[2021] UKFTT 0294 (TC)

TC08236

INCOME TAX – Construction Industry Scheme – Income Tax (Construction Industry Scheme) Regulations 2005 – refusal decision to grant relief under regulation 9(3) – s 61(1) FA 2004 – materials cost excluded for CIS withholding tax – distinction between plant hired-in and plant owned by subcontractors – Condition A relief criteria – whether 'reasonable care' taken – whether admission of 'errors in good faith' – whether 'genuine belief' held – ***appeal allowed***

Appeal number: TC/2019/06358

FIRST-TIER TRIBUNAL
TAX CHAMBER

BETWEEN

GELDER LIMITED **Appellant**

-and-

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

TRIBUNAL: JUDGE HEIDI POON
CHARLES BAKER

The hearing took place on 21 and 22 January 2021 on Tribunal Video Platform

With the consent of the parties, the form of the hearing was by video link ('V') on Tribunal video platform. Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

Mr Alastair Kendrick, of Streets Myton Mulholland LLP, for the Appellant

Mr Paul Hunter, Litigator of HM Revenue and Customs' Solicitor's Office, for the Respondents

DECISION

INTRODUCTION

1. Gelder Limited ('Gelder' or 'the Company') appeals against HMRC's refusal decision to grant relief under regulation 9 of the Income Tax (Construction Industry Scheme) Regulations 2005 ('reg 9' of 'the CIS Regulations 2005'). The claim was made under reg 9(3) for Condition A relief against the respondents' decision to assess additional income tax under the Construction Industry Scheme in the quantum of £33,781.

WITNESS EVIDENCE

2. For HMRC, Officer Duncan Leith gave evidence as the decision maker in relation to the refusal for reg 9(3) relief. Officer Leith was not directly involved with the CIS enquiry, but was the Technical Manager to whom the enquiry officer referred in respect of the reg 9 relief claims. We find Officer Leith a credible witness, and accept his evidence as to matters of fact.

3. The appellant called three of its employees as witnesses, who appeared in the order of (i) Mr Jason Gray, a Quantity Surveyor; (ii) Ms Rachel Barton, Subcontract Accounts Clerk; (iii) Mr Arran Fullwood, Finance Director. We find all three witnesses to be credible and reliable, and from their evidence, we make findings of fact relevant to the appeal as narrated below.

LEGISLATIVE FRAMEWORK

Section 61 of FA 2004

4. By virtue of s 61 FA2004, the Construction Industry Scheme ('CIS') imposes a statutory obligation on contractors to deduct income tax at source at the basic rate from payments made to subcontractors, and to file monthly CIS returns to pay over the income tax so withheld in relation to labour costs. Any payment to a subcontractor that represents reimbursement of the cost of materials is excluded from the amount to be subject to deduction of income tax as provided under sub-s 61(1):

> 'On making a contract payment the contractor … must deduct from it a sum equal to the relevant percentage of so much of the payment as is *not shown to represent the direct cost* to any other person of materials used or to be used in carrying out the construction operations to which the contract under which payment is to be made relates.' (italics added)

The Income Tax (Construction Industry Scheme) Regulations 2005

5. Regulation 13 of the CIS Regulations 2005 provides HMRC with the power to make a 'Regulation 13 Determination' to recover from a contractor any shortfall in the tax that should have been withheld, if HMRC have reason to believe that the contractor has not, in any particular tax year, returned the correct amount of income tax deductible from payments made to subcontractors. A Regulation 13 Determination is an appealable decision in its own right.

6. Regulation 9 provides for relief, under certain conditions, for a CIS contractor to be relieved from making good the shortfall assessed, usually by a Regulation 13 Determination:

> **'9 Recovery from sub-contractor of amount not deducted by contractor**
>
> (1) This regulation applies if—
>
> > (a) it appears to an officer of Revenue and Customs that the deductible amount exceeds the amount actually deducted, and
> > (b) condition A or B is met.
>
> (2) In this regulation—

> “the deductible amount” is the amount which a contractor was liable to deduct on account of tax from a contract payment under section 61 of the Finance Act 2004 in a tax period;
>
> “the amount actually deducted” is the amount actually deducted by the contractor on account of tax from a contract payment under section 61 of the Act during that tax period;
>
> “the excess” means the amount by which the deductible amount exceeds the amount actually deducted.’

7. HMRC may grant relief, by issuing a direction under para 5, if either set of circumstances under para 3 (‘Condition A’) or para 4 (‘Condition B’) obtains.

> ‘(3) Condition A is that the contractor satisfies an officer of Revenue and Customs—
>
> (a) that he took reasonable care to comply with section 61 of the Act and these Regulations, and
> (b) that—
> (i) the failure to deduct the excess was due to an error made in good faith, or
> (ii) he held a genuine belief that section 61 of the Act did not apply to the payment.
>
> (4) Condition B is that—
>
> (a) an officer of Revenue and Customs is satisfied that the person to whom the contractor made the contract payments to which section 61 of the Act applies either—
> (i) was not chargeable to income tax or corporation tax in respect of those payments, or
>
> (ii) has made a return of his income or profits in accordance with section 8 of TMA (personal return) or paragraph 3 of Schedule 18 to the Finance Act 1998 (company tax return), in which those payments were taken into account, and paid the income tax and Class 4 contributions due or corporation tax due in respect of such income or profits; and
> (b) the contractor requests that the Commissioners for Her Majesty's Revenue and Customs make a direction under paragraph (5).
>
> (5) An officer of Revenue and Customs may direct that the contractor is not liable to pay the excess to the Commissioners for Her Majesty's Revenue and Customs.’

8. Condition B relief is in point where HMRC have recovered the tax in question from the subcontractor, which renders it inequitable to recover the same tax from the contractor as well. A Regulation 13 Determination is often preceded by a consideration of whether Condition B relief is in point. HMRC’s decision as concerns Condition B relief is not appealable. The matter under appeal concerns HMRC’s decision to refuse the appellant’s claim for Condition A relief under para 3, and the refusal decision is pursuant to reg 9(6):

> ‘(6) If condition A is not met an officer of Revenue and Customs may refuse to make a direction under paragraph (5) by giving notice to the contractor (“the refusal notice”) stating—
>
> (a) the grounds for the refusal, and
> (b) the date on which the refusal notice was issued.’

9. A refusal notice in relation to Condition A relief carries a right of appeal, but only on specific grounds as provided under reg 9(7) and (8).

> ‘(7) A contractor may appeal against the refusal notice—
>
> (a) by notice to an officer of Revenue and Customs,
> (b) within 30 days of the refusal notice,
> (c) specifying the grounds of the appeal.
>
> (8) For the purpose of paragraph (7) the grounds of appeal are that—

> (a) that the contractor took reasonable care to comply with section 61 of the Act and these Regulations, and
>
> (b) that—
> (i) the failure to deduct the excess was due to an error made in good faith, or
> (ii) the contractor held a genuine belief that section 61 of the Act did not apply to the payment.'

10. The Tribunal's jurisdiction in relation to an appeal against HMRC's refusal decision to grant Condition A relief is provided under reg 9(9) in the following terms:

> '(9) If on an appeal under paragraph (7) that is notified to the tribunal it appears that the refusal notice should not have been issued the tribunal may direct that an officer of Revenue and Customs make a direction under paragraph (5) in an amount the tribunal determines is the excess for one or more tax periods falling within the relevant year.'

HMRC Guidance in respect of plant hire

11. By virtue of sub-section 61(1) FA 2004, any payment to a subcontractor which represents a reimbursement of the cost of materials is excluded from the amount subject to CIS deduction. By concession, HMRC allow the cost of plant hire incurred by a subcontractor to be treated as materials for CIS deduction purposes. In relation to the ascertainment of materials cost, and the treatment of plant hire as materials, the following paragraphs from HMRC Guidance CIS 340 *Construction Industry Scheme: a guide for both contractors and sub-contractors* have been referred to by parties in their submissions.

> '**3.13 Materials**
>
> The contractor can ask a subcontractor for evidence of the direct cost of materials.
>
> If the subcontractor fails to give this information, the contractor must make a fair estimate of the actual cost of materials. The contractor must always check, that the part of the payment for materials supplied is not overstated. If the materials element looks to be excessive we may seek to recover any under deduction from the contractor.
>
> **3.14 Plant hire claimed as materials**
>
> "Plant" includes, for example, scaffolding, cranes, cement mixers, concrete pumps, earth moving equipment and compressors.
>
> Where the subcontractor hires plant in order to carry out construction work, the cost of the plant hire and any consumable items such as fuel needed for its operation may be treated as materials for the purposes of calculating any deduction.
>
> This treatment only extends to plant and equipment actually hired by the subcontractor from a third party. *If the subcontractor owns the plant used in executing the work no notional deduction for plant hire may be made,* although consumable items such as fuel used by the plant may still be treated as materials.
>
> The contractor should check this with the subcontractor before making payment as failure to do so may leave the contractor responsible for any under deduction.' (italics added)

THE FACTS

Background to the refusal decision for Condition A relief

12. Gelder has been in business since 1993 as a large contractor in the construction industry with an annual turnover of around £40 million. It has 250 employees, including 7 Quantity

Surveyors ('QS'), and 15 to 20 contract managers. It has a good tax compliance history and is up to date with all its returns and payments. For CIS compliance, it uses the Exchequer accounting package (being software approved by HMRC) to maintain its nominal ledger, and to prepare and submit its CIS returns.

13. In February 2019, HMRC Officer Val Bailey opened a check into Gelder's CIS returns for the years 2017-18 and 2018-19. Correspondence followed between Officer Bailey and Mr Fullwood to address queries arising from the check, among which was a lengthy email from Mr Fullwood dated 25 March 2019, in which he referred to a Software Error on the Exchequer system. (Officer Bailey was not called as a witness, and we could not check with her what she had understood from the substance of Mr Fullwood's email at the time. It would seem that Officer Bailey had (mis)understood Mr Fullwood's reference to the Software Error as an admission of errors in the CIS returns.)

14. By letter dated 8 July 2019, Officer Bailey wrote to advise that she considered that a total of **£42,443** CIS tax had been under-deducted in respect of the cost of materials entries for four subcontractors, (all being scaffolders). Gelder was invited to provide further evidence in relation to the contentious amounts. Officer Bailey continued by advising that she would 'now make a claim on [Gelder's] behalf' for Condition B relief; she explained that HMRC's decision to refuse Condition B relief would not be appealable. Human Rights and Penalty factsheets were enclosed; a penalty percentage at 19.5% for inaccuracy in returns under Schedule 24 to Finance Act 2007 was assessed, though this was not further pursued (probably suspended) and the penalty is not a matter under appeal.

15. On 11 July 2019, Officer Bailey emailed to advise that her Technical Manager had now made a decision as regards Condition B relief, which she related in an attached letter with the Regulation 9 decision notices. She also asked for Gelder's agreement to the computation totalling £33,781 plus £377 interest thereon, and that a payment on account could be made online by following a special website link for '*pay-taxes-penalties-and-enquiry-settlements*'.

16. The Technical Manager who made the decision on Condition B relief was Officer Leith, whose decision notices of 10 July 2019 were to grant relief in relation to £8,662, and to refuse the balance of £33,781, which remained payable with details summarised as follows.

Year	**Subcontractor**	**Net of materials £**	**Correct CIS due £**	**CIS deducted £**	**CIS under deducted £**
2017-18	Jay Hardwick Scaffolding Ltd	800	160	136	**24**
2017-18	Gainsborough Scaffolding Ltd	13,900	2,780	1,383	**1,397**
2018-19	Magna Scaffolding Ltd	26,518	5,304	3,352	**1,952**
2018-19	Gainsborough Scaffolding Ltd	49,852	9,970	4,573	**5,397**
2018-19	M&M Scaffolding (NW) Ltd	249,897	49,979	24,968	**25,011**
				Total	**£33,781**

17. The misalignment of parties' positions in relation to the disputed matter would appear to be the real cause of the 'surprise' referred to in Officer Bailey's letter of 1 August 2019:

> 'Over the last 4 months you have contacted the scaffolders with the aim of obtaining evidence retrospectively, confirming that the subcontractors do hire in their equipment from a 3rd party for the work undertaken for Gelder Ltd. … I appreciate the regular calls from you giving me updates with your progress.

> Therefore, I am somewhat surprised that you are now saying that you have followed the guidance regarding checking plant ownership by subcontractors. I explained on several occasions … that I would have to consider whether the CIS tax had been under deducted on the material element if hire could not be confirmed.
>
> As you believe that you have followed the guidance then the next step would be to make a claim under Regulation 9(3) – 'Condition A' of [the 2005 Regulations] to be relieved of the CIS tax liability.'

18. Instead of serving a Regulation 13 Determination as an appealable decision at this juncture for the substantive issue to be contended, the letter of 1 August 2019 would seem to have channelled the disputed matter onto the course of claiming Condition A relief.

Reasons for refusing Condition A relief

19. Another referral to Officer Leith to consider Condition A relief resulted in the refusal notice of 19 August 2019, which is the subject matter in this appeal. The reasons for the refusal were given in the following terms:

> 'The hire [of plant] needs to be appropriately evidenced in order to satisfy the requirement by s. 61 that the materials cost is "*shown*" to have been incurred in carrying out the operations. I would contend that simply asking for a verbal assurance that plant has been hired-in does not represent reasonable care in satisfying this legislative requirement.' (emphasis original)

20. Of the four subcontractors, the largest sum of CIS tax in dispute related to M&M Scaffolding (NW) Ltd (henceforth 'M&M'), and was singled out in Officer Leith's letter in his reasoning as follows:

> 'All payments to M&M during 2018/19 had an element of materials deduction but the percentage of materials to invoice value of the final four payments was 65% and in momentary terms £114,045 accepted as having been expended on plant hire (presumably scaffolding and associated items).
>
> I consider that such figures as these should not have been accepted without challenge (and the subcontractor being asked to evidence the materials deduction: ie their hire costs) and that Gelder Ltd failed to take reasonable care in not having processes in place which would have triggered such a challenge.'

21. In evidence, Officer Leith remarked on the three invoices and a credit note in the month ended 5 February 2019 from Gainsborough Scaffolding Services Ltd ('Gainsborough'), which made up a total payment of £3,975 before CIS deduction. In each case, the face of the invoice showed the materials content as a net of VAT amount equal to exactly 50% of the gross of VAT invoice total. In other words, the net invoice was split 60% to materials and 40% to labour; (e.g. £600 materials, £400 labour, net total being £1,000, VAT gross total being £1,200; and net total for materials of £600 is at 50% of the gross invoice total of £1,200). In his view, it was not credible that the supply and erection of scaffolding at three different locations should have the same ratio of materials content, or that Gainsborough would hire in scaffolding for three small jobs when they owned scaffolding of their own.

22. Officer Leith clarified that what mattered, in his view, was not so much the materials cost being of a particular percentage of the invoiced total, but the actual costs being incurred by the subcontractors, to be supported by written evidence. It was put to him that paragraph 3.13 of CIS 340 does not stipulate the type of evidence required, and Officer Leith's reply was to emphasise that the statutory wording in s 61 FA 2004 being '*shown* to represent the direct cost' means documentary evidence is required in order to show; and that Gelder could have asked

for evidence of the materials cost, and that for such large amounts as with M&M, he would expect taking ‘reasonable care’ to have involved more than obtaining a verbal assurance.

Witness evidence for the appellant

Jason Gray

23. Mr Gray is a qualified Quantity Surveyor (‘QS’) and has worked for Gelder since 2015. Within Gelder, he confirmed that either the quantity surveyors or contract managers are responsible for managing all aspects of the contractual and financial side of the construction projects, to help ensure that the projects are completed within budget. In addition, he acts an estimator to feed price quotations into projects being tendered by Gelder. Typical projects under his management have a value of around £1.6 million with some 20 subcontractors. On average, he would have 4 to 5 such projects live on site, and another 4 or 5 in the background. He stated that ‘querying the ownership status of the plant used to carry out the works is standard practice following the placement of a subcontractor orders’.

24. Mr Gray was the QS on the project known as The Quarter in Chester, which was for external repairs undertaken on behalf of National House Building Council (‘NHBC’). The preliminary indication given by NHBC was to expect the project to run for 20 weeks at a cost of £300,000, but by the time of commencement, the estimated duration had been doubled to 40 weeks. There were delays outside Gelder’s control, and the project eventually took near to two years to complete, with a total value of just under £3.2 million.

25. The Quarter is a block of over 150 flats in four storeys, and required 4,000 square metres of scaffolding, weighing 150 tons, which would have a capital value of around £230,000. Gelder had difficulty securing a scaffolding contractor, as the requirement was beyond what most scaffolders could undertake. M&M was the eventual subcontractor, and Mr Gray had seen the credit check done by Mr Fullwood on M&M, which showed it had a net worth of £150,000, and concluded that it was implausible that M&M could have owned the required scaffolding.

26. In addition to the credit check, Mr Gray said he had on-site discussions with the representative of M&M and ascertained that the scaffolding would be hired in, which was what Mr Grey expected as well. In his view, it is simply uneconomical to hold stock of that quantity, not to mention the overhead costs for storage when the scaffolding is not in use.

27. Mr Gray explained that the labour costs on M&M’s invoices related to the erection and dismantling of the scaffolding, and some ‘adaptations’ as the job progressed. The materials element was for the hire of the scaffolding through the duration of the project, which started with an initial estimate of 20 weeks, extended to 40 weeks, and lasted for about two years. There was no labour element to the additional hire period, and that explained the high percentage value of materials cost for these invoices.

28. Mr Gray was not the QS on the Gainsborough jobs, and therefore could not speak to the invoices specifically. As a general comment, he said it was not unusual for scaffolding contractors to hire in extra scaffolding as their own stock was in use elsewhere.

29. When asked if he would request subcontractors to produce invoices to evidence that their scaffolding had been hired in, Mr Gray said generally he would not request invoices for hired-in plant if the materials element seems to be a fair estimate, but would request invoices if the subcontractor is supplying services on either a day-rate or cost-plus basis.

30. It was put to Mr Gray that there was no evidence that he had checked the invoices, and he disagreed, and confirmed that a major part of his job as a QS is to maintain the CVR (Cost Value Reconciliation) on the server for each project, which requires him to check the incoming invoices in order to maintain the CVR.

Rachel Barton

31. Ms Barton has been a Subcontract Accounts Clerk at Gelder for five and a half years, Her responsibilities include:

(1) Verify new subcontractors by input of details provided on the internal CIS form onto HMRC website, which would generate a reply to confirm the rate of CIS deduction for a subcontractor, either at 20% or at 30%. A deduction rate of 30% indicates that HMRC do not recognise the person as a subcontractor; she will ask a QS or contract manager to check the details with the subcontractor and re-run the verification.

(2) To process incoming invoices for payment through a paperless system as follows:

(a) *Invoice list for query*: details of invoices input onto Exchequer accounts system; then forwarded to the relevant QS or contract manager for checking.

(b) *Invoice list for checking*: the QS or contract manager checks an invoice and marks it as: (i) *approved* for payment, (ii) *disputed*, or (iii) *further action*. ('Marking' in this context means pressing the relevant button on the computer system to record their decision.)

(c) *Invoice list for payment*: once approval is received, the invoice will be added to the list for payment, but it is Mr Fullwood who signs cheques or authorised bank transfers. Typically there were about 750 invoices to process with a total value of around £1 million for payment. The main payment run is on the 6th of the month and accounts for 80% of the value with supplementary payment runs each week.

(3) Prepare and submit the monthly CIS return from Exchequer data, with a payment summary being issued to the subcontractors.

32. When asked why there were no stamps or marks on the copy invoices included in the bundle to show the checks performed by a QS or contract manager, Ms Barton explained that the Company preferred invoices to be submitted by email to enable them to be processed internally through the paperless system. The instructions from a QS or a manger are by email and not marked on the copy of the invoice. If a hard copy of invoice is received, it will be scanned to enter the electronic system of processing, and the hard copy will be destroyed.

33. Where materials content of an invoice appeared anomalous, Ms Barton would send an email highlighting this for the QS or contract manager who is the ultimate decision maker. Specifically, she was certain that Mr Gray did check the invoices from M&M.

Arran Fullwood

34. Mr Fullwood is a qualified Management Accountant and has worked for Gelders for 13 years. He said he was introduced to CIS by the former Finance Director, to whom he succeeded in December 2017. As Finance Director, CIS compliance is an important part of Mr Fullwood's remit. To that end, Mr Fullwood is familiar with the CIS manuals published by HMRC; he receives briefings from Gelder's external accountants, and is on HMRC's mailing list for updates. He circulates these updates and briefings to relevant staff members, who are enrolled on external training courses where appropriate to ensure that adequate training is provided. He confirmed that he was satisfied that Gelder had the right people working in each area.

35. Prior to the present enquiry, CIS checks were carried out some 5 or 6 years ago. While Mr Fullwood could not speak to the detail of the former enquiry which was dealt with by his predecessor, he understood that HMRC were very satisfied with Gelder's internal procedures.

36. In response to Officer Bailey's request for cost invoices from selected subcontractors, Mr Fullwood decided to telephone the subcontractors personally, partly to speed up the

response, and partly to reassure himself that the QS were actually doing what they said they were doing. In his lengthy email to Officer Bailey on 25 March 2019, he related the general situation why subcontractors with their own scaffolding may still hire in scaffolding. Both Gainsborough and M&M had confirmed in their telephone conversations with Mr Fullwood that their own stock was out on other jobs, and they had hired in scaffolding for those jobs undertaken for Gelder that were under query. We note other subcontractors had responded to Mr Fullwood's calls by forwarding the relevant invoices to evidence the scaffolding being hired in. For example, Cornwall Scaffolding Ltd forwarded an invoice dated 12 July 2018 from TJR Scaffolding Ltd for the 'Hire of various scaffold equipment July 2018 – July 2019' in the sum of £21,000. It would appear that many original queries had been cleared at this stage of the enquiry with actual invoices for the hire of the scaffolding being forwarded by subcontractors.

37. Mr Fullwood said that the job of the QS was to control all financial aspects of a project, and the QS had their own information system to assess the fairness of materials cost, chief of which was the CVR (Cost Value Reconciliation). CVR enabled the QS to compare in detail the budget and actual costs. For example, a QS would know the recognised range of acceptable price per metre for building a wall, and could check an invoice price for materials cost against the actual length built at the agreed rate.

38. Furthermore, on projects of any size, Gelder's client would also engage its QS to check and challenge Gelder's sales invoices. Often there were vigorous discussions between the QS on both sides about the make-up of the costs. The majority of Gelder's Quantity Surveyors have had the experience of working elsewhere, so there would be a peer system to reach a fair cost evaluation for materials against mark-up.

THE APPELLANT'S CASE

39. Mr Kendrick submitted that the issue was whether the Company had exercised reasonable care, and the evidence showed that the Company had robust systems operated by competent people to produce accurate returns. Paragraph 3.13 of HMRC manual CIS 340 explained what the Company had to do by way of checking, and that is exactly what the Company had done.

40. Turning to the specifics, the apparently high materials cost of the M&M invoices was fully explained by the unusual circumstances of the contract and, in particular, the considerable delays. He accepted that Gainsborough did seem to have made an arbitrary allocation of their invoices to materials. The very small size of the contract and the insignificance of the figures explained why this had not been challenged by the Company. This was not typical and did not cast doubt on the robustness of the systems.

41. In reply to HMRC's submissions, Mr Kendrick made the following response:

(1) The only error admitted by the Company was the Software Error, which was generated solely by a software package, and was not the fault of the Company.

(2) HMRC misunderstood and misrepresented the evidence of the Company, in particular, the roles of Ms Barton and the Quantity Surveyors.

(3) The purpose of the internal CIS form was to gather information for the initial registration of a new subcontractor: (i) to confirm that the sub-contractor was genuine and not a disguised employee, and (ii) to gather the factual information required to 'verify' the subcontractor with the HMRC system. The amendment of the form at the request of HMRC was not relevant to these purposes, and did not imply any inadequacy in the previous procedure.

(4) The HMRC guidance requires checks to be carried out. The Company did that, and there was nothing in the HMRC guidance requiring the checks to be recorded in any particular form.

HMRC'S CASE

42. For the respondents, Mr Hunter submitted that:

(1) To satisfy the first limb of reg 9(3) a taxpayer has to demonstrate 'reasonable care' having been taken to comply with s 61. A contractor must satisfy the reasonable care element of s 61 first. If he cannot demonstrate that he took reasonable care to comply, then any debate on the 'error in good faith' or 'genuine belief' condition is academic.

(2) It is the Company's practice to ask, when a subcontractor is first engaged, whether plant is hired-in by them for the specific purpose of fulfilling that engagement. Simply asking for a verbal assurance that plant has been hired-in does not represent reasonable care in satisfying this legislative requirement.

(3) The appellant's CIS irregularity is very specific, being a failure to confirm that materials deductions claimed by subcontractors were costs incurred for plant hire, and not plant owned by the subcontractors. The appellant has asserted that a process of seeking verbal reassurances is sufficient, but an examination of the invoices (by M&M) as detailed in the 'View of Matter' letter contradicts the verbal assurances, without that contradiction being recognised and the correct tax treatment being applied. This cannot be considered 'reasonable care'.

(4) All payments to M&M during 2018-19 had an element of materials deduction but the percentage of materials to invoice value of the final four payments was 65%, and in monetary terms £114,045. These are figures that should not have been accepted without challenge, and the subcontractor should have been asked to evidence the materials deduction in terms of their hire costs. Gelder failed to take reasonable care as no such processes were in place to trigger such a challenge.

(5) The appellant readily acknowledged measures were to be in place 'in order to avoid this mistake in future'. The appellant therefore used the word mistake, and had chosen the remedy to rectify this mistake in all future calculations per its email of 25 March 2019, and has confirmed that measures are now in place which were not in place before.

(6) HMRC cannot emphasise enough the importance of documenting checks. The failure to have documentation to evidence the checks carried out on third parties is a lack of reasonable care.

(7) The inconsistencies in the evidence of the three witnesses for the Company cast doubt on their evidence. What can be taken from their evidence is that the buck stops with the Quantity Surveyor and there is no effective supervision.

DISCUSSION

Whether admission of errors

43. Mr Hunter presented HMRC's case on the premise that Gelder had previously admitted that there were errors in its CIS returns, which was founded on the following factual inferences.

(1) An application for relief under reg 9(3) would make no sense unless there was an admission of errors;

(2) Gelder had explicitly admitted to mistakes in the returns;

(3) Gelder had altered its internal 'CIS form' (for verifying a new subcontractor) at the request of HMRC; thus acknowledging that the previous form was inadequate.

44. We consider firstly the background leading to Gelder's application for relief under reg 9(3) as set out at §17. The claim for the relief would seem to have been initiated by HMRC's letter of 1 August 2019. In the absence of a Regulation 13 Determination for Gelder to contend

that it had not made errors in the CIS returns on the substantive issue, Gelder had followed the procedural route to apply for reg 9(3) relief.

45. Secondly, HMRC would seem to have misunderstood the substance relating to the explicit admission of a mistake, which was a reference to Mr Fullwood's lengthy email of 25 March 2019 to Officer Bailey. The relevant paragraphs in the email read as follows:

> 'Steelgram Ltd: We are happy that the correct amount of CIS tax has been declared on the CIS return, however, the material amount is incorrect. We have re-run the system generated CIS reports from our accounts package, Exchequer, for the period in question and the same incorrect figure for materials is shown. We have looked into this and cannot come up with a logical reason why this has happened. We are therefore raising this issue with the software providers as this is an unusual case and I have not come across this before. …
>
> In order ***to avoid this mistake in future***, I have put in place a new procedure where we will run the report off in excel before submitting the final return. Once in excel we can run a formula down to check for any inconsistencies with any of the figures on the CIS report. Although in reality there should not be any, just in case we come across this system error again, we will now pick this up and correct the figure(s) accordingly.' (emphasis added)

46. We accept Mr Fullwood's explanation that the admitted error was no more than a 'Software Error' in respect of a subcontractor unrelated to this appeal. The Software Error was arithmetic in nature, and the total value of the Error was £7.60. We find that HMRC had misunderstood the mistake being 'admitted' in this email as relating to the disputed treatment of the materials cost of scaffolding for the four subcontractors.

47. Thirdly, as regards the CIS form, we accept Ms Barton's evidence that it serves as an internal questionnaire for gathering information such as the UTR, the national insurance number, or the company number, and so forth, for input into HMRC's system to verify a new subcontractor and to confirm whether 20% or 30% deduction rate should be applied. Another purpose for the form, as Mr Fullwood explained, was to check that an individual is a genuine subcontractor, and not acting as a disguised employee. We note the substance of the amendment to the form by insertion of two questions relating to the supply of plant as follows:

> 'Will the subcontractor provide plant to do the Job?
>
> If Yes, is the plant owned or hired-in?'

48. Mr Fullwood stated that it was Officer Bailey who suggested the incorporation of the additional questions into the CIS form, and that he had agreed simply to show a willingness to co-operate with HMRC, as stated in his email of 25 March 2019 to Officer Bailey.

> 'Our process is to ask verbally whether plant is owned or hired-in when we first verify the subcontractor with HMRC. As discussed on the phone with you, we are unable to provide much documentation to prove this, however, going forward you have suggested putting this on our CIS form, which we have now done (see attached CIS Form Amended).'

49. It was put to the appellant's witnesses that since Gelder had made the alteration to the CIS form, that was indicative of the inadequacy of the original version. The three witnesses all disagreed, and stated that the scaffolding subcontractors had always been asked about hire. We find that the original version of the form served the twin purposes as intended. The additional questions were added at the request of HMRC. The additional questions would only be applicable to the first contract undertaken by a new subcontractor; the answers recorded for the first contract would not necessarily apply to any subsequent contracts. Nothing turns on the

agreement on Gelder's part to insert those two questions for the purposes of this appeal; and the amendment itself does not equate to an admission of its existing system being inadequate.

50. We conclude that the appellant has not admitted to having made errors in its CIS returns, and that HMRC have misunderstood the position held by the appellant. This misunderstanding on HMRC's part would seem to be an attributing factor to the dispute being channelled for a decision on Condition A relief, rather than a Regulation 13 Determination being issued to enable the appellant to contest the assessment on substantive grounds.

The two limbs to Condition A relief

51. It is not for the Tribunal to consider whether the omission of a Regulation 13 Determination was a procedural anomaly in the present case; nor are we able to consider the substantive issue as concerns the correctness of the CIS tax assessment. We can only consider the appealable matter in front of us, which is HMRC's refusal decision to grant Condition A relief under reg 9(3). There are two limbs to reg 9(3) relief:

> (a) The first limb is that the taxpayer 'took reasonable care to comply with section 61 of the Act and these Regulations', ***and***
>
> (b) The second limb is either:
>
> > (i) 'the failure to deduct the excess was due to an error made in good faith', ***or***
> >
> > (ii) the taxpayer 'held a genuine belief that section 61 of the Act did not apply to the payment'.

52. Officer Leith's refusal decision was based on an understanding that the second limb was met with an admission of 'error made in good faith' by Gelder, and the refusal decision focused the failure of the first limb. It was a 'surprise' to Mr Hunter that Mr Fullwood was firm in maintaining that no errors were made in the CIS returns. The misalignment between what the respondents considered to be the case they are defending, and what Gelder considered to be the case it is advancing has presented some difficulty for us in evaluating the evidence.

53. The witness evidence for the appellant does not allow a finding of fact that there had been 'an error made in good faith' for the second limb of the test. We have regard to the burden in this case being on the appellant. For this reason, we need to consider the appellant's evidence in the alternative under reg 9(3)(b)(ii); that is, Gelder 'held a genuine belief that section 61 of the Act did not apply to the payment'.

54. We find as a fact that Gelder held a genuine belief that s 61 FA 2004 did not apply to the payment made to subcontractors in relation to the materials cost for plant hire in accordance with the guidance published by HMRC CIS 340, which was referred to in some length by Mr Fullwood in evidence. In his letter dated 3 September 2019 to HMRC, Mr Fullwood stated clearly the appellant's position in the following terms:

> 'We believe that the actions taken by the company fall within this published guidance and that no failure occurred.
>
> […]
>
> However, to re-iterate I would remind you that it is the practice of the company to check whether plant is owned or hired-in before making the appropriate payment.'

55. We also note that the appellant's position as stated in the Notice of Appeal filed by Mr Fullwood on 18 September 2019 was consistent with its earlier statements:

> 'I believe HMRC are incorrect in the decision they have taken. I consider I took reasonable care to comply with the rules set out in s61 of the act and I held a genuine belief that the law did not require a deduction to be made against the payments in question.'

Whether reasonable care taken to comply with s 61

56. The remaining issue for determination is whether Gelder took reasonable care to comply with s 61. We consider HMRC's contentions in turn against the appellant's responses in reply by adopting the approach as set out in *Barrett v HMRC* [2015] UKFTT 0329 (TC) at [161]:

> 'The test is one of reasonableness. No higher (or lower) standard should be applied. The mere fact that something that could have been done has not been done does not of itself necessarily mean that an individual's conduct in failing to act in a particular way is to be regarded as unreasonable. It is a question of degree having regard to all the circumstances, including the particular circumstances of the individual taxpayer. There can be no universal rule. What might be considered an unreasonable failure on the part of one taxpayer in one set of circumstances might be regarded as not unreasonable in the case of another whose circumstances are different.'

57. Officer Leith's decision of refusal hinged on the lack of documentation to evidence the actual materials content in the disputed invoices; that mere verbal assurance of plant being hired in was not enough; that the statutory wording of '*not shown to represent the direct cost*' is indicative of documentation; that 'to show' requires evidence in writing.

58. The statutory wording of '*shown*' in s 61 is the passive voice of 'to show', which is to be given its ordinary meaning. According to the Oxford English Dictionary, the group of meanings attributable to '*shown*' in the context of s 61 is under the heading of '*Make known by statement or argument*' and includes: (i) point out, reveal; make clear or explain; (ii) communicate, announce, tell, (a fact, story, etc); (iii) describe, give an account of; (iv) prove or demonstrate (a fact or statement) by argument, experiment, etc.; (v) of a thing, be proof or indication of.

59. The ordinary meaning of 'to show' indicates the diverse manner of the means to achieve the end of making known of something. We do not consider that '*shown*' in s 61 can be interpreted narrowly as stipulating that the instrument for showing must be by written documentation. If such a restrictive meaning is intended for s 61, the statutory wording would have specified the formality requirement to be in writing.

60. The issue for our consideration is whether Gelder took reasonable care to comply with s 61, which should not be blurred with the substantive issue of whether Gelder had complied with s 61 in relation to those disputed invoices. The mere fact that Gelder could have obtained written documentation from its subcontractors but had not done so, does not of itself, mean that its method by obtaining verbal assurances is to be regarded as unreasonable.

61. It is a question of degree, and we have regard to the broader circumstances in which the business of the appellant operates. Mr Fullwood has overall responsibility for the organisation of the finance function, and appears to us to be diligent and vigilant as regards potential CIS issues that may cause compliance failures. He keeps abreast with development in regulations, through briefings and discussions with the Company's external accountants, and receives updates from HMRC. The Company uses the Exchequer software approved by HMRC.

62. Ms Barton is the administrator working to the direction of Mr Fullwood; she maintains the Company's register for its subcontractors; processes a large volume of invoices each month from subcontractors; and prepares monthly CIS returns. We note that some 750 invoices and the £1million in payment are processed on average per month, which means that the number of CIS payments in dispute would represent a very small fraction of the overall volume of

payments being processed in 2017-18 and 2018-19. It is a clear indication that Gelder took reasonable care to a significant extent, and that there is a robust system in place to deliver a high level of compliance; and the disputed incidents of compliance are to be evaluated in the wider context that there is clearly no systemic failure resulting from the measures implemented.

63. Turning to the disputed incidents of compliance, we have special regard to the particular circumstances in which they arose, as all were concerned with scaffolding subcontractors. In this respect, HMRC submitted that the buck stops with the QS, and there is no effective supervision. It is true that the system relies on the QS or the contract manager with oversight of a project to authorise the materials cost to be excluded from CIS tax deduction. The QS or contract manager with oversight of a project is the relevant person with the experience and expertise to carry out the 'fair estimate'. In this respect, the checking mechanism in place to authorise the amount of materials cost on any invoice seems to concur with HMRC guidance at 3.13, which expressly advises that if a subcontractor fails to provide evidence of the direct cost of materials, 'the contractor must make a fair estimate of the actual cost of materials'.

64. We consider the evidence in the round, and reach the conclusion that the system in place was sufficiently robust, with checks and balances to pick up anomalies. Mr Gray is one of seven quantity surveyors responsible for the management of larger projects. The surveyors are organised in a team under a senior quantity surveyor, who would provide supervision and guidance on any technical issues and queries. There are industry standards that a QS can refer to in ascertaining the reasonableness of the materials cost in a subcontractor's invoice. The CVR system serves as a check on the overall costs of any one project that a QS needs to monitor at all times; there are the QS appointed by Gelder's clients, who would function as a counter-check on the judgment of an internal surveyor. As Mr Fullwood has emphasised, on these construction projects, there is always QS against QS to test the fairness of cost valuation.

65. The biggest sum of underdeclared tax assessed is in relation to payments to M&M in 2018-19, where the percentage of materials to invoice value of the final four payments was 65% and in monetary terms £114,045. While HMRC say that the materials content of the last four invoices at 65% should have triggered further enquiry, we accept Mr Gray's evidence that the duration of The Quarter project was repeatedly extended, from 20 to 40 weeks to nearly 2 years. The particular circumstances of The Quarter project meant that Gelder was liable to pay for the extended period of use of the scaffolding, and the high ratio of plant hire cost does not, of itself, cast doubt on the materials element in these invoices from M&M. For assurance, as Mr Gray stated, M&M could not have owned the scaffolding with a capital value of £230,000 required for The Quarter, as evidenced by the checks carried out on M&M. Furthermore, there is industrial standard as how much the hire cost for scaffolding for a fixed number of square metres would cost as a reference at the relevant time. We are unable to find anything on M&M invoices as 'contradicting' the assurance given to Gelder that the scaffolding was hired in from a third party, (this being a point raised in the 'View of Matter' letter). We are satisfied that the appellant took reasonable care in relation to its payments to M&M.

66. As to the payments made to Gainsborough, we agree with HMRC's criticism that the percentage split on these invoices appeared to be arbitrary and without reference to the actual costs of plant hire by the subcontractor. These invoices involved amounts which were comparatively small, but the principle involved is of significance. There is also the concern that the scaffolding supplied by Gainsborough was a mixture of owned and hired-in. The necessary apportionment of materials cost between owned and hired-in when the supply of scaffolding was mixed did not seem to have been observed by Gainsborough when rendering invoices, as related by Mr Fullwood's email of 25 March 2019:

> 'Gainsborough Scaffolding Services Ltd – I spoke to the owner who has confirmed that the majority of their scaffolding used on our projects is hired-

> in, but has said on occasion there could/has been a mixture. We discussed from an administrative point of view how it was practical to split this accurately as he works on both large and small projects for Gelder's and other contractors. He seemed very concerned and was seeking advice from his accountant.'

67. Consequently, we are minded to disallow a part of the appeal in relation to Gainsborough. While the appellant's system was sufficiently robust, there were instances when a mixed supply of plant, being partly owned, and partly hired-in by a subcontractor, were not being adequately monitored, and the requisite apportionment might have been overlooked, especially on small projects. Mr Fullwood is clearly aware of the issue in principle that needs to be addressed, as reflected in his email by way of discussing a practical way forward to record the split of materials cost *on both large and small projects*. Furthermore, some form of written record is clearly desirable, not only to facilitate HMRC when carrying out a check, but if a subcontractor is required to specify the hired-in plant element on an invoice (especially in a mixed supply situation), it is more likely to forestall this kind of arbitrariness as applied by Gainsborough.

68. In relation to the quantification of the CIS tax underdeclared on Gainsborough's invoices, the sums sought are respectively £1,952 for 2017-18 and £5,397 for 2018-19. We note the invoices examined (see §21) were rendered in February 2019; we have not examined the full cohort of invoices from Gainsborough. We also note that HMRC quantified the amounts of underdeclared tax on the basis that *no* scaffolding was hired in. However, we are of the view that some scaffolding was hired in by Gainsborough, even if not all. While we are minded to disallow relief on certain elements relating to Gainsborough's invoices, we are devoid of any equitable basis to quantify the amount of CIS tax to uphold.

69. As to Jay Hardwick and Magna Scaffolding, neither party made submissions related thereto. Magna's invoices in the supplementary bundle explicitly split the charge between labour and materials, and the split appears consistent with the narrative; and the hired-in status of the scaffolding confirmed by Magna. Jay Harwick invoices were assessed at £24 for CIS tax underdeclared, and we can draw no clear inference from the sampled invoices.

70. Finally, we have special regard to the fact that the appellant is unable to contend against the quantification of the assessment since no Regulation 13 Determination was raised. On an equitable basis, the quantum of CIS tax to be upheld is likely to be relatively small. For all these reasons, and given our overall finding that the appellant did exercise reasonable care to comply with s 61 and the CIS Regulations, Condition A as set out under reg 9(3) was fulfilled.

DISPOSITION

71. Accordingly, the appeal is allowed. In accordance with reg 9(9) of the CIS Regulations 2005, we direct that an officer of HMRC should make a direction under reg 9(5) in an amount of £1,421 in respect of 2017-18, and in an amount of £32,360 in respect of 2018-19.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

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

DR HEIDI POON
TRIBUNAL JUDGE

RELEASE DATE: 18 AUGUST 2021