



TC03323

Appeal number: TC/2012/07390

CONSTRUCTION INDUSTRY SCHEME – failure to deduct tax from payments made to sub-contractors – whether contractor took reasonable care – yes - whether error made in good faith – yes – appeal allowed – Regulation 9 Income Tax (Construction Industry Scheme) Regulations 2005

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

J & M INTERIORS (SCOTLAND) LIMITED

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE W RUTHVEN GEMMELL, WS
PETER R SHEPPARD, FCIS, FCIB, CTA**

**Sitting in public at George House, 126 George Street, Edinburgh on 16 January
2014**

**Mr Alistair Kendrick and Mr Dougie Agnew, Henderson and Loggie,
Accountants, for the Appellant**

Mr William Kelly, Officer of HMRC, for the Respondents

DECISION

1. This is an appeal against a decision by the Commissioners for HM Revenue and Customs (“HMRC”) to issue assessments under Regulation 13 of the Income Tax (Construction Industry Scheme) Regulations 2005 for the tax years 2008-2009 for £12,778.60 and 2009-2010 for £8,918.40, being sums which HMRC say J&M Interiors (Scotland) Limited (“J&M”) should have deducted from a sub-contractor.

Legislation

2. The Construction Industry Scheme (“CIS”) provides for payments by contractors to sub-contractors in the construction industry to be subject to deduction of amounts on account of the sub-contractor’s tax.
3. Section 61 of the Finance Act 2004 imposes the obligation to deduct on contractors; Section 59 defines contractors and Section 60 defines contract payments.
4. Regulation 6 of the Income Tax (Construction Industry Scheme) Regulations 2005 (“CIS Regulations”) provides as follows:

Verification etc of registration status of sub-contractor and nominee

- (1) A contractor must verify with the Commissioners for Her Majesty's Revenue and Customs whether a person to whom he is proposing to make—
- (a) a contract payment, or
- (b) a payment which would be a contract payment but for section 60(4) of the Act (contract payments: exceptions),
- and, where that person has appointed a nominee, his nominee, are registered for gross payment, for payment under deduction or is not registered under Chapter 3 of the Act. This is subject to paragraph (3).
- (2) For the purpose of verification the contractor must provide—
- (a) his name, unique taxpayer reference (UTR), accounts office reference and employer's reference, and
- (b) in relation to the person to whom he is proposing to make the payment and, where that person has appointed a nominee, his nominee—
- (i) if that person or nominee is an individual, his name, unique taxpayer reference (UTR) and national insurance number;
- (ii) if that person or nominee is a partner in a firm, the name of the firm and that partner, the unique taxpayer reference (UTR) of the firm, and if the partner is an individual, his unique taxpayer reference (UTR) or national insurance number or if the partner is a company the unique taxpayer reference (UTR) or the company registration number;
- (iii) if that person or nominee is a company, the name of the company, unique taxpayer reference (UTR) and the company registration number.

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5. Regulation 9 of the Income Tax (Construction Industry Scheme) Regulations 2005 (“CIS Regulations”) provides as follows:

Recovery from sub-contractor of amount not deducted by contractor -

- (1) This regulation applies if -
- 5 (a) it appears to an officer of Revenue and Customs 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 a contractor was liable to deduct
- 10 on account of tax from a contract payment under section 61 of the Act in a tax period;
- “the amount actually deducted” is the amount actually deducted by the contractor on account of tax from a contract payment under section 61 of the Act during that tax period;
- 15 “the excess” means the amount by which the deductible amount exceeds the amount actually deducted.
- (3) Condition A is that the contractor satisfies an officer of Revenue and Customs -
- (a) that he took reasonable care to comply with section 61 of the Act and these
- 20 Regulations, and
- (b) that -
- (i) the failure to deduct the excess was due to an error made in good faith, or
- (ii) he held a genuine belief that section 61 of the Act did not apply to the
- 25 payment.

Case References

PDF Electrical Limited v Commissioners of HM Revenue and Customs [2012] TC02375

Mr Steven Hoskins v Commissioners of HM Revenue and Customs [2012] TC01972

30 *Mr K G and Mrs H E Johnston (Johnston Builders) v Commissioners of HM Revenue & Customs* [2010] TC00513

The Evidence and Finding of Fact

6. J&M are a company specialising in the supply and installation of, amongst other things, suspended ceilings and partitions. They also offer repair and maintenance

35 support to their customers.

7. J&M started trading in May 2000 and used the CIS but only had a few sub-contractors. Their main contractor was John Butchart (“JB”) who is and was a verified sub-contractor by virtue of being “grandfathered” under the previous Construction Industry Scheme.

8. JB therefore has a unique tax reference (“UTR”) and J&M knew that JB had been verified with HMRC.
9. JB was a close friend of Michael Tracey, a director of J&M, and had known him for over 30 years.
- 5 10. JB incorporated two companies, J B Ceilings (Tayside) Limited (“JBC”) and J Butchart Limited (“JBL”).
11. In the tax year 2007-2008, HMRC noted that invoices had been received from JBC and in the years 2008-2009 and 2009-2010 from JBL.
- 10 12. At a meeting with Mr Michael Tracey of J&M on 5 May 2010, HMRC asked why JBL and JBC had not been verified, and ascertained that J&M had not sought advice from HMRC on whether that changed the amount deducted of 20%.
13. J&M continued to receive a pre-populated form from HMRC in relation to JB and deducted 20% and HMRC say that as JBL was not verified J&M should have deducted 30%.
- 15 14. As a result of this perceived failure, HMRC raised the determinations which are the subject of the appeal.
15. At the outset of the hearing, HMRC raised objections on the grounds that J&M were to call witnesses but had not done so. HMRC wished, in particular, to cross examine Michael Tracey, a director of J&M, whose witness statement was in the bundle of papers, as was the statement of James Witton, another director of J&M.
20 HMRC stated that in light of their inability to cross examine them, the Tribunal should give little weight to their evidence.
16. The witness statement of Michael Tracey stated that JB was initially engaged as a sub-contractor when he was a sole trader and a close friend.
- 25 17. Mr Tracey had been solely responsible for CIS administration, together with an extensive range of tasks covering accounting, personnel work, banking and negotiating contracts. Mr Tracey stated that he would verify a sub-contractor with HMRC and deduct the amount of tax according to their guidance and quote the verification number. The CIS voucher would be provided to the sub-contractor, the
30 monthly return submitted to HMRC and the income tax paid. He stated, “No failures have occurred before”. He continued “when I noticed on the invoice submitted by JB that the name had changed to that of two different companies, I contacted JB. I was advised by JB that there was no status change and it was only the trade names that had changed. I was advised that all other procedures were to stay the same, i.e. bank
35 payment details and the name of the person on the account, i.e. JB. As I had been advised by the sub-contractor, JB, that I should continue to pay him under the original name, I had no reason to suspect the status was incorrect or had an impact. I was continuing to receive pre-populated returns from HMRC in the name of JB from HMRC and assumed, therefore, that everything was in order. It was only when David
40 Campbell, HMRC, paid us a visit in 2010 and I was advised by him that I was using

the wrong UTR. He recommended that I verify the new UTR for JBL. This I did immediately in February 2010”.

5 18. The witness statement by James Witton had an explanation that a suspended ceiling is “a quick, generally low cost, decorative system hung from the structural soffit”.

19. J&M gave verbal evidence that in 2010 their ratio of work on repair/refurbishment against new builds was 70:30 and that in the tax year 2008-2009, the ratio was respectively 50:50.

10 20. J&M stated that Mr Tracey’s handling of the issue and the explanation he received, based on JB’s accountant’s advice, gave him comfort so he continued paying to JB as before. He had no administrative function or assistance; this was purely a task of Mr Tracey.

21. No tax was lost to HMRC as the sub-contractor met the tax liabilities.

22. No invoices or contracts were submitted to the Tribunal.

15 23. A letter dated 24 August 2011 from J&M’s agents to HMRC, set out details of payments made prior to 6 April 2007 under the old CIS and explained that with the introduction of the new CIS on 6 April 2007, JB had given J&M a copy of CIS365A with his new details. JB confirmed that he continued to work as a sole trader and that all payments would continue to be paid to the same personal bank account.

20 24. He stated “During the course of each engagement, JB would provide measures of the work he had done for payment. These were frequently incorrect and would be amended by the company to reflect the correct measure or the correct pricing of work done. These measures could be submitted on a variety of stationery. JB provided several measures on stationery headed up JBC. The stationery did not show a
25 company number or a registered office address. When questioned by the company (J&M), JB maintained he was working as a sole trader and that he was using up a supply of old stationery for a company that was now liquidated. Companies House noted that the company had been dissolved on 19 April 2007.” All payments continued to be made to the same personal bank account.

30 25. The letter continued “HMRC continued to supply the company with monthly returns detailing JB personally as a sub-contractor. At no point did the sub-contractor claim to be trading as a limited company. No company registration number was provided to the company [J&M] and no limited company bank details provided in order to receive payments”. “The Construction Industry Manual CIS340 also states
35 the following at Section 6.5: “Many businesses whether sole traders, partnerships or companies, conduct all or part of their business using one or sometimes more trading names. However, a trading name has no legal status of its own and is simply a brand name for the underlying entity. The company has always dealt with one legal entity, in this instance, JB. This is clearly evidenced by all the payments being made directly
40 to JB as an individual”.

26. A review by HMRC took place on 28 November 2011 upholding the refusal to grant relief under Regulation 9(5) of the CIS Regulations 2005 and, in relation to the use of trading names, stated “my [HMRC] view here is that JBC and JBL were separate companies set up in their own right with Unique Tax Payer reference numbers.....that the company was dissolved in April 2007 and that JB considered himself to be working as a sole trader sub-contractor. From the information, evidence and explanations put forward by you in support of the appeal, I cannot agree that reasonable care was taken and the decision notice issued on 28 July remains the same”.

27. HMRC further reviewed this decision and by letter dated 24 February 2012, conceded that as JBC was dissolved before or around the time of the first payment in April but noted that invoices from JBC continued to be received until September 2007. In these circumstances, HMRC held that the failure to deduct the correct percentage was due to an error in good faith and accepted that J&M took reasonable care and that they were not liable to pay the excess for 2007-2008.

28. HMRC say that the invoices received from JBL from October 2007 onwards were different and that J&M’s actions did not seem to HMRC to be taking reasonable care to ensure J&M were complying with the responsibilities under the CIS.

29. A document entitled “CISR 14000 – The Scheme: Construction Operations: Contents” was submitted to the Tribunal and agreed by the parties that this expanded on Section 74 of the Finance Act 2004 which defined “construction operations”.

30. J&M drew the Tribunal’s attention to the fact that this extensive list of types of construction operations did not include suspended ceilings and, furthermore, that of the work carried out by J&M, they estimated 50% to be repair in 2008-2009 and 70% to be repair in 2009-2010 and questioned whether these activities were within the CIS at all.

31. HMRC stated that Section 74(2)(e) referred to painting or decorating the internal or external surfaces of any building or structure which equated to J&M’s description of their activities as stated in their 2014 website advertisement.

30 J&M’s Submissions

32. J&M state that there is some doubt looking at the nature of J&M’s work whether they are fully within the scope of the CIS.

33. They say that they do not come within the definition of contractor operation because that only covers “new builds”.

34. They say that HMRC’s website does not specifically mention suspended ceilings and, in the event that this is relevant, 50% was new build in 2008-2009 and 30% in 2009-2010. In doing so, they rely upon the description of a suspended ceiling set out in the witness statement of Mr Witton.

35. J&M say that in any event they complied with the CIS Regulations and, in particular, with Regulation 9(3) (a and b); that they took reasonable care to comply with Section 61 of the Act and the Regulations and that any failure to deduct the excess was due to an error made in good faith.

5 36. J&M refer to Mr Tracey's witness statement to the effect that he was the sole administrative function for a large number of tasks; that he believed JB was the contractor but, on noting that stationery was being used suggesting a different entity raised the issue specifically with JB and received an explanation which J&M say was backed by JB's accountant. This was to the effect that there was no change in the
10 legal status of his contracting relationship.

37. This discussion gave Mr Tracey comfort and so he continued to make deductions as before using HMRC's pre-populated form and simply carried on.

15 38. J&M refer to the *PDF Electrical* case which involved similar circumstances. PDF had had no previous problems with the CIS and paid its tax on time. In this case, the office administrator made an error to the extent that she entered a sub-contractor as having a gross payment where it should have been as a net payment. Therefore the deductions that should have been made, were not. PDF had not benefited from the error. The Tribunal decided that reasonable care had been taken and that the failure to deduct was due to an error made in good faith.

20 39. J&M drew the Tribunal's attention to the judgement which says that "the standard required by Regulation 9 is that the business must take reasonable care in its compliance with CIS. It does not require that mistakes must never be made. We consider that the standard of reasonable care is one that must be appropriate and proportionate to the particular contractor's business... in the case of PDF we are
25 satisfied that it took reasonable care to meet its obligations under the CIS. The fact that this is the only error that PDF has ever made under the CIS in 10 years is particular evidence of this".

30 40. J&M referred to the *Hoskins* and *Johnston* cases, both of which appeals were dismissed. In both cases it was considered that there was a total disregard of the CIS and, in the latter, the tax payer was deemed to be "not even aware of the regulations".

41. J&M say they exercised reasonable care and that this was a one-off error due to a misunderstanding which was made in good faith.

HMRC's Submissions

35 42. HMRC say that they are not satisfied either that J&M took reasonable care or that the failure to deduct was made in good faith.

43. HMRC refer to Section 69 of the Finance Act 2004 and to Regulation 6 of the CIS Regulations which requires a person to make payments under contracts relating to construction operations and verify with HMRC whether a person to whom they are proposing to make (a) a contract payment, or (b) a payment which would be a contract

payment but for Section 60(4), is registered for gross payment or for payment under deduction.

44. Regulation 6 of CIS Regulations repeats this obligation.

5 45. HMRC further refer to Section 61 of the Finance Act 2004 which at sub-section 1 states “on making a contract payment, the contractor (see Section 57(3)) must deduct from it the sum equal to the relevant percentage of so much of the payment.....”.

10 46. HMRC, relying on the witness statement of Mr Tracey, state that he is solely responsible, that he had minimal CIS responsibilities, was aware of the process of verifying and, accordingly, the verification process held no secrets and he was not unfamiliar with the process.

47. HMRC, relying on Mr Witton’s statement, state that a suspended ceiling is a form of decoration, a “low cost decorative system” and, consequently, within the CIS.

15 48. HMRC say that J&M has admitted to not verifying JBC and JBL and that HMRC only continued to send the pre-populated documents with JB as a sole practitioner because HMRC had not been told they were tax payers within the CIS by J&M.

49. HMRC say that First-tier Tribunal decisions are not binding although they may prove persuasive and that none of the cases referred to by J&M assist them.

20 50. In relation to the *PDF* case, HMRC say that Mr Tracey was experienced and “hands on” whereas the employee in PDF was new to the task. HMRC say that in any event Mr Tracey did not verify JB as he was “grandfathered” over from the pre-2007 Scheme nor did he verify either of JBC or JBL.

51. HMRC say that JBL was a completely different legal entity, that the invoices supplied were different, that tax should have been deducted at the appropriate rate and J&M should have verified JBL so they knew how much to deduct.

25 52. HMRC say that in the *Hoskins* case, the Tribunal held that the fact that the appellant was under the impression that the sub-contractor would be declaring and paying the relevant tax was of no assistance in showing how the tax payer took reasonable care to comply with his own obligation to make deduction.

30 53. In the *Johnston* case, HMRC say that the contractors who were not even aware of the regulations, confirms the established view that ignorance of the law is not a defence.

35 54. HMRC say that J&M were fully conversant with the CIS and did not verify JB because of his relationship with the sole director of the company; that J&M knew that the work was within the CIS and that tax had to be deducted under the Finance Act 2004.

55. HMRC are not satisfied there was compliance with Section 61 of the Finance Act 2004 and that the failure to deduct the excess was not due to an error made in good faith.

Decision

5 56. On the evidence before it, the Tribunal were satisfied that the payments to JB came within the CIS.

57. No documentary evidence was submitted to the Tribunal to support the contention of the split between “installation or new build” and “repair or maintenance” and, as HMRC contended, Mr Witton was not present at the hearing on which to be examined and cross-examined on this issue. This issue had not been previously raised with
10 HMRC when the reviews were carried out.

58. The Tribunal were satisfied that (1) J&M took reasonable care to comply with the CIS (namely Section 61 Finance Act 2005 and The CIS Regulations), and (2) the failure to deduct the tax due under CIS (namely the “excess” for the purposes of
15 Regulation 9) was due to an error made in good faith.

59. Following the Tribunal’s decision in *PDF*, the Tribunal considered that the standard required by Regulation 9 is that the business must take reasonable care in its compliance with CIS.

60. This does not require that mistakes must never be made. Consequently, the
20 Tribunal consider that the standard of “reasonable care” is one that must be appropriate and proportionate to the particular contractor’s business.

61. This was the only error that J&M had made with its sub-contractors over a seven year period and, in a company the size of J&M, there was clearly no dedicated singular function for ensuring compliance with the CIS Regulations.

25 62. Mr Tracey did not verify JB as he was “grandfathered” from the previous CIS and, therefore, this was not necessary.

63. It seemed clear from the evidence that JB submitted invoices which were lacking in specification but, notwithstanding this, J&M did notice that some of them were being produced on stationery which indicated the use of a limited company.

30 64. Mr Tracey of J&M then raised the issue with JB who gave what appeared to be a plausible and satisfactory response that he was simply using up old stationery for a company that had been dissolved and that, in any event, the contractor continued to be JB and all payments were made to JB’s bank account.

65. JB told J&M that JB was the sub-contractor on the advice of his accountants.

35 66. J&M then proceeded, as before, relying on these assurances and mindful that many companies and traders adopt a practice of trading names or “trading as” where a name other than their own is used.

67. No contracts were produced between J&M and JBL or, for that matter JB, and, from J&M's perspective, they were still contracting with JB.

5 68. When the invoices appeared in the name of a different company without a note of a company bank account or registered office address, JB explained that it was simply an error in the use of stationery.

10 69. HMRC had accepted that J&M's conduct in respect of JBC was an error made in good faith and accepted that J&M took reasonable care. As a consequence of Mr Tracey making an enquiry of JB when the issue arose, J&M continuing to pay to JB's bank account, who was a registered sub-contractor under CIS, and, given JB's explanation of his use of the limited company stationery, J&M's behaviour, although in error, was made in good faith and, because of making enquiries, the Tribunal hold that they took reasonable care.

70. The appeal is allowed.

15 71. 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.

25 **W RUTHVEN GEMMELL**
TRIBUNAL JUDGE

RELEASE DATE: 12 February 2014