[2011] UKFTT 839 (TC)

TC01675

Appeal number: TC/2010/01069

National Insurance Contributions – Personal Liability Notice – decision on preliminary issue - personal liability to pay NICs which the company has failed to pay – whether attributable to the "neglect" of the company's officer – meaning of "neglect" – whether a subjective or objective test – held, that it is a subjective test – in consequence, medical evidence excluded at earlier Directions hearing to be readmitted for consideration by the Tribunal

FIRST-TIER TRIBUNAL

TAX

CHARLES MICHAEL O'RORKE **Appellant**

- and -

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

TRIBUNAL: SIR STEPHEN OLIVER QC (TRIBUNAL JUDGE)
ANNE REDSTON (TRIBUNAL MEMBER)

Sitting in public at 45 Bedford Square, London WC1 on 5 October 2011

Having heard the Appellant in person, and Eugene Walsh, an officer of HMRC, for the Respondents, and having considered written submissions provided by both parties following that hearing.

DECISION

1. Mr O'Rorke has appealed against a Personal Liability Notice ("PLN") imposed under s 121C(1)(b), Social Security Administration Act 1992 ("SSAA"). A hearing of the substantive issue began on 8 March 2011; it was adjourned and resumed on 5 October 2011. A question of law identified at that second hearing needed resolution before the case could continue; it is that issue which is the subject of this Decision.

2. A PLN can only be imposed if:

(1) there has been a loss of National Insurance Contributions ("NICs") which should have been paid over to HMRC by a body corporate; and

(2) that loss is attributable to the fraud or neglect of an officer of that body corporate.

3. Mr O'Rorke argues that "neglect" in this context must be interpreted subjectively, so that if the officer lacked mental capacity, for example, this would prevent a finding of neglect.

4. HMRC argue that the meaning of "neglect" is identical to that applying in tort law: in other words that it is an objective test. As a result, HMRC consider that the state of mind of the officer and his mental capacity are irrelevant.

5. The Tribunal adjourned the oral hearing and directed that both parties supply written submissions as to whether "neglect" in the context of ss 121C and 121D SSAA is to be considered subjectively or objectively ("the relevant question").

6. Having considered those written submissions, in our judgment the test is subjective. We have thus decided the relevant question in Mr O'Rorke's favour.

7. As a result, certain further evidence can now be considered by the Tribunal. This is referred to at the end of this Decision.

The legislation

8. The legislation relevant to this case is ss121C and 121D SSAA. This is set out in full as an Appendix. Some key provisions are summarised here.

9. Section 121C(1)(b) SSAA states that an officer of a body corporate can be personally liable to pay National Insurance Contributions which that body corporate has failed to pay. The PLN sets out the extent of his liability.

10. A PLN can only be issued if the failure to pay National Insurance Contributions is attributable to the "fraud or neglect" of that officer, who is designated as a "culpable officer".

11. Where more than one officer of the body corporate is within the ambit of the PLN provisions, s 121C(2) allows HMRC to apportion the liability depending on the "culpability" of each officer.

12. A person receiving a PLN can appeal under s 121D(2)(b) SSAA on the grounds that the failure was not "attributable to any fraud or neglect" on his part. The onus of proof in any appeal is on HMRC (s 121D(4)).

Background to the relevant question

13. Mr O'Rorke was previously the Finance Director of L Wear & Co. He resigned as director on 22 February 2007.

14. L Wear & Co. went into liquidation on 5 March 2007. As at the date of the liquidation, the company owed HMRC £321,306.60 of unpaid NICs.

15. On 3 September 2009, HMRC issued a PLN to Mr O'Rorke, in the amount of £290,307.60. On 25 June 2010 this was reduced to £218,593.77.

16. Mr O'Rorke appealed the PLN under s 121D(2)(b) SSAA, arguing that the failure was not attributable to any fraud or neglect on his part. He submitted that he was suffering from an addiction which affected his behaviour, and that this ought to be considered when assessing whether he was negligent in the carrying out of his duties.

17. HMRC argued that the test of negligence in s 121D(2)(b) was an objective test, and the state of mind and/or mental capacity of the Appellant was thus irrelevant to determining his negligence.

18. On 25 June 2010, a differently constituted Tribunal directed that Mr O'Rorke was not permitted to provide expert medical evidence in support of his case. Mr Walsh informed us that the Direction was issued because the judge accepted HMRC's submission that the test of negligence was objective.

19. Before this Tribunal, Mr O'Rorke argued that the 25 June 2010 Direction was wrong in law, and that the test in s 121D(2)(b) was subjective. As a result, he should be allowed to produce his medical evidence to us as part of his defence against the imposition of a PLN.

20. It was accepted by both parties that this Tribunal has the power, under Rule 5(2) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 ("the Tribunal Rules") to "amend, suspend or set aside" any earlier Direction.

21. We adjourned the hearing and issued a Direction dated 11 October 2011. It required both parties to provide written submissions to the Tribunal as to whether the test in s.121D(2)(b) is subjective or objective ("the relevant question"). Both parties provided written submissions, which we summarise below.

HMRC's submissions

22. HMRC submit that:

> "The Tribunal's basis for suggesting that negligence, under this legislation, possesses an extraordinary meaning appears to be based solely on one statement made by Lord Haskel during the debates on the

> introduction of the legislation where it was stated 'only those shown to have acted knowingly and deliberately will be penalised.'"

23. They quote the following further references to "neglect" in the Hansard report of the House of Lords debate on the introduction of the legislation:

> "Clause 63 allows the Government to make directors personally liable for the debts which cannot be paid by the company in cases where directors or officers of a company have perpetrated fraud, or been negligent in carrying out their responsibilities."

and

> "The Government propose to take action to make culpable directors personally liable for national insurance debts where the failure of their company to pay is due to serious negligence."

24. They further say that "there is nothing in the actual wording of the legislation at Section 121C or in the statements above that would allow a Court or Tribunal to apply a meaning to neglect other than that applied in all other cases, or to warrant anything other than an objective test being applied."

25. They submit that Lord Haskel's comments were made in the context of concerns being expressed as to how the legislation would be administered and carried out, and that the context can be seen from the following:

> "I thank noble Lords for their general support of the principle even though there is some disagreement as to the way in which it will be carried out. The noble Lord Higgins asked which directors are culpable. The investigation of each director's responsibility and knowledge will be carried out so that only those shown to have acted knowingly and deliberately will be penalised."

26. They accept that while "knowingly and deliberately" may be "subjective". Lord Haskel's statement was made in clear reference to how the legislation would be administered and applied by HMRC. They say that this administrative statement has no bearing on the meaning of neglect within ss 121C and 121D.

27. Furthermore, they submit that if Parliament intended the meaning of neglect to have a different meaning then they had the opportunity to word the legislation accordingly. Parliament chose not to do this: the legislation simply requires HMRC to prove fraud or neglect.

28. HMRC also say that "this issue has previously been addressed by the Special Commissioner Nicholas Aleksander at [24]-[26] of his decision in *Peter Inzani v R&C Commrs* [2006] STC SCD 279 ("*Inzani*"), as follows:

> "24. As to the meaning of neglect, I was referred to the decision of Alderson B in *Blyth v Birmingham Waterworks Co* (1856) 11 Exch 781 at 786, where he says:

> ‘Negligence is the omission to do something which a reasonable man, guided upon those considerations which ordinarily regulate the conduct of human affairs, would do, or doing something which a prudent and reasonable man would not do. The defendants might be liable for negligence, if, unintentionally, they omitted to do that which a reasonable person would have done, or did that which a person taking reasonable precautions would not have done.’
>
> 25. I was also referred to dictionary definitions, but I prefer the meaning established by the courts to that in the dictionaries. I consider that for these purposes the meaning of ‘neglect’ and ‘negligent’ are identical.
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> 26. For the personal liability notice to be upheld, the Revenue only need to prove, on the balance of probabilities, that the failure of IWM to pay the NICs was attributable to Mr Inzani's neglect.”

29. They also seek to rely on the judgment of J Gordon Reid QC in *Stephen Roberts & Alan Martin v R&C Commrs* [2011] UKFTT 268 (TC) at [32]-[33] (“*Roberts & Martin*”), where he states:

> “32. We were referred to a number of authorities on the meaning of neglect, including *Blyth v Birmingham Waterworks Co* 1856 11 EX 781 at 784 for a definition of negligence, *Livingstone v HMRC* TC 00369, 15/1/10 , a PLN case, and *Inzani v HMRC* 1996 SPD 529.
>
> 33. We do not need to consider these cases in detail. In our view, neglect consists of a failure to do what, in the circumstances, a reasonable and prudent person would have done. Neither party disputed that proposition. It is unnecessary and possibly inappropriate to embark on a consideration of negligence insofar as this may be thought to be different from neglect in the present context. Had we considered that necessary, an examination of modern Scottish authority on negligence would have been required. The modern notion of negligence is probably not quite the same as it was in 1856. Negligence involves identifying a duty of care, specifying the standard of duty to be achieved, foreseeability, causation and remoteness and raises the question whether it would be fair just and reasonable to impose a duty and consequent liability on the person concerned.”

30. HMRC also submit that the words of s121C and s121D SSAA are neither ambiguous nor obscure, and draw the Tribunal’s attention to the judgment of Mrs Justice Proudman in *JE Chilcott & Others v R&C Commrs* [2009] STC 453 (“*Chilcott*”) at [19] and [24], where she says that:

> “19. It seems to me that Mr Yerbury is inviting the court to do more than construe the section. He is asking for it to be completely rewritten to reflect what he submits it ought to have said…In such circumstances it seems to me that Parliamentary material cannot aid interpretation. Just or unjust, the words of the section can bear only one meaning.

> 24. If the words are there, and their meaning is prescriptive and clear, it is for Parliament, not the Court, to amend them. Such an amendment would in my judgment go well beyond the Court's role of interpretation."

31. In summary, HMRC say that if the Tribunal apply a subjective test to the meaning of neglect in the context of ss121C and 121D:

> "the Tribunal is effectively seeking to give its own interpretation to legislation HMRC considers to be clear and unambiguous. To allow an subjective test to be applied would go against the ordinary, natural and established by case law meaning of neglect, and would be wholly inconsistent with the legal and objective standard – that of acting as a reasonable man."

32. Finally, HMRC asked that, if the Tribunal was minded to find against them on the interpretation of the meaning of "neglect", that we should direct an oral hearing on the point so that "legal representatives for HMRC can present further arguments and submissions."

Mr O'Rorke's submissions

33. Mr O'Rorke relies in part on the statements of Lord Haskel in the parliamentary debates. He points out that in the second extract quoted at paragraph 23 of this Decision, Lord Haskel referred to "serious" negligence and says that this implies "a higher requirement than is needed for normal tort negligence cases: it is different and therefore the normal objective test cannot be applied."

34. He also refers to the extract quoted at paragraph 25 above, and in particular to Lord Haskel's statement that:

> "The investigation of each director's responsibility and knowledge will be carried out so that only those shown to have acted knowingly and deliberately will be penalised."

35. He says that the reference to "knowingly and deliberately" also "goes against the tort/negligence precedent of *Blyth v Birmingham Waterworks"* relied on by HMRC. He says "Lord Haskel clearly envisages a defence where a director does not know what he is doing (due to, say, mental illness)" and this defence would not be possible under the *Blyth v Birmingham Waterworks* definition.

36. As to whether the legislation is ambiguous, Mr O'Rorke submits that it is. He says that the wording refers only to "neglect" and does not specify whether this is to be interpreted in an objective or subjective sense. He says that "it is incumbent on the tribunal to look behind the legal words for the spirit and intention of the legislation. This is not a rewrite of the legislation, but a clarification of the true meaning of the legislation."

37. He also says that HMRC accept that before a PLN can be issued, they have to "make a judgement on whether a person has committed a serious enough act of

fraud/negligence". HMRC themselves are therefore assessing the matter subjectively, and as such "they have by default agreed that the test for negligence/fraud is subjective by their own actions."

38. He also relies on evidence from the charity Taxaid, as demonstrating that HMRC do make "allowances for the state of a person's mind in whether or not to pursue that person for a tax debt" and thus the concept of approaching liability in a subjective way "is not an alien idea to HMRC."

39. Mr O'Rorke asked that, if the Tribunal were minded to find against him on the relevant question, that we direct an oral hearing so that he could present further arguments and submissions.

Principles of statutory interpretation

40. We begin our discussion by reviewing some fundamental rules of statutory interpretation.

41. First, an Act of Parliament must be read as a whole. Sometimes, if there is an ambiguity, the scheme of the Act (or, if there is a discrete part of the Act, that part) may resolve the meaning of the statutory words: see for example *IRC v Priestly* [1901] AC 208 at 213, *per* Halsbury LJ.

42. Secondly, the statutory words under consideration must be construed in context: see *A-G v Prince Ernest Augustus of Hanover* [1957] AC 436 at 461 and 463.

43. Thirdly, legislation should be construed purposively. In *W T Ramsay Ltd v IRC* [1981] STC 174 at 179, Lord Wilberforce said:

> "A subject is only to be taxed on clear words, not on 'intendment' or on the 'equity' of an Act. Any taxing Act of Parliament is to be construed in accordance with this principle. What are 'clear words' is to be ascertained on normal principles; these do not confine the courts to literal interpretation. There may, indeed should, be considered the context and scheme of the relevant Act as a whole, and its purpose may, indeed should, be regarded."

44. That this is and remains the case was reiterated in *Barclays Mercantile Business Finance Ltd v Mawson* [2005] STC 1. Lord Nicholls, delivering the judgment of the judicial committee quoted the "influential speech" of Lord Wilberforce, set out above, and also said, at [11]:

> "As Lord Steyn explained in *IRC v McGuckian* [1997] STC 908 at 915, [1997] 1 WLR 991 at 999, the modern approach to statutory construction is to have regard to the purpose of a particular provision and interpret its language, so far as possible, in a way which best gives effect to that purpose. Until the *Ramsay* case, however, revenue statutes were 'remarkably resistant to the new non-formalist methods of interpretation'. The *Ramsay case* ([1981] STC 174, [1982] AC 300) liberated the construction of revenue statutes from being both literal and blinkered."

45. Fourthly, so far as it is possible to do so, legislation must be read and given effect in a way which is compatible with Convention rights within the meaning of the Human Rights Act 1998: see ss 1, 3 of that Act.

Interpreting ss 121C and 121D SSAA

46. To summarise the foregoing, the Tribunal is required, when interpreting the term "neglect", to consider its place in the Act of which it forms part. We must construe it in context and purposively. We must also, so far as possible, interpret it in a way which is compatible with the European Convention on Human Rights.

47. We now apply each of these principles to the statutory provisions under consideration.

The place of the sections within the statute

48. Sections 121C and 121D are placed within Part VI of the SSAA. This is headed "Enforcement". The Part is further divided. The first sub-part is entitled "Inspection and offences". It sets out various powers of HMRC as well as penalties for non-compliance. Some of the penalties (for example at s 114) are classified as criminal and enforced via the magistrates or crown court; others are civil and enforced via this Tribunal (for example at s 113B).

49. The next sub-part (ss 116-117A) deals with legal proceedings before a magistrates or county court.

50. There follows a sub-part headed "Unpaid Contributions". Section 118 deals with the evidence of non-payment which is to be accepted by a criminal court; s 119 with the recovery of unpaid contributions following a prosecution; s 120 deals with evidence relating to previous convictions and s 121 with other miscellaneous matters concerning the criminal prosecution of offences.

51. Section 121A sets out the procedure under which a Justice of the Peace issues warrants allowing HMRC to collect unpaid contributions by distraining goods and chattels, allowing the premises to be entered "by force if necessary."

52. Section 121B is repealed; ss 121C and 121D then follow. The Part ends with a definitions section at s 121DA.

53. We thus find that ss121C and 121D form part of a wider code which is almost exclusively concerned with criminal proceedings and penalties against defaulters.

The purpose of the provision

54. Section 121C operates by transferring a financial obligation – in practice one which is usually significant in amount – from the person legally liable (the employer) to one or more officers of the company.

55. Although the sum due has accrued by virtue of non-penal provisions, its transfer to the officer(s) is permitted only because of the latter's default.

56. In our judgment, the transfer of this onerous financial obligation from the body corporate to an officer of the company, cannot be regarded other than as a punishment.

The word "neglect" in context

57. We next consider the word "neglect" in its context.

(1) Section 121C opens by saying that it applies where the body corporate has failed to pay the NICs and:

> "the failure appears to the Inland Revenue to be attributable to fraud or neglect on the part of one or more individuals who, at the time of the fraud or neglect, were officers of the body corporate ('culpable officers')."

(2) At s 121C(3)(b), HMRC are given the power to divide the unpaid PAYE and NICs between the culpable officers, so that each bears "such proportion of the specified amount as, in the opinion of the Inland Revenue, the officer's culpability for the failure to pay that amount bears to that of all the culpable officers taken together."

(3) Section 121C(4) allows HMRC, when assessing an officer's culpability for the purposes of subsection (3)(b) above, to "have regard both to the gravity of the officer's fraud or neglect and to the consequences of it."

(4) Section 121D(4) states that "the burden of proof as to any matter raised by a ground of appeal shall be on the Inland Revenue."

58. The context within which the word "neglect" sits reinforces our view that this is a penal provision. In particular, the draftsman uses the term "culpable". The OED defines "culpable" as "guilty, criminal, deserving punishment or condemnation." It is not a neutral term. It is not the same as "the accountable officers" or "the officers responsible". It indicates that the officers are blameworthy, deserving of punishment.

59. We also note that the NICs are divided by HMRC, so that each officer bears that share of the default which reflects his level of "culpability" or guilt.

60. Finally, placing the burden of proof on HMRC is consistent with the penal nature of the provision.

Consistency with the Convention

61. We are also required, so far as possible, to interpret ss 121C and 121D in a manner consistent with the European Convention of Human Rights. In particular, we must consider whether the PLNs are "criminal" for the purposes of the Convention.

62. To answer that question we turn to what have become known as *Engel* criteria[1]. This established the three factors to be considered when deciding whether or not a person is charged with a criminal offence:

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[1] *Engel v The Netherlands (no. 1)* (1976) 1 EHRR 647

(1) The classification of the proceedings under national law (i.e., whether they are classed as civil or criminal proceedings).

(2) The 'essential' nature of the offence, which the court said was "a factor of greater import".

(3) The degree of severity of the penalty that the person risks incurring.

63. The application of these criteria to fiscal provisions was considered by the European Court of Human Rights("ECtHR") (Grand Chamber) in *Jussila v Finland* [2006] 9 ITLR 662 ("*Jussila*"). The case concerns surcharges imposed on a taxpayer for errors discovered by the Finnish fiscal authorities. At [32] the court in *Engel* considered whether the case law supported a different approach in tax cases, and held that the same approach was appropriate.

64. At [38] they held that:

> "the tax surcharges were not intended as pecuniary compensation for damage but as a punishment to deter re-offending. It may therefore be concluded that the surcharges were imposed by a rule whose purpose was deterrent and punitive. Without more, the court considers that this establishes the criminal nature of the offence."

65. Applying this analysis to the PLN provisions, the first of the "Engel" criteria is not met: these proceedings are classed as civil and not criminal under UK law.

66. The second criterion is the "essential nature" of the offence. Taking into account the further analysis in *Jussila* quoted above, the essential nature of the provision will be "criminal" if it is "imposed by a rule whose purpose was deterrent and punitive." Although the original NICs liability arose as a result of ordinary tax provisions, its transfer from the body corporate to one or more officers is punitive.

67. The third criterion is the "seriousness of the penalty" the person risks incurring. Although there is no statutory *de minimis* limit, we were informed by Mr Walsh that the PLN provisions are only used when the amounts involved are significant.

68. Taking the above factors into account, and in particular the importance ascribed by the European Court of Human Rights to the second criterion, we find that the PLN provisions are "criminal" within the meaning of the Convention.

The implications of a "criminal" categorisation for domestic law purposes

69. The fact that ss 121C and 121D are classed as criminal under the Convention does not necessarily mean that they are so categorised for domestic law purposes. The question of how the classifications relate to each other was considered by the Court of Appeal in *CIR v Han* [2001] STC 1188. The court first applied the *Engel* criteria. Potter LJ, giving the leading judgment, said at [84]:

> "It by no means follows from a conclusion that art 6 applies that civil penalty proceedings are, for other domestic purposes, to be regarded as criminal and, therefore, subject to those provision of the Police and

> Criminal Evidence Act 1984 and/or the codes produced thereunder, which relate to the investigation of crime and the conduct of criminal proceedings *as defined by English law*. Any argument as to whether and how far that Act and the codes apply is one which will have to be separately considered if and when it is advanced."

70. A similar point was made by Mance LJ in the same case, at [88]:

> "The classification of a case as criminal for the purposes of art 6(3) of the convention, using the tests established by the Strasbourg jurisprudence, is a classification for the purposes of the convention only. It entitles the defendant to the safeguards provided expressly or by implication by that article. It does not make the case criminal for all domestic purposes. In particular, it does not, necessarily, engage protections such as those provided by the Police and Criminal Evidence Act 1984. The submissions before us did not address this point, or, indeed, the subject of burden of proof...As Stephen Oliver QC and Potter LJ have both observed, the precise implications under the convention of classification of any case as criminal for the purposes of the convention will have to be worked out on a case by case basis."

71. Given that the PLN provisions are "criminal" under the Human Rights Convention, it is for this Tribunal to establish the "precise implications" of what that classification means under UK domestic law.

72. In particular, given the issue under consideration before us, we must decide whether the classification, either on its own or taken with other factors, means that the normal criminal presumption of *mens rea* applies to the concept of "neglect" under the PLN provisions. We explain this further below.

The common law presumption

73. The concept of *mens rea* derives from Sir Edward Coke's classic statement "*actus non facit reum nisi mens sit rea*" – "the act does not make a person guilty unless their mind is also guilty."

74. There is a common law presumption that *mens rea* is an essential ingredient of a criminal offence, unless Parliament has indicated a contrary intention either expressly or by necessary implication. This presumption is most clearly set out by Lord Reid in the leading case of *Sweet v Parsley* [1969] 1 All ER 347 at 349-350:

> "... there has for centuries been a presumption that Parliament did not intend to make criminals of persons who were in no way blameworthy in what they did. That means that, whenever a section is silent as to mens rea, there is a presumption that, in order to give effect to the will of Parliament, we must read in words appropriate to require *mens rea*... it is firmly established by a host of authorities that *mens rea* is an essential ingredient of every offence unless some reason can be found for holding that that is not necessary."

The alternative submissions

75. We take a moment to pause here and summarise the alternative submissions which we must consider: HMRC's view, that the meaning of "neglect" is objective, and Mr O'Rorke submission that it is subjective, requiring *mens rea*.

HMRC and the objective meaning of neglect

76. HMRC argue that the meaning of "neglect" in ss 121C and 121D is the same as its meaning in tort law, and is as summarised by Alderson B in *Blyth v Birmingham Waterworks Co* [1856] 11 Exch 781 at 786, where he says:

> "Negligence is the omission to do something which a reasonable man, guided upon those considerations which ordinarily regulate the conduct of human affairs, would do, or doing something which a prudent and reasonable man would not do. The defendants might be liable for negligence, if, unintentionally, they omitted to do that which a reasonable person would have done, or did that which a person taking reasonable precautions would not have done."

77. As the above extract makes clear, tortious liability arises if the person failed to act as "a reasonable man". His state of mind is not relevant, neither is his intention. The test is objective.

78. The consequence of this interpretation is that liability attaches, even where the officer is suffering from a mental disability: see *Morriss v Marsden* [1952] 1 All ER 925. The *ratio* of that decision, as summarised in the headnote, is that "the defendant knew the nature and quality of his tortious act, he was liable for damages for it even though he did not know that what he was doing was wrong."

79. In *Morriss v Marsden* the judge, Stable J, summarised his task as follows: "what degree of mental illness, if any, can constitute a defence to an action in tort, and in what circumstances." He concludes that there may be exceptions where the individual is acting as an automaton, or when sleepwalking: in these exceptional cases, he would have a defence in tort.

80. However, where the defendant "knew the nature and quality of his act" but "owing to mental infirmity, he was incapable of knowing that his act was wrong" Stable J says (at 928):

> "I have come to the conclusion that knowledge of wrongdoing is an immaterial averment, and that, where there is the capacity to know the nature and quality of the act, that is sufficient although the mind directing the hand that did the wrong was diseased."

Mr O'Rorke's interpretation

81. Mr O'Rorke submits that the meaning of "neglect" in ss 121C and 121D involves a subjective test. In other words, for there to be liability under the section, it is not enough that an officer has behaved other than as the hypothetical reasonable man: rather, the officer must have the mental capacity to intend the negligent act.

82. This is, in layman's language, the essence of the legal concept of *mens rea*.

The view of the Tribunal

83. Our analysis of the statutory provisions, using the interpretive principles set out earlier in this Decision, are as follows:

(1) Sections 121C and 121D form part of a code which is almost exclusively concerned with criminal proceedings and penalties against defaulters.

(2) Its purpose is penal.

(3) The context within which the word "neglect" sits reinforces our view that this is a penal provision. In particular, the use by draftsman of the term "culpable" is not accidental. The fact that the burden of proof is on HMRC is consistent with the penal nature of the provision.

(4) The provisions are classified as criminal under European law

84. In our judgment, taking all these factors together, we agree with Mr O'Rorke that the meaning of neglect in the PLN provisions requires *mens rea* and is not objective.

85. However, we are aware that HMRC strongly argue for the opposite. We thus considered whether the term is ambiguous, and if so, whether the other conditions are met so that reference can be made to Hansard.

References to Hansard

86. In *Pepper v Hart* [1992] STC 898 at 923, Lord Browne-Wilkinson set out the conditions under which it was permissible to consult Hansard in construing a taxing statute:

> "I therefore reach the conclusion, subject to any question of parliamentary privilege, that the exclusionary rule should be relaxed so as to permit reference to parliamentary materials where:
>
> (a) legislation is ambiguous or obscure, or leads to an absurdity;
>
> (b) the material relied on consists of one or more statements by a minister or other promoter of the Bill together if necessary with such other parliamentary material as is necessary to understand such statements and their effect;
>
> (c) the statements relied on are clear.
>
> Further than this, I would not at present go."

87. Mr O'Rorke accepts that the legislation is ambiguous, because it does not make clear on its face the subjective meaning for which he contends.

88. HMRC argue strongly against any ambiguity. They seek to rely on the meaning "applied in all other cases", and cite *Inzani* and *Roberts & Martin* in their support.

89. In neither case, however, was the objective meaning of "neglect" disputed by, or on behalf of, the Appellants, see *Inzani* at [34] and *Roberts & Martin* at [33]; the possibility of an alternative interpretation was therefore never raised before the Tribunal. The same is true of another decision relating to the imposition of a PLN,

Livingstone v R&C Commrs [2010] UKFTT 56, see [33]. It is also the case, of course, that these decisions are not binding on us.

90. HMRC also draw the Tribunal's attention to the judgment of Mrs Justice Proudman in *JE Chilcott & Others v R&C Commrs* [2009] STC 453 at [19] and [24], quoted above at paragraph 30.

91. In *Chilcott* the Appellants sought to have reference to Hansard so as to construe the meaning of the Income and Corporation Taxes Act s 144A; Proudman J said that this was not permissible because the legislation was clear.

92. The Tribunal does not of course seek to dissent from her authority, which reflects the House of Lord's criteria in *Pepper v Hart* for relaxing the exclusionary rule.

93. We note, however, that when Proudman J's decision was recently upheld by the Court of Appeal, Lord Neuberger MR ended his judgment with the following observation:

> "The fact that some might regard the operation of s 144A, according to its terms, as penal, merely emphasises that the court should construe it with care and if there is a narrower construction less beneficial to the Revenue, more beneficial to the taxpayer, available then the court should at least seriously consider it and, if appropriate, adopt it."

94. The instant case involves a penal provision. We must "construe it with care". We have explained that in our view there is a "narrower construction less beneficial to the Revenue, more beneficial to the taxpayer."

95. As discussed earlier in this Decision, we are persuaded by that construction, but we also accept that the tortious meaning of "neglect" is the more common, especially as it is not here qualified by the adjectives "wrongful" or "wilful" – although in our view, such a meaning is implied by the context.

96. In consequence, we accept that there is ambiguity. Reference to Hansard is thus permitted if the material relied on is that of a government minister or other promoter of the bill, and those statements are clear, see paragraph 85 above.

Hansard

97. The Minister responsible for introducing ss 121C and 121D into statute was Lord Haskel. The parliamentary debate took place in the Lords on 30 March 1998. The statements which we cite below are made by Lord Haskel and are clear: they thus satisfy the other requirements set out by Browne-Wilkinson LJ.

98. Some extracts from that debate are set out above at paragraphs 22, 23 and 25, and form part of the submissions made to the Tribunal. Perhaps the key paragraph in both parties' submissions, albeit for different reasons, is the following:

> "I thank noble Lords for their general support of the principle even though there is some disagreement as to the way in which it will be

> carried out. The noble Lord Higgins asked which directors are culpable. The investigation of each director's responsibility and knowledge will be carried out so that only those shown to have acted knowingly and deliberately will be penalised." (Col 80)

99. In addition to the passages quoted earlier, Lord Haskel also made the following statements in the course of the debate:

> "The total debt, which includes any associated penalty and interest, will be apportioned between the culpable directors in proportion to their degree of culpability without taking account of each individual's ability to pay. Thus no 'innocent' director will be pursued simply because he has not disposed of his assets." (Col 77)

> "I hope that both this Committee and legitimate businesses will welcome a measure aimed at dealing with the unscrupulous minority of directors who abuse their positions and ignore their responsibilities." (Col 78)

> "The principle of limited liability, raised by the noble Lord, Lord Higgins, is not really intended to protect fraudsters and those who are seriously negligent in carrying out their responsibilities." (Col 81)

100. HMRC say that while Lord Haskel's reference to "knowingly and deliberately" may be "subjective", the Minister was simply stating how the legislation would be administered: he was not explaining the meaning of "neglect."

101. We have considered whether HMRC are right to see Lord Haskel's statements as being a description of the manner in which the provisions would be implemented, rather than as finding what Lord Bridge of Harwich in *Pepper v Hart* called "the vital clue to the intended meaning of an enactment."

102. We first considered *Pepper v Hart* itself, where the substantive question was how in-house benefits would be taxed. The dispute was over the meaning of the phrase "the cost of the benefit" – was this the marginal cost or the full cost?.

103. The leading judgment was given by Lord Browne-Wilkinson. He summarised (at 630) the parliamentary material which elucidated the meaning of this ambiguous term:

> "Numerous inquiries were made of the Financial Secretary to elucidate the resulting effect of the Bill on in-house benefits, i.e., concessionary travel for airline, railway and merchant navy employees, on benefits for hotel employees and on concessionary education for the children of teachers. In responding to each of these requests for information (save that relating to teachers), the Financial Secretary stated that the effect of the Bill would be to leave their position unchanged from the previous law.."

104. At page 635 he states that one of the benefits of relaxing the exclusionary rule is that it will be possible to "identify the mischief" at which the provisions are aimed.

105. At page 638 he says that:

> "The courts should not deny themselves the light which Parliamentary materials may shed on the meaning of the words Parliament has used and thereby risk subjecting the individual to a law which Parliament never intended to enact."

106. In his concurring judgment, Lord Bridge of Harwich said, at 617:

> "Once the Parliamentary material was brought to our attention, it seemed to me, as, I believe, to others of your Lordships who had heard the appeal first argued, to raise an acute question as to whether it could possibly be right to give effect to taxing legislation in such a way as to impose a tax which the Financial Secretary to the Treasury, during the passage of the Bill containing the relevant provision, had, in effect, assured the House of Commons it was not intended to impose."

107. We now turn back to the case before this Tribunal. In our view, Lord Haskel's response to the question posed by Lord Higgins as to "which directors are culpable" was similar in nature to the questions asked of the Financial Secretary about the taxation of benefits: by answering the questions posed: both Ministers interpret the meaning of the otherwise ambiguous provisions.

108. As with the material examined in *Pepper v Hart*, the extracts from the debate on the PLN provisions also make clear "the mischief" at which s 121C is directed, namely "only those shown to have acted knowingly and deliberately." The PLN procedure was not aimed at the mentally incapable who fall below the standard of the reasonable man.

109. We thus disagree with HMRC's reading of these Hansard extracts. In our judgment they do not merely provide administrative guidance as to how the legislative provisions should be carried out in practice, but rather they elucidate the meaning of the term "neglect". Against the background of Lord Haskel's clear comments, we conclude that parliament intended that the PLN procedure should be used only where the officer had acted "knowingly and deliberately."

110. As a result, we find that the word "neglect" does not have the objective meaning familiar to practioners of tort law, but must be read as requiring *mens rea*.

111. Just as it seemed unacceptable to Lord Bridge that the court should apply a tax on benefits which the Financial Secretary had said he was not intending to impose, so do we find it invidious to apply the PLN provisions to those who are "objectively" negligent but are otherwise "innocent", when the Minister gave such clear statements that these provisions were to be used only against the "unscrupulous minority" and not against "innocent" directors.

If HMRC were right: the issue of discretion

112. If HMRC were right, they would have an extensive discretion. It would mean that, despite the meaning of the word "neglect" encompassing all officers who fall short of the objective standard of the reasonable man, HMRC nevertheless choose

only apply it only to the much narrower group of officers they select as being within the terms of the "administrative" guidance given by Lord Haskel.

113. The Taxes Management Act, s 1 does give HMRC discretion. Its scope and extent was recently been described by Lord Hoffman in *R (on the application of Wilkinson) v IRC* [2003] STC 1113 at [21] as follows:

> "This discretion enables the commissioners to formulate policy in the interstices of the tax legislation, dealing pragmatically with minor or transitory anomalies, cases of hardship at the margins or cases in which a statutory rule is difficult to formulate or its enactment would take up a disproportionate amount of parliamentary time."

114. The discretion allegedly being applied in the case of the PLN legislation is not a "minor or transitory anomaly", it does not sit in the "interstices of the tax legislation". If HMRC are right, their practice relating to PLNs represents a very significant narrowing of the statutory penalty regime.

115. But in our view, this is not the position. HMRC follow the statements given by Lord Haskel, not because they are exercising a broad discretion, but because these statements set out the meaning parliament intended to be given to the term "neglect" within the PLN legislation.

116. Of course, given that HMRC do generally apply a "subjective" interpretation to the term "neglect", cases such as the present are likely to arise only rarely: namely when HMRC reject the officer's defence and decide to rely on the "objective" meaning of the term to initiate and continue proceedings.

Decision

117. Section 121C is penal in nature and in our judgment the *mens rea* of the individual forms an essential ingredient of assessing liability. It follows that the test is subjective.

118. Both parties, in their written submissions, asked for an oral hearing if, on consideration of those written submissions, we were minded to decide the relevant question against them.

119. We considered these requests in the light of the Tribunal Rules, and in particular Rule 2. We had asked for, and received, written submissions. The case has already been adjourned on two occasions; we are mindful of our obligation to "avoid delay, so far as compatible with proper consideration of the issues." As will be clear from this Decision, taking all relevant factors into account, we decided not hold an oral hearing of this preliminary point.

Earlier Directions and Further Directions

120. On 25 June 2010, a differently constituted Tribunal directed that Mr O'Rorke was not permitted to provide expert medical evidence in support of his case.

121. As a consequence of our Decision on the relevant question, we set aside that Direction under Rule 5(2) of the Tribunal Rules.

122. The Tribunal intends to issue further Directions relating to the medical evidence, but will defer such Directions until such time as:

(1) it is clear that the Respondents have not appealed this Decision, or

(2) if it has been appealed, the final outcome of any such appeal is known.

123. 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.

Sir Stephen Oliver QC

TRIBUNAL JUDGE
RELEASE DATE: 19 December 2011

121C Liability of directors etc for company's contributions.

(1) This section applies to contributions which a body corporate is liable to pay, where—

(a) the body corporate has failed to pay the contributions at or within the time prescribed for the purpose; and

(b) the failure appears to the Inland Revenue to be attributable to fraud or neglect on the part of one or more individuals who, at the time of the fraud or neglect, were officers of the body corporate ("culpable officers").

(2) The Inland Revenue may issue and serve on any culpable officer a notice (a "personal liability notice")—

(a) specifying the amount of the contributions to which this section applies ("the specified amount");

(b) requiring the officer to pay to the Secretary of State—

(i) a specified sum in respect of that amount; and

(ii) specified interest on that sum; and

(c) where that sum is given by paragraph (b) of subsection (3) below, specifying the proportion applied by the Inland Revenue for the purposes of that paragraph.

(3) The sum specified in the personal liability notice under subsection (2)(b)(i) above shall be—

(a) in a case where there is, in the opinion of the Inland Revenue, no other culpable officer, the whole of the specified amount; and

(b) in any other case, such proportion of the specified amount as, in the opinion of the Inland Revenue, the officer's culpability for the failure to pay that amount bears to that of all the culpable officers taken together.

(4) In assessing an officer's culpability for the purposes of subsection (3)(b) above, the Inland Revenue may have regard both to the gravity of the officer's fraud or neglect and to the consequences of it.

(5) The interest specified in the personal liability notice under subsection (2)(b)(ii) above shall be at the prescribed rate and shall run from the date on which the notice is issued.

(6) An officer who is served with a personal liability notice shall be liable to pay to the Inland Revenue the sum and the interest specified in the notice under subsection (2)(b) above.

(7) Where, after the issue of one or more personal liability notices, the amount of contributions to which this section applies is reduced by a payment made by the body corporate—

(a) the amount that each officer who has been served with such a notice is liable to pay under this section shall be reduced accordingly;

(b) the Inland Revenue shall serve on each such officer a notice to that effect; and

(c) where the reduced liability of any such officer is less than the amount that he has already paid under this section, the difference shall be repaid to him together with interest on it at the prescribed rate.

(8) Any amount paid under a personal liability notice shall be deducted from the liability of the body corporate in respect of the specified amount.

(8A) The amount which an officer is liable to pay under this section is to be recovered in the same manner as a Class 1 contribution to which regulations under paragraph 6 of Schedule 1 to the Contributions and Benefits Act apply and for this purpose references in those regulations to Class 1 contributions are to be construed accordingly.

(9) In this section—

"contributions" includes any interest or penalty in respect of contributions;

"officer", in relation to a body corporate, means—

(a) any director, manager, secretary or other similar officer of the body corporate, or any person purporting to act as such; and

(b) in a case where the affairs of the body corporate are managed by its members, any member of the body corporate exercising functions of management with respect to it or purporting to do so;

"the prescribed rate" means the rate from time to time prescribed by regulations under section 178 of the Finance Act 1989 for the purposes of the corresponding provision of Schedule 1 to the Contributions and Benefits Act, that is to say—

(a) in relation to subsection (5) above, paragraph 6(2)(a);

(b) in relation to subsection (7) above, paragraph 6(2)(b).

121D Appeals in relation to personal liability notices.

(1) No appeal shall lie in relation to a personal liability notice except as provided by this section.

(2) An individual who is served with a personal liability notice may appeal against the Inland Revenue's decision as to the issue and content of the notice on the ground that—

(a) the whole or part of the amount specified under subsection (2)(a) of section 121C above (or the amount so specified as reduced under subsection (7) of that section) does not represent contributions to which that section applies;

(b) the failure to pay that amount was not attributable to any fraud or neglect on the part of the individual in question;

(c) the individual was not an officer of the body corporate at the time of the alleged fraud or neglect; or

(d) the opinion formed by the Inland Revenue under subsection (3)(a) or (b) of that section was unreasonable.

(3) The Inland Revenue shall give a copy of any notice of an appeal under this section, within 28 days of the giving of the notice, to each other individual who has been served with a personal liability notice.

(4) On an appeal under this section, the burden of proof as to any matter raised by a ground of appeal shall be on the Inland Revenue.

(5) Where an appeal under this section—

(a) is brought on the basis of evidence not considered by the Inland Revenue, or on the ground mentioned in subsection (2)(d) above; and

(b) is not allowed on some other basis or ground,

and is notified to the tribunal, the tribunal shall]5 either dismiss the appeal or remit the case to the Inland Revenue, with any recommendations the tribunal sees fit to make, for the Inland Revenue to consider whether to vary their decision as to the issue and content of the personal liability notice.

(6) In this section—

"officer", in relation to a body corporate, has the same meaning as in section 121C above;

"personal liability notice" has the meaning given by subsection (2) of that section;

"tribunal" means the First-tier Tribunal or, where determined under Tribunal Procedure Rules, the Upper Tribunal;

"vary" means vary under regulations made under section 10 of the Social Security Contributions (Transfer of Functions, etc) Act 1999.]2]1