



TC05288

**Appeal number: TC/2015/04977
TC/2015/04981**

INCOME TAX & NIC - liability of directors for unpaid PAYE liabilities of liquidated company - Reg 72 Income Tax (PAYE) Regs 2003 - Reg 86 Social Security (Contributions) Regs 2001 - whether conditions met - yes - Appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

**PHILLIP MARSH
and
DAVID PRICE**

Appellants

- and -

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

Respondents

**TRIBUNAL: JUDGE: MICHAEL CONNELL
MEMBER: IAN PERRY**

Sitting in public at City Hall, Birmingham on 2 March 2016

Mr Gary Rooney (Rooney Tax Services) for the Appellants

**Ms Pallavika Patel and Ms Savita Mistry Officers of HM Revenue and Customs
for the Respondents**

DECISION

The Appeal

5 1. This is an appeal by Mr Phillip Marsh and Mr David Price (“the Appellants”) against:

- a Direction on 13 January 2015 by HMRC under Regulation 72(5) Condition B Income Tax (PAYE) Regulations 2003 made against the Appellants, and
- 10 • a Notice of Assessment on 27 February 2015 for Tax under s 29 Taxes Management Act 1970 following a Revenue Amendment for the year 2010-11, and
- a Decision on 27 February 2015 for Primary Class 1 National Insurance Contributions (“NIC”) issued under s 8(1) Social Security Contributions (Transfer of Functions) Act 1999 in respect of the year 2010-11.

15 2. The Direction relieved Maypole Contracts Limited, of which the Appellants were former directors, of tax liabilities and transferred those liabilities to the Appellants.

20 3. The Direction, the Notice of Assessment and the Decision were made because in the opinion of HMRC, there had been a failure by the Appellants, for the year in question, to operate PAYE and to make appropriate deductions of Tax/NIC from payments made to them at the time payment was made. Furthermore, Tax and NIC (plus employer secondary NIC) was not paid to HMRC in accordance with the relevant regulations. The Appellants’ role in the company was that of joint directors. HMRC say that they were jointly responsible for ensuring that PAYE and NIC was correctly operated and the Appellants failed to comply with that obligation.

25 4. The sum of £30,728 in income tax is claimed from each Appellant, £42,000 NIC from Mr Marsh and £4,778.85 NIC from Mr Price.

Background

30 5. Maypole Contracts Limited (“Maypole”) was incorporated on 2 August 2005. Its main activity was to provide gardening and cleaning services. The Appellants were joint directors and equal shareholders, each having a 50% shareholding in the company. Previously, Mr Price ran and owned a small gardens business and Mr Marsh owned a cleaning company. The company premises were located in Maypole, South Birmingham.

35 6. The company started small but the turnover built up to £500K pa within a very short period. There were four main clients. Most of the Midlands area was covered with an average contract worth around £4K per annum.

40 7. In October of 2008, the opportunity arose to purchase another company, Blooming Gardens Limited, a company that had a good contract base of schools and Local Authority contracts and had a turnover of £450K per annum with an average contract value of £5K in and around Solihull.

8. The Appellants purchased the business for £210K. £160K was paid on completion of the transaction and £50K deferred to be paid over twelve months.
9. The Appellants say that the Blooming Gardens business model was very out dated and a significant amount of investment was necessary in order to update the vehicle fleet. As a result of the capital expense and staff increases the company started to use the services of an invoice discounting company, Peak Cash Flow Limited.
10. In June 2010, the Appellants agreed to purchase another business, DPM Developments Ltd, which had a turnover of £100K. The Purchase price was £34K with £30K payable on completion and £4K deferred and payable over five months. HSBC agreed to provide £20K by way of overdraft, the Appellants meeting the balance from their own resources.
11. It was around this time that the company's cash flow problems significantly worsened and VAT and PAYE payments were being paid late. With the onset of the winter period, income further declined.
12. HSBC then reduced the company's overdraft facilities and Peak Cash Flow, following an annual review, terminated the company's invoice discounting facility. The Appellants say that this exacerbated the company's cash flow difficulties.
13. Historically the Appellants received small amounts by way of salary from the company. Most of their income was received in dividends. In the 2009-10 tax year the Appellants' salary was £6,000 pa gross and each received £33,333 gross dividends, a total of £39,333 each at a total cost to the company of £78,666.
14. However for the 2010-11 year, the Appellants increased their salaries to £102,000, each being recorded as taking £8,500 per month at a total cost to the company, including NIC of £228,600. The Appellants maintain that the decision to increase their salary was made during an AGM but no documentary evidence has been produced to substantiate that.
15. HMRC say that despite the financial position of the company (which appeared to have deteriorated rapidly after June 2010), the Appellants' salary continued at the same level throughout the year, but no payments of PAYE tax or NIC in respect of their income was paid over to HMRC.
16. The Appellants' explanation for the salary being increased was that both directors were attempting to procure mortgages to purchase new homes; showing large salaries in their mortgage applications would assist in mortgage facilities being offered to them.
17. On 30 March 2011 the company submitted an end of year PAYE form P35 for the tax year 2010-11, showing a liability of £164,339.60 in respect of PAYE tax and NIC liability. Four payments only totalling £21,220.43 were received during 2010-11 between 23 July 2010 and 9 November 2010 leaving a total of £143,119.17 due and unpaid for 2010-11, of which £95,662.66 related to the Appellants as company directors.
18. The company was contacted by HMRC in August 2010, and a Time to Pay arrears agreement was reached which required the company to pay PAYE on time and

clear the arrears. The company did not adhere to the arrangement, but the Appellants continued to take similar sums of money throughout the year, despite the fact that from June 2010 the company was facing severe cash flow difficulties and a declining financial position.

5 19. On 4 April 2011, the company went into administration.

20. HMRC say that in the 2010-11 tax year, there were discrepancies between what the Appellants banked compared to what one would expect to see as regards a net figure based on a gross salary of £8,500. As an example, in months 1 to 4 of the 2010-11 year, based on gross pay of £8,500 one would expect to see net pay figures of
10 £5,632, £5,004, £5,004 and £5,004 respectively, that is a total of £20,644. However, according to the bank account, amounts of £4,404, £6,000 £6,660 and £4,500 respectively, a total of £21,564 was paid into the Appellants' bank accounts in those months. The figures throughout the year were invariably round sums and in some months exceeded their salary.

15 21. The Appellants accept that there was no pre-determined entitlement to salary and say that it would not be unusual for them to take round sums and then for subsequent adjustments to be made via their company directors loan account. They say that they had "lost control over income and expenditure" and that due to cash flow problems, their salaries were at times paid by way of intercompany loans from the
20 two associated companies, Blooming Gardens Ltd and DPM Developments Ltd. They explain that the net pay each month did not agree to the amounts drawn in that month as the directors took their wages if and when cash flow allowed. The Appellants say that they believed that the financial problems faced by the company were temporary cash flow issues and that there was never any intention not to comply with the PAYE and NIC Regulations.
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22. HMRC say that where drawings, as the sums appeared to be, are taken, as opposed to a salary, and in particular when the loan account is overdrawn or amounts are taken in advance of salary, then PAYE should have been operated contemporaneously with payment of salary. HMRC say that the Appellants have not
30 explained how the company could afford to continue paying the directors large salaries throughout the year, when for the same period it had been unable to afford to submit payments to HMRC.

23. HMRC assert that the Appellants were aware that the company was not correctly operating PAYE and NIC in respect of drawings taken, and that there was
35 therefore a wilful failure to pay over the amounts due to HMRC. They took drawings on a monthly basis when their director's loan accounts were in debit and knowing that PAYE/NIC deductions were not actually being made and paid over to HMRC. Both directors were in a position of responsibility and control, and were aware of their obligations to pay over tax due to HMRC. As a result, their conduct was wilful.

40 **Evidence**

24. The documentary evidence consisted of two bundles prepared by HMRC, one bundle containing copy relevant documentation, copy extracted bookkeeping information held by the Appellants' accountants relating to the Appellants' salaries, recorded PAYE, copy company accounts for the year ended 31 August 2010;
45 correspondence, witness statements by each of the Appellants, their accountant Mr

David Baldwin and by Mr Naresh Gurawal a PAYE Directions Caseworker for HMRC, each of whom gave oral evidence to the Tribunal. The second bundle contained relevant legislation, regulations and case law authorities.

Relevant legislation

5 25. Income Tax (PAYE) Regulations 2003 (SI 2003/2682)

Regulation 72 - *Recovery from employee of tax not deducted by employer*

(1) This regulation applies if -

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

10 (b) condition A or B is met.

(2) In this regulation—

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

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(3) Condition A is that the employer satisfies the Inland Revenue—

20 (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.

25 (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.

30 (6) If a direction is made, the excess must not be added under regulation 185(5) or 188(3)(a) (adjustments to total net tax deducted for self-assessments and other assessments) in relation to the employee.

(7) If condition B is met, tax payable by an employee as a result of a direction carries interest, as if it were unpaid tax due from an employer, in accordance with regulation 82 (interest on tax overdue).

35 (8) The tax payable carries interest from the reckonable date until whichever is the earlier of—

(a) the date on which payment is made, or

(b) the date (if any) immediately before the date on which it begins to carry interest under section 86 of TMA(1).

40 Regulation 72C - *Employee’s appeal against a direction notice where condition B is met*

(1) An employee may appeal against a direction notice under regulation 72(5A)(b)—

- 5 (a) by notice to the Inland Revenue,
 - (b) within 30 days of the issue of the direction notice,
 - (c) specifying the grounds of the appeal.
- (2) For the purpose of paragraph (1) the grounds of appeal are that—
- 10 (a) the employee did not receive the payments knowing that the employer wilfully failed to deduct the amount of tax which should have been deducted from those payments, or
 - (b) the excess is incorrect.
- (3) On an appeal under paragraph (1) the Commissioners may—
- 15 (a) if it appears to them that the direction notice should not have been made, set aside the direction notice; or
 - (b) if it appears to them that the excess specified in the direction notice is incorrect, increase or reduce the excess specified in the notice accordingly.

Social Security (Contributions) Regulations 2001 (SI 2001/1004)

Regulation 86 - *Special provisions relating to culpable employed earners*

(1) As respects any employed earner's employment—

- 20 (a) where there has been a failure to pay any primary contribution which a secondary contributor is, or but for the provisions of this regulation would be, liable to pay on behalf of the earner and
 - (i) the failure was due to an act or default of the earner and not to any negligence on the part of the secondary contributor, or
 - 25 (ii) it is shown to the satisfaction of an officer of the Board that the earner knows that the secondary contributor has wilfully failed to pay the primary contribution which the secondary contributor was liable to pay on behalf of the earner and has not recovered that primary contribution from the earner; ...

30 the provisions of paragraph 3(1) of Schedule 1 to the Act (method of paying Class 1 contributions) shall not apply in relation to that contribution.

Social Security Contributions (Transfer of Functions, Etc.) Act 1999

Section 8 - *Decisions by officers of Board.*

(1). Subject to the provisions of this Part, it shall be for an officer of the Board—

- 35 (a) to decide whether for the purposes of Parts I to V of the Social Security Contributions and Benefits Act 1992 a person is or was an earner and, if so, the category of earners in which he is or was to be included,
- (b) to decide whether a person is or was employed in employed earner's employment for the purposes of Part V of the Social Security Contributions and Benefits Act 1992 (industrial injuries),
- 40 (c) to decide whether a person is or was liable to pay contributions of any particular class and, if so, the amount that he is or was liable to pay,

The Appellant's case

26. The Appellant's stated grounds of appeal in each of their Notices of Appeal to the Tribunal were:

5 "HMRC made a direction under Regulation 72(5), Condition B, Income Tax (Pay as you Earn) Regulations 2003 and also under Regulation 86 of the Social Security (Contributions) Regulations 2001 to transfer the liability (for tax and NIC unpaid to HMRC) from the appellants former employer to the appellants on the basis that there was a wilful failure to deduct the correct amount of deductions and that the appellant was knowing of that.

10 We believe that HMRC's decision is incorrect on the basis that there was no failure to deduct the appropriate deductions under PAYE. There is a good amount of evidence to indicate the contemporaneous deduction under PAYE by the employer from the Appellants' earnings.

15 On the basis that deductions were properly made and accounted for, HMRC cannot make a direction under the regulations mentioned above."

27. In prior correspondence with HMRC, Mr Rooney on behalf of the Appellants conceded that, as directors, they had to be either seen to be in control of, or be ultimately responsible for, the actions of the company and therefore he did not propose to pursue any argument as to whether the required conditions of "knowingly" or "willingly" may or may not have been satisfied. His main contention was that before any consideration as to whether those conditions were satisfied, the other remaining condition "failed to deduct sufficient tax" had to be satisfied, for the relevant directions to be made. His point was that HMRC could not, on the evidence, show that there had been any failure to deduct sufficient tax.

25 28. At the hearing Mr Rooney pursued the same argument, saying that any doubt about the failure, if any, to deduct sufficient tax, is a very different question to the inability on the part of the company to pay the amounts deducted to HMRC. He argues that a failure or inability of the company to pay does not satisfy the requirements of the Regulation 72 which requires a "failure to deduct".

30 29. He said that although he had not been able to obtain the actual company records from the liquidator, he had met with the company accountants and had been able to review their papers.

35 30. Mr Rooney acknowledged that the company was obliged to enter the directors' gross pay onto a P11 deduction working sheet so that the required deductions could be calculated along with their net pay. However, he argues that payment of the deductions to HMRC is not a requirement for the purposes of Regulation 72(5).

31. The company accounting and PAYE records were maintained on a SAGE system. An employee operated the system on a routine basis and entered the appropriate details into the system for the directors and employees on the payroll.

40 32. As part of their normal work pattern the accountants obtained print outs from the SAGE system from time to time and this included copies of the P11 Deduction working card. Copies of those records show a print-out date of 31 March 2011, which clearly indicates that on that date all of the entries required to complete those

documents were already in the SAGE payroll system and that they had been entered contemporaneously.

5 33. Mr Rooney argues that these documents, and indeed others held in the accountants file, show that the recording of gross pay and the computation of deduction from that pay was both properly recorded in the records of the company and, more importantly, was properly documented at the time of payment.

10 34. He says that figures for director's remuneration in the company accounts are entirely consistent with the payroll records maintained by the company and fully reflects the change in the gross pay several months into the accounting period in question.

15 35. It is also clear that the company operated a director's current/loan account. The directors recorded amounts taken from the company, or paid out on their behalf, and at the end of the year the accountants would have, by way of a journal, combined the figures in the wages paid and the amounts drawn to arrive at the end of year position. This is normal practice and, in effect, means that the directors would have their net pay credited to their accounts.

20 36. Mr Rooney says that evidence has been provided to HMRC to show the source of receipts into the director's personal accounts and the interaction with connected companies which would make intercompany loans to Maypole to assist its cash-flow from time to time. He acknowledged that unfortunately the Appellants had been unable to obtain any of the records from the liquidator that might have assisted.

25 37. In summary, Mr Rooney argues there is a significant amount of documentary evidence of contemporaneous deduction of PAYE and NIC. This, he says, means that the conditions required to enable HMRC to make a direction are not met; there was no failure to deduct.

30 38. He says that HMRC are concerned that the directors changed the way that they operated in 2010-11 compared to previous years. Because of increasing pressure on profits it became quite impracticable for the directors to repeatedly withdraw funds through a dividend which, after all, is a distribution of profit rather than through a salary. If the profit was not there it could not be distributed. It was at that point that it was decided to increase salaries. The increased salary also had several advantages in that it would assist with potential property purchases and pension planning.

35 39. The decision was taken at a time when the unforeseen issues that led to the rapid deterioration of the company financial position were simply not on the horizon. The directors thought that they had both time and the resources to continue trading successfully for many years to come.

40 40. The accountant's records confirm the increase in director's salaries being entered onto the payroll. The decision to increase pay was subsequently documented in the payroll records on a contemporaneous basis. There are no minutes, but directors control the company and they are not required to minute every decision that they may make.

41. When pay is "made available" to a director it is, of course, paid to him and PAYE should be applied. In the present case, when pay is credited to the director then

5 it is entered onto his P11 deduction working sheet/card and the net pay is then recorded as credited to him. The director may then draw from his current/loan account as circumstances may dictate. At the end of the year the accountants assess the directors overall position with the company, as is quite normal in these types of companies.

10 42. Mr Rooney argues that it is therefore not unusual that the monthly net pay is not precisely the sum drawn out by the director or vice-versa. The director's current/loan account would include numerous adjustments along the way and so on a practical level the withdrawal of round sums was not unusual. Why would a director withdraw say £2,012.49 rather than just calling it £2,000? There is nothing sinister or out of the ordinary in this practical approach; after all, the directors pay had already suffered deductions before being credited for him to draw upon.

15 43. If a director overdoes it then he is indebted to the company, if he underdoes it then the company is indebted to him. That does not displace the basic fact in this case that, in the records of the company, the gross pay suffered deductions before the net was made available to the director regardless of whether or not he withdrew it all at the time or piecemeal over time. The deduction of PAYE had very clearly taken place before the interaction with the director's current/loan account.

20 44. Mr Rooney referred us to the decision of *Prowse and Prowse v HMRC* [2012] 8608 and 8609 which bore similarities to the present case in terms of the directors deciding to take a reduced dividend and an increased salary. The explanation which they gave to the Tribunal in that case was that when the tax fell due on the dividends they had received, it always came as something of a shock and they preferred the certainty of PAYE paid incrementally during the course of the year. However in the event, because of unforeseen cash flow problems, the PAYE was never paid. In that case, Mr Rooney who appeared on behalf of Mr and Mrs Prowse argued, as he does in this case, that there is an important distinction between a failure to deduct and a failure to pay. The payroll had been run by an unconnected third party company, who correctly computed the necessary deductions, produced payslips contemporaneously with salary payments and produced information for forms P35. The payslips could not have been produced without the necessary computations on the P11 working sheets and were sufficient evidence of the fact of "deduction". The inability to pay, which arose on a subsequent liquidation, did not change the fact of deduction. At the time the salaries had been paid the company was not in financial difficulties and it was only the unexpected cash flow problems and subsequent liquidation which prevented payment of the outstanding PAYE previously deducted.

40 45. The matter is a little confused because of some funds being loaned to the company by connected companies and the loss, in effect, of the records given to the liquidator. However HMRC have already been provided with an analyses of amounts personally banked by the Appellants and despite the unavailability of prime records, this reconciles the position very well.

45 46. A liquidator was appointed on 4 April 2011. The reasons why the company failed are well documented and began with the bank, quite unexpectedly, withdrawing a promise of finance to fund a business transaction at the last possible moment; leaving the company legally committed to the considerable expenditure but without

the promised funds. From that point on matters moved quickly and the factoring company also withdrew its facility leaving the company cash flow in complete tatters.

47. A company cannot trade whilst insolvent and once the consequences of the above were realised the directors had no lawful option but to appoint a liquidator. The circumstances giving rise to the sudden demise of the company were not within the directors' control and were as unexpected as they were rapid. There is no criticism of the directors and their running of the company or record keeping by the liquidator in his report.

48. HMRC's assertion that there was a failure to make deductions by the company is incorrect, and that being the case Regulation 72(5) Condition B Income Tax (PAYE) Regulations 2003 cannot apply.

HMRC's case

49. The Appellants, at the relevant time, were directors of Maypole and responsible for the operation of PAYE for the company. The Direction, the Decision and the Assessments are consequential on the determination by the Commissioners that the Appellants knew that the Company had failed to deduct and pay to HMRC, PAYE tax and Class 1 NIC from remuneration payments made to them during the tax year from 6 April 2010 to 5 April 2011. The tax and Class 1 NIC has not been paid to HMRC.

50. PAYE is a continuous system for directors as well as employees which requires PAYE tax and Class 1 NIC to be deducted and accounted for when remuneration is paid or payments are made on account. A contemporaneous record must be kept of all payments made and tax deducted (s 66 Income Tax (PAYE) Regs 2003). The Appellants' annual end of year arrangement with their accountant is no excuse for ignoring this requirement. There is no "net pay" situation without a contemporaneous deduction and payment (Regulation 66 - Form P11).

51. Payments to the employee should be "net pay". The word "net" is not confusing, it is easy to understand. The Oxford dictionary gives the meaning of net (nett) as "remaining after all necessary deductions". Despite this and the clear requirements of the PAYE legislation to deduct tax and NIC, to arrive at "net income" the Appellants, as directors, authorised payments to themselves without actual deduction and payment, whilst simultaneously operating PAYE correctly in respect of remuneration of other employees - (68 in 2009, 54 in 2010 and 33 in 2011). The PAYE and NIC payable on the director's remuneration were not included in the company's monthly payments to HMRC.

52. The circumstances of the case *Regina v Commissioners of Inland Revenue ex parte McVeigh* [68 TC 121] are similar to those in this case. In *McVeigh*, the director drew money which was entered as a debit to his loan account. At the year-end a calculation was made of the amount which needed to be added to this to reach a gross amount which, if tax and NICs were deducted from it, would produce an amount approximately equivalent to the amount already received. This gross amount was then declared as a "bonus". Book entries were made for the tax and NIC showing them as creditors in the accounts, but the amounts of tax and NICs were neither accounted for in employer end of year returns nor paid over. In his judgement May J said:

5 “In these circumstances I consider that it would be a misuse of language to say that the book-keeping and accounting alone, without actual payment, and without any of the procedures which the Regulations require, constitute a deduction of tax from gross payment. There was, on the contrary, a wilful failure to do anything relating to tax obligations, beyond making some internal paper entries which the company proceeded to ignore for tax accounting purposes and which McVeigh also ignored when he submitted his own tax returns. In my judgement there was no deduction of tax by the company.”

10 53. HMRC say the circumstances in this case are the same as those in *McVeigh* in that the tax/NIC calculated was included in “end of year” returns made to HMRC, but tax had not been deducted. Book-keeping and accounting records alone do not constitute a deduction of tax. It is clear from *McVeigh* that whilst some of the procedures which the Regulations require (such as the P35 end of year return) had been carried out, no tax/NIC was actually deducted on the full amount paid at time of payment to the directors and neither has the tax been paid over to HMRC.

15 54. HMRC submit that the Appellants knew that the company wilfully failed to make deductions from relevant payments made to them. Both directors were responsible for the payroll, were signatories for bank purposes and would have known exactly how much to deduct and authorise payment of the relevant net amounts. It is clear that condition B (‘knowing’ and ‘wilfully’) of Regulation 72 (4) is satisfied.

55. In the tax case *R v IR Commissioners, ex parte Chisholm* [1981] STC 253 McNeil J said:

20 “.....I accept that for the purpose of construing that regulation, the word ‘knowing’ means what it says and does not mean ‘ought to have known’ or ‘should have been suspicious’ or any other weakening of knowledge. I also accept that the word ‘wilfully’ means ‘intentional’ or ‘deliberate’ and may, in the context of PAYE scheme and the collection of tax, import a measure of blameworthiness at least in the sense that it is blameworthy not to pay the tax that is due.”

30 56. In the case of *Michael Owen Williams* [2012] UKFTT 302 (TC) the judge recognised that the company was not in a position to award dividends due to the “precarious financial condition”. The limited company had very limited capital reserve and this would have been reduced substantially if not down to nil once the wages, salaries and tax liabilities were paid. The afterthought of adding the undeclared earnings to the directors as dividends points to the fact that the drawings were and should have been treated as PAYE remuneration.

57. In this case the directors chose to not pay HMRC stating they “paid the ones that shouted the loudest first” and this again points to the fact that the directors wilfully avoided operating PAYE and paying HMRC. The director’s loan accounts were in a debit situation and no drawings could therefore be made against these.

40 58. HMRC take the view that at all relevant times the Appellants were directors and 50% shareholders of the company - in other words the employer. The Appellants were responsible for the company’s payroll and were familiar with the payment of wages and salaries and the operation of PAYE. As such they were very much aware of their responsibilities in the running of the company. Whilst PAYE was operated correctly on remuneration paid to other employees, the Appellants authorised payments to themselves without operating PAYE at the point of receipt and in so doing they knew

that the company was failing to meet its legal obligation to operate PAYE correctly - a failure which occurred during the time the employer company was in financial difficulties.

59. Prior to the year in question, the two directors drew small salaries topped up by dividends so that their total remuneration was commensurate with the company's net profits. In later years and in particular in 2010-11, it was unable to pay dividends because of a lack of distributable reserves. The company accounts and bank statements show that the Appellants continued to draw funds in round sums from the company and at a time when they knew the company was not deducting and paying to HMRC the tax and NIC payable on the amounts paid to them.

60. Based on evidence produced, the Appellants were aware that the remuneration they received from the company had not, in fact, been subjected to PAYE and Class 1 NIC deductions, as and when required by law. The Appellants were, and are, very aware that such deductions should have been made from their gross pay, and as directors with responsibility for "due diligence" in the running of the company, should have ensured that those deductions were actually made and that appropriate amounts of tax and Class 1 NIC were remitted to HMRC within the defined time periods.

61. The result of these failures in the operation and remission of tax and Class 1 NIC is that HMRC took the decision that responsibility for payment of the resulting liabilities transferred to the Appellants. HMRC accordingly issued assessments on 27 February 2015 to recover the unpaid tax and NIC included within the Reg 72 Direction.

62. The assessments were made within normal time limits, (sections 29 and 34 TMA 1970). Section 29(4) is in point because the Appellants knew that the company had wilfully failed to deduct the tax and NIC from relevant payments made to them. Section 29(5) is also in point as the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the situation mentioned in s 29(1) that is, that income which ought to have been assessed to income tax has not been assessed. The calculation of the amounts assessed have not been challenged by the Appellants.

Conclusion

63. The issues for the Tribunal to decide are whether the full salaries declared and payments made to the Appellants from Maypole Contracts Limited are subject to PAYE Tax and Class 1 National Insurance for the tax year 2010-11 and whether that tax and NIC is payable by the Appellants.

64. The Appellants were the directors of Maypole and were responsible for the operation of the company's administration, payroll and banking. They had overall and everyday control of Maypole at all material times and therefore were in a position to ensure that PAYE and NIC was correctly operated. As directors of Maypole the Appellants had to ensure that the company complied with the Income tax (PAYE) Regulations 2003 and relevant NIC Regulations.

65. The Appellants drew substantial salaries from the business at a time when the company's profits could not support those salaries. During the tax year in question no

PAYE or National Insurance deductions were made. Their remuneration was disclosed on the Employer's Annual Return Forms P35 and P14 but the deductible amounts were not actually deducted and were not accounted for to HMRC.

5 66. In years prior to 2010-11 the Appellants were remunerated by modest dividends which were then supplemented by dividend distributions commensurate with the company's net profits. It must have been clear to the Appellants at the time they decided to receive a salary instead of dividends, that the company would not have been able to pay a dividend of an equal amount As such the payments by way of salary were in excess of the company's profits. Had the payments been made by way
10 of distributions they would have been unlawful.

67. The Appellants maintain that all payments of PAYE tax and NIC were deducted, but they are not able to produce any evidence of actual deductions and payment to HMRC. The burden of proof is on the Appellants. Referring to a liability for PAYE and National Insurance Contributions in the Employer's Annual Return is
15 not the same thing as actually making the deductions and accounting to HMRC. Regulation 72(1)(a) specifically refers to liability arising where the deductible amount exceeds the amount *actually* deducted.

68. The word 'knowing' does not mean 'ought to have known'. Knowing means knowing. 'Wilfully' means 'intentionally' or 'deliberately' and may in the context of
20 the PAYE scheme and the collection of tax import a measure of blameworthiness, at least in the sense that it is blameworthy not to deduct tax that is due [*Chisolm* JR decision 04/03/1981].

69. The question is whether HMRC have reasonable grounds for forming the opinion that the two directors did wilfully procure the company to pay their
25 remuneration without deduction of tax knowing that tax should have been deducted. In *Cook and Keys* (JR decision 1/05/87) the judge said he found it hard to separate the requirements of wilfulness and of knowledge because both go to the intentions and knowledge of the two directors. Here, both directors were responsible for the payroll and the operation of it and were in a position to know the full practices of operation of
30 deduction on wages and salaries. We do not accept that "the unforeseen issues that led to the rapid deterioration of the company financial position were simply not on the horizon". On the Appellants' own admission, the company was struggling financially prior to their decision to take salaries rather than a dividend and the situation only got worse after that.

35 70. Mr Rooney's main contention was that before any consideration as to whether the conditions requiring non-deduction of PAYE to be 'knowing' and 'wilful' were satisfied, the other remaining condition 'failed to deduct sufficient tax' had to be satisfied, for the relevant directions to be made. He asserts that payment of the deductions to HMRC is not a requirement for the purposes of Regulation 72(5) and
40 that an inability of the company to pay does not satisfy the requirements of the above regulations which require a "knowing and wilful failure to deduct".

71. The facts of this case, whilst similar to those of *Prowse* differ crucially insofar as the company was clearly in a difficult financial position at the time when the Appellants decided to take salaries instead of dividends. It is difficult to reconcile the
45 Appellants assertion (paragraph 38 above) that – "because of increasing pressure on

profits it became quite impracticable for the directors to repeatedly withdraw funds through a dividend, which after all is a distribution of profit rather than through a salary. If the profit was not there it could not be distributed. It was at that point that it was decided to increase salaries” – with their decision to award themselves substantial salaries. In *Prowse* the Tribunal found that the decision to change the method of cash extraction was reached at a time when there was no indication there would not be sufficient profits to cover future dividends. In this case, it is clear that the company was already in financial difficulties when the directors decided to take salaries instead of dividends. The company’s position became even more financially precarious in the ensuing months but the Appellants continued to take substantial salaries when it must have been clear that funds did not exist to discharge the commensurate PAYE and NIC. On that basis actual, deductions could not have been made.

72. However although the onus of proof falls to HMRC show that the Appellants received payments from their employer, knowing that the employer had wilfully failed to deduct PAYE and NI, it also falls on the Appellants to demonstrate that the deductions have *actually* been made and that the assessments are therefore excessive. The Appellants have not provided any evidence to show that *actual* deductions were made and paid to HMRC.

73. The company was persistently in arrears with its PAYE liability and quite evidently never in a position to pay the sums calculated when they fell due. The company was clearly in financial difficulties. That in our view is the real reason why dividends could not be awarded; distributions can only be made out of profits. Otherwise they would be ultra vires and unlawful. A dividend cannot be in excess of retained profits.

74. The Appellants’ failure to make deductions from their salaries were deliberate and the Tribunal is satisfied that they come within the definition of “wilful” for the purpose of Regulation 72(5) and s 81(1)(c) mentioned above

75. We conclude that the Direction under Regulation 72(5) Condition B Income Tax (Pay As You Earn) Regulations 2003 and the Decision under s 8(1)(c) Social Security Contributions (Transfer of Functions) Act 1999 were properly made. Assessments for the tax year 2010-11 to recover tax/under-deductions from relevant earnings paid to the Appellants by their employer Maypole Contracts Limited made under the provisions of s 29 Taxes Management Act 1970 were correct.

76. The Appellants are accordingly personally liable to pay tax and National Insurance as assessed and set out in paragraph 4 above.

77. The appeals are dismissed.

78. 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.

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**MICHAEL CONNELL
TRIBUNAL JUDGE**

RELEASE DATE: 02 AUGUST 2016

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