TC03096

Appeal number: TC/2013/04821

MONEY LAUNDERING REGULATIONS – penalty for failure to register – whether HMRC were precluded from issuing a penalty – whether the penalty structure is effective, proportionate and dissuasive – whether the penalty levied on the Appellant was appropriate – appeal dismissed and penalty confirmed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

CHRISTINE HOUGHTON **Appellant**

- and -

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

TRIBUNAL: ANNE REDSTON (TRIBUNAL PRESIDING MEMBER)

The Tribunal determined the appeal on 5 November 2013 without a hearing under the provisions of Rule 26 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (default paper cases) having first read the Notice of Appeal dated (with enclosures), HMRC's Statement of Case submitted on 2 September 2013 (with enclosures) and the Appellant's Reply dated 25 September (with an enclosure).

DECISION

1. HMRC charged Mrs Houghton a penalty of £921.25 for breaching the registration requirement in the Money Laundering Regulations 2007 ("the MLR").

2. The penalty was calculated in two parts. The first part represented the fees which Mrs Houghton would have paid had she been registered at the right time; the second part was a fixed amount of £500. Mrs Houghton only appealed against the second part.

3. The Tribunal decided to dismiss her appeal and confirmed the penalty of £500.

The issues

4. Mrs Houghton is a book-keeper and as such accepts that she is a "relevant person" for MLR purposes and required to be registered.

5. The issues in the case were:

(1) whether HMRC had complied with its statutory obligation to take "reasonable steps" to bring the register of relevant persons to the attention of those affected;

(2) whether Mrs Houghton had taken "all reasonable steps and exercised all due diligence" to ensure that she complied with her obligations; and if not

(3) whether the penalty was "effective, proportionate and dissuasive".

The law[1]

6. The MLR implement in part the European Parliament and Council Directive 2005/60 ("the Directive") which seeks to prevent the financial system being used for the purpose of money laundering and/or terrorist financing.

7. Article 39(1) of the Directive is headed "Penalties" and reads:

> "Member States shall ensure that natural and legal persons covered by this Directive can be held liable for infringements of the national provisions adopted pursuant to this Directive. The penalties must be effective, proportionate and dissuasive."

8. The MLR require that "relevant persons" should be registered. By virtue of Regulation 3 "external accountants and tax advisers" are "relevant persons".

9. Regulation 3(7) defines an "external accountant" as "a firm or sole practitioner who by way of business provides accountancy services to other persons, when providing such services." The term "accountancy services" is not defined.

[1] In this decision, all references to "Regulation" are to the MLR, unless otherwise stated.

10. Regulation 3(8) defines a "tax adviser" as "a firm or sole practitioner who by way of business provides advice about the tax affairs of other persons, when providing such services."

11. Regulation 32(4) states that HMRC may maintain a register of external accountants and tax advisers who are not otherwise appropriately supervised for money laundering purposes. Regulation 32(5) states that if HMRC maintains a register, they must "take reasonable steps to bring the decision [to maintain a register] to the attention of those relevant persons in respect of whom the register is to be established."

12. Regulation 33 states that a relevant person must not carry on "the business or profession in question for a period of more than six months beginning on the date on which the supervisory authority establishes the register unless he is included in the register."

13. HMRC have the power, by virtue of Regulation 42(1), to impose "a penalty of such amount as it considers appropriate" on a relevant person who does not comply with Regulation 33. Regulation 42(1C) states that "appropriate" means "effective, proportionate and dissuasive."

14. Regulation 42(2) reads as follows:

> "The designated authority must not impose a penalty on a person…where there are reasonable grounds for it to be satisfied that the person took all reasonable steps and exercised all due diligence to ensure that the requirement would be complied with."

15. Regulation 42(3) reads:

> "In deciding whether a person has failed to comply with a requirement of these Regulations, the designated authority must consider whether he followed any relevant guidance which was at the time--
>
> (a) issued by a supervisory authority or any other appropriate body;
>
> (b) approved by the Treasury; and
>
> (c) published in a manner approved by the Treasury as suitable in their opinion to bring the guidance to the attention of persons likely to be affected by it."

16. Regulations 43(2) and (6) give a person on whom HMRC have imposed a Regulation 42 penalty, a right to appeal that penalty to this Tribunal.

17. Regulation 43(4) gives this Tribunal the power to:

> "(a) quash or vary any decision of the supervisory authority, including the power to reduce any penalty to such amount (including nil) as it thinks proper, and
>
> (b) substitute its own decision for any decision quashed on appeal."

18. Regulation 45 allows criminal penalties to be levied for failure to register, being fines and imprisonment for a term not exceeding two years, or both. Penalties cannot be levied both under Regulation 45 and Regulation 42.

19. Regulation 46 empowers HMRC (along with other bodies) to take such criminal proceedings.

The evidence

20. The Tribunal was provided with the correspondence between the parties, and between the parties and the Tribunal. HMRC also provided extracts from Notice MLR9D, the *Registration Guide for Accountancy Service Providers*. This has been approved by the Treasury as "relevant guidance" under Regulation 42(3). It is available in full on the HMRC website via a link on the "businesses and corporations" section of that site.

21. These extracts provided to the Tribunal included the following paragraphs:

> **2.3 Do I need to register with HMRC?**
>
> Yes, if you are an Accountancy Service Provider and are not already supervised for compliance with MLRs by the Financial Services Authority (FSA) or a professional body listed in section 8.
>
> **3.1 Who needs to register?**
>
> *1.1.1 What is an Accountancy Service Provider?*
>
> Accountancy Service Providers (ASPs) is the term used by us for auditors, external accountants and tax advisers…
>
> An external accountant is any firm or sole practitioner who by way of business provides accountancy services to other persons.
>
> A tax adviser is any firm or sole practitioner who by way of business provides advice about the tax affairs of another person.
>
> **3.6 What types of businesses will be covered?**
>
> Businesses covered include:
>
> - accountants…
> - tax advisers
> - book-keepers…
>
> **3.16 I am a bookkeeper/accountant with only a few clients. Am I an ASP?**
>
> All bookkeeping and accountancy businesses are ASPs.
>
> **3.25.2 When do I register?**
>
> You must be registered with HMRC before you carry on any activity as an ASP.

22. HMRC also provided an extract from their MLR Manual at MLR1PP9410, the relevant part of which reads:

> "The basic steps for calculating registration penalties for failure to notify HMRC of change of details are listed below:
>
> **Step 1** - The starting penalty is set at £5,000 for each breach.
>
> **Step 2** - Where appropriate, this starting penalty should be reduced to the simplified behaviour-based reduced penalty sums which can be found at MLR1PP10150. Where the failure is deliberate the standard reductions table at MLR1PP10100 should be applied.
>
> The basic steps for calculating late registration penalties (Regulations 26 and 33) are calculated as follows:
>
> **Step 1** - Unprompted Disclosure: £100 fixed penalty plus any unpaid fees by the business
>
> **Step 2** - Prompted Disclosure: £500 fixed penalty plus any unpaid fees by the business."

The facts

23. Mrs Houghton runs an accounts and book-keeping business from her home. She began trading on 6 April 2008.

24. On 6 November 2009 she obtained an "agent code" from HMRC for self-assessment. This is a prerequisite before a person can apply for authorisation to act for an individual client. On 25 March 2010 she obtained agent authorisation for VAT, and on 14 October 2010 she registered for "VAT messages". On 15 January 2011 she registered to receive online email messages from HMRC although this service "never worked".

25. Her profit in 2012 was £7,000 and in 2013 it was £10,000.

26. On 24 September 2012 HMRC wrote to Mrs Houghton, reminding her of her money laundering obligation. On 10 October 2012, HMRC received her application for registration.

27. On 21 March 2013, Mrs Houghton was informed that a penalty of £921.25 was to be imposed by HMRC under Regulation 42. This was made up of a fixed penalty for "prompted disclosure" of £500 and a further £421.25, equal to the fees she would have had to pay to HMRC had she registered under the MLR at the correct time.

28. A formal penalty Notice was issued on 24 April 2013 in the same amount.

29. Mrs Houghton accepted that she should pay the £421.25 but appealed the £500 to the Tribunal.

HMRC's submissions

30. In their Statement of Case for the Tribunal, HMRC list the steps they took to publicise MLR9 – the "relevant guidance", extracts from which are set out earlier in this decision. Some of these occurred before April 2008 (when Mrs Houghton began her business). Those which took place after that date included the following:

(1) References in the VAT Notes 1-4 of 2008 (issued with all the VAT returns in that year).

(2) Advertisements in Accountancy Age and Taxation Magazine on 28 August 2008.

(3) Information in the Financial Times on 1 and 8 September 2008.

(4) The MLR section of the HMRC website. On 20 October 2008, HMRC advised, using that section of the website, that all existing ASPs had until 1 January 2009 to register.

31. HMRC submit that:

> "it would be reasonable for a business to consider whether there was any requirement to be fulfilled in respect of MLR, particularly where the nature of the business include accountancy services or tax advising."

32. In relation to the fixed penalty of £500, they say that:

> "the regulations do not make any exceptions for small businesses. The fee is calculated on the number of premises through which a business operates and is therefore fixed with no increase or reduction in fee for those required to register. This method was adopted as a simple and effective way of assessing the relative size of businesses thereby avoiding the need for more costly and burdensome methods requiring regular declarations of turnover or business activity."

33. They say that Mrs Houghton "does not have a reasonable excuse for not having registered [and] the penalty in the amount of £921.25 is correct (in accordance with the departmental policy guidelines)." As a result, they ask the Tribunal to dismiss her appeal.

Mrs Houghton's submissions

34. Mrs Houghton says that she made an "honest mistake" and did not deliberately avoid registration. She honestly informed HMRC of the date she started in business, and has agreed to pay the backdated fees. However, she appeals against the £500 balance of the penalty. She submits that, given that she was registered as an agent, HMRC did not take adequate steps to tell her sooner that she needed to be registered.

35. In particular, she did not see any of the advertisements in accountancy magazines or newspapers as she does not buy either. Although she did have one VAT-registered client, she "did not recall seeing the VAT notes" and does not know if they were passed to her with the other client papers.

36. Finally, Mrs Houghton says that imposing a penalty of this size on her business was "a massive amount to pay and quite frankly unjust."

Whether HMRC are precluded from levying a penalty

37. Regulation 42 states that no penalty shall be charged by HMRC if "there are reasonable grounds for [HMRC] to be satisfied that the person took all reasonable steps and exercised all due diligence" to ensure that the regulation would be complied with.

38. In deciding whether or not this is the case, HMRC must consider whether the person followed "any relevant guidance". The MLR9D is such guidance. It is approved by the Treasury and published on the HMRC website.

39. Mrs Houghton did not see this guidance, or the various publications in which its existence was drawn to the attention of possible ASPs, and she did not follow it.

40. This does not of itself mean that she failed to take "all reasonable steps." A relevant factor here is that HMRC also has similar but not identical obligation under Regulation 32(5): to "take reasonable steps to bring the decision [to maintain a register] to the attention of those relevant persons in respect of whom the register is to be established."

41. Mrs Houghton says that, as HMRC knew she was an agent, they should have done more to bring her money laundering obligations to her attention. A similar complaint was voiced by Mr Clarke, the appellant in *Clarke & Co v R&C Commrs* [2012] UKFTT 300(TC) ("*Clarke*"). The Tribunal (Judge Hellier and Nigel Collard) said at [23] that:

> "an e-mail to all known tax agents would have been a surer way to reach all those potentially affected. Such an e-mail could easily have indicated that those supervised by professional bodies were exempt: we had no evidence as to the cost of arranging such an e-mail, but we find it difficult to believe that it would have been much greater than the newspaper advertising campaign. Sending out such an email would in our view have been a reasonable step to bring the change to the attention of almost all those affected."

42. However, as that Tribunal points out at [24]:

> "regulation 32(5) does not require HMRC to take <u>all</u> reasonable steps; simply reasonable steps. That is meaner language. It seems to us that the steps which HMRC took were reasonable by reference to the required purpose even if they were not the best that could have been taken."

43. Unlike HMRC, Mrs Houghton is required to take "all" reasonable steps. It is only if she has taken all such steps that HMRC is precluded from levying a penalty.

44. In the context of "reasonable excuse" Judge Medd QC made the following comments in *The Clean Car Co Ltd v Customs and Excise Comrs* [1991] VATTR 234:

> "[whether a taxpayer has a reasonable excuse] is an objective test in this sense. One must ask oneself: was what the taxpayer did a reasonable thing for a responsible trader conscious of and intending to comply with his obligations regarding tax, but having the experience and other relevant attributes of the taxpayer and placed in the situation that the taxpayer found himself at the relevant time, a reasonable thing to do?"

45. Although Mrs Houghton's appeal is not founded on "reasonable excuse", in my judgment a similar approach is appropriate when considering whether she took "all reasonable steps".

46. HMRC say that "it would have been reasonable" for a person running a business involving accountancy and/or tax to have considered whether they were within the scope of the MLR, and they also say that Mrs Houghton does not have a reasonable excuse. Given that there is no "reasonable excuse" defence in the MLR, I have taken these as submissions that, although accidental, Mrs Houghton's behaviour was not objectively reasonable.

47. I agree with HMRC that the reasonable book-keeper, who had contracted with clients to file their tax and VAT returns, would have checked the regulatory obligations to which she is subject. These include data protection, National Insurance and tax, as well as money laundering. I also find that it would be objectively reasonable for a person registering as an agent on HMRC's site, to check on that site for other obligations which attach to the role she had undertaken.

48. I therefore find that Mrs Houghton failed to take "all reasonable steps" and that HMRC are not precluded from levying a penalty.

The penalty structure

49. Regulation 42 allows HMRC to levy a penalty which is "appropriate". This means "effective, proportionate and dissuasive" - words which come from the Directive. Mrs Houghton submits that the penalty is "a massive amount to pay and quite frankly unjust." This is, in terms, a submission that it is disproportionate.

50. I understand "effective" as simply meaning that the penalties should have the intended effect, namely that relevant persons will register as required by the MLR. I am encouraged in this view by noting that it is used in this sense elsewhere in the Directive on numerous occasions (see paragraphs (18), (32), (38), (43) and Articles 21(1), 31(3), 33(1), 35(3), 37(1) of the Directive).

51. The penalty must also be "dissuasive". Part of the purpose of this penalty is therefore to "dissuade" ASPs from not bothering to register. In my judgment a penalty must have a certain absolute minimum size to be dissuasive, and in this context I note

that the penalty is imposed on ASPs, all of whom are in business; it is not relevant to private individuals.

52. Finally, the penalty must be proportionate. The MLR are derived from the Directive, and so any penalty must comply with EU principles of proportionality. It must also comply with human rights law.

53. The Upper Tribunal in *Total Technology (Engineering) v R&C Commrs* [2012] UKUT 418(TC) ("*Total Technology*") has recently examined the principles of proportionality under EU law at [23] to [49] and under human rights law at [50] to [66]. I gratefully adopt their analysis, which is not repeated here.

54. Against that background, the task of this Tribunal is first to assess whether the structure of the money laundering penalties for late registration is proportionate. Relevant factors might include:

(1) The gravity of the offence.

(2) The extent of the financial risk as a result of the default.

(3) The culpability of the defaulter.

(4) The length of time for which the failure continued.

(5) The power to mitigate.

(6) The assets, profits and/or turnover of the defaulter.

(7) The ease and simplicity of operating the penalty regime

55. In a particular case, other factors may need consideration.

56. I begin with *gravity*. The Directive, and hence the MLR, is aimed at "the prevention of the use of the financial system for the purpose of money laundering and terrorist financing." This is a serious and important international objective.

57. A relevant factor in this context is that there are two parties to the registration requirement. Compliance ensures that the government has a register of those who might process transactions relevant to money-laundering. Registration also means that the ASP has explicitly recognised its money laundering obligations, including customer due diligence, reporting suspicious transactions and keeping appropriate records.

58. Failing to register for money laundering is therefore more serious than failing to comply with the many administrative obligations imposed on accountants and tax advisers, such as timely submission of client accounts and tax returns. A proportionate penalty should recognise that the failure to register for money laundering is a serious matter.

59. The second factor is the *extent of financial risk*. An unregistered ASP which carries out a significant number of large volume money transactions represents a bigger risk than a book-keeper with only a single farm shop as her client. A

proportionate penalty would reflect the volume and size of money transactions being processed by the ASP.

60. But financial risk is difficult to measure. Accounts record turnover, assets and profits, but there is no correlation between a client's cash inflows and outflows on the one hand, and the ASP's turnover, assets or profits on the other. There is a very rough relationship between the number of staff members and the extent of financial risk, in that the more employees, the higher the chance that someone will encounter a transaction relevant to money laundering. HMRC have used an even cruder measure: their penalty is "calculated on the number of premises through which a business operates."

61. The third factor is *culpability*. Mrs Houghton submits that the £500 fixed penalty is disproportionate because it does not distinguish between those who deliberately fail to register, and those who are unaware of their obligation.

62. However, the penalties set out in the second part of HMRC manual page MLR1PP9410 deal only with "prompted" and "unprompted" disclosure. The Tribunal was not provided with the whole range of penalties HMRC has the power to levy, but I note that the first part of HMRC's page MLR1PP9410 gives the much higher sum of £5,000 for failure to notify a change of details. This indicates that the "prompted" and "unprompted" penalties are only part of a wider HMRC penalty menu. Furthermore, the MLR give HMRC a wide range of powers, including the imposition of criminal penalties (Regulation 45).

63. The fourth factor is *length of time*. The longer an ASP is unregistered, the longer the period during which she may be unaware of her money laundering responsibilities, and the longer the period she is not on the government's register. There is a direct correlation between the length of time an ASP is unregistered, and exposure to the risks the MLR are designed to remedy. A proportionate penalty would take this into account.

64. The fourth factor is the *assets, profits and/or turnover* of the ASP's business. This is another way of saying that small and/or unprofitable businesses should have a lower penalty than those which are large and/or unprofitable. Mrs Houghton makes this point explicitly.

65. HMRC do not disagree with Mrs Houghton in principle, but say that they have decided to use the number of separate premises as proxy for the size of a business. I am less convinced. In my judgment, there is no necessary correlation between the assets, profits or turnover of business, and the money-laundering risk which the MLR are seeking to monitor and control. Small businesses may even be a higher risk than larger businesses, because their proprietors may be over-stretched, making employee oversight difficult.

66. In my judgment, this aspect of proportionality would only be jeopardised if the penalty was extremely high in absolute terms. I respectfully echo the words of

the Upper Tribunal in *Total Technology*, when they said (in the context of the VAT default surcharge):

> "the absolute amount of the penalty must be proportionate in the context of the aim pursued...[and] therefore that there must be some upper limit, although it is not sensible for us in the present case to suggest where that might be."

67. The fifth factor is *power to mitigate*. Although HMRC have put forward their table of fixed fees, it is clear from regulation 42(1) that they have a discretion as to the penalty they impose, and so have the power to mitigate. This allows them to reduce the penalty in meritorious cases or where there is particular hardship, so as to make a particular penalty proportionate if it would not otherwise be the case.

68. The sixth factor is the *ease of operating* the penalty. HMRC have decided to have a simple fixed penalty regime based on numbers of outlets, because this is

> "a simple and effective way of assessing the relative size of businesses thereby avoiding the need for more costly and burdensome methods requiring regular declarations of turnover or business activity."

69. Proportionality is relevant not only to the recipient of the penalty, it also affects HMRC. The easier a penalty is to assess and collect, the less time has to be spent on administration. While it is true that a simple penalty can on occasion be disproportionate (as was the fixed penalty of 100,000 Hungarian forints in the Case C-210/10 *Márton Urbán v Vám-és Pénzügyőrség Észak-alföldi Regionális Parancsnoksága*) this risk is significantly reduced when there is power to mitigate.

Whether the penalty structure is "appropriate"

70. From the above analysis I find that:

(1) In order to be effective, dissuasive, and to reflect the gravity of the obligation, a MLR registration penalty needs to be of a certain minimum size.

(2) The use of "number of outlets" is crudely proportionate to the level of risk presented by business. Although a more sophisticated measure would be more proportionate to the risks of non-registration, this has to be weighed in the balance against the simplicity of the current system. I find that this is a reasonable "trade-off".

(3) The regime would be more proportionate if it charged a penalty which reflected the length of time an ASP is unregistered. Simply requiring the payment of an amount equivalent to the unpaid fees only puts the ASP back in the position it would have been in had it not failed to register. To the extent that the penalty regime does not recognise this time factor, it is not proportionate.

(4) While I agree with Mrs Houghton that a penalty regime would probably be disproportionate if it treated innocent, careless and deliberate errors in an identical manner, that is not the position here. There are two levels of penalty

for prompted and unprompted disclosure, and a wider range of penalties which can be imposed in other situations.

(5) The existence of a power to mitigate helps to make the penalty structure proportionate.

(6) For the reasons given in the previous part of this judgment, I find that the assets, turnover or profits of an ASP are not relevant to proportionality, unless the penalty were to be set at a level which was very high in absolute terms. Given that the maximum penalty charged by HMRC for prompted disclosure is £500, this issue does not arise.

71. On the basis of the foregoing, I find that the penalty regime is by and large proportionate, other than it does not take account of the period during which a person has failed to register.

Whether the penalty levied on Mrs Houghton is "appropriate"

72. Regulation 43(4) gives this Tribunal full appellate jurisdiction in relation to appeals against MLR penalties, and I am thus able to determine whether the penalty levied on Mrs Houghton is appropriate.

73. The penalty is £500. Taking into account the need for it to be effective, dissuasive and reflect the gravity of the offence, and given that those who are being charged the penalty are all in business as ASPs, I find this sum to be at very much the lower end of the possible penalty range.

74. It is true that Mrs Houghton did not deliberately avoid registration. But it follows from my findings on "reasonable steps" that she was careless. The penalty is not disproportionate for a careless error.

75. Mrs Houghton has argued that her penalty is disproportionate because it is the equivalent of 9% of this year's profit. I have found that the size of an ASP's profits is not a relevant consideration when assessing the proportionality of a penalty.

76. I also note that the 9% figure includes both the £500 penalty and the amount equivalent to the unpaid registration fees. It has also been calculated on the basis of a single year's profits, while Mrs Houghton's failure to register extended over almost four years.

77. HMRC have charged Mrs Houghton the outstanding money laundering fees as well as the £500 fixed penalty. As I have already found, the former simply puts her back in the position she would have been in had she registered when she started her business. As a result the penalty is not proportionate to the time for which she was unregistered.

78. In the light of these findings, an "appropriate" penalty would be no lower than £500. I have considered whether to exercise my appellate jurisdiction so as to increase the penalty to take account of the length of the period for which Mrs

Houghton was not registered. However, taking into account all the factors in this case, including HMRC's simple penalty structure, I have decided not to change the penalty.

79. As a result, I dismiss Mrs Houghton's appeal and confirm the penalty of £500

Appeal rights

80. 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.

81. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

ANNE REDSTON
TRIBUNAL PRESIDING MEMBER

RELEASE DATE: 28 November 2013