TC01697

Appeal number: TC/2010/03141

Income tax – PAYE – employer's under-deduction – did the employer take reasonable care – no – appeal allowed

FIRST-TIER TRIBUNAL

TAX

THOMAS JAMES BLANCHE **Appellant**

- and -

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

TRIBUNAL: LADY MITTING (TRIBUNAL JUDGE)
ALBAN HOLDEN (MEMBER)

Sitting in public in Manchester on 29 November 2011

The Appellant appeared in person.

Mr Brian Morgan, an officer of the Commissioners, for the Respondents.

DECISION

1. Thomas James Blanche appeals against a direction given by the Commissioners by Notice dated 29 January 2010 in respect of tax years 2006/07 and 2007/08 pursuant to Regulation 72 (5) Income Tax (Pay as You Earn) Regulations 2003 ('the Regulations').

2. The relevant legislation is contained in Regulations 72 and 72B of the Regulations which read as follows:

"**72. Recovery from employee of tax not deducted by employer**

1. This regulation applies if…

a) it appears to the Inland Revenue that the deductible amount exceeds the amount actually deducted, and

b) condition A or B is met

2. In this regulation –

'the deductible amount' is the amount which an employer was liable to deduct from relevant payments made to an employee in a tax period;

'the excess' means the amount by which the deductible amount exceeds the amount actually deducted.

3. Condition A is that the employer satisfies the Inland Revenue –

a) that the employer took reasonable care to comply with these regulations, and

b) that the failure to deduct the excess was due to an error made in good faith

4…

5. The Inland Revenue may direct that the employer is not liable to pay the excess to the Inland Revenue

72B. Employee's appeal against a direction notice where condition A is met

An employee may appeal against a direction notice under regulation 72(5A)(a) –

a) by notice to the Inland Revenue

b) within 30 days of he issue of the directions notice,

c) specifying the grounds of the appeal

2. For the purpose of paragraph (1) the grounds of appeal are that –

a) the employer did not take reasonable care, or

b) the excess is incorrect

3. On an appeal under paragraph (1) [that is notified to the tribunal, the tribunal] may –

a) if it appears …. that the direction notice should not have been made, set aside the Direction Notice

3. The Commissioners in February 2009, detected an underpayment of PAYE for Mr Blanche in the sums of £1,393.19 for year 2006/07 and £1,390.92 for 2007/08. Initially the Commissioners held the employer liable to make good the underpayment but on appeal by the employer changed their minds and by the Notice of 29 January 2010, they relieved the employer of the liability and imposed it upon Mr Blanche. Mr Blanche, to succeed in his appeal against the Notice, must satisfy the Tribunal on a balance of probabilities that the employer did not take reasonable care (the fact of and the amount of the underpayment not being in dispute).

Chronology

4. In July 2003 Mr Blanche took early retirement after 25 years employment with Lloyds TSB. He immediately started to receive a pension from the Bank and the whole of his personal tax allowances were utilised in the PAYE Tax Code operated against that source of income.

5. Also in July 2003, Mr Blanche signed up as an agency driver with Driven Solutions Ltd ("Driven") which is itself a franchise of the Driver Hire Nationwide Group. From the information which Mr Blanche gave on a form P46, Driven correctly started to operate a PAYE tax code of BR (basic rate tax). Indeed they continued to operate the BR tax code throughout each of the tax years 2003/4, 2004/5 and 2005/6.

6. In September 2005, Mr Blanche entered full time employment with Help, a charitable organisation with whom he stayed until January 2006. When paying his salary, Help operated PAYE tax code 489 on a Month 1 emergency basis until confirmation of the correct code by HMRC. However, it would appear that they did not notify HMRC of the commencement of Mr Blanche's employment with them until after he had left.

7. Mr Blanche at all times, throughout the period September 2005 to January 2006, remained on Driven's books, having advised them that he was available for work during weekends and holidays although none in fact was forthcoming.

8. In January 2006, Mr Blanche left Help and returned to full time availability with Driven. He received a P45 from Help, showing tax code 489 Month 1, which he immediately handed to Driven's finance officer, Mr Steve Weatherald. As he had never left Driven there was actually no requirement for him to have done this and Mr Weatherald, we understand, also took that view and simply filed the P45, taking no

action from it. Driven therefore continued to operate the BR tax code which they had originally been operating until the end of 2005/6. This is evidenced by Mr Blanche's pay statement for 30 March 2006 clearly showing the BR tax code.

9. As the tax code in operation at the end of 2005/6 was BR, then it is this code that should automatically have been carried forward to 2006/7 on all of Driven's systems. In fact Mr Blanche's pay statement for 6 April 2006 (week 1 2006/7) shows tax code 503L as having been operated. Driven has failed to explain how and why they changed the tax code from BR to 503L at the start of the 2006/7 tax year. There is no indication that Driven ever received from the Commissioners any tax code other than BR during 2006/7.

10. On 10 May 2006, the Commissioners issued a BR Coding Notice to Driven, with copy to Mr Blanche. We assume, but this is only an assumption, that this action by the Commissioners was triggered by Driven's use of an incorrect tax code. For reasons which we set out below, the BR Coding was never activated and tax continued to be deducted in line with Code 503L during 2006/2007, being carried forward and updated in line with budget requirements in 2007/08. The failure by Driven to use the correct coding has resulted in the under-payment of tax out of which this case arises.

11. On detecting the underpayment, the Commissioners began enquiries and entered into correspondence with a Mr Holt of Driven. Mr Holt explained that the company used the SAGE payroll system which is of course a standard fully authorised system. However, Driven also used an internal and separate Driver Hire IT system, known as dhOps (driver operating system). This system holds all the customer and driver information including bookings, driver hours etc. and is used both to invoice the customer and for the driver payroll. The two systems dhOps and SAGE, are set up to operate in conjunction with each other. The manner of integration was described by Mr Holt as follows in his letter of 6 July 2009.

"

- dhOps holds the customer and candidate (agency worker) details as two databases.

- Client bookings are entered on to the system, and candidates are linked to the booking.

- The following week after a booking has been completed, dhOps is used to produce the invoicing for the client and the payroll for the candidate. Timesheet information from the candidate is entered once onto the dhOps system, and a file is exported to our franchisor.

- Our franchisor returns two files back to us. The first contains invoicing details. The second file contains payroll details in the form of hours and hourly pay rates worked the previous week which payment is required for, and particularly relevant, the personnel details, i.e. name, address, NI number, tax code, WIMI, and bank account details for BACS payment.

The payroll details sent in the file are a 'snap shot' of the information held on the system at the point when the payroll files are sent.

- This second file is processed through linking software, so that SAGE software in the office is automatically pre-populated with all of the candidates' payroll details, i.e. how many hours worked and pay rates to make correct and accurate payment without having to re-enter the same details for a second time from the timesheets. Relevant to this case, is the fact that personnel details within the file from the franchisor will over ride any existing data held on the candidate within the SAGE software. This is confirmed in Alan's email in paragraph 4. This is actually a very useful function for a new candidate, as the data is used to automatically set up a new employee within SAGE without a member of staff in the office having to set a new starter up manually.

- The rest of the payroll function is then processed 'normally' using SAGE."

12. It is clear, and so we find, that Driven received the May 2006 notice of BR coding and they correctly processed it in the SAGE system. This is evidenced by the extract from the IR secure mail box showing it was 'actioned' on 21 May 2006 and the activity is marked 'success'.

13. However, in Driven's use of the integrated system it was not sufficient to merely enter the code onto the SAGE system because the dhOps system was in effect the master and it overwrote any information on SAGE. What therefore happens is that if a re-coding is necessary it must not only be entered onto the SAGE system but critically onto the dhOps system because if it is not the old code as recorded on dhOps overwrites whatever has been inserted into the SAGE system. Here, the Driven operative entered the new code only in SAGE, failed to enter it into dhOps and dhOps therefore overwrote the SAGE entry.

14. Mr Holt, having explained the above situation pleaded his company's good PAYE record. This was the first case of an under deduction in over six years by a company with 752 employees going through the payroll. The system of electronic coding was new to the company. The company, having been made aware of how the situation had arisen, had taken steps to correct it and eliminate any potential repetition. The loss of £3,000 would have a severe effect on cash flow. Finally, Mr Holt submitted that Mr Blanche was fully aware of what had happened and, given time to pay, had expressed his preparedness to make the repayment himself. This latter statement was, in his oral submission to us, totally refuted by Mr Blanche who labelled it as simply untrue. Given Mr Blanche's vehement denial of any liability, we would be surprised if he had given any such assurance. Mr Holt clearly believed that he had and how he came to this view we do not know but it is not a factor which is relevant to the determination of the issue before us and we make no further comment on it or give it any further consideration.

15. The Commissioners made specific enquiries into the degree of training which the payroll staff had had into the use of the dhOps system and were told that all operatives had undertaken a two day residential course in its use. Mr Holt was unsure whether any specific instruction had been given on changing tax codes or on the interaction of dhOps and SAGE but he passed on to the Commissioners two screenshots from the dhOps user manual which contained the following prominent words of caution:

> "Banking Details and Payroll Details are used to transfer through to Sage Payroll for payment and tax control purposes. Details added into dhOps will overwrite any details held in the Sage Payroll System. These details can be updated within dhOps at any time but the details will not be passed through to the Sage Payroll system until such time as the candidate is paid via dhOps (Timesheet, Expense, Holiday or Bonus Payment)."

> "**Important**

> All Payment and Tax details shown here will overwrite those in Sage Payroll when the candidate is next paid. You must always make changes to candidate Payroll and Tax details here and not within Sage Payroll."

16. The Commissioners reviewed all the information they have been given and by letter dated 6 November 2009 held Driven liable to make the repayment in the following terms:

> "The dhOps User Manual makes it quite clear that the details from the dhOps system will overwrite any information held on the SAGE payroll system. However, there doesn't appear to be any specific instruction informing the payroll staff that if any amendments are required to the employee's tax codes these must be made via the dhOps system. It is this failure to supply this guidance on how to enter new or amended tax codes that resulted in the above under-deduction of tax.
>
> The failure to have the appropriate instruction in place showed the company didn't take any reasonable care and I am therefore unable to relieve you of paying the under-deducted tax."

17. The company appealed against this Decision by letter dated 9 November 2009. The gist of the appeal was that the company was in effect the end user of the dhOps software system and any deficiency in its operation or in training lay with the provider and not Driven. Further enquiries from the Commissioners were answered in a letter of 23 December 2009 explaining that although the payroll number was 750, the majority of personnel was so short lived that amendment of tax coding was never needed and that is why the problem had never manifested itself before. Mr Blanche was unusual in the length of his service.

18. Mr Mowbray, the reviewing officer, carried out a review as detailed in his two page note dated 29 January 2010. His note records in part how the error arose and that he went on to look at the following factors:

"When considering reasonable care I have looked at:

- The IT systems operated by the employer – the employer uses an accredited payroll system (SAGE) and a system provided by the franchiser (dhOps). The franchiser has over 100 franchises employing over 4000 drivers, and as such it is not unreasonable to expect the employer to believe that dhOps was fit for purpose and that operation of this system posed no threat to the correct operation of PAYE.
- The level of training provided – The employer has confirmed that the full time office staff undertook a 2 day residential training course, with staff receiving 1 to 1 training.
- The employer previous performance – The employer has been trading since 2003 and this appears to be the first instance of any failure in the operation of PAYE."

Mr Mowbray concluded that Driven had taken "reasonable care to deduct the correct amount of tax from the relevant payments you made but, due to an error made in good faith, deducted too little."

19. It appears from Mr Mowbrey's note that he did not consider how and why Driven had operated tax code 503L from the beginning of the 2006/7 tax year when they had operated the BR code to the end of the preceding year. It appears that he had erroneously assumed that Driven had been operating tax code 489L during 2005/6 and that this code had been carried forward to 2006/7 (updated to 503L by the budget increase) on both the dhOps and SAGE systems. Therefore his understanding appears to have been that when tax code BR was entered on to the SAGE payroll system during May 2006, the code on dhOps (503L) overwrote the BR code. Mr Blanche informed Mr Mowbray that Driven were aware of his correct tax code and had changed it during 2006/7 without valid reason. As a consequence, Mr Mowbray wrote to Driven on the 5 February 2010, concluding his letter as follows:

"If, as appears to be the case, the code in operation at the end of 2005-06 was BR, then this code should have been automatically carried forward to 2006-07, on both the dhOps and SAGE systems. As code 503L must have been on dhOps for it to overwrite the BR code entered on to SAGE in May 2006, I can only assume that Mr Blanche's code on dhOps was changed from BR to 503L during 2006-07.

I am not aware that any code other than BR was issued to you during 2006-07 and as such cannot understand why the apparent change from BR to 503L was made.

Can you please review Mr Blanche's payroll records and confirm that code BR was in operation at the end of 2005-06, and if and when the code was changed to 503L (it may be of assistance if you can provide a copy of Mr Blanche's payroll records for 2006-07). If your records confirm that Mr Blanche's code was changed from BR to 503L, can you please inform me on what authority this change was made."

20. The reply from Driven dated 8 February 2010 did not address the points raised by Mr Mowbray but merely asserted that when Mr Blanche re-joined the agency in January 2006, he presented a P45 upon which they acted. Notwithstanding the unsatisfactory nature of this response, Mr Mowbray then made the Direction against which Mr Blanche appeals.

Consideration

21. We understand from Mr Morgan that Driven had been invited but had declined to come to the Tribunal and we therefore can only rely on our interpretation of the correspondence from Driven and its enclosures. With this proviso, we comment first on the correspondence to which we refer in our previous couple of paragraphs. There are a number of errors and misunderstandings revealed here. Driven informed Mr Mowbray that Mr Blanche had "rejoined the agency" in January 2006. In fact he never left it, remaining on their books throughout. He was never given a P45 by Driven when he began work for Help and he did not see himself as a new employee when he resumed working with Driven in January 2006. Secondly, Driven did not act on the P45 when they received it in January 2006, continuing to operate the BR code correctly for the remainder of that tax year. Thirdly, no explanation was given as to why Driven suddenly changed the tax code from BR to 503L not only some months after receiving the P45 but in a different tax year. We have no idea what went on within Driven's payroll department but whatever they did, it was incorrect and at this stage would not appear to have involved any computer error. For reasons unknown, Driven adopted an incorrect 489L code, updating it to 503L. This was done without any authority and could not have happened if proper care were being taken.

22. The train of events following the issue of tax code BR on 10 May 2006 is somewhat clearer and we believe that the initial view taken by the Commissioners was in fact correct – that in the circumstances Driven did not take reasonable care in dealing with the activation of Mr Blanche's amended BR tax code for 2006/7.

23. The two screenshots clearly and unequivocally highlight the need to enter payroll changes onto the dhOps system as well as SAGE. It is our understanding that these screenshots came from the training manual to which all operatives would at the time have had access. Re-coding may well have been an activity which the operatives did not have to do with any degree of frequency but that cannot excuse the failure to follow clear instruction in the training manual. We accept Mr Morgan's contention that the period we must consider is that of the underpayment because the issue before us is how that underpayment came about but we think that this can only be properly understood in the context of how the company had previously dealt with Mr Blanche. This reveals to us a careless approach to the payroll which we see as being perpetuated in the failure to follow the instructions in the dhOps training manual. For these reasons we find that the company did not take reasonable care and we allow Mr Blanche's appeal. Although we find that the company did not take reasonable care we do not for one moment find or even imply that it acted in bad faith.

24. We should add one further comment. A good part of Mr Morgan's submission to us was that Mr Blanche either did or, if he did not should have, known of the failure

of his employer to implement the correct code. Mr Morgan pointed out that he would have received the notice of coding and that he had access to his weekly payslips which would have made both the amount of tax deducted and the code being used quite clear. Mr Blanche maintained that he never looked at his payslips as these were dealt with by his wife. In any event he did not understand coding and as he worked different hours each week at differing rates, the amount of pay he received differed every week and an incorrect deduction of tax would not therefore have been apparent to him. This argument is not one that Mr Mowbray took into account and quite rightly. As Mr Morgan accepted in the oral hearing, the conduct we are considering is that of the company and not Mr Blanche and the mere fact that Mr Blanche should have realised is not a relevant issue.

25. The appeal is therefore allowed and in line with the jurisdiction given to us under Regulation 72B 3, we set the Direction Notice dated 29 January 2010 aside.

26. 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: 29 December 2011