TC05641

Appeal number: TC/2015/03337

NATIONAL INSURANCE CONTRIBUTIONS – Class 1 – secondary contributor – whether earnings – yes – whether liability is extinguished by the reimbursement of the payments after the end of the tax year – no

FIRST-TIER TRIBUNAL
TAX CHAMBER

M NAJIB & SONS LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE JANE BAILEY
MR G. NOEL BARRETT

Sitting in public at Centre City Tower, Birmingham on 12 May 2016

Mr Martin Tomes, HSKS Greenhalgh, for the Appellant

Mr Philip Oborne, presenting officer, for the Respondents

DECISION

Introduction

1. By notice of appeal filed 21 May 2015, the Appellant appealed against the Respondents' review decision dated 24 April 2015, which upheld assessments for the years 2006/07, 2008/09, 2009/10 and 2010/11 raised on 29 January 2015 to give effect to the Respondents decision, dated 16 January 2015, that further Class 1 National Insurance Contributions ("NICs") in the total sum of £6,222.96 were due in respect of earnings of the Appellant's directors in those years.

2. By letter to the Tribunal dated 23 October 2015 the Appellant also appealed against penalties for the years 2006/07, 2008/09, 2009/10 and 2010/11 in the total sum of £874.55, raised on 6 and 16 March 2015.

Preliminary issue

3. As a preliminary issue we were required to consider whether the Appellant's appeal to the Tribunal against the imposition of penalties should be admitted out of time. The penalties were imposed in two assessments, a penalty in the sum of £116 imposed by an assessment dated 6 March 2015 and penalties in the total sum of £758.55 imposed by an assessment dated 16 March 2015. By letter dated 12 March 2015, the Appellant appealed the earlier penalty assessment. This penalty assessment was upheld by the Respondents in their review decision of 24 April 2015. We have no record of the Appellant making an appeal to the Respondents against the later penalty assessment. Neither penalty was appealed against in the Appellant's appeal to the Tribunal received on 21 May 2015. It was not until 23 October 2015 that the Appellant confirmed that it wished to appeal against the penalties as well as the NICs.

4. On behalf of the Appellant, Mr Tomes explained that when the original decision had been upheld by the Respondents, the Appellant's focus had been upon preparing for the substantive appeal before the Tribunal, so it had not been appreciated that no appeal had been lodged with the Tribunal against the imposition of penalties. The Respondents indicated that they had no objection to an extension of time being granted to the Appellant to appeal against the penalties imposed.

5. Applying the principles in *Data Select Ltd v HMRC* [2012] UKUT 187 (TCC), we considered the length of the Appellant's delay in appealing (approximately five months for the penalty of £116, and six months for the penalties of £758.55), the reasons provided for the Appellant's delay (oversight) and the prejudice which would be caused to each party if we either granted, or did not grant, an extension of time. If we did not grant an extension of time then the Appellant would lose the opportunity to appeal against the penalties imposed; if we granted the application then the Respondents would be required to respond to the Appellant's appeal. However, in not opposing the Appellant's application for an extension of time, the Respondents had indicated that no or very little prejudice would be caused to them. After weighing these factors, in particular the very limited prejudice felt by the Respondents, we

considered it appropriate to grant an extension of time to the Appellant. We admitted the appeals against the two penalty assessments out of time.

Background to this appeal

6. The Appellant has been trading since late 2003. At all relevant times it has had two directors. In February 2012 an officer of the Respondents visited the Appellant's office and undertook a check of the Appellant's employer records.

7. As a result of the officer's checks, the Respondents identified that, from the tax year 2009/10, the Appellant had paid a mileage allowance of 40 pence per mile to each of its two directors but that no mileage logs had been kept to identify the business mileage the directors had undertaken. The Respondents also identified that, from the tax year 2006/07, the Appellant had paid the premiums for the directors' private health insurance and these payments had not been debited to the Directors' loan account ("DLA"). The Respondents took the view that both these categories of payment constituted earnings of the directors, and that Class 1 NICs should have been paid by the Appellant in respect of these earnings.

8. The Respondents put their findings to the Appellant. As a result, the Appellant debited the payments of the directors' healthcare insurance premiums to the DLA. There was some discussion between the Appellant and the Respondents regarding the mileage allowance. It was agreed that the allowance paid should be reduced to remove payments the Appellant made for the directors' home to work mileage, and the Appellant made an adjustment to the DLA to claw back the overpayments.

9. Although the Appellant had made good in respect of the premium payments and the mileage allowance, the Respondents considered that a liability to Class 1 NICs remained. The Appellant took the view that rectification removed the charge to NICs. As the parties were unable to agree, the Appellant referred the dispute to the Tribunal.

Respondents' submissions

10. Having called the Respondents' only witness, Mrs Swarbrooke, to set out her understanding of the enquiry and explain why assessments had been raised, Mr Oborne took the decision not to make any submissions on behalf of the Respondents.

11. In reply to the Appellant's submissions Mr Oborne sought permission to call Mrs Swarbrooke again. It became clear that Mrs Swarbrooke wished to respond to Mr Tomes' submissions rather than give evidence of further facts. Therefore we suggested Mrs Swarbrooke take over as presenting officer to respond. Mrs Swarbrooke submitted that the Respondents considered the payments to be earnings as they were for the benefit of the directors.

12. The Respondents also considered the penalties to be appropriate as the directors bore responsibility for the Appellant's accounts and their failure to spot the errors was considered to be careless. No submissions were made in respect of the authorities cited by the Appellant.

Appellant's submissions

13. On behalf of the Appellant, Mr Tomes accepted that the Appellant had paid the directors' healthcare insurance premiums and overpaid the directors' mileage allowance. The figures were not in dispute but it was submitted that both types of payment had arisen in error. Mr Tomes submitted that as soon as the erroneous payments had been identified, the position had been rectified. As the Appellant's directors had made good the payments to the Appellant in a subsequent accounting period, and there was no personal gain to the directors, Mr Tomes submitted that the Respondents had not made the case for the payments in question amounting to earnings. Mr Tomes referred to *Apollo Fuels Ltd v HMRC* [2016] EWCA Civ 157 to argue that the absence of any profit by the directors indicated that no earnings arose.

14. Mr Tomes submitted that the DLA was in profit for the majority of the period so there was no economic gain or bounty to the directors. As there was no remuneration or profit derived from an employment, therefore the payments could not be characterised as earnings and so there was no liability to Class 1 NICs. Mr Tomes noted that the Respondents had not required an adjustment to be made to the Appellant's corporation tax or the directors' income tax for the years in question.

15. In correspondence the Appellant had placed reliance upon *Marcia Willett Ltd v HMRC* [2012] UKFTT 625 (TC). Before us Mr Tomes accepted that this decision related to Class 1A NICs but argued that delay in making good should not affect liability; a purposive approach should be adopted so that liability arose only when profit had genuinely arisen.

16. In respect of the penalties imposed under Schedule 24 Finance Act 2007 ("FA 2007") Mr Tomes submitted that the Appellant took reasonable care and that it was reliant upon its expert advisors, therefore the Schedule 24 penalties should be reduced to zero. Mr Tomes accepted the penalty imposed under Section 98A Taxes Management Act 1970 ("TMA 1970") but stated the Appellant's hope that all penalties would fall away as a result of our decision in respect of the NICs.

Evidence heard

17. On behalf of the Respondents we heard evidence from Mrs Susan Swarbrooke, the decision-maker. For the Appellant we heard evidence from Mr Kultaran Singh, chartered accountant, and Mr Ajaz Najib, one of the Appellant's directors. We found all the witnesses to be truthful and we accept their evidence. We were particularly impressed by the patent honesty of, and straightforward answers from, Mr Najib.

Facts found

18. On the basis of the documents in the bundle and the oral evidence we heard, we find the following facts:

<u>Background</u>

19. The Appellant was formed in 1998 and has been trading since late 2003 as a whole meat supplier. The Appellant has two directors, Mr Ajaz Najib and Mr Mohammed Najib, who are brothers. Prior to 2003 the two directors traded together in partnership as whole meat suppliers.

20. Both directors work long hours. The directors' expertise is in meat supplies rather than book keeping or accounts. The Appellant employs a book keeper and a firm of accountants in order to provide the management information and records required to comply with its statutory obligations and run its business successfully. The Appellant's advisors have been engaged by the Appellant (and previously the partnership) for more than twenty years, and the directors place great reliance upon them. The book keeper prepares monthly management accounts for the Appellant. The accountants prepare the Appellant's annual accounts, provide audit services, and conduct an annual review. The book keeper's staff consult the accountants if they are unsure of the appropriate accounting treatment or require advice.

The 2003 restructuring

21. The changes in 2003 were significant and there were discussions at that time between the two directors, its accountants and its book keeper about the restructuring and also about the accounting requirements once the Appellant began trading.

22. As part of the 2003 restructuring it was necessary for the partners to decide whether to transfer or retain various partnership assets which would be required by the Appellant for its business. The cars owned by the partnership prior to 2003 were not transferred to the Appellant as part of the 2003 restructuring. The directors had discussed the use of these cars with their advisors as the directors would need to travel considerable distances by car on behalf of the Appellant. The directors and their advisors decided that the two directors should retain the cars they owned as partners. This retention avoided the charges which would have been incurred had the Appellant purchased the cars from the partnership and subsequently made the cars available for the directors' personal, as well as business, use.

DLA

23. The DLA is drawn up to the last day of February each year. There is one DLA for both directors. The annual summary of the DLA shows various payments made in by the Appellant, including rent paid to the directors, directors' remuneration and dividends paid to the directors. We accept Mr Singh's evidence that all payments were put through the DLA.

24. The DLA was in credit throughout the year ended 28 February 2007, the year ended 28 February 2011 and the year ended 29 February 2012.

25. The DLA was overdrawn at the end of the month in some months during each of the years ended 29 February 2008, 28 February 2009 and 28 February 2010. Interest was paid in respect of the overdrawn periods. The amount of interest paid, ranging from £64.02 (in the year to 28 February 2010) to £6,083.90 (in the year to 29 February 2008) is shown in the annual summary of the DLA.

26. The Appellant's accountants would look at the DLA as part of their annual review of the Appellant, including the inspection of underlying records.

Health insurance

27. The discussion between Mr Najib and the sales representatives relating to the purchase of healthcare insurance happened in Mr Najib's office. This discussion would have taken place in the afternoon. Mr Najib works from 4 a.m. each morning and so had already been at work for several hours by the time of the sales discussion. Mr Najib does not carry a bank card with him while he is at work. We accept Mr Najib's explanation that, once he had decided the directors should take out healthcare insurance, it was simpler for him to ask the office staff to pay the premiums from the Appellant's business account than for him to find and supply his own personal bank details and those of his co-director.

28. We accept Mr Singh's evidence that he made it clear to the Appellant's book keeper that it must be careful to correctly allocate any personal liabilities of the directors. We also accept Mr Najib's evidence that the book keepers were instructed that any personal liabilities of the directors which were met by the Appellant must be charged to the DLA.

29. The Appellant paid the following healthcare insurance premiums on behalf of the directors:

Accounting period	Premiums paid
Year to 28 February 2007	£4,971
Year to 29 February 2008	£5,047
Year to 28 February 2009	£5,636
Year to 28 February 2010	£6,114
Year to 28 February 2011	£5,026

30. Mr Najib believed that the healthcare insurance premiums would be posted to the DLA. Neither director intended the Appellant to bear the cost of the healthcare insurance premiums.

31. Despite the clear instructions of Mr Singh and Mr Najib, the healthcare insurance premiums paid by the Appellant were not charged to the DLA. This mistake was not identified and rectified until after the Respondents' 2012 employer check. These adjustments were not made until February 2012.

Mileage payments

32. In February 2010 Mr Singh noted that neither director had made a claim upon the Appellant in respect of the business mileage undertaken in their privately owned cars. Mr Singh advised that the directors claim for business mileage. For the years

2009/10 and 2010/11, the Appellant credited certain payments to the DLA by way of a mileage allowance.

33. Although the mileage allowance credited to the DLA was expressed to be calculated at 40 pence per mile travelled on business, no records were kept to establish the number of miles travelled on business by either director. The Respondents accept that the Appellant's directors would have undertaken some travel on behalf of the Appellant. The parties agree that mileage allowances paid in respect of home to work travel should not have been paid.

34. The following payments are accepted by the Appellant to be excess mileage allowance payments which relate to home to work travel:

Accounting period	Excess mileage allowance paid
Year to 28 February 2010	£2,391
Year to 29 February 2011	£2,031

35. The DLA was adjusted to remove these payments in March 2012, after the Respondents' 2012 Employer check.

Decision

36. Having set out the facts we have found, we now apply the relevant legislation to consider first what is required for liability to pay Class 1 NICs to arise, whether the payments made by the Appellant constitute earnings, and whether any liability which has arisen can be extinguished by an employee making good. Finally, we consider the penalty position.

Liability for Class 1 contributions

37. Liability to pay Class 1 NICs is prescribed by Section 6 of the Social Security Contributions and Benefits Act 1992 ("SSCBA 1992"). The relevant parts of this section, in force since July 2000, are as follows:

> **6 Liability for Class 1 contributions**
>
> (1) Where in any tax week earnings are paid to or for the benefit of an earner over the age of 16 in respect of any one employment of his which is employed earner's employment—
>
>> (a) a primary Class 1 contribution shall be payable in accordance with this section and section 8 below if the amount paid exceeds the current primary threshold (or the prescribed equivalent); and
>>
>> (b) a secondary Class 1 contribution shall be payable in accordance with this section and section 9 below if the amount paid exceeds the current secondary threshold (or the prescribed equivalent).

…

(4) The primary and secondary Class 1 contributions referred to in subsection (1) above are payable as follows—

(a) the primary contribution shall be the liability of the earner; and

(b) the secondary contribution shall be the liability of the secondary contributor;

but nothing in this subsection shall prejudice the provisions of paragraphs 3 to 3B of Schedule 1 to this Act.

38. In this appeal we are concerned only with the secondary contributions payable by the Appellant (as the secondary contributor). It is accepted that the directors are both earners within the meaning of Section 6. Mr Tomes' main submission, on behalf of the Appellant, is that the Appellant's payments do not constitute "earnings".

Do the Appellant's payments constitute "earnings"?

39. Section 3 of SSCBA 1992 provides as follows:

3 "Earnings" and "earner"

(1) In this Part of this Act and Parts II to V below—

(a) "earnings" includes any remuneration or profit derived from an employment; and

(b) "earner" shall be construed accordingly.

(2) For the purposes of this Part of this Act and of Parts II to V below other than those of Schedule 8—

(a) the amount of a person's earnings for any period; or

(b) the amount of his earnings to be treated as comprised in any payment made to him or for his benefit,

shall be calculated or estimated in such manner and on such basis as may be prescribed by regulations made by the Treasury with the concurrence of the Secretary of State.

40. Therefore in considering whether the payments made by the Appellant constitute earnings, we should look at whether the payments are made to either director or for either director's benefit. In considering this we must bear in mind that earnings includes payments which are remuneration in the hands of the directors or which constitute profit to the directors, derived from their employment. Although it is possible for earnings to be something other than remuneration or profit (as Section 3(1) provided an inclusive, rather than exclusive, list) we consider that anything else included would be of a similar nature.

41. Mrs Swarbrooke's submissions, in the Respondents' reply, was that the directors gained a benefit, either in having a sum credited to the DLA or in having the

Appellant meet a liability which they would otherwise meet personally; therefore the payments were earnings. Mr Tomes argued that there was ultimately no benefit to the directors from the payments, and so the payments were not earnings. Mr Tomes took us to the Respondents' guidance and a selection of Schedule E tax authorities to make good his submissions.

42. Mr Tomes took us first to the Respondents' leaflets CA44, *National Insurance for Company Directors*, in use from April 2015, and CWG2, *Employer Further Guide to PAYE and NICs*, in use from 6 April 2015. Chapter 5 of the later leaflet included a table setting out what should be included on an employer's the payroll record for NICs and PAYE. That table included the following entry:

Type of payment	Include on payroll record for NICs	Include on payroll record for PAYE
Director's personal bills charged to loan account: · the transaction makes the account overdrawn (or more overdrawn) and it is normal practice for you to pay the director's earnings into the same account · all other circumstances	Yes, on the overdrawn (or additional overdrawn) amount No	No No

43. In respect of this guidance Mr Tomes submitted that it was clear from the Respondents' guidance that there was no benefit where a loan account was not overdrawn, and thus there was no benefit here.

44. We note that neither CA44 nor CWG2 have force of law. While guidance without force of law can be helpful in providing clarity as to the Respondents' understanding of the law, it remains only opinion. Therefore it is not conclusive of the issue even where it supports a taxpayer's arguments. Here, we cannot see that the Respondents' guidance does help the Appellant's case. Despite Mr Tomes' valiant submissions that the DLA was not overdrawn for the majority of the years in dispute, it was clear from the evidence before us (and we have found) that the DLA was overdrawn for several periods during the years in dispute. It is possible that the DLA would have become overdrawn in further periods if the directors' healthcare premiums had been posted, as Mr Najib had instructed, and only the correct mileage allowance had been paid. (The rectified version of the DLA which we were shown set out the end of year position but not the account drawn up on a monthly basis.) Therefore, as the DLA was overdrawn, the Respondents guidance indicates that NICs would be due upon the Appellant's payments of the healthcare premiums even if they had been correctly charged to the DLA in the relevant tax year.

45. Mr Tomes took us through the authorities, beginning with *Donnelly v Williamson* 54 TC 636, a High Court decision looking at whether a mileage allowance

was an emolument for the purposes of Schedule E. We agree that guidance on what constitutes an emolument can provide useful assistance in determining whether a payment constitutes earnings. In *Williamson* Walton J held that the mileage allowance paid was not an emolument, on the basis that it was paid to reimburse travel expenses and related wear and tear to the taxpayer's vehicle, and there was no evidence that the payment included any element of bounty. Mr Tomes argued that this supported the Appellant's submission that there was no benefit to the directors in the payment of the mileage allowance.

46. Mr Tomes then took us to the Court of Appeal decision in *HMRC v Apollo Fuels Ltd* [2016] EWCA Civ 157. The issue in dispute was whether an employee was liable to income tax in respect of a car leased to him on commercial terms by his employer. HMRC had accepted that the employer did not derive any financial benefit but contended that a charge arose under Chapter 6 of Part 3 of Income Tax (Earnings and Pensions) Act 2003 ("ITEPA 2003"). As part of their consideration, the Court of Appeal looked at the meaning of the word "benefit". Mr Tomes drew our attention to paragraph 45 where Lord Justice David Richards held:

> These are all considerations which, in my judgment, show that the choice of word "benefit", without any definition qualifying or altering its ordinary meaning, was intended to show that, before a charge to income tax in these circumstances arises, there must be a benefit to the employee in the ordinary sense of that word.

47. We agree with Mr Tomes that there is considerable authority to support his proposition that payments which do not confer a benefit on an employed earner are not earnings. However, we do not agree with Mr Tomes that the payments made by the Appellant in this case did not confer a benefit in the period in which they were paid.

48. We look first at the mileage allowance payments paid to reimburse the directors for their business travel. As is clear from *Williamson*, any fair attempt to reimburse the estimated expense incurred would not confer a benefit on the directors. However, no records were kept of the business mileage of the Appellant's directors. Although the parties have agreed that some business mileage occurred, they are also agreed that the mileage allowance paid to the directors included an element for home to work commuting for which no allowance was payable. It was agreed that the amount of mileage allowance credited to the DLA included an overpayment. In the circumstances, we do not see how that overpayment could be anything other than bounteous. It was not the reimbursement of the estimated expenses of business travel but an additional payment. We consider that overpayment to the directors must have conferred a benefit upon them.

49. We look next at the healthcare insurance premiums. The directors were liable to pay these premiums but, in the relevant years, that liability was met by the Appellant. We accept that this was unintended but despite happening in error, we consider that it was of benefit to the directors to have the Appellant meet their

personal liabilities. We consider that the Appellant conferred a benefit on the directors by meeting their liability to pay the healthcare insurance premiums.

50. Although not mentioned by the parties, we also note that the overpayments to the DLA and accidental non posting of the premiums to the DLA resulted in the DLA being less overdrawn in the months in which the summary of the DLA show it to have been overdrawn. This reduction in the indebtedness of the DLA reduced the interest payable by the directors. If the DLA had become overdrawn in further periods, as noted above as a possibility, then the directors would have been liable to pay more interest. The reduction in the amount of interest payable by the directors was also a benefit to them. The rectified DLA does not appear to take into account the changes in the amount of interest payable.

Can a liability be extinguished by making good?

51. The second part of the Appellant's submissions was that, even if there was a benefit to the directors in the tax year that the payments were made, there was ultimately no benefit to the directors because once the errors were discovered the positon was rectified. Therefore by making good in a subsequent tax year, any benefit to the directors was removed. Mr Tomes referred us to the principles discussed in *Marcia Willett Ltd*, and urged us to take a purposive interpretation.

52. In *Marcia Willett Ltd*, this Tribunal considered whether there was a liability to Class 1A contributions. Liability for Class 1A contributions arose under Section 10 SSCBA, and depended upon there being a charge to income tax. The charge to income tax had arisen under Section 203 ITEPA 2003, which enabled an employee to make good the benefit received after the end of the relevant tax year. HMRC accepted that once an employee had made good the benefit then the income tax charge was extinguished. The Tribunal held that the liability to pay Class 1A contributions must also fall away as the income tax charge upon which the Class 1A liability was founded no longer existed.

53. Liability to Class 1 NICs arises by virtue of Section 6 SSCBA 1992, as set out above. Section 6 SSCBA 1992 provides that the liability to pay NICs arises on a weekly basis. Section 9 SSCBA 1992 (as applied during the relevant years) also calculates the amount of the contribution by reference to a tax week:

> **9 Calculation of secondary Class 1 contributions**
>
> (1) Where a secondary Class 1 contribution is payable as mentioned in section 6(1)(b) above, the amount of that contribution shall be the secondary percentage of so much of the earnings paid in the tax week, in respect of the employment in question, as exceeds the current secondary threshold (or the prescribed equivalent).

54. However, this is modified for directors by Regulation 8(3) of the Social Security (Contributions) Regulations 2001 (SI 2001/1004) which provide that the relevant earnings period is the whole of the year. Regulation 1 provides that "year" means a tax year. Therefore the Appellant's liability to pay secondary Class 1 NICs in respect

of a director's earnings is calculated by reference to the director's aggregated earnings in a tax year, as that is the relevant earnings period. If the directors had made good the overpayment of mileage allowance or lack of reimbursement of the premiums at the end of each tax year then that rectification could have been taken into account when the directors' earnings were aggregated over the course of the tax year.

55. Having established the period over which earnings are calculated, we consider the position if the directors make good after the end of the relevant earnings period. Section 203 ITEPA 2003 enabled a liability which arose in a tax year to be extinguished if there was a subsequent making good but there is no such provision within Section 6 SSCBA 1992. The legislation is clear in requiring calculation of liability to be over the relevant earnings period.

56. Mr Tomes urged us to adopt a purposive interpretation of the legislation but, unfortunately for the Appellant, we cannot write a rectification clause into the legislation where none appears. We reach this conclusion with some reluctance as we accept that the Appellant did not intend to make payments to or for the benefit of the directors in the relevant tax years. The Appellant and its directors moved quickly to unpick the payments once the Respondents' check brought the earnings to their attention. However, the legislation does not provide for the subsequent repayment of earnings after the relevant tax year.

57. We conclude that a liability to Class 1 NICs, once incurred in one tax year, cannot be extinguished by an employed earner making good the earnings in a subsequent tax year. Therefore, we agree with the Respondents that the Appellant is liable to pay Class 1 NICs for the years 2006/07, 2008/09, 2009/10 and 2010/11.

Penalties

58. Having confirmed the imposition of Class 1 NICs, we turn to consider the following penalties which have been imposed upon the Appellant:

Year	Amount	Penalty regime
2006/07	£116	Section 98A(4) TMA 1970
2008/09, 2009/10 and 2010/11	£758.55	Schedule 24 FA 2007

59. The Respondents were willing to suspend the penalties imposed under Schedule 24 but this would have required the Appellant to accept liability. The Appellant was not willing to do this and so the penalties remain unsuspended.

60. As a result of our decision in respect of the Class 1 NICs, we are satisfied that there were outstanding amounts of Class 1 NICs unpaid for the tax years 2006/07, 2008/09, 2009/10 and 2010/11.

61. We consider first the penalty for 2006/07 imposed under Section 98(4) Taxes Management Act 1970. The relevant parts of Section 98 TMA 1970, as it applied for the tax year ended 5 April 2007, provide as follows:

> **98A Special penalties in the case of certain returns**
>
> (1) PAYE regulations or regulations under section 566(1) (sub-contractors) of the principal Act may provide that this section shall apply in relation to any specified provision of the regulations.
>
> …
>
> (4) Where this section applies in relation to a provision of regulations, any person who fraudulently or negligently makes an incorrect return of a kind mentioned in the provision shall be liable to a penalty not exceeding the difference between—
>
> > (a) the amount payable by him in accordance with the regulations for the year of assessment to which the return relates, and
> >
> > (b) the amount which would have been so payable if the return had been correct.

62. Regulation 73 of the Income Tax (Pay As You Earn) Regulations 2003 (SI 2003/2682) provides that Section 98A(4) applies to an Employer's annual return of relevant payments made to employees. As a result of our conclusion that the Appellant is liable to pay additional Class 1 NICs in 2006/07, we are satisfied the Appellant's Employer's annual return for the year ended 5 April 2007 was incorrect.

63. The onus is upon the Respondents to satisfy us that Section 98A(4) applies in this case. There is absolutely no suggestion that the Appellant acted fraudulently in delivering an incorrect Employer's return for 2006/07. However, we agree with Mrs Swarbrooke that, in its failure to identify that there were additional payments which amounted to earnings of the directors, the Appellant did not take sufficient care in its Employer's annual return. We consider that this carelessness amounts to negligence for the purposes of Section 98A(4) TMA 1970. Therefore a penalty may be imposed.

64. In considering the size of the penalty to be imposed we note that the Appellant has already been given the maximum reduction possible for disclosure and co-operation. The reduction for size and gravity was 30% out of a maximum of 40% on the basis that the Appellant did not have sufficient controls in place to identify the errors which had occurred. Mr Tomes made no submission as to why a penalty should not be imposed upon the Appellant under Section 98A(4) TMA 1970. In the circumstances we agree that no greater reduction to the penalty should be given, and we confirm the penalty imposed upon the Appellant for the year ended 5 April 2007 in the sum of £116.

65. Next we consider the penalties imposed for 2008/09, 2009/10 and 2010/11 under Schedule 24 FA 2007. Schedule 24 provides that a penalty is payable by a person who delivers a return (including an Employer's annual return) which contains an inaccuracy which leads to an understatement of a liability to tax, and that the

inaccuracy was careless or deliberate. As a result of our conclusions in respect of the Appellant's liability to Class 1 NICs, we are satisfied the Appellant's Employer's annual return for the years ended 5 April 2009, 2010 and 2010 contained inaccuracies which led to an understatement of a liability to tax.

66. The Respondents took the view that the Appellant's behaviour was careless, rather than deliberate, and that the disclosure was prompted. Mr Tomes submitted that the Appellant had taken reasonable care and had been reliant upon its advisors. Paragraph 18(3) of Schedule 24 provides that a person is not liable to a penalty which has arisen as a result of anything done or omitted by that person's agent if the person concerned took reasonable care to avoid the inaccuracy.

67. In this case the inaccuracy arose through two mistakes: the Appellant's overpayment of mileage allowance to the DLA, and the Appellant's failure to post the directors' premiums to the DLA. In respect of the first of these inaccuracies, it appears that the Appellant, its book keeper and its accountants were all aware that the directors did not keep any records to establish their business mileage. Although the Appellant may have been reliant upon its advisors to produce figures for the mileage allowance payment to its directors, we consider that the Appellant's decision to pay a mileage allowance despite the absence of any mileage records was not the action of a person taking reasonable care to avoid an inaccuracy.

68. In considering the second inaccuracy, the Appellant's failure to post the premiums to the DLA, we bear in mind that Mr Singh and Mr Najib both gave clear instructions to the Appellant's book keeper that the directors' personal liabilities must be posted to the DLA. The Appellant employed its accountants to undertake an annual review which included looking at the Appellant's underlying records. The second inaccuracy in the Appellant's Employer's annual returns arose as a result of the book keeper failing to post the directors' personal liabilities to the DLA, and the accountants failing to identify this error. Therefore we should consider whether the error was such that the Appellant should have spotted it when it conducted its own check of its advisors' work. We accept that the Appellant engaged its advisors precisely because the directors have no specialism in book-keeping and accounts, and so we do not expect them to have in-depth knowledge of complex or highly technical transactions. However, we take the view that the Appellant, through its directors, was capable of checking whether a personal liability had been posted to the DLA in accordance with a director's instructions. The amounts – approximately £5,000 in the first year, or about £415 each month – are sufficiently large for their omission to have been noted when the directors considered the management information in the first month after the premium payments were instigated or in the accounts at the end of each year. Ultimately the Appellant is responsible for checking that its instructions are carried out correctly. We conclude that by failing to check the work undertaken by its advisors, the Appellant did not take reasonable care to avoid the second inaccuracy in its Employer's annual return.

69. When calculating the Schedule 24 penalties to be imposed, the Respondents gave a reduction for disclosure of 100%, resulting in a penalty percentage of 15%, the minimum possible for a prompted disclosure penalty. Paragraph 11 of Schedule 24

allows the Respondents to further reduce a penalty imposed under Schedule 24 if they consider there are special circumstances which would make it right to do so. In this case the Respondents decided that there were no special circumstances. We can only interfere with that decision of the Respondents if we conclude that it was flawed when considered in light of the principles applicable in judicial review proceedings. Given the information considered by the Respondents when calculating these penalties, we cannot conclude that their decision not to grant a special reduction was flawed, and so the Respondents' decision not to grant a special reduction stands.

70. Therefore we confirm the penalty percentage of 15% in respect of the penalties imposed under Schedule 24 for the years 2008/09, 2009/10 and 2010/11.

Conclusion

71. Having decided that the Appellant's overpayments of mileage allowance to the DLA and payment of the directors' health insurance premiums both constituted earnings, and concluded that the reimbursement by the directors after the relevant tax year cannot extinguish the liability which accrued during the year, we conclude that the Appellant's appeals against the assessments to Class 1 NICs for the years 2006/07, 2008/09, 2009/10 and 2010/11 must be dismissed.

72. We are satisfied that the Respondents were entitled to raise penalties for the years 2006/07, 2008/09, 2009/10 and 2010/11. We confirm the penalty for the year 2006/07 in the amount of £116. We confirm the penalties for the years 2008/09, 2009/10 and 2010/11 in the total amount of £758.55.

73. Therefore we dismiss these appeals.

74. 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.

JANE BAILEY

TRIBUNAL JUDGE
RELEASE DATE: 14 MARCH 2017