



TC02330

Appeal number: TC/2011/09994

INCOME TAX – PAYE – Schedule 56 Finance Act 2009 – penalty for late payment – held payments under time to pay agreement only excluded where due after agreement requested - Whether penalty disproportionate – No – Whether a reasonable excuse for late payment – No – Whether “special circumstances” justifying a special reduction – No – Appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

FRITH’S FLEXIBLE PACKAGING LIMITED

Appellant

- and -

**THE COMMISSIONERS FOR HER MAJESTY’S
REVENUE & CUSTOMS**

Respondents

**TRIBUNAL: JUDGE GREG SINFIELD
SONIA GABLE**

Sitting in public at 45 Bedford Square, London on 20 July 2012

Mr David Watson, managing director, for the Appellant

**Mrs Gloria Orimoloye, advocate of the office of the General Counsel and
Solicitor to HM Revenue and Customs, for the Respondents**

DECISION

Introduction

1. Frith's Flexible Packaging Limited ("the Company") appealed against a penalty of £5,448.90 imposed under Schedule 56 to the Finance Act 2009 for late payments of PAYE by the Company during the year 2010-11.

2. The Company did not dispute that the payments were made late and acknowledged that it had received a penalty default letter dated 28 May 2010. The Company made late payments of PAYE on eight occasions between May 2010 and March 2011 (ie every month except for September and October 2010 and January 2011). The level of penalty is set by paragraph 6 of Schedule 56 by reference to the number of defaults in the year. There were eight late payments during the year ended 5 April 2011 (but the first late payment did not count towards the penalty) and the penalty under paragraph 6 was 3% of the aggregate of the amounts paid late.

3. At the hearing on 20 July 2012, Mr David Watson, the managing director of the Company, submitted that it was not liable to pay the penalty because it had an agreement for deferred payment of PAYE with HMRC. Mr Watson also submitted that the Company had not been informed that it had incurred a penalty until 15 months after it had started to incur it. He said that the penalty was disproportionate and unfair as it was equivalent to an amount of interest at 81% and that HMRC had not considered the circumstances of the Company. The Tribunal gave its decision dismissing the appeal orally at the end of the hearing.

4. On 2 August 2012, the Tribunal sent a written summary decision to the parties confirming the decision given at the hearing. The final paragraph of the summary decision stated that a party wishing to appeal against the decision must apply to the Tribunal within 28 days of the date of release for full written findings and reasons. Mr Watson emailed the Tribunal on 29 August 2012 to request full written findings and reasons for the decision as he intends to appeal to the Upper Tribunal. We set out below in full our findings and the reasons for our decision in the appeal.

Issues

5. The issues for the Tribunal were

- (1) Was an agreement for deferred payment of PAYE in force at the relevant time, and if so, did it relieve the Company from liability to a penalty?
- (2) Did the Company have a reasonable excuse for the late payments?
- (3) Were there any special circumstances that meant that the penalty should be reduced?
- (4) If the Company is liable to a penalty was the penalty disproportionate?

Facts

6. Mr Watson gave evidence. The parties also produced bundles of documents containing correspondence and legislation. On the basis of the witness evidence and documents, we find the material facts to be as follows.

5 7. The Company suffered very considerable financial difficulties in 2009 which
continued into the following years. The Company's invoice discounters withdrew
their support and its bank withdrew the Company's overdraft facility. The Company
entered into a company voluntary arrangement ("CVA"). The supervisor that
10 managed the CVA would not allow the Company to pay amounts of VAT and tax.
Mr Watson said that the Company just about pulled through and obtained the services
of a new invoice discounter.

8. In a letter dated 15 October 2009, HMRC agreed dates for the payment of
arrears of PAYE/NIC by monthly payments up to and including 28 June 2010. On 16
15 March 2010, HMRC terminated the Company's time to pay agreement because the
Company had not made the scheduled payments. On 8 April 2010, the Company sent
HMRC a proposal for a new deferred payment agreement. This was refused in July
2010. Mr Watson said that this was a time of great stress as the Company faced being
wound up by HMRC and he borrowed as much as he could in order to keep the
Company going.

20 9. Following several telephone calls and emails, HMRC accepted the Company's
proposal for a new deferred payment arrangement in a letter dated 30 September
2010. The agreement related to, among other liabilities, £176,940.46 arrears of the
Company for PAYE/NIC for 2009/10. It was a condition of the deferred payment
agreement that the Company pay PAYE/NIC arrears for months 1-5 of 2010/11 in full
25 by 8 October 2011. As Mr Watson accepted, this was a reference to arrears of an
associated company, A M (Holdings) Limited, for months 1-5 of 2010/11. The
Company had already paid its PAYE/NIC liabilities for months 1-5 of 2010/11
(although months 2, 3 and 4 had been paid late). The letter also stated that late
30 payment of 2010/11 PAYE liabilities may also incur penalties and "if this occurs you
will be notified".

10. Following the letter dated 30 September 2010, the Company made late
payments of PAYE in respect of November (eight days), December (paid in eight
instalments up to 63 days late), February (four days) and March 2011 (eleven days).

Legislation

35 11. The new penalty code for late payments of tax was introduced by Schedule 56
to the Finance Act 2009. The relevant paragraph of the Schedule, applying to late
payments of PAYE, was paragraph 6, which came into force on 6 April 2010 (SI
2010/466 art 3). Although newly enacted, paragraph 6 was amended with effect from
25 January 2010 (SI2011/132 art 2(b)) by paragraphs 1 and 6 of Schedule 11 Finance
40 (No2) Act 2010. For the purpose of this appeal, which spans the tax year 2010-2011
both versions of paragraph 6 are relevant and are set out below. We do not, however,

believe that the difference in wording of the two versions paragraph 6 has any material impact on the outcome of this appeal, but set them out for ease of reference.

12. Paragraph 6, as originally enacted and in force for the period 6 April 2010 to 24 January 2011, read as follows:

5 “6(1) P [the taxpayer] is liable to a penalty under this paragraph of an amount determined by reference to the number of defaults in relation to the same tax that P has made during the tax year.

(2) P makes a default in relation to a tax when P fails to pay an amount of that tax in full on or before the date on which it becomes due and payable.

10 (3) But the first failure during a tax year to pay an amount of tax does not count as a default in relation to that tax during that tax year.

(4) If P makes 1, 2 or 3 defaults during the tax year, P is liable to penalty of 1% of the total amount of those defaults.

15 (5) If P makes 4, 5 or 6 defaults during the tax year, P is liable to penalty of 2% of the total amount of those defaults.

(6) If P makes 7, 8 or 9 defaults during the tax year, P is liable to penalty of 3% of the total amount of those defaults.

(7) If P makes 10 or more defaults during the tax year, P is liable to penalty of 4% of the total amount of those defaults.

20 (8) In this paragraph—

(a) in accordance with sub-paragraph (1), the references in sub-paragraphs (4) to (7) to a default are references to a default in relation to the tax mentioned in sub-paragraph (3),

(b) the amount of a default is the amount which P fails to pay, and

25 (c) a default counts for the purposes of sub-paragraphs (4) to (7) even if the default is remedied before the end of the tax year.”

13. The amended paragraph 6, in force from 25 January 2011 to the end of that tax year, read as follows:

30 “(1) P [the taxpayer] 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—

5 (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);

10 (c) a payment due under the Income Tax (Construction Industry Scheme) Regulations 2005 (SI 2005/2045);

(d) a repayment in respect of a student loan due under the Education (Student Loans) (Repayments) Regulations 2009 (SI 2009/470) or the Education (Student Loans) (Repayments) Regulations (Northern Ireland) 2000 (SR 2000 No 121).

15 (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.

20 (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.

25 (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.

30 (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;

(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.

35 (9) The Treasury may by order made by statutory instrument make such amendments to sub-paragraph (2) as they think fit in consequence of any amendment, revocation or re-enactment of the regulations mentioned in that sub-paragraph.”

40 14. It will be seen from both versions of paragraph 6(3) that seven, eight or nine defaults in the tax year renders a taxpayer such as the appellant liable to a penalty of 3% of the total amount of tax comprised in those defaults.

15. Schedule 56 also contains provisions relating to a reduction in a penalty for "special circumstances" (paragraph 9), removing liability (subject to re-imposition) to a penalty during the period of a deferred payment agreement (paragraph 10) and removing liability to a penalty where there was a "reasonable excuse" for the failure (paragraph 16). Paragraph 9 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—

(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—

(a) staying a penalty, and

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

16. Paragraph 10 of Schedule 56 states as follows:

"(1) This paragraph applies if—

(a) P fails to pay an amount of tax when it becomes due and payable,

(b) P makes a request to HMRC that payment of the amount of tax be deferred, and

(c) HMRC agrees that payment of that amount may be deferred for a period ("the deferral period").

(2) If P would (apart from this sub-paragraph) become liable, between the date on which P makes the request and the end of the deferral period, to a penalty under any paragraph of this Schedule for failing to pay that amount, P is not liable to that penalty.

(3) But if—

(a) P breaks the agreement (see sub-paragraph (4)), and

(b) HMRC serves on P a notice specifying any penalty to which P would become liable apart from sub-paragraph (2),

P becomes liable, at the date of the notice, to that penalty.

(4) P breaks an agreement if—

(a) P fails to pay the amount of tax in question when the deferral period ends, or

(b) the deferral is subject to P complying with a condition (including a condition that part of the amount be paid during the deferral period) and P fails to comply with it.

(5) If the agreement mentioned in sub-paragraph (1)(c) is varied at any time by a further agreement between P and HMRC, this paragraph applies from that time to the agreement as varied.”

17. Paragraph 16 contains the provisions relating to "reasonable excuse". As was the case with paragraph 6, paragraph 16 was amended as regards PAYE payments with effect from 25 January 2011 (SI 2011/132 art 3). The original version of paragraph 16, in force from 6 April 2010 to 24 January 2011 read 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,

(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

(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."

18. From 25 January 2011, paragraph 16 read as follows:

"(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.]

(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,

(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

(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."

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19. In our view, the different versions of paragraph 16 do not materially affect the outcome of this appeal.

20. Paragraph 13 of Schedule 56 introduces the provisions relating to appeals against penalties imposed under that Schedule. Paragraph 13 provides:

10 "(1) P may appeal against a decision of HMRC that a penalty is payable by P.

(2) P may appeal against a decision of HMRC as to the amount of a penalty payable by P."

21. An appeal in respect of the deferred payment agreement provisions of paragraph 10 and "reasonable excuse" provisions of paragraph 16 would fall under paragraph 13(1) because if a reasonable excuse is found to exist no liability to a penalty arises. On the other hand, an appeal relating to "special circumstances" under paragraph 9 would fall under paragraph 13(2) because it would relate to the amount of the penalty payable.

22. Paragraph 15 of Schedule 56 sets out the tribunal's jurisdiction in relation to such appeals. Paragraph 15 provides:

"(1) On an appeal under paragraph 13(1) that is notified to the tribunal, the tribunal may affirm or cancel HMRC's decision.

(2) On an appeal under paragraph 13(2) that is notified to the tribunal, the tribunal may—

(a) affirm HMRC's decision, or

(b) substitute for HMRC's decision another decision that HMRC had power to make.

(3) If the tribunal substitutes its decision for HMRC's, the tribunal may rely on paragraph 9—

(a) to the same extent as HMRC (which may mean applying the same percentage reduction as HMRC to a different starting point), or

(b) to a different extent, but only if the tribunal thinks that HMRC's decision in respect of the application of paragraph 9 was flawed.

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(4) In sub-paragraph (3)(b) “flawed” means flawed when considered in the light of the principles applicable in proceedings for judicial review.

(5) In this paragraph “tribunal” means the First-tier Tribunal or Upper Tribunal (as appropriate by virtue of paragraph 14(1))."

5 23. Thus, in relation to an appeal involving the deferred payment agreement or
whether the Company has a reasonable excuse, paragraph 15 (1) allows the Tribunal
either to affirm or cancel HMRC's decision. In relation to an appeal involving the
issue of special circumstances, the Tribunal may rely on paragraph 9 to a different
extent from HMRC only if the Tribunal considers HMRC's decision to be flawed in
10 the judicial review sense of that expression.

Submissions

24. Mr Watson’s primary submission on behalf of the Company was that paragraph
10(2) of Schedule 56 meant that the Company was not liable to pay a penalty for late
payment. Paragraph 10(2) states that a person is not liable to a penalty for failing to
15 pay tax between the date on which the person makes a request for deferral of payment
of the amount of tax and the end of the deferral period. Mr Watson referred us to
Budget Note 90 of 2009 which was issued at the time of the legislation introducing
the new penalty regime. Paragraph 12 of the Note stated that “late payment penalties
will not be charged during an agreed time to pay arrangement with HMRC unless the
20 taxpayer defaults or misuses the arrangement”. Mr Watson submitted that the
Company was, accordingly, not liable to pay any penalty for late payments between 8
April 2010, when the Company first made the proposal for a deferred payment
arrangement, and the end of the deferral period (which would have covered the period
for which the penalty had been imposed). Mr Watson contended that once a deferred
25 payment agreement is in place then penalties cannot be applied and any other
interpretation would make the provisions of paragraph 10(2) irrelevant.

25. Mr Watson also submitted that the amount of the penalty was disproportionate
because it was equivalent to a rate of interest of 81% per annum. Mr Watson said that
the Company had not been informed of the liability to penalty that was accruing and
30 had not been given any opportunity to go to the bank to obtain finance to pay its
PAYE liabilities on time. The penalty was unfair as HMRC did not consider the
Company’s circumstances. The Company made significant efforts to pay off its
arrears despite difficult circumstances and was rewarded with a fine.

26. Mrs Gloria Orimoloye submitted on behalf of HMRC that "that amount" in
35 paragraph 10(2) of Schedule 56 refers to the amount of tax the person has failed to
pay and in respect of which deferment is requested under paragraph 10(1)(a). The
deferred payment proposal in April 2010 and the agreement of 30 September covered
the Company’s arrears for 2009/10. It did not cover the payments for 2010/11
(months 1-5 had already been paid so no deferred payment agreement was necessary
40 and it did not refer future payments). The letter of 30 September stated that late
payment of 2010/2011 PAYE may incur penalties and this is what happened.

27. Mrs Orimoloye contended that the amount of the penalty was fixed by the legislation and there was no discretion to reduce it. The deferred payment agreement did not provide the Company with a reasonable excuse for the late payments and there were no special circumstances.

5 Discussion

28. We do not accept the Company's primary submission on the effect of paragraph 10(2) of Schedule 56. In our view, the paragraph only applies to the unpaid tax which is referred to in paragraph 10(1) and is the subject of the deferred payment agreement. Paragraph 10(2) removes liability to a penalty for late payment of "that amount" ie the amount of tax mentioned in paragraph 10(1)(a) which was not paid on time and payment of which HMRC agree can be deferred in paragraph 10(11)(c). Paragraph 10(2) does not relieve the taxpayer from liability to a penalty for late payment of any amount which is not covered by the deferred payment agreement.

29. The proposal by the Company in April 2010 did not refer to payments of PAYE in 2010/11 for the obvious reason that such payments were not yet due and so the circumstances for an agreement under paragraph 10(1) had not yet arisen. The letter of 30 September clearly stated that late payment of PAYE relating to 2010/11 could lead to penalties. Payments were made late and the Company was notified of the penalty. We consider that, in the circumstances, paragraph 10(2) does not apply to late payment of PAYE relating to 2010/11 and the Company is liable to the penalty.

30. We do not consider that the Company has a reasonable excuse. Mr Watson frankly admitted that the Company had received the penalty default letter of 28 May 2010. The Company paid its PAYE for May, June, July and August late. Until the letter of 30 September 2010, the Company could not have assumed that a deferred payment arrangement would be agreed and so cannot have had any expectation (mistakenly as we have held) that it would be relieved of liability to penalties by paragraph 10(2) of Schedule 56. As we have already said, the letter stated that late payment of 2010/11 PAYE may lead to penalties so the Company had notice of that possibility from that time. The Company's financial circumstances are not capable of being a reasonable excuse because paragraph 16(2) specifically states that an inability to pay is not a reasonable excuse. Similarly, the Company's financial position cannot constitute special circumstances for the purposes of paragraph 9 because inability (or, more accurately, inability) to pay is specifically excluded by paragraph 9(2)(a). The Company did not suggest that there were any other potential special circumstances.

31. Mr Watson argued that the level of the penalty was disproportionate because it equated to an excessive interest charge. We do not accept this argument. The penalty under Schedule 56 is calculated by reference to the amount of tax in default and not the length of that default. While we accept that, in some circumstances, a penalty may be struck down as disproportionate, we consider that the test is whether the penalty is not merely harsh but plainly unfair (see *Dina Foods Ltd v Revenue & Customs* [2011] UKFTT 709 (TC) at [41]). We are satisfied that the penalty in this case is not disproportionate because, in the circumstances, it cannot be said to be plainly unfair.

Decision

32. For the reasons given above, our decision is that the penalty of £5,448.90 for late payments of PAYE imposed under paragraph 10(1) of Schedule 56 to the Finance Act 2009 should be confirmed and the Company's appeal is dismissed.

5 Rights of appeal

33. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with the Tribunal's 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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**GREG SINFIELD
TRIBUNAL JUDGE**

RELEASE DATE: 24 October 2012

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