of Schedule 56.

9. The Appellant appeals against the penalty. It is common ground that the payments were made late, as claimed by HMRC. The Appellant claims to be relieved of the penalty by reason of having a reasonable excuse for the default. The reasonable excuse it seeks to rely on is that it was suffering from a severe shortage of funds during the relevant period, attributable to events outside its control.

10. There is also a technical objection to part of the penalty, covered below.

### **Background facts**

11. Mr Harlow gave oral evidence about the factual background to the defaults, which we accepted. He provided some documents in support, which corroborated and amplified his evidence in certain respects. From the evidence he gave, we find the following facts.

12. The Appellant carried on business operating two hotels (reducing to one hotel from August 2010) and a shop.

13. The late payments as set out above are not disputed. The degree of lateness of one of the payments was not agreed, but that is immaterial for the purposes of our decision.

14. We heard from Mr Harlow how the Appellant had been trading reasonably until the sudden and severe impact on its business caused by the credit crunch of 2008 and subsequent recession really started to take effect. The directors had been examining possible responses, and had obtained indications from expert surveyors in July 2009 that it should be able to sell one of its two hotels (the Cricklade hotel) for approximately £4.6 million. They approached the Appellant's bank (Bank of Scotland) in September 2009, asking for a capital repayment holiday on the existing loan from the bank (which stood at that time at around £3.7 million). The bank refused, and insisted instead on the repayment of the outstanding loan in full.

15. The Appellant decided that the only way out of its problems was to sell the Cricklade hotel. It pressed on with that sale as quickly as it could, but market conditions made it a slow process, and the sale price eventually agreed was only £3.3 million, a major drop in value.

16. In the meantime, the Appellant's directors injected funds into the Appellant on loan account to fund its working capital, and they ceased to draw any remuneration from it. £130,000 was injected in January 2010 and a further £95,000 was injected in May 2010. The difficulties of the business continued as customers cancelled wedding receptions through inability to pay. Then the severe weather at Christmas 2010 caused a further significant cash flow problem at the Appellant's busiest time of year (when it normally does some 30% of its annual trade).

17. The Appellant had difficulties with its VAT payments as well during this period, but used HMRC's "Time to Pay" scheme quite successfully to manage that situation. They did not appreciate that they were accruing PAYE and NIC penalties so they did not think to ask for time to pay the PAYE and NIC, nor did HMRC mention it to them as a possibility during the many contacts that took place between them before and during the year in question.

18. The Appellant had planned to release approximately £500,000 from the expected sale proceeds of the Cricklade hotel to assist it with its working capital requirements, but in July 2010 (shortly before the sale completed) the bank said that it required substantially all of the sale proceeds to be applied in partial repayment of its loan. The net effect was that the working capital position of the Appellant was not immediately improved at all by the sale, it simply reduced its debt to the bank by £3.2 million, to around £500,000. However, the regular capital repayments to the bank were sharply reduced, which at least had a positive impact on the Appellant's cash flow thereafter.

19. Shortly after, one of the directors of the Appellant was able to complete the sale of her house and injected sale proceeds of £260,000 into the Appellant on 4 November 2010.

20. The directors of the Appellant had lost all trust in their bank and they sought to extricate the Appellant from its clutches. They were eventually able to refinance the remaining £465,000 due to the bank by taking out a £690,000 loan with another bank, thus providing an immediate injection of some £220,000. The new bank also agreed to a 15 month capital repayment holiday, which improved matters further. However, the Appellant was only able to complete this refinancing in June 2011.

## 10 The Legislation

21. A clear summary of Schedule 56 is set out by Judge Berner in *Dina Foods v HMRC* [2011] UKFTT 709. We do not propose to repeat it here.

22. Unfortunately, the copy of the legislation which HMRC supplied at the hearing was out of date. It did not take account of the changes made to Schedule 56 with effect from 25 January 2011 by Schedule 11 to the Finance (No 3) Act 2010. We take the amended legislation to be the correct legislation to apply to a penalty assessment raised after 25 January 2011, as in this case.

23. There was one significant difference between the two versions of the legislation for present purposes: in the legislation as originally drafted, paragraph 16 of Schedule 56 provided that liability to a penalty did not arise in relation to any failure for which there was a reasonable excuse. In the amended version, the paragraph also went on to say: “the failure does not count as a default for the purposes of paragraph 6...”. The effect of this change is therefore that under the amended legislation, it is clear that defaults for which there is a reasonable excuse are not to be counted when fixing the appropriate rate of penalty to be charged.

24. Paragraph 6 is the provision which sets out how the penalty is to be calculated. It provides (since 25 January 2011), so far as relevant, as follows:

“(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);

....

5 (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.

10 (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.

15 (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.

20 (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;

25 (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.”

### **The Appellant’s Arguments and our Findings**

25. The Appellant argued that it had a reasonable excuse for its late payments, by reason of insufficiency of funds attributable to events beyond its control.

30 26. It also argued that the penalties were disproportionate and also unfair (because HMRC had allowed them to build up to a large amount without warning).

35 27. The Appellant also alleged that in relation to the payment due on 19 May 2010, the degree of lateness was affected by HMRC mislaying the cheque for a period of time. Also, it alleged the March 2011 payment was delayed because the Appellant’s bank refused to pay a cheque because it suspected (wrongly) it had been drawn fraudulently. We disregard the first matter because even if the cheque had been issued when stated by the Appellant and paid straight away, it would still have been late. We disregard the second because it relates to the March 2011 payment, which HMRC have not recorded as a late payment for penalty purposes in any event.

### *Reasonable excuse*

28. We accept that the Appellant was clearly experiencing severe financial difficulties over the period from at least mid-2009 until it was finally able to complete its refinancing in June 2011. We were prepared to accept in principle that this could  
5 have given rise to an insufficiency of funds that was attributable to events outside its control. However on examining the few bank statements that Mr Harlow had supplied for the hearing, it became apparent that, for example, immediately after the injections of funds in January 2010, the Appellant's bank account was in credit in the amount of £167,000 on 29 January 2010. The difficulties faced by the Appellant are  
10 evident from the fact that, by 28 May 2010, this had reduced to £11,460. Nonetheless, after the injection of funds on that day, the balance was back up to £107,000 and, before the final injection of director's funds on 4 November 2010, the credit balance was still around £84,000.

29. We therefore consider that the Appellant has only made out a reasonable  
15 excuse for the late payment of the PAYE and NIC due on 19 May 2010. We find no reasonable excuse for all subsequent late payments.

### *Proportionality*

30. The Appellant also argued that the penalty was disproportionate. We agree with the comments made in *Dina Foods* on the point at [40] to [42]. We do not  
20 consider this penalty to be disproportionate to the default involved. It is harsh, but we do not consider it to be "plainly unfair".

### *Unfairness*

31. HMRC had given much publicity of a general nature in advance of the new penalty regime coming into force. Details were included in its "Employer's Bulletin"  
25 on more than one occasion, as well as other publicity.

32. We saw that HMRC's records include a note that Mr Harlow was warned on 27 May 2010 during a telephone call with HMRC that legal action and penalties would ensue if the PAYE and NIC due on 19 May 2010 were not paid quickly. There was a similar telephone conversation on 24 September 2010. Mr Harlow had no  
30 memory of those conversations. We find that they did in fact occur. HMRC also maintained they had sent a warning letter. We find that they did send a number of letters estimating the PAYE and NICs due (in the absence of any payment) and warning of possible distraint if payment was not made. However we found no evidence that HMRC had sent a letter specifically warning of the possibility of  
35 penalties. We find no such letter was sent.

33. We do not accept that HMRC were under any positive duty to inform the Appellant of the risk of penalties if it continued to pay late, but in fact the Appellant was informed twice over the telephone of the risk of penalties during the year in question, and in our view should have been aware of the possibility also from the  
40 general publicity that had been issued by HMRC. In the light of this and the telephone

conversations, we reject any argument that HMRC allowed the penalty to build up unfairly before notifying it to the Appellant, even if they were under such a duty.

### **Decision**

5 34. HMRC have not argued that the payment due on 19 April 2010 was late, and indeed since that payment would have been in respect of the PAYE and NIC due for the tax year 2009-10, we do not consider any such lateness could have been taken into account in assessing a penalty under Schedule 56. This is because the Order which brought Schedule 56 into force for the purposes of PAYE and NIC (SI 2010/466) on 6 April 2010 makes it clear that Schedule 56 only applies in relation to “amounts of tax  
10 which are... chargeable in respect of a tax period starting on or after 6<sup>th</sup> April 2010”.

35. We have found that the Appellant has a reasonable excuse for the late payment that it made of the amount due on 19 May 2010. The default that occurred on 20 May 2010 is therefore not counted as a default at all (under paragraph 16(1)(b) of Schedule 56).

15 36. The default which occurred on 20 June 2010 is not counted as a default (under paragraph 6(3) of Schedule 56) because it is treated as the first failure in the year to pay on time.

37. The remaining defaults occurring on 20 July 2010 to 20 February 2011 are all counted as defaults.

20 38. There was no default on 20 March 2011.

39. The default occurring on 20 April 2011 does not count as a default in calculating the penalty for late payments during the 2010-11 tax year. This is because it did not occur during the tax year 2010-11 and paragraph 6(1)(a) makes it clear that only defaults which occur during the tax year are to be taken into account. The  
25 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 could not include reference to a default which took place after the end of that year. In any event, the default occurring on 20 April 2011 was clearly the first default in the new tax year 2011-12 and accordingly does not count as  
30 a default under paragraph 6(3) of Schedule 56.

40. For the purposes of paragraph 6, therefore, there are eight defaults and accordingly the penalty is to be calculated at the 3% rate.

41. The next step is to calculate “the amount of the tax comprised in the total of those defaults”.

35 42. By reference to the amounts in the schedule attached to HMRC’s original penalty notice (and set out above), the amounts paid late in the relevant eight months totalled £183,153.50.

43. Applying the 3% penalty rate, the correct penalty to be charged is therefore £5,494.60, which we substitute for HMRC's decision pursuant to paragraph 15(2) of Schedule 56.

5 44. We do not consider the penalty, as so reduced, can be attacked either on grounds of proportionality or on grounds of fairness.

45. We therefore allow the appeal to the extent necessary to reduce the penalty from £7,418.10 to £5,494.60.

10 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.

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