[2018] UKFTT 0220 (TC)

TC06453

Appeal number: TC/2017/06460

INCOME TAX - individual tax return - penalties for late filing - whether properly imposed - no - purpose for which the notices to file were served - to establish chargeability - no – Goldsmith and Wandsworth v Winder considered - Tribunals jurisdiction to consider validity of notices - yes - whether reasonable excuse - no - whether special circumstances - no - appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

BARRY LENNON **Appellant**

- and -

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

TRIBUNAL: JUDGE NIGEL POPPLEWELL

The Tribunal determined the appeal on 23 March 2018 without a hearing under the provisions of Rule 26 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (default paper cases) having first read the Notice of Appeal dated 29 August 2017 (with enclosures) and HMRC's Statement of Case (with enclosures) prepared by the respondents on 11 October 2017 and various correspondence between the parties.

DECISION

Background

1. This is an appeal against the following penalties, visited on the appellant under Schedule 55 Finance Act 2009 for the late filing of an individual tax return for the tax year 2014-2015.

(1) A late filing penalty of £100 ("**late filing penalty**").

(2) Daily penalties of £900 (the "**daily penalties**").

(3) A 6 month late filing penalty of £300 ("**6 month penalty**").

Evidence and findings of fact

2. From the papers before me I find the following facts:

(1) During the 2014-2015 tax year, the appellant earned employment income from five separate employments which were subject to tax deduction at source under the PAYE regime.

(2) The appellant was in the PAYE system during the 2014-2015 tax year and has five separate employments during that year. The total income from all of those employments brought him into the higher rate tax band. Because of the number of changes of employment he had during that year, his employers were unable to collect all the tax due from the appellant.

(3) HMRC sent a calculation to the appellant on 27 October 2015 showing that he owed £321.12 for the tax year 2014-2015. Notwithstanding that neither the calculation itself nor any covering letter which might have accompanied this calculation has been tendered in evidence by HMRC, the appellant accepts, in the notice of appeal that "HMRC ..... issued him [i.e. the appellant] with a tax calculation on 27 October 2015". I therefore find as a fact that a tax calculation was sent to the appellant on that date identifying the amount of £321.12 as the income tax underpaid by the appellant from his employments in the tax year 2014-2015.

(4) Because HMRC were unable to collect this underpayment through coding out, they issued a voluntary payment letter on 29 October 2015. A further voluntary payment letter was issued to the appellant on 21 January 2016. The evidence of the issue of these letters is copies of two computer printouts which suggest that a document (VPL1 and VPL2) was sent to the appellant on those dates. I surmise that VPL stands for voluntary payment letter, and find as a fact that, as indicated by HMRC in their Statement of Case, the voluntary payment letters were indeed sent to the appellant on the dates in question.

(5) The voluntary payment letters refer to the tax calculation (a P800 tax calculation) and indicate that "If you don't pay the amount that you owe or

come to an arrangement with us, we will have to consider collecting the amount from the Self-Assessment Tax System. If we need to use self-assessment you will have to fill in a self-assessment tax return…..".

(6) A notice to file for the tax year 2014-2015 was issued to the appellant on 21 April 2016. The filing date for this return was 28 July 2016 for a non-electronic return or 28 July 2016 for an electronic return.

(7) The appellant's electronic return for this year was received on 28 March 2017. It was processed on 28 March 2017.

(8) As the return had not been received by the due filing date, HMRC issued a notice of penalty assessment on or around 12 August 2016 for the £100 late filing penalty.

(9) As the return had still not been received six months after the penalty date, HMRC issued a notice of penalty assessment on or around 21 February 2017 in the amount of £300.

(10) On 24 January 2017 the appellant's agent appealed against the penalties.

(11) Following further exchanges of letters between HMRC and the appellant's agent, on 23 May 2017 that agent requested a review of HMRC's decision to impose the penalties.

(12) HMRC carried out a review and issued their review conclusion on 15 August 2017. The outcome of the review was that HMRC's decision should be upheld.

(13) On 29 August 2017 the appellant's agent notified the appellant's appeal to the tribunal.

Daily Penalties

3. Although the appeal is against the daily penalties, and the original decision by HMRC to assess the appellant to these, HMRC in their Statement of Case have indicated that they are not putting forward a case for the daily penalties "and therefore that aspect of the appeal wins". So this decision deals only with the late filing penalty and the 6 month penalty.

The Law

Legislation

4. A summary of the relevant legislation is set out below:

Obligation to file a return and penalties

(1) Under section 8 of the Taxes Management Act 1970 ("TMA 1970"), a taxpayer, chargeable to income tax and capital gains tax for a year of

assessment, who is required by HMRC to submit a tax return, must submit that return by 31 October immediately following the year of assessment (if filed by paper) and 31 January immediately following the year of assessment (if filed on line).

(2) Where a notice to file a return is given to a taxpayer after the 31 October immediately following the year of assessment, the filing date is three months after the date of that notice.

(3) Failure to file the return on time engages the penalty regime in Schedule 55 Finance Act 2009 ("Schedule 55") (and references below to paragraphs are to paragraphs in Schedule 55).

(4) Penalties are calculated on the following basis:

(a) failure to file on time (i.e. the late filing penalty) - £100 (paragraph 3).

(b) failure to file for 6 months (i.e. the 6 month penalty) - 5% of payment due, or £300 (whichever is the greater) (paragraph 5).

(5) If HMRC considers a taxpayer is liable to a penalty, it must assess the penalty and notify it to the taxpayer (paragraph 18).

(6) A taxpayer can appeal against any decision of HMRC that a penalty is payable, and against any such decision as to the amount of the penalty (paragraph 20).

(7) On an appeal, this tribunal can either affirm HMRC's decision or substitute for it another decision that HMRC had the power to make (paragraph 22).

Special circumstances

(8) If HMRC think it is right to reduce a penalty because of special circumstances, they can do so. Special circumstances do not include (amongst other things) an ability to pay (paragraph 16).

(9) On an appeal to me under paragraph 20, I can either give effect to the same percentage reduction as HMRC have given for special circumstances. I can only change that reduction if I think HMRC's original percentage reduction was flawed in the judicial review sense (paragraph 22(3) and (4)).

Reasonable excuse

(10) A taxpayer is not liable to pay a penalty if he can satisfy HMRC, or this Tribunal (on appeal) that he has a reasonable excuse for the failure to make the return (paragraph 23(1)).

(11) However, an insufficiency of funds, or reliance on another, are statutorily prohibited from being a reasonable excuse. Furthermore, where a person has a reasonable excuse, but the excuse has ceased, the taxpayer is still deemed to have that excuse if the failure is remedied without unreasonable delay after the excuse has ceased (paragraph 23(2)).

Case law

5. A summary of the relevant case law relating to the penalties is set out below

Reasonable excuse

(1) The test I adopt in determining whether the appellant has a reasonable excuse is that set out in *the Clean Car Co Ltd v C&E Commissioners* [1991] VATTR 234, in which Judge Medd QC said:

> "The test of whether or not there is a reasonable excuse is an objective one. In my judgment it is an objective test in this sense. One must ask oneself: was what the taxpayer did a reasonable thing for a responsible trader conscious of and intending to comply with his obligations regarding tax, but having the experience and other relevant attributes of the taxpayer and placed in the situation that the taxpayer found himself at the relevant time, a reasonable thing to do?"

(2) Although the Clean Car case was a VAT case, it is generally accepted that the same principles apply to a claim of reasonable excuse in direct tax cases.

(3) Indeed, in the First-tier Tribunal case of *Nigel Barrett* [2015] UKFTT0329 (a case on late filing penalties under the CIS) Judge Berner said:

> "The test of reasonable excuse involves the application of an impersonal, and objective, legal standard to a particular set of facts and circumstances. The test is to determine what a reasonable taxpayer in the position of the taxpayer would have done in those circumstances, and by reference to that test to determine whether the conduct of the taxpayer can be regarded as conforming to that standard."

(4) HMRC's Compliance Manual recognises that reasonable care cannot be identified without consideration of a particular person's abilities and circumstances, and HMRC recognises the wide range of abilities and circumstances of persons completing returns or claims.

> "So whilst each person has a responsibility to take reasonable care, what is necessary for each person to discharge that responsibility has to be viewed in the light of that person's abilities and circumstances".

> "In HMRC's review it is reasonable to expect a person who encounters a transaction or other event with which they are not familiar to take care to find out about the correct tax treatment or to seek appropriate advice".

Special Circumstances

(5) There have been a number of cases on special circumstances from which I derive the following principles (see *Bluu Solutions Ltd v Commissioners for Her Majesty's Revenue & Customs* [2015] UKFTT 0095 and the cases cited therein):

(a) While “special circumstances” are not defined, the courts accept that for circumstances to be special they must be “exceptional, abnormal or unusual” (*Crabtree v Hinchcliffe* [1971] 3 All ER 967) or “something out of the ordinary run of events” (*Clarks of Hove Ltd v Bakers Union* [1979] 1 All ER 152).

(b) HMRC's failure to consider special circumstances (or to have reached a flawed decision that special circumstances do not apply to a taxpayer) does not mean the decision to impose the penalty, in the first place, is flawed.

(c) Special circumstances do not have to be considered before the imposition of the penalty. HMRC can consider whether special circumstances apply at any time up to, and during, the hearing of the appeal before the tribunal.

(d) The tribunal may assess whether a special circumstances decision (if any) is flawed if it is considering an appeal against the amount of a penalty assessed on a taxpayer.

(e) The tribunal should assess any decision (or failure to make one) in light of the principles applicable to judicial review.

(f) Failure to have considered the exercise of its discretion to reduce a penalty by virtue of special circumstances, in the first place, or failure to give reasons as to why, (if HMRC has made a decision), special circumstances do not apply, can render the "decision" flawed.

(g) I can allow the taxpayer's appeal if I find that HMRC's decision is unreasonable unless it is inevitable that HMRC would have come to the same decision on the evidence before him (as per Lord Justice Neill) (*John Dee Limited v Commissioners of Customs and Excise* 1995 STC 941).

> "I turn therefore to the second matter raised in the appeal, I can deal with this very shortly.
>
> It was conceded by Mr Engelhart, in my view rightly, that where it is shown that, had the additional material been taken into account, the decision would inevitably have been the same, a Tribunal can dismiss an appeal. In the present case, however, though in the final summary the Tribunal's decision was more emphatic, the crucial words in the Decision were:
>
> > "I find that it is most likely that, if the Commissioners had had regard to paragraph (iii) of the conclusion to Mr Ross' report, their concern for the protection of the revenue would probably have been fortified."

I cannot equate a finding "that it is most likely" with a finding of inevitability.

On this narrow ground I would dismiss the appeal."

(h) In deciding whether HMRC's decision was unreasonable, I should follow the approach summarised by Lord Greene MR in *Associated Provisional Picture Houses Limited v Wednesbury Corporation* [1948] 1 KB 223:

> "The court is entitled to investigate the action of the local authority with a view to seeing whether they have taken into account matters which they ought not to take into account, or, conversely, have refused to take into account or neglected to take into account matters which they ought to take into account. Once that question is answered in favour of the local authority, it may be still possible to say that, although the local authority have kept within the four corners of the matters which they ought to consider, they have nevertheless come to a conclusion so unreasonable that no reasonable authority could ever have come to it."

(i) As Lady Hale said, in *Braganza v BP Shipping* [2015] UKSC 17 at [24], this test has two limbs:

> "The first limb focuses on the decision-making process - whether the right matters have been taken into account in reaching the decision. The second focusses upon its outcome - whether even though the right things have been taken into account, the result is so outrageous that no reasonable decision-maker could have reached it. The latter is often used as a shorthand for the Wednesbury principle, but without necessarily excluding the former."

(j) Having undertaken that assessment:

> (i) if the tribunal considers the decision is flawed, it may itself consider whether there are special circumstances which could justify substituting it's decision for that of HMRC unless it considers that HMRC would inevitably have come to the same decision on the evidence before them.
>
> (ii) if the tribunal considers that HMRC have properly exercised its discretion in relation to special circumstances, it cannot substitute its own decision for that of HMRC when considering by what amount, if any, it should reduce a penalty.

Proportionality

(6) In relation to the doctrine of proportionality and its application to the issues in this case, I have reviewed the following cases:

(a) *Paraskevas Louloudakis v Elliniko Dimosio* (Case C-262/99) [2001]

ECR I-5547 ("*Louloudakis*")

(b) International Transport Roth GmbH v Secretary of State for the Home Dept [2003] QB 728 ("*Roth*")

(c) James v UK (Application 8793/79) (1986) 8 EHRR 123 ("*James*")

(d) Wilson v SoS for Trade and Industry [2003] UKHL 40 [2004] 1AC816 ("*Wilson*")

(e) R(on the application of Lumsden and others) (Appellants) v Legal Services Board (Respondent) [2015] UKSC 41 ("*Lumsden"*)

(7) A summary of the principles relating to proportionality is set out below:

(a) Proportionality as a general principle of EU law involves a consideration of two questions: first, whether the measure in question is suitable or appropriate to achieve the objective pursued; and secondly, whether the measure is necessary to achieve that objective, or whether it could be attained by a less onerous method (*Lumsden* at [33])

(b) As is the case for other principles of public law, the way in which the principle of proportionality is applied in EU law depends to a significant extent upon the context (*Lumsden* at [23]).

(c) In the context of its application to penalties, the principle of proportionality is that:

(i) penalties may not go beyond what is strictly necessary for the objective pursued; and

(ii) a penalty must not be so disproportionate to the gravity of the infringement that it becomes an obstacle to the freedoms enshrined in the Treaty (*Louloudakis* at [67]).

(d) In deciding whether the measures or their application is appropriate and not disproportionate, the court must exercise a value judgment by reference to the circumstances prevailing when the issue is to be decided. It is the current effect and impact of the legislation which matters, not the position when the legislation was enacted or came into force (*Wilson* at [62]).

(e) The margin of appreciation given to law makers in implementing social and economic policy should be a wide one and the courts will respect the law makers judgment as to what is in the public interest unless that judgment is manifestly "without reasonable foundation" (*James* at [46]) or "not merely harsh but plainly unfair" (*Roth* at [26]).

Burden and standard of proof

6. The burden of establishing that the appellant is prima facie liable for penalties which have been properly notified and assessed lies with HMRC.

7. The burden of establishing that he should not be liable for such penalties because, amongst other reasons, he has a reasonable excuse, or that the penalties are disproportionate, lies with the appellant.

8. In each case the standard of proof is the balance of probabilities.

Discussion and conclusion

Service of relevant notices

9. To engage the penalty regime in Schedule 55, HMRC must have given the taxpayer a valid notice to file a tax return. For reasons given a little later I am not satisfied on the evidence that they have done so. They must also assess the appellant to the penalties and notify him of that assessment. I am satisfied on the evidence that HMRC have done this.

Appellant's grounds of appeal

10. The appellant appears to put forward three grounds of appeal:

(1) The appellant was taxed under the PAYE system and is not a higher rate taxpayer. If incorrect tax was deducted this is not the appellant's fault. It is HMRC's responsibility to get tax codes correct so a taxpayer can be taxed correctly.

(2) There was no need to put the appellant into self-assessment even though HMRC's tax calculation showed that he had underpaid tax.

(3) The fact that the appellant was late paying his tax is no reason to put him into self-assessment.

Respondents' submissions

11. The respondents submit that:

(1) The appellant should have realised that the PAYE system was not being operated properly by some of his employers and should have contacted the relevant departments at those employers to get things put right.

(2) Having been sent a notice to file a tax return for 2014-2015, a prudent person, exercising reasonable foresight and due diligence, having proper regard for their responsibilities and the Tax Acts would have ensured that the return was completed and submitted by the due deadline, or without undue delay once the late filing penalty notice had been received

(3) In September 2016 the appellant went on line to claim a PAYE tax repayment of £244.60 for the 2015-2016 tax year, when he knew that he owed tax of £321.12 for the 2014-2015 tax year.

Should the appellant have been "put into self-assessment"

12. The appellant raises as one of his grounds of appeal that he should not have been put into self-assessment. HMRC do not address this ground, head-on, in their Statement of Case. But is a very pertinent point.

13. As set out in [6] above it is for HMRC to show that the penalties have been properly assessed on the appellant, and are payable by him.

14. This requires them to have served a valid notice to file on the appellant pursuant to section 8(1) TMA 1970.

15. Paragraph 1(1) of Schedule 55 states that:

> "a penalty is payable by a person ("P") where P fails to make or deliver a return, or to deliver any other document, specified in the Table below on or before the filing date".

16. The Table referred to is in paragraph 1(5). It specifies an income tax return as being a return under section 8(1)(a) of the TMA 1970.

17. Under section 8(1):

> "For the purpose of establishing the amounts in which a person is chargeable to income tax and capital gains tax for a year of assessment, and the amount payable by him by way of income tax for that year, he may be required by a notice given to him by an officer of the Board –
>
> a) to make and deliver to the officer, a return containing such information as may reasonably be required in pursuance of the notice.....".

18. So in order to engage Schedule 55, HMRC must comply with section 8(1)(a) which in penalty appeals means that they must establish that a valid section 8(1)(a) notice to file has been notified to the appellant.

19. The position if they fail to serve such a valid notice is reasonably clear. Even if a taxpayer has failed to make a return on time, Schedule 55 is not engaged. The taxpayer has not failed to deliver a return since he had not been properly notified that he had to.

20. But the position is less clear if HMRC can establish that they have issued and served a notice to file, but it was not "for the purpose of establishing the amounts in which a person is chargeable to income tax and capital gains tax for a year of assessment…..".

21. In such circumstances, is the notice valid? Does this tribunal have jurisdiction to look behind the notice and consider its validity? And what is the consequence (if we can consider that validity) if the notice turns out to be invalid?

22. These are not easy questions to answer, but they have been considered and dealt with head on by Judge Thomas in *Goldsmith (David Goldsmith v HMRC* [2018] UKFTT 00005), which contains a masterful and scholarly analysis of these issues.

23. I have read *Goldsmith* a number of times and find myself in complete agreement with the reasoning and conclusions that Judge Thomas has laid out in that case. It is not binding on me, but I adopt those principles for the purposes of this decision.

24. The salient principles are these:

(1) The PAYE system was designed to take employees out of the usual return and assessment system which, when it was introduced, applied to the self-employed and others.

(2) The PAYE system involves the use of a code number which identifies the amount of tax free pay to which an employee is entitled, and enables the employer to deduct the correct amount of tax, on a cumulative basis, from an employee's wages.

(3) Complete agreement between the tax deducted under PAYE and the correct tax liability for an employee was not always possible. From 1945 to the computerisation of PAYE (in the 1980's), in each tax year from about June onwards, a physical reconciliation was carried out by Inland Revenue staff.

(4) This reconciliation could result in one of four outcomes.

(a) no action because the liability and tax suffered reconciled exactly or within laid down margins;

(b) a repayment because the tax deducted under PAYE exceeded the liability;

(c) an underpayment of tax which under the PAYE system could be coded out i.e. reducing the code number that would otherwise apply in the year of the reconciliation or the next year;

(d) an assessment under section 29 TMA 1970 where the underpayment might be too large to code out or coding out was not possible for other reasons.

(5) When self-assessment was introduced with effect from 1996-1997, little changed. The PAYE system continued to operate for those outside the new self-assessment regime, but HMRC's PAYE computer systems started to carry out reconciliations automatically.

(6) These automatic reconciliations led to the computer producing a tax calculation on Form P800 which explained to a taxpayer how any over or underpayment would be dealt with.

(7) Where coding out an underpayment is not possible, HMRC's first approach in P800 cases is to seek a voluntary payment. But they still have the

option of doing what they did before the arrival of the self-assessment system and making an assessment under section 29 TMA 1970. I consider this in more detail later in this decision.

(8) The purpose for which a notice to file under section 8 TMA 1970 (i.e. for establishing the amounts in which a taxpayer is chargeable to income tax or CGT) is given to a taxpayer is important and must be given some meaning.

(9) If HMRC already know the amounts in which a taxpayer is chargeable to income tax and CGT for a year of assessment (for example because they have issued voluntary payment letters to the taxpayer and/or a P800 showing an underdeduction and asking the taxpayer to pay the balance), is it really the case that HMRC's purpose in serving the notice to file is to establish that amount?

(10) Although the Tribunal, in a penalty appeal, must determine the "matter in question" (which means the matter to which an appeal relates - see section 49 I(1)(a) TMA 1970) this is wide enough to include an examination of the validity of a penalty notice. Indeed, this is what *Donaldson* was all about.

(11) The cases of *Birkett & others v HMRC* [2017] UKUT (0089) and *PML Accounting Limited v HMRC* [2017] EWHC 733 can be distinguished from the cases of *B&S Displays Limited and others v Special Commissioners of Income Tax & Cir* 52 TC 318 (1978) and *Kempton v Special Commissioners of Income Tax & Cir* 66 TC 249 (1992) ("*Kempton*") (and the cases cited therein).

(12) Importantly, in Kempton the Special Commissioner, Judge Patrick Medd QC, was faced with a challenge to the validity of a notice under section 20 TMA 1970. In his decision Judge Medd sets out the rival contentions:

> "It was accepted by Mr. Koenigsberger that the notice, under s 20(1) Taxes Management Act 1970, had been issued to Mrs. Kempton as alleged in the summons, and that Mrs. Kempton had not complied with the notice within the period specified in the notice.
>
> Mr. Koenigsberger indicated, however, that it was his contention that the notice issued by the Inspector was invalid and that, therefore, Mrs. Kempton had a good defence and was not liable to a penalty. In answer to this submission, Mr. Baron asserted that it was not open to Mrs. Kempton to take this point in these penalty proceedings and that the point could only be raised in an application for judicial review."

(13) Judge Medd held:

> "It is clear from the Coombs case [*R v Inland Revenue Commissioners, Exp T C Coombs &* Co [1991] 2 AC 283] that the Inspector's decision to issue a notice under s 20(3) can be challenged by way of judicial review, and I have no doubt that the

same must apply if the notice is issued under s 20(1). The question is, therefore, whether, in addition to being able to challenge the Inspector's decision by way of judicial review, the taxpayer is entitled alternatively to challenge it by way of a defence to penalty proceedings.

The answer to this question was not given by the House of Lords in the Coombs case but Bingham L.J., in the Court of Appeal in the case of *Regina v. Inland Revenue Commissioners ex parte Taylor (No. 2)* 1990 STC 379 which was a case where a notice was issued to a solicitor under s 20(2) (which gives similar powers to the Board of Inland Revenue as are given to an inspector by s 20(1)), said, at page 384j

> 'Strictly, however, the taxpayers' remedy is, in the event of non compliance followed by penalty proceedings, to resist the penalty proceedings and then attack the giving of the notice.'

A similar view was expressed by Brightman L.J. in *Essex and Others v. Commissioners of Inland Revenue and Grugan* 53 TC 720, which was an action for a declaration that certain notices were invalid, when he said, at page 743:

> 'I should mention at this stage that ss 98 and 100 of the Taxes Management Act 1970 impose penalties on a person who fails to comply with the requirements of a notice served under s 490 of the other Act. It would therefore have been open to the Plaintiffs to challenge the validity of the notices in any proceedings which might have been brought under ss 98 and 100 of the Taxes Management Act instead of claiming a declaratory judgment, as had been done in the present action.'

Those two dicta in the Court of Appeal which were both directed to the situation where notices of a similar nature to the one with which I am concerned were served are, of course, strong persuasive authority for the proposition that a person on whom a notice under s 20(1) is served may raise the question of the validity of the notice as a defence in penalty proceedings brought against him for failure to comply with the notice. However, the question seems to me to have been answered even more authoritatively by the reasoning in the decision of the House of Lords in the case of Wandsworth London Borough Council v. Winder [1984] 3 All ER 976. …

…

> I, therefore, hold that it is open to Mrs. Kempton to challenge the validity of the Inspector's decision to serve a notice on her under s 20(1) by way of defence in these proceedings for a penalty."

(14) As can be seen from the foregoing extract, it is open to an appellant to challenge the validity of HMRC's decision to serve a notice on him/her under section 20(1) TMA 1970. The same principle applies to a notice purportedly served pursuant to section 8(1)(a) TMA 1970.

(15) The reconciliation process referred to at [24(4)-(8)] above, followed in many cases by a P800, is a finalisation of a non self-assessment taxpayer's tax liability.

(16) If that reconciliation evidences an underpayment which cannot be coded out, HMRC's powers enable them to issue an assessment under section 29 TMA 1970. But it is not open to them to choose an alternative mechanism, namely to issue a notice to file under section 8 TMA 1970.

25. In *Kempton*, as can be seen from the extract above, Judge Medd said that the question as to whether a person on whom a section 20 TMA 1970 notice is served can raise its validity as a defence in penalty proceedings "…. has been answered even more authoritively by the reasoning in the decision of the House of Lords in the case of Wandsworth London Borough Council v Winder [1984] 3 ER 976……" ("*Wandsworth*").

26. Why did he say this? Why is *Wandsworth* such an important authority in this area?

27. In *Wandsworth* Mr Winder occupied a flat let by Wandsworth Borough Council ("Wandsworth BC") on a secure weekly tenancy. Wandsworth BC resolved to increase his rent to an amount which he considered to be excessive and which he refused to pay. Wandsworth BC sued him for possession and rent arrears. Mr Winder defended that claim contending that the rent increases were ultra vires and void. This defence was initially struck out on the basis that the resolution to increase the rents by Wandsworth BC could only be challenged by judicial review under RSC order 53, and it could not be used as a defence in his proceedings. Mr Winder said that he should be allowed to defend the claim for possession and for rent arrears on the basis that the resolution was ultra vires.

28. The House of Lords finally decided the matter in favour of Mr Winder. In his judgment, Lord Fraser made the following comments:

> "The respondent [i.e. Mr Winder] seeks to show in the course of his defence in these proceedings that the appellants' [Wandsworth BC] decisions to increase the rent were such as no reasonable man could consider justifiable. But your Lordships are not concerned in this appeal to decide whether that contention is right or wrong. The only issue at this stage is whether the respondent [i.e. Mr Winder] is entitled to put forward the contention as a defence in the present proceedings. The appellants

> [i.e. Wandsworth BC] say that he is not because the only procedure by which their decision could have been challenged was by judicial review...."

29. Lord Fraser then reviewed the House of Lords Authorities of *O'Reilly v Mackman* [1983] 2 A.C. 237 ("*O'Reilly*") and *Cocks v Thanet District Council* [1983] 2 A.C. 286 ("*Cocks*").

30. Lord Fraser distinguished *O'Reilly* on the basis that in *O'Reilly* the plaintiffs had initiated the proceedings (whereas in *Wandsworth*, Mr Winder was defending proceedings); and secondly that in *O'Reilly*, the plaintiffs had not suffered any infringements of their rights under private law, whereas Mr Winder complained that Wandsworth BC had infringed his contractual rights in private law.

31. The essential difference between the case of *Cocks* and the position of Mr Winder was that in *Cocks* the impugned decision of the local authority did not deprive the plaintiff of pre-existing private law eight. It prevented him from establishing a new private law right. Furthermore, as in *O'Reilly*, the party complaining of the decision was the plaintiff.

32. Lord Fraser then considered the principle underlying the decisions in *O'Reilly* and *Cocks*. One of which was that there is a "need, in the interests of good administration and third parties who may be indirectly affected by the decision, for speedy certainty as to whether it has the effect of a decision that is valid in public law".

33. He went on to say that judicial review proceedings may provide that speedy certainty but there are other ways of obtaining speedy decisions and:

> "In any event, the arguments for protecting public authorities against unmeritorious or dilatory challenges to their decisions have to be set against the arguments for preserving the ordinary rights of private citizens to defend themselves against unfounded claims".

34. Lord Fraser then went on to say as follows:

> "It would in my opinion be a very strange use of language to describe the respondent's [i.e. Mr Winder] behaviour in relation to this litigation as an abuse or misuse by him of the process of the court. He did not select the procedure to be adopted. He is merely seeking to defend proceedings brought against him by the appellants [Wandsworth BC]. In so doing he is seeking only to exercise the ordinary right of any individual to defend an action against him on the ground that he is not liable for the whole sum claimed by the plaintiff. Moreover he puts forward his defence as a matter of right, whereas in an application for judicial review, success would require an exercise of the court's discretion in his favour. Apart from the provisions of Order 53 and section 31 of the Supreme Court Act 1981, he would certainly be entitled to defend the action on the ground that the plaintiff's [i.e. Wandsworth BC] claim arises from a resolution which (on his view) is invalid..... I find it impossible to accept that the

right to challenge the decision of a local authority in course of defending an action for non-payment can have been swept away by Order 53, which was directed to introducing a procedural reform…..

Nor, in my opinion, did section 31 of the Supreme Court Act 1981 which refers only to "an application" for judicial review have the effect of limiting the rights of a defendant sub silentio. I would adopt the words of Viscount Simonds in *Pyx Granite Co. Ltd v. Ministry of Housing and Local Government* [1960] A.C. 260, 286 as follows:

> "It is a principle not by any means to be whittled down that the subject's recourse to Her Majesty's courts for the determination of his rights is not to be excluded except by clear words".

The argument of the appellants [i.e. Wandsworth BC] in the present case would be directly in conflict with that observation.

If the public interest requires that persons should not be entitled to defend actions brought against them by public authorities, where the defence rests on a challenge to a decision by the public authority, then it is for Parliament to change the law."

35. It is also worth mentioning here the observations of Lord Justice Parker in the Court of Appeal.

> "It is not suggested that the defendant [i.e. Mr Winder] has not an arguable case that the rents were unreasonable. He was in my view well entitled to sit back and leave it to the authority to sue him if they thought fit. He was under no obligation to initiate proceedings against them. However wide the general rule is, I cannot regard it as an abuse of process to raise his challenge in this case by way of defence. He has of course in that defence attacked not only the rent itself but the decision-making process and it is plain that, had he desired himself to initiate such a challenge, his proper course would have been to do so under Order 53, but this makes no difference. I would allow this appeal and set aside the order of the judge, with the result that the defence and counterclaim would be restored and the action would proceed."

36. And by Lord Justice Goff in the Court of Appeal:

> "I fully appreciate that public authorities may be exposed to great inconvenience if they are unable to invoke the principle of *O'Reilly v Mackman* [1983] 2 A.C. 237 in a case such as the present. But such inconvenience may arise in many cases where a citizen successfully challenges action by public authority affecting his private law rights under a decision by the public authority which proves to have been made ultra vires. The successful challenge by the citizen may be a source of great embarrassment for the public authority, as it contemplates all the earlier occasions upon which it has given effect to the ultra vires decision and the

> possibly immense cost to ratepayers of putting the matter right. Sometimes indeed, as experience has shown, it may even be necessary to legislate in order to extricate the public authority from its difficulties. But it does not in my judgment follow that there is an abuse of process by the citizen in invoking the assistance of the ordinary courts, by action or by defence, in order to enforce, or to claim the protection of, his private law rights. If it is thought that any limit should be placed upon citizens proceeding in this way, in the interests of good administration, then this is, in my judgment, a matter for Parliament."

37. As can be seen from the foregoing, the Court of Appeal and the House of Lords both recognised that it is not an abuse of process to challenge the validity of a notice by way of a defence to a claim from a public body. The defendant is simply asserting that he is not liable for such a claim. In *Wandsworth* the claim was for rent arrears.

38. Judge Medd had no difficulty in asserting that the reasoning in *Wandsworth* applies to notices served under section 20 TMA 1970 which related to a power (now repealed) which permitted HMRC to call for documents to be delivered to it.

39. But it seems to me that the principles in *Wandsworth* and the reasoning behind them are even more relevant to penalty appeals. *Wandsworth* was a money case. It involved rent arrears which Wandsworth BC alleged were due and payable by Mr Winder. Penalty cases are money cases too. HMRC asserts that a taxpayer is liable to a financial penalty for failing to do something. If Mr Winder had failed in his defence, Wandsworth BC could have enforced the rent arrears as a civil debt. If the appellant in this case fails to successfully challenge the penalty assessments, the penalties can be enforced as a civil debt. Indeed the assessments have already created that debt, enforcement of which is postponed pending the outcome of this appeal.

40. And so it is my view that the question of whether a taxpayer on whom a penalty assessment has been served, can raise the validity of that assessment (and any notice on which that assessment is based) as a defence in penalty proceedings has been answered equally authoritively by the reasoning of the House of Lords in the case of *Wandsworth*. The answer is that he can.

Section 29 TMA 1970

41. Under section 29 TMA 1970 as it applied before the introduction of self-assessment, an Inspector could make an assessment under section 29(1)(c) in respect of income arising in a tax year to the best his judgment by reference to actual income or estimated income (whether from any particular source or generally) or partly by reference to one and partly by reference to the other.

42. Under section 29(1)(A) TMA 1970 as it stood then, where such an assessment is made, any necessary adjustment shall be made after the end of the year of assessment (whether by way of assessment, repayment of tax or otherwise) to secure that tax is charged in respect of income actually arising in the year.

43. It is true that the version of section 29 TMA 1970 which applies following introduction of self-assessment is more restrictive than that which applied before it. As Lord Justice Moses said at paragraph 24 of his judgment in *Tower McCashback LLP v HMRC* [2010] EWCA Civ 32.

> "…. the new s 29 …. confers a far more restrictive power than that contained in the previous s 29. The power to make an assessment if an Inspector discovers that tax which ought to have been assessed has not been assessed or an assessment to tax is insufficient or relief is excessive is now subject to the limitations contained in s 29(2) and (3).....".

44. However, in the context of this appeal, the restrictions in section 29(2) and (3) do not apply. This is because they only apply where the taxpayer has made and delivered a return under section 8 TMA 1970. And of course in this appeal the taxpayer has not. Indeed it is the appellant's case that he should not be put into the self-assessment system and thus required to submit a return under section 8 TMA 1970.

45. It seems to me, therefore, that the breadth of section 29 TMA 1970 which applied before the introduction of self-assessment is broadly the same after the introduction of self-asessment where the taxpayer has not made and delivered a section 8 return.

46. In such circumstances where an officer of the Board discovers that any income which ought to be assessed to income tax has not been assessed on a taxpayer, then the officer can make an assessment of the amount or the further amount, which ought to be charged to make good the loss of tax.

47. Since there has, therefore, been little change to the breadth of section 29, in circumstances where a taxpayer has not filed a self-assessment tax return, before and after the introduction of self-assessment, it seems to me that the power to ensure that the correct amount of tax has been paid by a taxpayer who has underpaid tax due to an underdeduction of PAYE, is still via the section 29 assessing mechanism; and not by putting that taxpayer into the self-assessment regime by serving a notice on him to file a return under section 8 TMA 1970.

Discussion

48. I have found as a fact that HMRC knew the amount of income tax which the appellant owed as a result of PAYE underdeductions by his employers. It was £321.12.

49. HMRC sent the appellant a tax calculation on Form P800 and followed this up with two voluntary payment letters.

50. So it is clear that they did not send the appellant a notice to file a tax return for the purpose of establishing the amount on which he was chargeable to income tax. HMRC must have known that amount in order to calculate the tax due of £321.12.

51. As I have said above the appellant can challenge the imposition of the penalty by asserting that the notice to file is invalid. In my view this is the case. A valid

section 8 notice can only be given for the purposes set out in that section. In the case of this appellant, the notices to file were not given for that purpose. Since no valid section 8 notice was given to the appellant, there was no obligation on him to file a self-assessment tax return for 2014 - 2015, so Schedule 55 is not engaged.

52. I have therefore decided to allow the appeal on this ground.

53. The route which HMRC should have taken was to issue an assessment under section 29 TMA 1970 when it had become apparent that the underpayment could not have been coded out.

54. HMRC's statements in their voluntary payment letters that in such circumstances they might consider putting a taxpayer into the Self-Assessment Tax System in order to collect the underpayment may need to be reconsidered.

55. However, in case I am wrong about the validity of the notice to file, and it is valid (and so Schedule 55 is engaged), and because HMRC have addressed these points in their Statement of Case I have gone on to consider reasonable excuse and special circumstances.

Reasonable excuse

56. The test of whether a taxpayer has a reasonable excuse is set out above at [5(3)].

57. I do not consider that the appellant has a reasonable excuse for failing to submit his 2014-2015 tax return on time.

58. I do not accept, as HMRC assert, that the appellant should have challenged his employers as regards their operation of the PAYE system, so as to ensure that the correct amount of tax had been deducted by them at source. PAYE, generally, and the application of tax codes in particular, is notoriously complicated, and it is often very difficult for a taxpayer to understand whether tax codes are being applied properly such that the appropriate amount of tax is being deducted.

59. The appellant, through is agent, suggests that it is up to HMRC to get a taxpayer's tax codes correct. That is true. But it is my understanding that the underpayments stem not from incorrect tax codes, but from an incorrect application of those to the taxpayer's income.

60. But the essential reason why I consider that the taxpayer does not have a reasonable excuse is that, for whatever reason, he was sent, on 21 April 2016, a notice to file for the 2014–2015 tax year.

61. The form of that notice to file, as evidenced by HMRC includes the statements

> "we are sending you this letter as, by law, you must send us your Self-Assessment tax return and any documents or information we ask for on the tax return.

> You need to do this even if you don't owe any tax or have already paid all the tax you owe.
>
> If you think you don't need to complete a tax return for this year go to **www.gov.uk/check-if-you-need-a-tax-return".**

62. There is no evidence that the appellant sought to contact HHMRC at that website to tell HMRC that, in his view, there was no need to complete a return (perhaps on the basis, as has been suggested on his behalf in this appeal, that it was up to HMRC or his employers to ensure that the correct PAYE deductions had been made).

63. The form makes it clear that a taxpayer must complete and deliver the return to HMRC even if he doesn't owe any tax, but in this case the appellant knew that he did owe tax. The amount was £321.12, and a notice of that amount had been sent to him in October 2015.

64. It is my view that (as suggested by HMRC) a prudent person exercising reasonable foresight and due diligence and having a proper regard for their responsibilities under the Tax Acts would have ensured that the return sent to him in April 2016 would have been completed and returned to HMRC within the three month filing deadline to which that return was subject.

65. If the appellant genuinely felt that he owed no tax, then he could have contacted HMRC (notwithstanding the fact that the form, and the law, obliges a taxpayer who has been sent a notice to file, to do so). There is no evidence that he did this.

Special circumstances

66. HMRC indicate they have taken into account special circumstances. They say that they have considered:

(1) whether that the taxpayer was a higher rate taxpayer or not;

(2) that incorrect tax was deducted from his salary;

(3) that it is HMRC's responsibility to issue correct tax codes;

(4) the reasons why HMRC put the appellant into the self-assessment system.

67. They then go on to indicate that they do not think that any of these amount to a special circumstance.

68. However, they have not set out the reasons why they do not amount to special circumstances. In light of this (see [5(5)(f)]) it is my view that HMRC's decision regarding special circumstances is flawed.

69. That means, in accordance with the principles set out at [5(5)(j)] above, I must consider whether there are special circumstances which apply to this taxpayer. I do not believe there are. As is mentioned at [5(5)(a)] to comprise special circumstances, they must be exceptional, abnormal or unusual or there must be something out of the

ordinary run of events as regards the taxpayer's situation. None of the appellants circumstances fall into either category.

Proportionality

70. Although not argued by the appellant, it is my view that the penalties are proportionate. In light of the principles set out at [5(7)] above, and in view of the justification for the imposition of penalties (namely that it is essential for the proper function of a self-assessed tax regime that the taxpayer provides timely and accurate information) I consider that penalties for late filing do not go beyond what is strictly necessary for the objective pursued. The penalties are far from being not merely harsh but plainly unfair.

Decision

71. In light of the decision I have reached at [51] above, I allow this appeal.

Appeal rights

72. 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 a Company a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

73.

NIGEL POPPLEWELL
TRIBUNAL JUDGE

RELEASE DATE: 17 APRIL 2018