TC01988

Appeal number: TC/2011/00958

Income tax and NIC – whether appellant as a shareholder but not a director of company knew that it wilfully failed to deduct sufficient tax from monies paid to him and also knew that company had failed to pay sufficient NIC in respect of his earnings – Yes – discovery assessment to income tax confirmed – appeal dismissed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

MICHAEL OWEN WILLIAMS **Appellant**

- and -

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

TRIBUNAL: DAVID DEMACK (JUDGE)
MRS B TANNER (MEMBER)

Sitting in public in Manchester on 21 February 2012

The Appellant did not appear and was not represented.

Mr P G Kane of HM Revenue and Customs, for the Respondents

DECISION

1. This appeal by Mr Michael Owen Williams is against a direction made under reg. 72(5) of the Income Tax (Pay As You Earn) Regulations 2003 ("the 2003 Regulations"), a discovery assessment to income tax of £56,979.60 for tax year 2006/07 raised under s.29(1) of the Taxes Management Act 1970 on 7 July 2010, and a decision of the Commissioners that he was liable to pay £4,367.15 national insurance contributions ("NIC").

2. Regulation 72 of the 2003 Regulations applies if it appears to the Commissioners that the amount of income tax deductible from payments of PAYE income to an employee exceeds the amount actually deducted by an employer and one of two conditions applies. The second condition, condition B, is that the Commissioners are of the opinion that the employer has received relevant payments knowing that the employer wilfully failed to deduct the amount of tax which should have been deducted from those payments, and it is that condition which is relevant. The reg. 72(5) direction was given to Mr Williams on 15 October 2009. It informed him that the Commissioners had determined that his employer, Instafix Ltd ("Instafix"), was not liable for tax of £56,979.60 it ought to have deducted but did not in fact deduct from relevant payments, defined in reg. 4(1) of the 2003 Regulations as "payments of, or on account of, net PAYE income", made to him in 2006/07.

3. The tax assessment, made following the reg. 72(5) direction, was raised against Mr Williams personally. It was raised as Instafix allegedly failed to deduct sufficient tax from relevant payments and the Commissioners were of the opinion that he received those payments knowing that his employer wilfully failed to deduct sufficient tax therefrom. The Commissioners made the assessment saying that they were satisfied that the failure to deduct sufficient tax from Mr Williams net PAYE income was brought about carelessly or deliberately by Instafix or a person acting on its behalf. Instafix went into liquidation on 22 May 2007 owing the Commissioners £281,238.48, none of which has since been paid.

4. An officer of the Board also determined that Instafix failed to pay sufficient primary Class 1 NIC in respect of earnings paid to Mr Williams, and did not recover the contributions from him by way of deduction. A notice was given to Mr Williams on 13 October 2009 under s.8(1)(c) of the Social Security Contributions (Transfer of Functions) Act 1999 in respect of reg 86 Social Security (Contributions) Regulations 2001 that he was liable to pay primary Class 1 NIC contributions in the sum of £4,367.15. The officer expressed himself satisfied that the failure was due to an act or default of Mr Williams and not to any negligence on the part of Instafix.

5. Mr Williams appealed the reg. 72(5) direction, the Commissioners' decision that he was liable for the NIC on the sums he had received from Instafix, and the discovery assessment.

6. In his Notice of Appeal to the tribunal, Mr Williams gave the following grounds for appeal:

"a) The decision has been made without interview with me.
b) HMRC suggest a 'wilful' non payment of tax by me – this is not the case.
c) No documentary evidence shown to me.
d) HMRC suggest I was a controlling party. This is not the case. I was not a director nor a shareholder at the time of liquidation."

7. Notice of the hearing of the appeal was given to Mr Williams. He responded saying that he did not propose to attend, but asked the tribunal to deal with the appeal on the basis of what he claimed to be "the facts". Those "facts" were set out in a statement he provided as follows:

"I have written the following in support of my appeal because I would find it difficult to accurately plead my case verbally to the tribunal and I am unable to afford to fund any further representation on this matter.

HMRC have never questioned or interviewed me in relation to this matter either verbally or in written format, it is therefore of great importance to me that I have chance for my defence to be fully considered at this late stage.

Without consultation or the chance to give any facts about my previous employment by Instafix Ltd I was issued with a direction that I had 'wilfully' failed to make the PAYE contributions. I strongly dismiss these allegations and fully believe that my employer would meet the contributions according to my P60 end of year summary.

Background Information

I was involved with Instafix Ltd from the point of incorporation. It was essentially a business arrangement between Mr Milligan (Director) and me. We were both to be full time employed by the company. The initial start-up costs and working capital were introduced by me together with a portfolio of manual sub-contract labourers. Mr Milligan supplied the client base, business contacts, sales and health and safety qualifications necessary to make the business succeed. I was made majority shareholder (65/100) to protect my investment, I was not a director. It was agreed that as the company developed and my investment was returned then the shareholding would be equally shared with Mr Milligan.

My day to day job was making sure that the installation sites were fully manned and operated smoothly. Also, I had to collate weekly information from sub contractors regarding the amount and type of work they had carried out each week. I then had to make sure clients were issued invoices to reflect the sub contractor's work. I then had to make sure that the sub contractors were paid at the end of each week. I had a remit from the directors and authority at the company bank to pay subcontractors and to issue any necessary payments to suppliers to implement work completion. I did not control cash flow, debt

collection, credit control, regular bill payment, HMRC payments or returns etc. These were entirely handled by the director.

This arrangement continued until I became concerned that the Director was taking on larger installation projects that the company did not have the facilities to fund or manage. The situation became intolerable for me and I transferred my remaining shares to Mr Milligan and severed all ties with Instafix Ltd. Some months later Instafix Ltd entered administration.

Supporting Statement

At no time have I been responsible in the company for making PAYE returns or payments. These were all prepared by book keeping and accountancy staff, they were approved and signed by Mr Milligan and the HMRC cheques signed by Mr Milligan.

The evidence from company records produced by HMRC marked 'Extracts from company records' is supposed to suggest that I controlled the company finances. This is not the case. The evidence produced in folder 'E' is simply documentation from sub contractors indicating the work carried by them over previous week, and payments authorised by me to sub contractors. This was my job.

I have not been allowed access to any company documentation which may support my case because all paperwork and records are either with the insolvency practitioner or with HMRC and because I was not a director or shareholder I am not entitled to view them. I am sure if I had the opportunity to read records there would be more contained in correspondence and documents to prove that I did not have 'wilful' knowledge that PAYE payments would not be made as required by the director.

I would like to refer to the correspondence folder sheets C35 and C36 from Instafix accountants to HMRC which seems to show that my remuneration was entirely accounted for correctly. This has been disregarded by HMRC without explanation.

Summary

It would appear to me that the case against me by HMRC has no solid evidence to prove their allegations under regulation 72(5) condition B of the Income Tax (PAYE) Regulations 2003 that I had knowledge that there would be wilful non payment of PAYE.

I have not had opportunity to build a more detailed defence because I do not have the specialist accountancy knowledge to represent myself, nor have I been allowed access to any company records that may prove my innocence."

8. In a number of material aspects we do not accept the truth of Mr Williams' statement, and shall explain why we do not do so when dealing with the facts as we find them.

9. Since the hearing had been properly notified, in the circumstances we determined to proceed in Mr Williams' absence.

10. At the hearing the Commissioners were represented by Mr PG Kane of their Specialist Investigations department. He produced a bundle of documents, and called the case officer, Mrs Susan Jane Elston, to give oral evidence. Where necessarty we shall refer to the contents of the bundle by reference to the tab and page numbers. From that evidence and the statement provided by Mr Williams, we make the following findings of fact.

11. Instafix was incorporated on 23 January 2003, and its trading activity was described in documents submitted to Companies House as "joinery installations". Its sole director was Mr Glenn Milligan. In the notes to the company's accounts for the year to 31 March 2005, under the heading 'Controlling interest', it was said, "Mr M O Williams owns 65% of the issued share capital of the company, although he is not also a director he is deemed to be the controlling party…." We accept that statement as fact. The issued share capital consisted of 100 £1 shares. We further accept a claim by the Commissioners that Mr Williams was a significant controlling influence within Instafix, and for all practical purposes was a shadow director thereof. Mr Williams was also a signatory to Instafix's bank account, a fact to whose relevance we shall later return.

12. In the tax year 2004/05, Mr Williams received a salary from Instafix of £4,680 and a dividend of £58,000. In the following year, he received a salary of £4800 and a dividend of £110,000. The Commissioners accepted that Instafix might structure its payments to directors and shareholders in that way, so that they were satisfied that the company had no liability to account for tax on the salaries paid to Mr Williams, each being below his personal allowance for the years in question. Instafix was however required to prepare and maintain a deductions working sheet for PAYE purposes (see reg 66 of the 2003 Regulations). We find that it did not do so. We infer that Instafix was provided with a PAYE code for Mr Williams.

13. From the accounts produced to us, it would appear, and we find, that in the tax year 2006/07 Instafix moved into a loss making situation. Consequently, in November 2006 it was not in a position to pay a dividend for 2006/07 out of income, or for that matter out of reserves. Nevertheless, from April 2006 onwards Mr Milligan and Mr Williams both continued a practice of withdrawing round sums from the company's bank account on a weekly basis. Such monies were initially shown in the company's nominal activity ledger as "dividends" (E8 and 9). The sums in question were not insignificant, in Mr Williams' case being of the order of £2000 per week. He continued withdrawing similar sums until 4 April 2007, but claimed that from April 2006 onwards they represented salary net of tax and NIC. On 10 July 2009 (C36), CCW, Instafix's accountants, wrote to Mrs Elston saying, " We were later advised, prior to the liquidation, that the November 2006 dividend was not declared as there

was concern as to whether it was legal (i.e. a possible lack of distributable funds) – so we therefore presume the loan account was cleared by way of a bonus, but as we have not seen the payroll records as they were submitted to Campbell, Crossley & Davis [the firm in which the liquidator was a partner], we are unable to comment further." (The reference to the clearing of Mr Williams' loan account must be read against a background of the account having been overdrawn at 31 March 2006 to the extent of £102,163). In our judgment, the accountants' letter speaks for itself as indicating that Mr Williams was advised, and thus was well aware, of Instafix's precarious financial position at the end of 2006 and in the early part of 2007.

14. Mr Williams claimed to have severed all connection with Instafix in January 2007, and to have transferred his shareholding to Mr Milligan on 3 January of that year (Statement of Company's Affairs filed by the liquidator pursuant to section 95/99 of the Insolvency Act 1986 at B99 et seq). Yet on 24 February 2007 Mr Williams signed "[an authorisation] in accordance with the [RBS] Bank Account Mandate" (E1) sending a CHAPS payment of £4526.10 from Instafix's account to Clear View Windows. He continued to withdraw sums of approximately £2000 per week from Instafix's bank account through to April 2007 (D9-D14). We find that he did not sever his connection with the company in January 2007: he remained the controlling party of Instafix until the company went into liquidation, was closely connected with the daily operation of its financial affairs and dealt with its finances. .

15. Further, Mr Williams instructed Instafix's bookkeeper, Mrs Angela Stanworth, to reconstruct the company's nominal activity account on its Sage system, and we find that she did so on 22 February 2007. In an email of 9 February 2007 (E6) Mrs Stanworth had informed Mr Williams that she had "finished calculating the amended wages for the current year", adding "This will increase the company PAYE liability by £63,400". She asked that he "confirm that this is ok so that I can amend the sage account accordingly". We are satisfied that he did so confirm for, in a note endorsed on the print out of that account, in handwriting we find on the balance of probabilities to have been that of Mrs Stanworth, she recorded (E11):

> "Reallocation of dividends posted in error for MOW [Mr Williams] per MOW 9/2/07 all amounts for him in 06/07 related to net wages, shares were reallocated but forgot to advise. Have reworked wages to take this into account and advised of additional [tax] liability."

16. We do not accept that dividends were posted 'in error' to Mr Williams or that he 'forgot to advise' Mrs Stanworth of the 'reallocation' of his shares; indeed we find to the contrary. All the evidence, and particularly that of the company not having declared a dividend in November 2006, points to his having been advised, or realised, that the company was not in a position to pay a dividend in 2006-07. We further find that he deliberately instructed Mrs Stanworth to reconstruct Instafix's records in such a way as hopefully to ensure that he had no personal tax or NIC liability on the drawings he had made from the company in that year.

17. On 15 May 2007 Instafix submitted its annual return of the PAYE tax and NIC for which it had to account (reg. 73 of the 2003 Regulations) showing tax due of

£174,465.20 and NIC of £75,892.01. The majority of the tax returned related to payments made to Mr Milligan and Mr Williams, and has never been paid.

18. Mr Williams included a salary of £249,400 from Instafix in his self-assessment return for 2006/07, and claimed that tax of £91,706 had been deducted therefrom, so that he was entitled to a tax refund of £1,265.36. His net salary on the declared basis would have been £157,694, which closely compares with the figure of £156,700 showed as paid to him in the company's bank statements and BACS payment sheets (D3 et seq). No explanation has ever been provided for the discrepancy between the amount returned and Mr Williams' actual receipts.

19. We might add that Mr Williams was asked by the Commissioners to provide evidence of deduction of tax and NIC from his salary but, apart from his producing payslips which the Commissioners rejected as having being prepared no earlier than February 2007 and being designed to deceive (see the submissions of Mr Kane below), he never did so. Mr Milligan claimed that Mr Williams was responsible for Instafix's financial affairs throughout the events with which we are concerned. Since Mr Williams chose not to attend the hearing, we are unable to test his own claim that he was not so responsible and, on the basis of all the evidence before us, we conclude that Mr Milligan's claim was correct.

20. The law we must apply in dealing with the appeal is that set out in the Schedule to this decision.

21. In his closing submissions, Mr Kane dealt with Mr Williams' reasons for appealing seriatim. We propose to follow that pattern, but to omit those matters on which we have already made findings of fact. Of Mr Williams' claim that the Commissioners' decision to assess tax and NIC was made 'without interview with me', Mr Kane accepted that to be the case, but observed that two offers of interview been made to Mr Williams which had not been taken up. He added that, since there was no requirement in law for interview, Mr Williams' claim in that behalf took matters no further.

22. Mr Kane observed that 'wilful non payment of tax' as specified in Mr Williams' second reason for appealing, was not a statutory requirement of reg. 72; rather the Commissioners had to be of the opinion that the employee had received relevant payments 'knowing that the employer wilfully failed to deduct the amount of tax which should have been deducted from these payments'. Mr Kane maintained that, on the evidence of what had occurred in the two years of assessment immediately preceding that of 2006-7, we should infer that it was always the intention of Mr Williams to cover his drawings by the payment of dividends. We do so infer. When it became apparent that Instafix had insufficient distributable reserves, and no doubt those behind the company having been advised that any such distribution would be closely scrutinised by any liquidator who might have to be appointed and would almost certainly result in its having to be repaid, an alternative method was sought to 'cover' the monies already withdrawn from the company. Mr Kane contended that the method selected was to instruct Mrs Stanworth to recategorise the distributions as salary (E11 and E6). He maintained that Mr Williams did so instruct her in the full

knowledge that the company was significantly in arrear with payments due to the Commissioners (a further fact we find) and had no prospect of being able to account for the tax and NIC calculated on the grossing-up of the monies he had withdrawn from the company (B102).

23. In Mr Kane's yet further submission, it was only when Mr Williams became aware that were his drawings to be treated as dividends and constitute "a financial pitfall that might hold for him" that he personally instructed Mrs Stanworth to recategorise the statements as salary. The basis of recalculation was to gross up the net payments he had received in the previous months of tax year 2006-7, he knowing full well that Instafix was not in a position to account for the tax and NIC concerned. Mr Kane maintained that the method adopted for payment to Mr Williams was a most unusual one for someone who was no longer a shareholder in Instafix and was not an officer of the company.

24. Of Mr Williams' claim that no documentary evidence was shown to him, Mr Kane merely observed that Mr Williams had been supplied with copies of all the documents on which the Commissioners' relied and, in any event, Mr Williams' claim was not a reason for appealing.

25. We have already dealt with Mr Williams final reason for appealing as dealt with by Mr Kane - that he was not a controlling party, and was neither a director nor a shareholder when Instafix went into liquidation – but, in view of its importance, we repeat that, even after the date on which Mr Williams claimed to have transferred his entire shareholding in Instafix to Mr Milligan, he continued to give instructions as to the company's finances (E6), as well as continuing to draw monies from its bank account (D6 et al).

26. In all the circumstances, Mr Kane submitted that we should dismiss the appeal in its entirety.

27. We accept the interpretation put upon the facts by Mr Kane, but observe that it is not that interpretation on which we are required to decide the case.

28. In our judgment, the Commissioners correctly dismissed Mr Williams' appeal against the reg 72(5) direction: he did receive the payments from Instafix knowing that the company wilfully failed to deduct the amount of tax which should have been deducted from the payments.

29. In relation to the s29(1) tax assessment, we are required to be, and are, on the balance of probabilities satisfied that Instafix failed to deduct sufficient tax from relevant payments made to Mr Williams, and that he received those payments knowing that Instafix wilfully failed to deduct sufficient tax therefrom. We are also satisfied that the situation in which Mr Williams was assessed to tax was brought about deliberately by his acting on Instafix's behalf. The Commissioners most fairly treated the monies withdrawn by Mr Williams from Instafix in 2006/07 as a gross payment of salary and/or bonus, so that we are also satisfied that the quantum of the assessment is correct. We dismiss the appeal against the tax assessment of

£56,979.60. Mr Williams will be liable to interest on the tax assessed under reg. 72(7) of the 2003 Regulations.

30. We are further satisfied that the primary Class 1 NIC which ought to have been deducted by Instafix from Mr Williams' salary and/or bonus in 2006/07 were not recovered from him by way of deduction. That failure was, in our judgment, due to an act or default of Mr Williams and not to any negligence on Instafix's behalf. We thus hold that Mr Williams is liable to pay the contributions in question of £4,367.15

31. We dismiss the appeal in its entirety.

32. 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.

TRIBUNAL JUDGE

RELEASE DATE: 9 May 2012

THE SCHEDULE

The Income Tax (Pay as You Earn) Regulations 2003
Net PAYE income

3.-
(1) "Net PAYE income" means PAYE income less any –
(a) allowable pension contributions, and
(b) allowable donations to charity.

Relevant payments

4.-
(1) In these Regulations, any reference (however expressed) to relevant payments means payments of, or on account of, net PAYE income.

Deduction and repayment of tax by reference to employee's code

21.-
(1) On making a relevant payment to an employee during a tax year, an employer must deduct or repay tax in accordance with these Regulations by reference to the employee's code, if the employer has one for the employee.

Deductions working sheets

66.-
(1) Paragraph (2) applies if a code has been issued to an employer in respect of an employee.

(2) The employer must, on making a relevant payment to the employee, prepare a deductions working sheet (unless the employer has already done so).

(3) The employer must record in the deductions working sheet –

(a) the employee's name
(b) the employee's national insurance number, if known
(c) the employee's code, and
(d) the tax year to which the deductions working sheet relates

(4) The employer must record in the deductions working sheet in respect of every relevant payment which the employer makes to the employee –

(a) the date of the payment
(b) the amount of the payment, and
(c) the amount of tax, if any, deducted or repaid on making the payment, or to be deducted or accounted for under regulation 62(4) or (5) (notional payments).

Recovery from employee of tax not deducted by employer

72.

(1) This regulation applies if-

(a) it appears to the Inland Revenue 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 an employer was liable to deduct from relevant payments made to an employee in a tax period;

"the amount actually deducted" is the amount actually deducted by the employer from relevant payments made to that employee during that tax period;

"the excess" means the amount by which the deductible amount exceeds the amount actually deducted.

(3) …

(4) Condition B is that the Inland Revenue are of the opinion that the employee has received relevant payments knowing that the employer wilfully failed to deduct the amount of tax which should have been deducted from those payments.

(5) The Inland Revenue may direct that the employer is not liable to pay the excess to the Inland Revenue.

(7) If condition B is met, tax payable by an employee as result of a direction carries interest, as if it were unpaid tax due from an employer, in accordance with regulation 82 (interest on tax overdue).

(8) The tax payable carries interest from the reckonable date until whichever is the earlier of-

(a) the date on which payment is made, or

(b) the date (if any) immediately before the date on which it begins to carry interest under section 86 of TMA(a)

Employee's appeal against a direction notice where condition B is met

72C. –

(1) An employee may appeal against a direction notice under regulation 72(5A)(b) –
(a) by notice to the Inland Revenue
(b) within 30 days of the issue of the direction notice,
(c) specifying the grounds of the appeal.

(2) For the purpose of paragraph (1) the grounds of appeal are that –
(a) the employee did not receive the payments knowing that the employer wilfully failed to deduct the amount of tax which should have been deducted from those payments, or
(b) the excess is incorrect.

(3) On an appeal under paragraph (1) the Commissioners may –
(a) if it appears to them that the direction notice should not have been made, set aside the direction notice; or
(b) if it appears to them that the excess specified in the direction notice is incorrect,
increase or reduce the excess specified in the notice accordingly.

Taxes Management Act 1970

(1) If an officer of the Board or the Board discover, as regards any person (the taxpayer) and a year of assessment-
(a) that any income which ought to have been assessed to income tax, or chargeable gains which ought to have been assessed to capital gains tax, - have not been assessed, or
(b) that an assessment to tax is or has become insufficient, or
(c) that any relief which has been given is or has become excessive,
the officer or, as the case may be, the board may … make an assessment in the amount, or the further amount which ought in his or their opinion to be charged in order to make good to the Crown the loss of tax.
(2) …
(3) Where the taxpayer has made and delivered a return under section 8 or 8A of this Act in respect of the relevant year of assessment, he shall not be assessed under subsection (1) above – (a) in respect of the year of assessment mentioned in that subsection: and (b) in the same capacity as that in which he made and delivered the return, unless one of the two conditions mentioned below is fulfilled.
(4) The first condition is that the situation mentioned in subsection (1) above was brought about carelessly or deliberately by the taxpayer or a person acting on his behalf.