[2016] UKFTT 0477 (TC)

TC05229

Appeal number: TC/2015/00613

INCOME TAX – whether the appellant took reasonable care in complying with the PAYE regulations – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

PARINGDON SPORTS CLUB LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE HARRIET MORGAN
MEMBER MR LESLIE HOWARD

Sitting in public at Fox Court, 30 Brooke Street, London on 1 February 2016

Mr David Hancock, a director of the appellant, for the appellant

Mr Kruyer, an officer of the Respondents, for the Respondents ("HMRC")

DECISION

1. The appellant appealed against HMRC's decision of 20 August 2014, as upheld on review on 16 January 2015, refusing to relieve the appellant of liability for £1,259.80 of income tax which the appellant had failed to deduct under the Pay As You Earn ("**PAYE**") system from the employment income of an employee (the "**employee**") in the tax year 2011/12.

2. There is no dispute that in the tax year 2011/12 the appellant did not account for sufficient tax in respect of the employee's relevant earnings from employment with the appellant as required by the PAYE rules. HMRC are generally entitled to recover such under-deducted tax from the employer. They can direct, however, that the employer is not so liable if the employer satisfies them (a) that it took reasonable care to comply with the Regulations and (b) the failure to deduct the full amount was due to an error made in good faith ((under Regulation 72 of the Income Tax (PAYE) Regulations 2003 (the "**Regulations**"). HMRC treated the appellant's objection to making the payment as a request for such a direction (which an employer can make under regulation 72A) but refused to make the direction on the basis that they were not satisfied the appellant had taken reasonable care to comply with the Regulations.

Facts

3. The employee commenced employment with the appellant on 18 July 2011 and left that employment in September 2012. He received total employment income from the appellant in the tax year 2011/12 of £10,280 from which the appellant, as his employer, deducted tax of £760.20 under the PAYE system. The appellant used tax code 747L. HMRC calculate that an additional amount of £1,295.80 should have been deducted.

4. It appears that initially HMRC sought to recover the underpaid amount of £1,295.80 direct from the employee. The employee wrote to HMRC on 11 December 2013 objecting to being required to pay additional income tax for the tax years 2011/12 and 2012/13 on the basis that the underpayment was due to employer error. He said that he had written to HMRC twice in the 2011/12 tax year advising that he did not think his tax codes were correct and that:

> "Paringdon Sports Club had me on the wrong tax code and did not action the letters that they received from HMRC. My P60 for the tax year ending 5 April 2012 states than my final tax code was 647L which is a tax code from 2009/10."

5. He went on to note that when he started working also for another employer in that tax year 2011/12 (in September 2011) he advised the appellant and the other employer that was the case. In his view neither employer was using their tax tables correctly or taking into account that his personal allowance should be split between both employments. He states that this was the same for the tax year 2012/13.

6. In a letter dated 9 January 2014 HMRC wrote to the employee stating that the underpayment for 2012/13 was not an employer error and the tax was due from him but that there may be an employer error for the tax year 2011/12 which HMRC would investigate.

7. On the same day HMRC wrote to the appellant stating that the appellant had failed to deduct £1,295.80 of income tax from the employee's employment income for the tax year 2011/12. HMRC noted that the employer's PAYE guide states that, if an employee starts work without a P45 or P46 to hand over, the employer should use "code OT week/month 1". They also noted that the employee had informed them that he had advised the appellant he had another employment and, therefore, the appellant could have submitted a P46 online ticking Box C and code BRX could have been used. HMRC stated the correct tax code to be OTX.

8. On 16 January 2014 Mr Hancock of the appellant wrote to HMRC disputing that the appellant was liable for the underpaid tax. He said that he was aware that the employee had another job and so had asked him what tax code he was on but the employee was unable to tell him:

> "I explained to him that I needed a tax code, and he would need to get one for me. I explained that I would put a standard tax code on, but he urgently needed to contact HMRC. He did not supply me with any document either when he started or at any time after that. To back this up I gave him the letter below with his first wage packet. He obviously did not bother to contact HMRC to sort this out. I was a new employer at the time, and I believed that I had done all I could to get this correctly set up."

9. The text of the letter which Hancock said had been sent to the employee is as follows:

> "Welcome to Paringdon Sports Club Ltd. Please find enclosed your first pay statement. Based on the information I have, I have applied a standard single person tax code. Please contact your tax office and confirm this is correct."

10. In a letter of 31 January 2014 HMRC responded noting again that when a new employee joins without providing a P45, the employer should give the employee a P46 to complete and that there were then a number of options as to the code to be used depending on the information received. HMRC stated that if no P46 was provided the employer should use code OT pending the employee providing a P45/P46 or HMRC providing a code. HMRC noted that the employee informed the appellant that he had other employment in which case code BR was appropriate.

11. Mr Hancock wrote to HMRC on 6 February 2014 again stating that the appellant was not liable for the underpaid tax. He noted, in addition to the points made previously, that although the employee told him he had another job, he believed he had stopped that job soon after starting work for the appellant.

12. On 28 July 2014 HMRC wrote to Mr Hancock explaining that the appellant could be relieved of liability for the under-deducted tax only on satisfying the conditions in regulation 72 of the Regulations and asking for further information to assess whether those conditions were satisfied. In this letter HMRC state that after receiving a form P 46 from the employee, the appellant should have operated code OT on a week 1/month 1 basis until HMRC issued the code 13T in February 2012.

13. On 5 August 2014 Mr Hancock replied noting that the employee had not provided a P46, at the time he was unaware of the employee's other employment, he was new to operating PAYE and he provided a letter to the employee informing him that he needed to contact his tax office. He felt he had done what he could in the circumstances. He now knows the correct procedures to follow with new employees and was doing so. He also noted that he had no knowledge of receiving a change of tax code for the employee in 2012. Mr Hancock confirmed this at the hearing and we accept his evidence in that respect.

14. On 20 August 2014 HMRC notified the appellant that they had decided not to make a direction under regulation 72 as they were not satisfied that the appellant had taken reasonable care in operating the PAYE system:

> "In particular you did not show sufficient diligence in operating Pay As You Earn by ensuring you had the skills necessary to operate the scheme competently. HMRC are always available for help and advice both on the telephone and online, at no point did you make contact with HMRC for assistance. You state that you told [the employee] it was his responsibility to contact HMRC and inform us of his employment, but you as his employer had an equal responsibility to notify us, you failed to do this. You also state in your letter that you did not receive a change of tax code for [the employee], this is because you did not notify HMRC of his employment.

15. In letters of 26 September and 8 December 2014 HMRC upheld their decision. They note that the instructions in the employer's pack (Booklet E13 - day to day payroll) state that if no P45 is received a P46 should be completed by the employee. If the employee has not completed a P46 or provided the employer with the information to fully complete section 1 of the P46 on time for their first payday, the employer must complete section 1 to the best of their knowledge and belief and use code OT on a week 1/month 1 basis. HMRC stated that in all cases the employer must send in a P46.

16. The decision was reviewed by an HMRC officer not previously involved in the case who upheld the decision in a letter of 16 January 2015. In this letter HMRC state

> "By your own admission you were new to operating the new company PAYE and did all you could with the limited experience you had. Aware that you lacked the necessary skills and knowledge I would expect you to have contacted HMRC for advice/support to assist you in applying the correct procedures. Whilst I acknowledge that the error was made in good

faith, the position remains unchanged in that you, the employer, failed to operate PAYE correctly resulting in an underpayment of tax for [the employee]".

17. The appellant appealed to the tribunal on 29 January 2015. The grounds of appeal were stated to be as follows:

> "I started this business in June 2011. [The employee] was one of my early employees. When [the employee] was given his first payslip, he was also given a letter. This letter stated that I had put him on a standard tax code for a single person as I was unaware of his exact status, as he had not supplied any P45. The letter told him to contact HMRC and get a confirmed tax code. He did not do this, so he stayed on this tax code, until he left employment. Although it is now evident that I made a mistake (simply due to new employer ignorance) I feel I made every effort to get things in order as soon as possible. I made every attempt to get the correct tax code, and [the employee] just ignored my request. I have spoken to [the employee] and he is aware of the situation, and understands that he should have paid the tax. I feel the HMRC are penalising my company unfairly. [The employee] has had the benefit of the money and should pay it back. My company is still operating on tight budgets, and cannot afford to pay this tax. I believe HMRC should be recovering it from [the employee].

18. Mr Hancock essentially confirmed at the hearing that the facts set out in his correspondence with HMRC were correct and his view remained as set out above. He accepted that he had make a mistake and he had not investigated all applicable codes for PAYE purposes. However, at the time the appellant had a small relatively new business and Mr Hancock was new to operating PAYE. Mr Hancock feels that in the circumstances the actions he had taken, such as requesting information from the employee and informing the employee that he should provide the correct code (which the employee ignored), were sufficient to demonstrate that reasonable care was taken to comply with the PAYE rules.

Law

PAYE rules regarding new employees

19. The Regulations set out detailed provisions on the PAYE scheme requiring employers to deduct tax from employment earnings paid to employees in a tax year according to the employee's code. The Regulations include specific provisions on the procedures to follow and codes to apply when a new employee joins. In outline:

> (1) Under regulation 46, where the employee does not provide a P45, the employee is required instead to provide information and certain confirmations in a P46. This must be signed by the employee or delivered by the employer after the employer has verified the information in it relating to the employee. The employer is also required to set out certain

information in the P46 including the tax code it is using as regards the employee's earnings.

(2) Where the employee has not provided the relevant confirmations, on making the first relevant payment to the employee the employer must amongst other obligations send the form P46 to HMRC even if the employee has not provided all information required and it must provide such information (under regulation 49).

(3) If a P46 is sent in where the employee has not given the required confirmation, the employer must deduct tax on the non-cumulative basis using code OT (under regulation 46(2C)).

20. It is clear from these rules that, where an employee does not provide a P45, the employer must send HMRC a P46 even where the employee does not in fact fill in that form with some or all of the relevant information and, where the relevant confirmations are not given, must then use code OT.

21. We note that the Employer Helpbook E13 as in place at the relevant time contains detailed guidance as to the procedure to follow where an employee does not provide a P45. This includes a statement (on page 22) which is based on the above rules as follows:

> "Exceptionally, if your employee has not completed the form P46, or provided you with the information fully to complete Section one in time for their first payday, you must complete Section one to the best of your knowledge on their behalf and use OT code on a week 1/month 1 basis"

PAYE rules whereby HMRC can relieve the employer of the obligation to deduct tax

22. Regulation 72 of the Regulations provides that HMRC can direct that an employer is not liable for tax which it is otherwise required to account for under the PAYE system where certain conditions are satisfied as follows:

> "(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 [and regulations 72A and 72B] –
>
> "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 amount actually deducted" is the amount actually deducted by the employer from relevant payments made to that employee during that 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) Condition B is that the Inland Revenue are of the opinion that the employee has received relevant payments knowing that the employer wilfully failed to deduct the amount of tax which should have been deducted from those payments.

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

(5A) Any direction under paragraph (5) must be made by notice ("the direction notice"), stating the date the notice was issued, to-

(a) the employer and the employee if condition A is met;
(b) the employee if condition B is met."

23. An employer can request HMRC to make a direction under regulation 72(5) under regulation 72A which provides as follows:

(1) In relation to condition A in regulation 72(3), the employer may by notice to the Inland Revenue ("the notice of request") request that the Inland Revenue make a direction under regulation 72(5).

(2) The notice of request must –

(a) state –

(i) how the employer took reasonable care to comply with these Regulations; and

(ii) how the error resulting in the failure to deduct the excess occurred;

(b) specify the relevant payments to which the request relates;

(c) specify the employee or employees to whom those relevant payments were made; and

(d) state the excess in relation to each employee.

(3) The Inland Revenue may refuse the employer's request under paragraph (1) by notice to the employer ("the refusal notice") stating –

(a) the grounds for the refusal, and

(b) the date on which the refusal notice was issued.

(4) The employer may appeal against the refusal notice –

(a) by notice to the Inland Revenue,

(b) within 30 days of the issue of the refusal notice,

(c) specifying the grounds of the appeal.

(5) For the purposes of paragraph (4) the grounds of appeal are that –

(a) the employer did take reasonable care to comply with these Regulations, and

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

(6) If on appeal under paragraph (4) [that is notified to the tribunal] it appears to the tribunal that the refusal notice should not have been issued the tribunal may direct that the Inland Revenue make a direction under regulation 72(5) in an amount the tribunal determines is the excess for one or more tax periods falling within the relevant tax year."

Submissions

24. The appellant's submissions were as set out in the correspondence and in the notice of appeal. In summary, Mr Hancock considered that, acting on behalf of the appellant he had taken reasonable care as regards PAYE obligations, taking into account that at the time the appellant had a relatively new small business and he was new to operating the PAYE system. He had asked the employee for relevant information and to approach HMRC for the correct code and had issued a letter to that effect which the employee had ignored. Mr Hancock feels the employee did not act properly in failing to provide full information and that, as it is his tax liability ultimately, HMRC should seek to recover the tax from the employee. He emphasised that he was now aware of the correct procedure when taking on new employees and was following that. He had sought to do this as soon as he became aware of the error as regards the employee. Mr Hancock also made representations that HMRC had been incompetent and unprofessional in their dealings and that the employee had misrepresented the position in his correspondence with HMRC.

25. HMRC's submissions were also essentially as set out in the correspondence outlined above. In brief the appellant, as a new employer, would have received a

copy of the employer's helpbook E13 which sets out the procedure to follow when taking on a new employee including as regard when the employee does not provide a P45 or P46. It is clear from this that if the employee does not provide the relevant details for the P46 the employer must nevertheless fill it in and provide details of what code it is using. The appellant failed to comply with this and did not contact HMRC for any assistance.

Decision

26. It is not disputed that the appellant failed to deduct and account for £1,295.80 of tax due under the PAYE system from the earnings of the employee for the tax year 2011/12 as the employer mistakenly applied the incorrect tax code. HMRC accept that this was an error made in good faith. However, the appellant can be relieved of liability to account for this amount to HMRC only if it is held to have taken reasonable care to comply with the Regulations in this regard.

27. Following the approach in other tax contexts, we consider that whether there is a failure to take reasonable care falls to be judged by reference to a prudent and reasonable taxpayer in the position of the taxpayer in question. The question, therefore, is what action a prudent and reasonable taxpayer, in the appellant's circumstances, would have taken as regards its PAYE obligations in relation to the employee, as the PAYE rules applied at the relevant time.

28. It is an essential part of the PAYE system that the obligation is on the employer correctly to deduct and account for income tax on an employee's earnings. Our view is that the hypothetical reasonable and prudent taxpayer can be attributed with an awareness of this obligation and with the need to be mindful to take reasonable steps to fulfil that obligation. In the context of taking on a new employee, a reasonable and prudent employer would, therefore, take all reasonable steps to ensure it is aware of the correct procedures to follow and code to use according to the Regulations.

29. As set out, it is clear that, under the applicable Regulations at the time, the obligation was on the appellant to submit a P46 as regards the employee even though the employee had not provided or filled in the relevant section of the P46 and to use code OT. We note that information on the correct steps to take is set out clearly in the employer's helpbook to which HMRC refer. We would expect a reasonable and prudent employer to consult this and, if still in doubt as to the correct position, to contact HMRC or take advice. These are basic steps which we would expect a new employer, acting reasonably and prudently, to take, in particular, where the employee has not provided a P45. As it is inherent in the PAYE system that the onus is on the employer to deduct and account for tax on employees' earnings, we would not expect a reasonable and prudent employer to assume that asking the employee for information and seeking to put the onus for providing the correct code on the employee suffices to comply with its PAYE obligation without seeking any further information from the available materials or assistance from HMRC (or elsewhere).

30. We accept the appellant's evidence that he did not receive a code from HMRC in 2012 as HMRC suggested in their correspondence (see above) but this does not affect

our conclusion. The failure to take reasonable care arose at the earlier stage by the failure correctly to submit a P46 and apply code OT.

31. We note that the appellant has raised issues with the way HMRC has handled this matter. However, this tribunal does not have jurisdiction to deal with complaints as regards HMRC's conduct.

Conclusion

32. For all of the reasons set out above, we have decided that HMRC were correct to refuse to make a direction under regulation 72(5) of the Regulations. The appellant's appeal is dismissed.

33. 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.

HARRIET MORGAN
TRIBUNAL JUDGE

RELEASE DATE: 6 JULY 2016