[2013] UKFTT 307 (TC)

TC02712

Appeal number: TC/2012/08936

INCOME TAX – whether self-assessed tax paid late so as to attract surcharges – subcontractor completing accounts and tax returns on an accruals basis – Contractor not paying for work done until the following tax year – whether CIS deductions made by the Contractor are offset against the subcontractor's SA tax on his profits from that work – held, the deductions are offset – the Tribunal's jurisdiction considered – held, not a tribunal of full jurisdiction – whether HMRC behaved unlawfully – no – whether legislation can be read down to allow Tribunal to consider reasonable excuse – yes – whether reasonable excuse – yes – surcharges set aside and appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

JOHN O'KANE **Appellant**

- and -

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

TRIBUNAL: ANNE REDSTON (TRIBUNAL PRESIDING MEMBER)

The Tribunal determined the appeal on 4 March 2013 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 10 September 2012 (with enclosures), HMRC's Statement of Case submitted on 12 December 2012 (with enclosures) and the Appellant's Reply dated 23 January 2013.

DECISION

1. This is Mr O'Kane's appeal against two self-assessment ("SA") late payment surcharges totalling £559.50, in relation to the payment of his 2009-10 SA tax.

2. The Tribunal decided that **the appeal was allowed** and set aside the surcharge.

The issues in the case

3. In 2009-10 Mr O'Kane worked as a subcontractor. His accounts for the year 2009-10 were prepared on an accruals basis, and so included sums earned but not yet paid. In 2010-11 these amounts were paid to him by the contractor for whom he worked ("the Contractor"), net of Construction Industry Scheme ("CIS") deductions which were remitted to HMRC.

4. Mr O'Kane's agent, Mr Ephraim Bradley, argued that the CIS deductions made after the end of the 2009-10 tax year but received by HMRC before 31 January 2011, should eliminate Mr O'Kane's SA tax due on 31 January 2011. HMRC contended that the deductions only reduced Mr O'Kane's tax liability in 2010-11, the year the Contractor made the deductions and paid them to HMRC.

5. If Mr Bradley is correct, Mr O'Kane had no outstanding tax to pay on 31 January 2011, and therefore no surcharges should have been triggered. However, the Tribunal then has to consider whether or not it has jurisdiction to allow the appeal on that ground, or whether it can only consider a reasonable excuse defence, and if the latter, whether Mr O'Kane has such an excuse.

6. Mr Bradley also argues that Mr O'Kane should be excused the surcharge because:

(1) he was experiencing severe cash flow problems;

(2) he should have requested a Time to Pay ("TTP") arrangement;

(3) tax avoiders had been invited to settle their outstanding SA liabilities under a "Tax Return Initiative" which Mr Bradley said levied a lower penalty than that now being applied to Mr O'Kane.

The statutory provisions

7. Taxes Management Act 1970 ("TMA") s 59B prescribes as follows, so far as relevant to this case:

> **Payment of income tax and capital gains tax**
>
> (1) Subject to subsection (2) below, the difference between—

(a) the amount of income tax and capital gains tax contained in a person's self-assessment under section 9 of this Act for any year of assessment, and

(b) the aggregate of any payments on account made by him in respect of that year (whether under section 59A of this Act or otherwise) and any income tax which in respect of that year has been deducted at source,

shall be payable by him or (as the case may be) repayable to him as mentioned in subsection (3) or (4) below…

(2)…

(3) In a case where the person—

(a) gave the notice required by section 7 of this Act within six months from the end of the year of assessment, but

(b) was not given notice under section 8 or 8A of this Act until after the 31st October next following that year,

the difference shall be payable or repayable at the end of the period of three months beginning with the day on which the notice under section 8 or 8A was given.

(4) In any other case, the difference shall be payable or repayable on or before the 31st January next following the year of assessment.

(4A) – (6) …

(7) In this section any reference to income tax deducted at source is a reference to income tax deducted or treated as deducted from any income or treated as paid on any income….

8. TMA s 59C prescribes as follows, again so far as relevant to this case:

Surcharges on unpaid income tax and capital gains tax

(1) This section applies in relation to any income tax or capital gains tax which has become payable by a person (the taxpayer) in accordance with section 55 or 59B of this Act.

(2) Where any of the tax remains unpaid on the day following the expiry of 28 days from the due date, the taxpayer shall be liable to a surcharge equal to 5 per cent of the unpaid tax.

(3) Where any of the tax remains unpaid on the day following the expiry of 6 months from the due date, the taxpayer shall be liable to a further surcharge equal to 5 per cent of the unpaid tax.

(4)-(6)…

(7) An appeal may be brought against the imposition of a surcharge under subsection (2) or (3) above within the period of 30 days beginning with the date on which the surcharge is imposed.

(8) Subject to subsection (9) below, the provisions of this Act relating to appeals shall have effect in relation to an appeal under subsection

(7) above as they have effect in relation to an appeal against an assessment to tax.

(9) On an appeal under subsection (7) above that is notified to the tribunal section 50(6) to (8) of this Act shall not apply but the tribunal may—

(a) if it appears that, throughout the period of default, the taxpayer had a reasonable excuse for not paying the tax, set aside the imposition of the surcharge; or

(b) if it does not so appear, confirm the imposition of the surcharge.

(10) Inability to pay the tax shall not be regarded as a reasonable excuse for the purposes of subsection (9) above.

(11) The Board may in their discretion—

(a) mitigate any surcharge under subsection (2) or (3) above, or

(b) stay or compound any proceedings for the recovery of any such surcharge,

(12) In this section—

"the due date", in relation to any tax, means the date on which the tax becomes due and payable;

"the period of default", in relation to any tax which remained unpaid after the due date, means the period beginning with that date and ending with the day before that on which the tax was paid.

9. The CIS requires contractors to deduct tax from payments made[1] to all subcontractors, unless the latter are registered for gross payment (FA 2004, ss 61 and 63). The rate at which tax is to be deducted is set out in regulations[2] as follows:

> "(a) 20% if the person for whose labour (or for whose employees' or officers' labour) the payment in question is made is registered for payment under deduction, or
>
> (b) 30% if that person is not so registered."

10. The Contractor can therefore only pay the 20% rate to those who are "registered for payment under deduction." The CIS Regulations[3] state at Reg 6 that the Contractor must verify with HMRC whether or not the subcontractor is so registered by *inter alia* providing HMRC with the subcontractor's name, Unique Taxpayer Reference ("UTR") number and NI number.

11. The legislation relating to the interaction between SA and CIS deductions is at Finance Act 2004 ("FA 2004") s 62:

Treatment of sums deducted

[1] Other than for materials, see FA 04, s 61(1).
[2] SI 2007/46: the Finance Act 2004, Section 61(2), (Relevant Percentage) Order 2007
[3] Income Tax (Construction Industry Scheme) Regulations, 2005 (SI 2005/2045)

(1) A sum deducted under section 61 from a payment made by a contractor—

(a) must be paid to the Board of Inland Revenue, and

(b) is to be treated for the purposes of income tax or, as the case may be, corporation tax as not diminishing the amount of the payment.

(2) If the sub-contractor is not a company a sum deducted under section 61 and paid to the Board is to be treated as being income tax paid in respect of the sub-contractor's relevant profits.

If the sum is more than sufficient to discharge his liability to income tax in respect of those profits, so much of the excess as is required to discharge any liability of his for Class 4 contributions is to be treated as being Class 4 contributions paid in respect of those profits.

(3) If the sub-contractor is a company—

(a) a sum deducted under section 61 and paid to the Board is to be treated, in accordance with regulations, as paid on account of any relevant liabilities of the sub-contractor;

(b) regulations must provide for the sum to be applied in discharging relevant liabilities of the year of assessment in which the deduction is made;

(c) if the amount is more than sufficient to discharge the sub-contractor's relevant liabilities, the excess may be treated, in accordance with the regulations, as being corporation tax paid in respect of the sub-contractor's relevant profits; and

(d) regulations must provide for the repayment to the sub-contractor of any amount not required for the purposes mentioned in paragraphs (b) and (c).

(4) For the purposes of subsection (3) the "relevant liabilities" of a sub-contractor are any liabilities of the sub-contractor, whether arising before or after the deduction is made, to make a payment to the Inland Revenue in pursuance of an obligation as an employer or contractor.

(5) In this section—

(a) "the sub-contractor" means the person for whose labour (or for whose employees' or officers' labour) the payment is made;

(b) references to the sub-contractor's "relevant profits" are to the profits from the trade, profession or vocation carried on by him in the course of which the payment was received;

(c)"Class 4 contributions" means Class 4 contributions within the meaning of the Social Security Contributions and Benefits Act 1992 (c 4) or the Social Security Contributions and Benefits (Northern Ireland) Act 1992 (c 7).

(6)-(7) …

12. The regulation required by FA 2004, s 62(3) is at Reg 56 of the CIS Regulations. It deals only with subcontractors who are companies.

The evidence

13. The Tribunal was provided with the correspondence between the parties, and between the parties and the Tribunals Service. In addition, HMRC provided:

(1) A screenprint of Mr O'Kane's CIS and SA amounts for the year ended 5 April 2011, showing deductions of £8,750 which were received by HMRC in January 2011, and that these deductions were from payments of £43,750.

(2) The HMRC guidance for completing Box 37 of the SA return, which states:

> "if you are a subcontractor in the construction industry, enter the total deductions made by your contractors from payments you received in the year 6 April 2009 to 5 April 2010. The deductions are shown on your CIS payment and deduction statements."

(3) A press release setting out the "Tax Return Initiative" dated 3 July 2012 which, although aimed at higher rate taxpayers who "have been told to submit a self-assessment tax return for 2009-10 or earlier but have not done so" was "also available to any individual who has tax returns to submit to HMRC for these years."

(4) Three pages of guidance about the Business Payment Support Service.

The facts

14. On the basis of this evidence, the Tribunal found the following facts.

15. Mr O'Kane was in partnership until 5 April 2007, when the partnership ended. He completed SA returns for 2007-08.

16. In the tax year 2009-10 he worked as a subcontractor for the Contractor and earned £43,750. He did not inform HMRC that he had self-employment income and HMRC did not issue him with an SA return. The Contractor did not pay him for his work until 2010-11.

17. In January 2011, HMRC received CIS tax deductions of £8,750 from the Contractor, being 20% of the £43,750 Mr O'Kane had earned in 2009-10.

18. The 20% deduction rate can only be applied to registered subcontractors and I therefore find that Mr O'Kane was a registered subcontractor.

19. On 13 February 2012, Mr O'Kane filed an electronic SA return for the 2009-10 tax year. This showed his profits, calculated on an accruals basis, of £26,240. The tax liability thereon was £3,953 and the Class 4 NIC liability was £1,642, making a total of £5,595.

20. It was common ground that, in accordance with TMA s 59B(1) and s59C(2)(3)[4]:

(1) the due date for Mr O'Kane to pay "the difference" between his 2009-10 SA tax and any tax "which in respect of that year had been deducted at source" was 31 January 2011;

(2) if any such tax due was not paid by 28 February 2011 ("the first surcharge trigger date") a 5% surcharge would become due;

(3) if it remained unpaid by 31 July 2011 ("the second surcharge trigger date") a further 5% was payable.

21. On or around 17 February 2012 HMRC issued both the first and second surcharges, each being 5% of the liability shown on Mr O'Kane's SA return and totalling £559.50.

22. On 12 March 2012 Mr Bradley appealed the surcharges on his client's behalf, on the basis that the "works were carried out before 5 April 2010, but no payment was received until the following year ended 5 April 2011, when tax was deducted from any monies received."

23. On 4 May 2012 HMRC responded, saying:

> "with reference to the appeal against the 2009/10 surcharge, based on the information provided regarding CIS payments received in 2010/11 relating to work carried out in 2009/10, you may want to consider amending both years to reflect this."

24. On 23 May and 1 June 2012, Mr Bradley spoke to HMRC on the telephone. Following those conversations, on 7 June 2012 HMRC issued a further letter. It says:

> "I have to advise you that unfortunately my colleague, who responded to your letter on 4 May 2012, did not perhaps understand what you were asking for which I apologise and the resultant answer was not very comprehensive.
>
> As in any profession, where accounts have to be prepared, you are required to declare the income that is invoiced at that time, and in this case, the tax paid via CIS has to be shown when the payment is actually received."

25. On the same day, HMRC wrote to Mr O'Kane, rejecting his appeal on the grounds that "the taxpayer is expected to keep money aside to pay his tax bill when it is due." This decision was upheld on review.

[4] Specifically, it was not argued that any later payment date applied under TMA s 59B(3). In the Tribunal's view this was correct - notice of chargeability had not been given for 2009-10.

Mr Bradley's submissions on behalf of Mr O'Kane

26. Mr Bradley said that the CIS deductions received by HMRC in January 2011 should have been matched against the tax due for 2009-10, as those deductions were made from the earnings which had given rise to Mr O'Kane's 2009-10 profits. As a result, no tax was underpaid on 31 January 2011 and no surcharges should have been levied.

27. If he was wrong in this, then he said that HMRC should nevertheless have exercised their discretion under TMA s 59C(11), so as to mitigate the surcharge to nil. HMRC already had the tax, and although Mr O'Kane did not notify chargeability in 2009-10, it was reasonable for him to have assumed that the Contractor had verified his status with HMRC under the CIS rules and that HMRC were therefore aware he was working as a subcontractor.

28. Mr Bradley also said that Mr O'Kane was experiencing severe cash flow problems at the time, and "with hindsight" should have requested a Time to Pay ("TTP") arrangement. Since 2009-10 Mr O'Kane's working environment had worsened so that "he can only find enough work for a two and three day week."

29. Finally, he said that tax avoiders had been invited to settle their outstanding SA liabilities under a "Tax Return Initiative" which levied a lower penalty than that now being applied to Mr O'Kane.

HMRC's submissions

30. HMRC's submissions to the Tribunal on the interaction between CIS and SA are those in the letter sent to Mr Bradley on 7 June 2012, set out earlier in this decision.

31. HMRC also say that:

(1) inability to pay is precluded by statute from being a reasonable excuse;

(2) it is irrelevant that Mr O'Kane "should have" requested a TTP agreement; HMRC can only take into account agreements which are actually made; and

(3) Mr O'Kane did not fall within "the remit" of the Tax Return Initiative, which was aimed at 40% taxpayers who had not filed their 2009-10 returns by 3 July 2012. The Initiative charged a "minimum rate charge of 10% of tax owed [which] is higher than the 5% surcharge subject to this appeal which John O'Kane has incurred."

Discussion of the interaction between CIS and SA

32. The legislation is set out in full earlier in this decision. The statutory provisions which are most in point are the following:

(1) TMA s 59B(1) and (4) require that, on 31 January after the end of a tax year, a person must pay the difference between (a) the amounts shown on his SA return, and (b) any payment on account, together with "any income tax which in respect of that year has been deducted at source".

(2) TMA s 59B(7) reads "in this section any reference to income tax deducted at source is a reference to income tax deducted or treated as deducted from any income or treated as paid on any income."

(3) FA 2004, s 62(2) states that sums deducted by the contractor are "to be treated as income tax paid in respect of the sub-contractor's relevant profits."

33. The starting point is therefore that CIS deductions are "to be treated as income tax paid" (FA 2004, s 62(2)). As such they are within TMA s 59B(7) and do not form part of the "difference" which the taxpayer is required to pay on 31 January following the end of the tax year. This is not in dispute: both parties agree that CIS deductions reduce the subcontractor's SA liability.

34. The key question is one of timing. Should the CIS deductions reduce the tax on the profits in the tax year of the deduction (as HMRC assert), or should they reduce the tax on profits of the previous year (as Mr Bradley contends), when:

(1) the payments which make up those profits were included in the profits of the previous year; and

(2) the payments and related deductions are made after the end of the tax year but before the 31 January following the end of that tax year.

35. The answer to this question can be found by establishing whether the deductions are both:

(1) "in respect of" the subcontractor's "relevant profits" (FA 2004, s 62(2)); and

(2) income tax which has been treated as paid "in respect of that tax year" (TMA s 59B(1)).

In respect of the subcontractor's relevant profits

36. The material provisions here are that the income tax paid is to be "treated as being income tax paid in respect of the sub-contractor's relevant profits" and that "relevant profits" are "the profits from the trade, profession or vocation carried on by him in the course of which the payment was received" (FA 2004, s 62(2) and (5)).

37. In my judgment, the straightforward and natural meaning of these provisions is that tax deducted by the contractor on payments made for work carried out by the subcontractor is to be treated as income tax paid on the subcontractor's profits from that work. This is for the following reasons.

38. First, the link between the income tax deducted, and the income tax "treated as paid" is the subcontractors *profits* – not his payments, or his receipts, or his income received. Profits must be calculated on an accruals basis in order to accord with UK GAAP (Income Tax Act 2007, s 997).

39. Secondly, the word used to qualify "profits" is "relevant". The Oxford English Dictionary says that the primary meaning of "relevant" is a legal one, applying to a

"claim, charge, defence etc", where it means "legally sufficient, adequate or pertinent." The second meaning is more general: "relevant" means "bearing on or connected with the matter in hand; closely relating to the subject or point at issue; pertinent to a specified thing."

40. It is reasonable to conclude that, by using the word "relevant", the parliamentary draftsman meant to indicate a close connection between the deduction and the profits; in other words, the income tax deduction is meant to be linked to the profits which are subject to tax.

41. Thirdly, FA 2004, s 62(3) prescribes different rules for corporate subcontractors. In their case, sums deducted under CIS must first "be applied in discharging relevant liabilities of the year of assessment *in which the deduction is made*." In other words, specific legislation is required to secure that corporate subcontractors' CIS deductions are initially matched with liabilities arising in the same year as the deductions. The matching is to all liabilities in that tax year, irrespective of when in the tax year the deduction is made – see FA 2004 s 62(4).

42. FA 2004, s 62(3)(c) states that once deductions have been matched with the corporate subcontractor's relevant liabilities, any excess "may be treated, in accordance with the regulations[5], as being corporation tax paid in respect of the [corporate] sub-contractor's relevant profits" – in other words, once these subcontractors have dealt with their relevant liabilities, the position is similar to that applying to individuals.

43. In the light of the explicit timing rules for corporate subcontractors, if parliament had also intended that excess deductions for companies, and all deductions for individuals, should only be offset against tax liabilities on profits in "the year of assessment in which the deduction is made", as HMRC assert, then the absence of similarly explicit provisions prescribing that matching is very surprising.

44. Fourthly, if HMRC were right, their meaning would do violence to the statute. This can be seen by considering the position in the year of cessation. If a subcontractor had carried out £10,000 of work in Year 1, and ceased business in Year 2, he would have to include the £10,000 in his taxable profits from his self-employed subcontractor business in Year 1 (because this is required under UK GAAP). If the contractor paid the £10,000 to the subcontractor in year 2, on HMRC's interpretation, the CIS deduction would belong to Year 2. But how would this CIS deduction be "treated as income tax deducted from the sub-contractor's relevant profits", as the statute requires, given that "relevant profits means profits from his trade"? In Year 2 there are no such profits[6]. If the section means that the tax deductions should be offset against the profits which gave rise to the deductions, as Mr Bradley asserts, then there is no such difficulty.

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[5] I have not been able to identify any regulations relating to this provision.

[6] I considered whether the post-cessation receipt provisions (Income Tax(Trading and Other Income) Act ("ITTOIA") s 243) were in point, but decided that they were not. A sum accrued in year 1 does not become a post-cessation receipt in Year 2: it is properly taxed in Year 1, see ITTOIA s 243(2).

45. Fifthly, if HMRC are right, the legislation is unfair to the subcontractor. He has done the work, included the payment due in his taxable profits, received the payment and HMRC are in possession of the tax deducted from that payment – all before the due date for his self-assessment return. It is difficult to see why parliament would have required that him to pay over a further amount to HMRC in addition to the tax they already have in hand, when the source of the profits on which tax is being levied are the very payments from which tax has been deducted and paid over to HMRC.

46. The above reading of the legislation does not, of course, mean that the subcontractor obtains tax relief in advance of the CIS deduction actually being made. FA 2004, s 62(1) is clear that there has to be "a sum deducted…and paid to the Board" before the subcontractor can treat it as income tax paid. But where, as in this case, the deduction has been made after the end of the tax year, but before the due date for payment of the self-assessment tax, then the amount which has been deducted and paid over is properly offset against the subcontractor's liability on the same profits.

Whether income tax in respect of that year has been treated as paid

47. The material provisions here are TMA s 59B(1): a person must pay the difference between (a) the amounts shown on his SA return, and (b) any payment on account together with "any income tax which in respect of that year has been deducted at source", together with TMA s 59B(7), which reads "in this section any reference to income tax deducted at source is a reference to income tax…treated as paid on any income."

48. The first question is whether the CIS deductions made after the end of the tax year, but in relation to income taken into account in that tax year, is "income tax…*in respect of that year*."

49. The income tax deducted from payments made by the Contractor for the work Mr O'Kane carried out in 2009-10 is in my judgment clearly "in respect of" 2009-10. That is the year in which the work was done, it is the year for which the earnings are included in his tax return, and it is the year in which he is taxable on the profits from that work.

50. The second question is whether the tax deducted by the Contractor in 2010-11 counts as income tax which *has been treated as paid* (TMA s 59B(1)(b) and 7, read together with FA 2004 s 62(2)).

51. Again, the answer is yes: for the reasons set out in the previous section, the tax has been "treated as paid" because it is in respect of his relevant profits.

52. To say – as HMRC do – that the deduction from the payment must in fact have been paid, or treated as paid, *before the end of the tax year in question,* is to add extra words to the statute, and there is no justification for such an insertion.

Conclusion

53. The tax deducted by the Contractor and paid over to HMRC in January 2011 related to the profits which Mr O'Kane included on his 2009-10 tax return. Those deductions were received by HMRC, before the SA due date of 31 January 2011. The statute requires that they be treated as income tax paid, and so they are offset against his self-assessment profits.

54. The total tax due on 31 January 2011 was £5,595, so the CIS deductions of £8,750 £8,392 were more than enough to cover his tax liability. As a result, there was no SA underpayment by Mr O'Kane on the surcharge trigger dates and the surcharges were incorrectly charged.

The Tribunal's jurisdiction

55. However, there is a further complexity.

56. Under TMA s 59C(9), set out earlier in this decision, the Tribunal only has jurisdiction to set aside the surcharge if "it appears that, throughout the period of default, the taxpayer had a reasonable excuse for not paying the tax." If "it does not so appear", the Tribunal must confirm the imposition of the surcharge.

57. This is in contrast to the normal powers of the Tribunal on appeal, which are set out at TMA s 50(6)-(8). Those provisions allow the Tribunal to "reduce or increase" the amount charged by HMRC. TMA s 59C(9) disapplies those provisions.

58. The jurisdiction of the Tribunal is thus explicitly limited. In particular, it has no power to cancel Mr O'Kane's surcharge on the basis that there was in fact no tax outstanding on 31 January 2011.

59. This surcharge does, however, fall under the protection of Article 6(1) of the European Convention of Human Rights. Article 6(1) gives the right of appeal to a "court of full jurisdiction."

60. The issue of tax penalties in the context of Article 6(1) and the court's jurisdiction were extensively considered in *Linda Jarvis v R&C Commrs* [2012] UKFTT (433 (Judge Brannan). That case concerned a fixed penalty for late filing of a partnership return. At [32]-[35] Judge Brannan sets out the *ratio* of *Jussila v Finland* (2006) (A/73053/01), a decision of the European Court of Human Rights.

61. This Tribunal gratefully adopts Judge Brannan's analysis as set out in those paragraphs, which are not repeated here. At [36] he summarised why Mrs Jarvis's penalty came under the protection of Article 6(1):

> "I have come to the conclusion that the penalty imposed by Section 93A is such that the criminal head of Article 6.1 of the Convention is invoked. First, the penalty is civil in nature under domestic UK law, but as the Court in *Jussila* indicated, this is by no means determinative. Secondly, the purpose of the penalty is deterrent and punitive in nature. It is intended to deter taxpayers, trading in partnership, from submitting late partnership tax returns. It is not intended to compensate the UK government. The penalty is of general application to all

> persons trading in partnership. The relatively small size of the penalty is not, in my view, sufficient to deprive it of criminal characteristics for the purposes of Article 6."

62. In my judgment, the same is true of Mr O'Kane's penalty. It too is "deterrent and punitive in nature" and of general application to all those submitting individual SA returns. It is also not prevented from falling within Article 6(1) either because it is civil in nature or because it is relatively small in amount.

63. At [40]-[51] of *Linda Jarvis* Judge Brannan reviews the ECHR case law on the meaning of a court of full jurisdiction. Again, this Tribunal gratefully adopts that analysis, which is not repeated here. At [52] he continues:

> 52.This Tribunal must take account of relevant decisions of the ECHR: Section 2 Human Rights Act 1998. As the Court of Appeal stated in *Han v C & E Commissioners* [2001] EWCA Civ 1048 at [25]:
>
> > 'Since s.2(1) of the HRA requires the court or tribunal to take into account the Strasbourg case law of the European Court of Human Rights ("Strasbourg") when determining a question which has arisen in connection with a Convention right, that case law provides the starting point for the domestic court or tribunal's deliberations and the court or tribunal has a duty to consider such case law for the purposes of making its adjudication. It is not bound to follow such case law (which itself has no doctrine of precedent) but, if study reveals some clear principle, test or autonomous meaning consistently applied by Strasbourg and applicable to a Convention question arising before the English courts, then the court should not depart from it without strong reason.'
>
> 53. In my view, the above cases establish a clear test which I should take into account. If a penalty falls within the criminal head of Article 6.1 the Convention requires that the taxpayer should have access to a tribunal of full jurisdiction…If domestic law provides for a penalty at a fixed rate, the fact that a tribunal does not have discretion to reduce the rate set by the national legislature does not, of itself, prevent the tribunal being a tribunal of full jurisdiction. Provided that, otherwise, the tribunal has the power to determine all questions of fact and law and can substitute its own decision for that of the tax administration, and is not limited to a purely supervisory role (eg if the tribunal can intervene only where the decision is 'unreasonable' in the *Wednesbury* sense), it will be a tribunal of full jurisdiction for the purposes of Article 6."

64. In the case of Mr O'Kane's surcharge, the Tribunal does not have "the power to determine all questions of fact and law" and it cannot "substitute its own decision for that of the tax administration". This Tribunal is therefore not a "tribunal of full jurisdiction" as required by the Convention. If it were a court of full jurisdiction, I

would set aside the surcharges on the grounds that Mr O'Kane had no underlying liability.

65. The Human Rights Act 1988 ("HRA"), s 3 requires that "so far as it is possible to do so, primary legislation and subordinate legislation must be read and given effect in a way which is compatible with the Convention rights."

66. The requirement to interpret legislation "so far as it is possible to do so" and the use of the word "must" denote a strong obligation. In *Ghaidin v Godin-Mendoza* [2004] ("*Ghaidin*") UKHL 40 guidance was given on how HRA s 3 was to be applied. Lord Nicholls said, at [32]:

> "the intention of Parliament in enacting section 3 was that, to an extent bounded only by what is 'possible', a court can modify the meaning, and hence the effect, of primary and secondary legislation."

67. Lord Millett at [67] said that the section:

> "means only that the court must take the language of the statute as it finds it and give it a meaning which, however unnatural or unreasonable, is intellectually defensible. It can read in and read down; it can supply missing words, so long as they are consistent with the fundamental features of the legislative scheme; it can do considerable violence to the language and stretch it almost (but not quite) to breaking point."

68. There are limits to the obligation. Lord Nicholls said at [49]:

> "inherent in the use of the word 'possible' in section 3(1) is the idea that there is a Rubicon which courts may not cross. If it is not possible, within the meaning of section 3, to read or give effect to legislation in a way which is compatible with Convention rights, the only alternative is to exercise, where appropriate, the power to make a declaration of incompatibility."

69. Lord Rodger said, at [121]

> "When the court spells out the words that are to be implied, it may look as if it is 'amending' the legislation, but that is not the case. If the court implies words that are consistent with the scheme of the legislation but necessary to make it compatible with Convention rights, it is simply performing the duty which Parliament has imposed on it and on others. It is reading the legislation in a way that draws out the full implications of its terms and of the Convention rights. And, by its very nature, an implication will go with the grain of the legislation. By contrast, using a Convention right to read in words that are inconsistent with the scheme of the legislation or with its essential principles as disclosed by its provisions does not involve any form of interpretation, by implication or otherwise. It falls on the wrong side of the boundary between interpretation and amendment of the statute."

70. TMA s 59C(9) explicitly excludes the normal appeal jurisdiction of the Tribunal. In my judgment, to read down the legislation so as to give the Tribunal that jurisdiction would be "on the wrong side of the boundary between interpretation and amendment of the statute." I thus find that the provision cannot be "read down" so as to be compatible with the Convention.

71. The Tribunal also does not have the power, under the HRA, to declare that the legislation is incompatible with the Convention, as this power is reserved to higher courts (see HRA, s 4).

72. However, if HMRC have acted "unlawfully" the Tribunal is able to "grant such relief or remedy, or make such order, within its powers as it considers just and appropriate" (HRA, s 8(1)) The only relief or remedy available to this Tribunal is to allow the appeal against the surcharge.

73. HRA s 6(1) states that the public body will have acted "unlawfully" if they have acted "in a way which is not compatible with any convention right." However, this subsection does not operate, so that HMRC will not have acted "unlawfully" if "as the result of one or more provisions of primary legislation, [HMRC] could not have acted differently" (HRA, s 6(2)(a)).

74. Has HMRC acted in a way "incompatible" with a Convention right, and thus "unlawfully"? HMRC are only empowered to impose surcharges under TMA s 59C if "any of the tax remains unpaid" at the surcharge trigger dates. On the basis of the statutory analysis set out in the previous section of this decision, none of Mr O'Kane's tax remains unpaid on the those dates.

75. HMRC thus had the power to impose, or not impose, the surcharges. Furthermore, as Mr Bradley says, they also have discretion under TMA s 59C(11) as to whether or not to mitigate the surcharges. This is therefore not a situation where HMRC "must" impose a penalty: it was clearly possible for HMRC not to levy the surcharges.

76. However, the breach of Mr O'Kane's Convention rights has not arisen because of the surcharge itself, but from TMA s 59C(1), which prevents the Tribunal from deciding surcharge cases other than on the basis of reasonable excuse.

77. This is not something which HMRC have the power to remedy: TMA s 59C(9) is a statutory provision put in place by parliament. As a result, HMRC have not acted "unlawfully" within the meaning of HRA s 6, and the Tribunal has no power to remedy the breach under HRA s 8, by discharging the surcharges.

78. The Tribunal therefore next considers whether the surcharges can be set aside on the ground of reasonable excuse.

Reasonable excuse

79. Under TMA s 59C(9)(a) the Tribunal has an explicit statutory jurisdiction to consider whether a person has a reasonable excuse for the default."

Does the Tribunal have jurisdiction where there is no default?

80. Although TMA s 59C(7) gives Mr O'Kane a right to appeal "against the imposition of the surcharge", under TMA s 59(9)(a) the Tribunal may only set aside that surcharge:

> "if it appears that, throughout the period of default, the taxpayer had a reasonable excuse for not paying the tax."

81. TMA s 59C(12) states that:

> "'the period of default', in relation to any tax which remained unpaid after the due date, means the period beginning with that date and ending with the day before that on which the tax was paid."

82. In this case the Tribunal has found that there is no "tax which remained unpaid after the due date". The first question is whether it is possible to exercise this jurisdiction in a situation where the Tribunal has found that there is no liability, and so no default.

83. However, such a finding would deprive Mr O'Kane of all appeal rights, and for the reasons set out in the previous part of this decision, he has a Convention right under Article 6(1) to appeal the surcharges.

84. In consequence, also as previously discussed, HRA s 3 requires that "so far as it is possible to do so" the Tribunal "read down" the legislation so as to make it compatible with the Convention. The House of Lords in *Ghaidin* set out the guidelines which courts and tribunals must use when applying HRA s 3.

85. *Ghaidin* requires me first to identify the "scheme of the legislation" (*per* Lord Rodger at [121]). The relevant provision is TMA s 59C(9)(a), and the scheme of that legislation is that the Tribunal has the jurisdiction to rule on whether or not a taxpayer, on whom a surcharge has been imposed, has a reasonable excuse for his behaviour.

86. TMA s 59C(9) explicitly gives a reasonable excuse jurisdiction to the Tribunal and I find that it is (in the words of Lord Millet at [67]) "intellectually defensible" that the Tribunal should be able to exercise that jurisdiction when HMRC have imposed a surcharge even though there has, as a matter of fact, been no default.

87. In the same passage, Lord Millett also says that in carrying out the obligation imposed by HRA s 3, the Tribunal can

> "read in and read down; it can supply missing words, so long as they are consistent with the fundamental features of the legislative scheme."

88. In accordance with that guidance, I further find that TMA s 59C(9) should be read down as follows:

> "…the tribunal may—

(a) if it appears that, throughout the period *during which HMRC has held there to be a* default, the taxpayer had a reasonable excuse for *the behaviour which caused HMRC to levy the surcharge*, set aside the imposition of *that* surcharge;

(b)…"

89. This reading down is necessary to make TMA s 59C(9) compatible with the Convention, and it is also consistent with the legislative scheme. In the words of Lord Rodger at [121], with whom Lord Nicholls agreed at [33], it "goes with the grain of the legislation."

Whether Mr O'Kane has a reasonable excuse

90. Having read down the statutory provision in this way, I go on to consider whether Mr O'Kane has a reasonable excuse.

91. There is no definition in the legislation of a "reasonable excuse". It has been held to be "a matter to be considered in the light of all the circumstances of the particular case" (*Rowland v HMRC* [2006] STC (SCD) 536 at [18]).

92. More recently, it has been held by this Tribunal that "an excuse is likely to be reasonable where the taxpayer acts in the same way as someone who seriously intends to honour their tax liabilities and obligations would act" (*B&J Shopfitting Services v R&C Commrs* [2010] UKFTT 78 (TC) at [14]).

93. Mr Bradley's primary case is that Mr O'Kane should not have had to pay the surcharges because he did not, in fact, owe any tax. The tax which had been deducted and paid over to HMRC in January 2011 was on the self-same payments which formed the basis of Mr O'Kane's self-assessment profits. On my analysis of the legislation, set out earlier in this decision, Mr Bradley is correct.

94. Mr O'Kane has therefore acted "in the same way as someone who seriously intends to honour his tax liabilities and obligations"; he owed nothing at 31 January 2011 because a sum in excess of his liabilities had already been deducted and paid over to HMRC by the Contractor. In all the circumstances of this case, he has a reasonable excuse for not paying further tax.

95. What would be the position were I to be wrong in my analysis of the legislation? By January 2011, Mr O'Kane had suffered flat rate deductions of 20% from his payments of £43,750. This is the same as the basic rate of tax, but does not take into account the personal allowance of £6,475. The Class 4 NICs rate on profits is 8%, after the lower profit limit of £5,715. Most importantly, no allowance has been made for deductible costs (other than materials).

96. Mr O'Kane had worked as self-employed in 2007-08, so will have had a working knowledge of how to calculate his taxable profits, and in particular, to know that the CIS regime does not take into account allowable expenses. He will also have known whether he had other earnings in the year, and how much these were. Since the

tax on his 2009-10 profits was only £5,595, it is clear that if he had earnings other than from the Contractor, these were small.

97. On the basis of the foregoing, I find as a fact that Mr O'Kane knew by January 2011 that the CIS tax deducted by the Contractor exceeded the 2009-10 income tax actually due on 31 January 2011, and thus believed he had overpaid his tax for that year.

98. As set out above, in my judgment Mr O'Kane's belief that the CIS deductions reduced his 2009-10 tax is soundly based on the legislation. But if I am wrong, was it reasonable of him to think that the tax system would operate so as to match the tax on his profits with the tax deducted from the same payments? I find it to be entirely reasonable. His understanding, like Mr Bradley's submissions on his behalf, is based on a sensible analysis of how profits, tax and accounting normally interact.

99. As a result, he has a reasonable excuse, whether or not my analysis of the statutory provisions is correct.

Other grounds of appeal

100. For completeness I also cover Mr Bradley's other grounds of appeal.

101. I agree with HMRC that belatedly recognising the need for a TTP agreement does not assist Mr O'Kane. I also agree that inability to pay is prevented by statute from constituting a reasonable excuse. Although this statutory exclusion is not absolute (see *C&E Commissioners v Steptoe* [1992] STC 757), there is no evidential basis here for such an exception. Nevertheless, there is a certain irony in HMRC's statement that "the taxpayer is expected to keep money aside to pay his tax bill", given that this is exactly what the CIS regime is designed to achieve. The Contractor had already given HMRC the tax on the payments which gave rise to Mr O'Kane's liability.

102. The Tribunal has no jurisdiction over HMRC's amnesties or settlement offers, including the Tax Return Initiative. I merely note that if Mr O'Kane had been liable to the surcharges, he would have suffered a 10% penalty (not 5% as stated by HMRC). If he had not filed his return on 13 February 2012, so that it remained outstanding on 3 July 2012, and he had then taken advantage of this Initiative, he would have suffered an identical 10% penalty.

Decision and appeal rights

103. The Tribunal thus allows the appeal and sets aside the penalties because Mr O'Kane had a reasonable excuse.

104. 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 Rules. 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.

ANNE REDSTON
TRIBUNAL PRESIDING MEMBER

RELEASE DATE: 17 May 2013