



TC02592

Appeal number: TC/2012/7616

*INCOME TAX – penalty – PAYE “overpayment” at same time as unpaid tax
for earlier year due – whether reasonable excuse – no – whether special
circumstance - yes*

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

CHRISTOPHER HORNE

Appellant

- and -

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

**TRIBUNAL: JUDGE BARBARA MOSEDALE
CAROL DEBELL**

Sitting in public at Bedford Square, London on 8 January 2013

Mr Horne in person

Mrs K Weare, HMRC officer, for the Respondents

DECISION

1. Mr Horne appealed against a first late payment penalty of £80 and a second late payment penalty of £79 in relation to his (alleged) late payment of tax for the tax year ended 5 April 2011. We note in passing that originally the penalties were higher: they have been reduced as HMRC have accepted that tax owed by Mr Horne is rather less than HMRC first thought and they now reflect 5% of the tax now considered by HMRC to be outstanding as at the penalty dates. There is no dispute on the calculation.

2. The appeal was lodged on 27 April 2012 in respect of the first late payment penalty. Mr Horne later notified the Tribunal, by implication at least, that he wished to appeal the second late payment penalty. HMRC stated that they accepted his notification of appeal to the tribunal as notification to HMRC in accordance with the rules and considered the Tribunal had jurisdiction to consider both penalties. The Tribunal accepted jurisdiction.

The facts

3. In brief the facts are as follows:

4. Mr Horne suffered a brain haemorrhage on 24 June 2010 and spent some time in hospital. His consultant said it would take a year for Mr Horne to fully recover. HMRC accepted his ill health as a reason for late filing/payment of his return for year ended 5 April 2010.

5. Mr Horne, despite the recommendation of his consultant, nevertheless returned to work in early 2011.

6. In February 2011 there was a serious fire in Mr Horne's home which resulted in a lot of smoke damage. He and his family were forced to move into rented accommodation for six months while the house was repaired and redecorated. His papers were put into store.

7. Mr Horne was the managing director of a large company with about 1,000 employees. The business got into difficulties due to Mr Horne's enforced absence through ill health in the second half of 2010. Financial problems became acute at the end of 2011 and Mr Horne put the company into administration in late March 2012.

8. Despite all these difficulties, Mr Horne filed his paper tax return for the year ended 5 April 2011 on time on 31 October 2011.

9. Mr Horne received his tax calculation for the year 10/11 from HMRC dated 16 November 2011. It showed his liability to be £4,180.61. Mr Horne thought this was obviously wrong. He was right. As he pointed out in a letter to HMRC which he sent in April 2012, it contained three errors of differing magnitude.

10. These errors were:

- It showed underpaid tax of £1,455.73;
- It included the wrong figure for benefits (£16,429.00 instead of £16,129.00); and
- It did not credit Mr Horne with a deduction to which he was entitled of about £462
5 in respect of some property income.

11. Of the three errors we find that HMRC was responsible for the 2nd error. At the hearing Mr Horne produced evidence, which we accept, that he entered the correct figures on his tax return which amounted to £16,129.29 for his P11D benefits but, we find, this was keyed in by an HMRC operative as £16,429.29.

10 12. Mr Horne accepted that he was responsible for the third error (he failed to claim the relief at first).

13. The first error was by far the largest. The parties disputed whose responsibility this was. Mr Horne's evidence was that his main source of income was earnings which were taxed via PAYE coding. His position was that he could only have unpaid
15 tax liability at the end of the year if (1) his tax code was wrong and/or (2) to the extent he had earned bank interest (as this would only have savings rate of tax deducted at source and he was a higher rate tax payer). In the past, he said he had always opted (as he had in year 10/11) to have any underpayments collected through his PAYE code.

20 14. We are minded to accept this evidence as it was supported by his 10/11 tax return and an earlier coding notice and HMRC offered no real challenge to it.

15. However, Mr Horne produced a large quantity of papers at the hearing – mostly letters to and from HMRC and his 10/11 tax return. Mrs Weare did not object to them being admitted but not all the documents were referred to at the hearing. One of the
25 documents not referred to was a SA statement of accounts dated 3 April 2012 which showed that Mr Horne owed a balancing payment for 09/10 of £960.07. A handwritten note says this was paid, together with interest, on 27 April 2012.

16. A letter dated 3 April 2012 from HMRC which appeared to accompany the statement of accounts and which was also not referred to in the hearing shows that
30 this tax liability arose through an HMRC amendment of Mr Horne's tax return. He had failed to include bank interest in his tax return for 09/10. So he failed to declare his liability to the difference between the savings tax rate and higher tax rate on this. HMRC opened an enquiry and the letter of 3 April 2012 was the letter closing the enquiry and amending his tax return to increase his liability.

35 17. Having considered all this we find that it does not affect the conclusion we were minded to reach in any event that Mr Horne's evidence that he always opted for *known* underpayments to be collected by PAYE is reliable. Further, we find this underpayment is no explanation of the figure for unpaid tax in the 16 November 2011

statement as HMRC did not close the enquiry and make the amendment until 3 April 2012.

18. Overall, we find that Mr Horne has made out a prima facie case that the claim for underpaid tax was an error made by HMRC. This is because he has explained his tax affairs and it seems unlikely that he would have owed approximately £1,500 in tax and if he did, that he should not have opted for it to be collected through his PAYE code. As HMRC have given no justification for the figure, and agreed it was erroneous, we conclude that on the balance of probability it was a mistake made by HMRC.

19. Returning to the sequence of events, Mr Horne queried these three errors in a letter to HMRC dated 22 April 2012.

20. HMRC sent a new calculation on 16 May 2012 showing the much lower figure of £2,724.88 as due in tax for 10/11.

21. Mr Horne wrote again on 4 June 2012 as only the largest of the errors had been corrected. Mr Horne wrote again on 3 August 2012 asking for the last two adjustments to be made. On 22 August 2012 HMRC issued a third statement which showed £2,604.48 as owing for 10/11. A later statement, issued sometime after September 2012 after yet another correction, shows what HMRC now believe to be the correct position of £2,419.68 in tax owing.

22. HMRC's position at the hearing was that this last tax calculation was right. Mr Horne did not concede it was right but made no challenge to its accuracy and therefore for the purpose of this hearing we find that Mr Horne's tax liability for the year ended 5 April 2011 was £2,419.68.

23. He did not pay this amount at that date. Nevertheless it is his case that he is not liable to penalties for late payment. As we understand it his grounds for this view are:

(a) The money should have been collected from his PAYE tax code for the next year of assessment (ie 2012/13) and he was therefore not liable to pay it on 31 January 2012;

(b) He was not liable to pay the tax until HMRC sent him a correct tax calculation. This was particularly the case, in Mr Horne's view, as HMRC was largely responsible for the earlier incorrect tax calculations;

(c) He is still confused as to how much tax is actually due for 10/11.

(d) He had "paid" the tax, in that the PAYE deductions from his salary in April 2012 were in excess of his liability to tax for 12/13.

24. We consider these matters in turn but first outline the law.

The law

25. The liability to pay tax is contained in s59B of the Taxes Management Act 1970 ("TMA"). This provides:

“59B payment of income tax and capital gains tax

(1) Subject to subsection (2) below, the difference between -

(a) the amount of income tax and capital gains tax contained in a person’s self-assessment under section 9 of this Act for any year of assessment, and

(b) the aggregate of any payments on account made by him in respect of that yearand any income tax which in respect of that year has been deducted at source,

shall be payable by himas mentioned in subsection (3) or (4) below...

(2)

(3) [not applicable]

(4) In any other case, the difference shall be payable on or before the 31 January next following the year of assessment.

26. In other words, Mr Horne was liable to pay £2,419.68 on 31 January 2012 in respect of his tax liability for 10/11.

27. Penalties for non-payment are provided for in Schedule 56 of the Finance Act 2009. There is no dispute about the meaning of these provisions and we do not set them out in full. Sections 1 & 3 created liability to a penalty if self assessment income tax due on 31 January 2012 was not paid 30 days later and a second penalty if it was not paid by 3 August 2012. Both penalties were payable at 5% of the unpaid tax at the date the penalty was payable.

28. Regulation 13 (referred to in more detail below), gave a taxpayer the right of appeal. Regulation 16 gave the taxpayer a defence of reasonable excuse as follows:

“16 Reasonable excuse

(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.”

29. We consider whether any of the matters raised by Mr Horne amount to a reasonable excuse.

PAYE coding

30. Mr Horne's position was that his liability was less than £2000 and it should have been collected through his PAYE coding. He had made the option in his tax return for underpayments to be collected through his tax code. The return stated:

5 If you owe tax for 2010-11 and have a PAYE tax code, we will try to collect the tax due (if less than £2,000) through your tax code for 2012-13 unless you put "X" in the box."

31. He did not put an X in the box. Whilst a reasonable belief that the underpayment would be collected through PAYE coding might amount to a reasonable excuse for not paying the tax on 31 January 2013, we cannot accept that Mr Horne's belief was reasonably held. By the time that the tax was due to be paid (31 January 2012) he knew that HMRC considered that tax considerably in excess of £2,000 was due and therefore he knew that HMRC would not be collecting it through the PAYE code.

15 32. While we accept that at 31 January 2012, Mr Horne genuinely held the view that the tax he owed for 10/11 would be found to be less than HMRC had demanded and in particular less than £2,000 (this latter view was mistaken), at the same date he knew that not only did HMRC consider over £4,000 to be due but he had failed to draw to their attention the reasons why the assessment was wrong. It is not reasonable, therefore, to complain that he ought to have been allowed to have the underpayment collected through his code: the sum was too great and he had failed to bring the errors resulting in the excessive assessment to HMRC's notice.

25 33. For these reasons, we find that Mr Horne's genuine but mistaken belief that his underpayment would be found to be less than £2,000 did not amount to a reasonable excuse for failing to pay the tax on 31 January 2012.

Tax calculation wrong

34. Mr Horne did not know as at 31 January 2012 how much tax he owed for tax year 10/11: he was only certain that it was less than HMRC had requested and in this he was correct.

30 35. So far as "reasonable excuse" is concerned the Tribunal expects the taxpayer to act as a prudent person having due regard to their liability to pay tax. Ordinarily where a taxpayer is uncertain of the tax they owe at the due date, the Tribunal would expect a prudent person with due regard to their tax liabilities, to pay an estimate of that tax.

35 36. However, Mr Horne's position was somewhat unusual. He had submitted his tax return on time. It contained the following printed statement by HMRC:

 "Calculating your tax – if we receive your tax return by 31 October 2011....we will do the calculation for you and tell you how much you have to paybefore 31 January 2012."

37. It seems reasonable to us for a taxpayer to rely on this undertaking. HMRC did not keep to this undertaking. They did not tell Mr Horne what he actually owed until sometime late in 2012. And the failure to tell Mr Horne the correct amount was largely (measured in amount of tax), as we have said, due to errors made by HMRC.

5 38. Had Mr Horne drawn the error to HMRC's when he first noticed it (in approximately November 2011) and had HMRC taken, as they did, 6 months (April-September 2012) to put it right, we would be minded to find this was a reasonable excuse for late payment by Mr Horne. However, this is not what happened. Mr Horne's evidence was that he knew the figure was wrong and that was why he did not
10 pay it.

39. But he did not write to HMRC about it until April 2012, a delay of some 5 months on his part. While we do not find it at all acceptable that it took HMRC 6 months and 3 letters from Mr Horne to get it right, we find Mr Horne is responsible for the delay from November 2011 to April 2012.

15 40. Does he have a reasonable excuse for this delay? His explanation is that he was overwhelmed with trying to save his business from insolvency and that as soon as he failed to do that (late March/early April 2012) he turned his attention to sorting out his tax affairs.

41. We are unable to accept Mr Horne's preoccupation with his business, however
20 understandable, as a reasonable excuse. A person cannot in general choose to prioritise his business or job entirely above his obligations to return and pay tax: the only exception would be in a case where there was an unexpected emergency. On the contrary, it was Mr Horne's evidence that the problems with his business started with his long sick absence following the haemorrhage and he had been under pressure to
25 return to work long before the recommended one year of convalescence had expired.

42. Therefore, while we accept that Mr Horne was very busy indeed between his return to work early in 2011 and April 2012, this cannot have been unexpected and Mr Horne should have made time or other arrangements to sort out his tax affairs and in particular to query the tax demand which he knew was wrong, to give HMRC time
30 to sort it out before 31 January 2012.

43. He did not do so and therefore we are unable to find that this was a reasonable excuse for the late payment of tax on 31 January 2012.

44. If he had pointed out the error when he first knew of it, in late November 2011, and had HMRC not sorted it out by 31 January 2012, then we might well have been
35 minded to find this was a reasonable excuse. But that is not what happened.

Confusion

45. The third matter proffered as a reasonable excuse is that Mr Horne still does not know how much tax he owes. We were shown various statements of account. HMRC consider that some £1,585.14 is outstanding as at May 2012. Mrs Weare was

not in a position to fully explain the various credits allowed to Mr Horne by HMRC. They may relate to overpayments in earlier years.

46. We do not consider this confusion a reasonable excuse. It is clear to us and we consider should have been clear to Mr Horne, that HMRC considered that his tax liability for 10/11 was £2,419.68 but that only a smaller sum was considered outstanding and was required to be paid. Mr Horne does not give any grounds for challenging the accuracy of these figures. In particular, he does not claim that he owes *less* than the £1,585.14 now demanded.

47. (We note in passing that had it turned out that the figures were wrong and HMRC had demanded too little, we consider that paying what was demanded without any specific reason to think that the figures were wrong, would be likely to be a reasonable excuse for not paying the right amount).

48. Therefore, we are unable to find Mr Horne's confusion was a reasonable excuse for non-payment of the tax due on 31 January 2012.

15 *Conclusion on first penalty*

49. For Mr Horne to have a reasonable excuse for either of the penalties charged he would have to show that in both cases the reasonable excuse existed on 31 January 2012, the due date for payment. For the reasons given above he has failed to do this.

50. The fourth matter put forward by Mr Horne as a potential reasonable excuse was his "overpayment" of tax in April 2012. This had not taken place on 31 January 2012 and therefore could not be causative of the failure to pay on that date and therefore cannot be a reasonable excuse for it.

51. The first penalty date was 3 March 2012. It follows from the above that we have found that as no reasonable excuse existed on 31 January 2012 and the tax was unpaid on 3 March 2012, the first penalty was properly imposed and we dismiss the appeal in respect of it.

The second penalty

52. There is perhaps a potential unfairness in the rules because from April to September 2012 there was a great deal of delay by HMRC in dealing with Mr Horne's notification of the errors in his tax calculation which were largely (in a numerical sense) the fault of HMRC. If Mr Horne had actually paid his tax immediately after HMRC finally issued his correct tax calculation in approximately September 2012, we might have been minded to consider a reasonable excuse existed between those dates. But as we have said, that would not have helped Mr Horne as he has to show a reasonable excuse back to 31 January 2012 and he cannot do that for the reasons given above. Nevertheless, had these been the facts we might have considered whether this amounted to "special circumstances" such that the second penalty should be reduced (perhaps to 0%). But these were not the facts. Mr Horne has still not paid the tax. He needs to show a reasonable excuse exists to the present day.

53. And Mr Horne's case is that from April 2012 the reason he did not pay the tax was because he overpaid tax in April 2012 for the year 12/13 and therefore, from that point, did not "owe" HMRC any tax for 10/11.
54. The reason the tax was allegedly overpaid was that Mr Horne's employment
5 ceased within a week or so of the commencement of the new tax year in April 2012, yet of course his PAYE code was calculated on his expected salary. So (in rough terms) one twelfth of his estimated tax liability based on a very high income was deducted from half of one twelfth of his normal salary.
55. We were not given any accurate figures but from his tax return for 10/11 it was
10 clear he was a high earner and the logic of the PAYE system is that there would have been a substantial deduction for tax in April 2012.
56. By letter dated 23 September 2012 Mr Horne asked HMRC to offset his PAYE
15 "overpayment" in the current tax year against his taxes owed. His evidence was that HMRC had agreed to this. Mrs Weare's case was that she agreed the request had made by Mr Horne but did not agree that HMRC had made any response to it.
57. The reason we put "overpayment" in inverted commas is because, it seems to us
20 as a matter of strict law, there was no overpayment of PAYE in April 2012. No one has suggested that Mr Horne's PAYE coding notice was wrong at the time it was issued or that it was wrongly applied by his erstwhile employer. But nevertheless the payment is likely to have been in excess of his tax liability in that tax year because so far he has been unable to secure further employment.
58. Either way it seemed to us that Mr Horne and Mrs Weare were in agreement
25 that HMRC ought at some point to repay the "overpaid" PAYE. The Income Tax (PAYE) Regulations 2003 Regulation 161 however only require the repayment to be made at the end of the tax year or (if earlier) when payment of jobseekers allowance ceases.
59. So Mr Horne may well have "overpaid" his PAYE in April 2012 but HMRC
were not liable to repay this to him until January 2013, or if earlier, when he ceased to be on jobseekers allowance.
- 30 60. Even though HMRC were not liable to repay the "overpaid" PAYE to him at the time the second penalty arose, nevertheless could the "overpayment" of PAYE in April 2012 be treated as payment of all or some of his outstanding tax liability for 10/11 as at April 2012, so that he could be treated as having "paid" his 10/11 tax by the second penalty date in August 2012?
- 35 61. We have concluded that it cannot. The Income Tax (Earnings and Pension) Act 2003 s683 and 684 make it clear that PAYE deductions are made in respect of current year liability to tax. It is the clear intention of the legislation that they cannot be treated as payment of prior years' tax liabilities, but held until the current year's liability could be determined. Any other view would undermine the fundamental
40 scheme of PAYE. PAYE payments are ring-fenced.

62. We have considered whether a genuine belief that he had overpaid PAYE in April 2012 excused payment of outstanding tax for earlier years could be a reasonable excuse. Irrespective of whether it would be reasonable to believe this, for the reason given above it cannot be a reasonable excuse as such a belief could not have existed before April 2012 yet to be a reasonable excuse it would have had to be the reason the tax was not paid on 31 January 2012.

Special circumstances

63. The only remaining option is to consider whether it could be “special circumstances”. Regulation 9 of Schedule 56 provides:

9 Special reduction

(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 the penalty, and

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

64. HMRC’s view was that there were no special circumstances. Indeed they stated their view in the Statement of Case that:

“the law allows HMRC to reduce a penalty below the statutory minimum if they think it right because of special circumstances. While special circumstances are not defined the courts accept that for circumstances to be special they must be ‘exceptional, abnormal or unusual’ ...or ‘something out of the ordinary run of events’....

HMRC do not consider there are any special circumstances which would allow the penalty to be reduced.”

65. It is therefore clear that HMRC did not address its mind to the question of whether a potential overpayment of his 2012/13 liability to tax by the appellant in April 2012 was a special circumstance, to the extent it equalled or exceeded his outstanding tax liability for 2010/11.

66. We only have jurisdiction to consider this as provided for in Regulation 15:

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(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 has power to make.
- 5 (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.
- 10 (4) In sub-paragraph (3)(b) ‘flawed’ means flawed when considered in the light of the principles applicable in proceedings for judicial review.

67. This section envisages an appeal being made either under Regulation 13(1) (whether or not a penalty is payable at all) or an appeal under Regulation 13(3)(against the amount of the penalty). Mr Horne, not surprisingly, did not specify either sub-paragraph. His notice of appeal asked for the penalty to be removed. It seems to us that (to avoid unnecessarily stifling the grounds of appeal) that removal of a penalty should be seen as encompassing the reduction of a penalty and that therefore Mr Horne’s appeal was made under both Regulation 13(1) and 13(2). HMRC do not suggest otherwise: they say that there are no special circumstances, not that the Tribunal cannot consider whether there are special circumstances on the grounds Mr Horne asked for the penalty to be removed rather than reduced.

68. Therefore, we find that the appeal was made under both sub-heads of Regulation 13 and we can substitute our own decision on “special circumstances” but only if (as we are in 15(3)(b) territory) if we think HMRC’s decision was flawed.

69. HMRC’s decision will have been flawed in judicial review terms if they failed to consider something they should have considered. They did not consider the PAYE “overpayment” point. Should they have done?

70. It is clear from Regulation 9(2)(b) that potential overpayment by *another* taxpayer is not a special circumstance. This certainly does not rule out the possibility that overpayment by the late paying taxpayer *himself* as a special circumstance.

71. We think HMRC should have considered this. They did not. So we find their decision was flawed, and by virtue of Regulation 15(2) we can therefore substitute our own decision.

72. As we have already said the scheme of PAYE regulations is that PAYE payments are ring-fenced and held against liability for the current tax year. Indeed, the Regulations are designed to ensure that personal allowances are spread throughout the year and the person pays the “right” amount of tax each month. It is certainly not the case that the law is intended to be interpreted so that taxpayers are able to apply their PAYE deductions against other tax liabilities.

5 73. But Mr Horne's circumstances are unusual. We accept his evidence that he was a high earner whose employment income suddenly ceased two weeks into the tax year, since when he has been on benefits. HMRC accept that he will be due a large, if as yet unquantified, repayment of PAYE. It is likely to exceed the unpaid tax for 10/11.

10 74. It seems to us that this is a special circumstance: that at the time of the second penalty the unpaid tax was likely to be less than what was in effect an excessive payment on account by the same taxpayer. While PAYE payments should be ring-fenced, it is also their purpose to ensure tax is deducted evenly throughout the year. Regulation 65 of the Income Tax (PAYE) Regulations 2003 ordinarily would permit a taxpayer to reclaim PAYE "overpayments" when employment ceases and does not recommence: Mr Horne cannot benefit from this because of his claim for jobseekers allowance. Further, if on the facts of this case, we did not see the PAYE "overpayment" as special circumstances, Mr Horne would in effect (although not in law) be making an enforced interest free loan to HMRC at the same time as HMRC would be imposing penalties for non-payment of other tax.

20 75. In this situation, we do see the PAYE "overpayment" as special circumstances. Our decision under paragraph 9 is that (a) the penalty should be stayed until Mr Horne's tax liability for 12/13 is known and then (b) to the extent the PAYE deduction in April 2012 exceeds Mr Horne's tax liability for 12/13, that figure ('X') should be notionally 'deducted' from the outstanding tax liability for 10/11 as at August 2012 and the penalty on that part reduced to 0%. To the extent the outstanding tax liability for 10/11 as at August 2012 exceeds that figure of 'X', there should be no deduction in % penalty applied.

25 76. 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 30 "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

35 **BARBARA MOSEDALE**
TRIBUNAL JUDGE

RELEASE DATE: 11 March 2013

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