

[2016] UKFTT 493 (TC)



**TC05243**

**Appeal number TC/2015/06968**

*Penalties for late payment of income tax - whether reasonable excuse - yes - appeal allowed.*

**FIRST-TIER TRIBUNAL**

**TAX**

**JONATHAN PADLEY**

**Appellant**

**- and -**

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

**Respondents**

**TRIBUNAL JUDGE: MICHAEL CONNELL  
MEMBER: LESLIE HOWARD**

**Sitting in public at HMCTS, Lincoln County Court, Lincoln on 23 February 2016**

**The Appellant appeared in person**

**Ms Esther Hickey Officer of HM Revenue and Customs for the Respondents**

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## DECISION

1. This is an appeal by Jonathan Padley (“the Appellant”) against:

5 (1) A first late payment penalty imposed under Paragraph 3(2) of Schedule 56 Finance Act (“FA”) 2009 for the failure to pay tax on time for the year ending 5 April 2011 and also year ending 5 April 2012.

(2) A second late payment penalty imposed under Paragraph 3(3) of Schedule 56 FA 2009 for the failure to pay tax on time for the year ending 5 April 2011 and also year ending 5 April 2012.

10 (3) A third late payment penalty imposed under Paragraph 3(4) of Schedule 56 FA 2009 for the failure to pay tax on time for the year ending 5 April 2011 and also year ending 5 April 2012.

The total penalty values are £1,945 for year ending 2011 and £3,503 for year ending 2012. The penalties under appeal therefore total £5,448.

15 2. The point at issue is whether the Appellant has a reasonable excuse for making late payments.

### **Background facts**

#### *2010 - 11 tax year*

20 3. A notice to file for the year ending 5 April 2011 was issued to the Appellant on 6 April 2011. The filing date for a non-electronic return was 31 October 2011 or 31 January 2012 for an electronic return. The Appellant chose to file his tax return online whereby the liability was automatically calculated by HMRC’s computer system. This was received by HMRC on 30 January 2012 and was ‘processed’ on the same date.

25 4. The Appellant’s tax liability for the year was £21,037.52. The tax was due to be paid on or before 31 January 2012 in accordance with s 59B(4) TMA 1970.

30 5. If the amount of tax is paid late then penalties are applied under FA 2009. Schedule 56, s 107 ‘*Penalty for failure to pay tax*’ Paragraph 1 (5), Item (1) specifies that a penalty is applicable and stipulates that the first penalty date is “30 days after the due date for payment”. Accordingly, 30 days after 31 January 2012 is 2 March 2012 which was the ‘penalty date’.

35 6. At 2 March 2012, £21,037 of the tax liability remained unpaid. HMRC issued a notice of penalty assessment on or around 17 May 2012, in the amount of £1,051, being 5% of the tax unpaid at the penalty date. The first penalty is calculated in accordance with Paragraph 3(2) Schedule 56 FA 2009.

7. Where tax remains unpaid, after the end of the period of five months beginning with the March penalty date, that is 2 August 2012, a further penalty of 5% of the tax

unpaid is imposed under Paragraph 3(3) Schedule 56 FA 2009 (the six-month penalty).

5 8. At 2 August 2012, £11,060 of the tax liability remained unpaid. The sum of £4,960 had been received on 11 May 2012 and a further sum of £5,000 on 11 June 2012.

9. HMRC issued a notice of penalty assessment on or around 8 November 2012 in the amount of £553.

10 10. Eleven months after the penalty date, that is 2 February 2013, where tax remains unpaid, a further penalty of 5% of the tax unpaid is imposed under Paragraph 3(4) Schedule 56 FA 2009, (the 12-month penalty). £6,810 of the tax liability remained unpaid, as a further sum of £4,250 had been paid.

11. HMRC issued a notice of penalty assessment on or around 28 March 2013 in the amount of £341, being 5% of the tax unpaid.

*2011 – 12 tax year*

15 12. The notice to file for the year ending 5 April 2012 was issued to the Appellant on 6 April 2012. The filing date was 31 January 2013 for an electronic return.

13. The Appellant's return was received on 12 September 2012 and was processed on the same day. The Appellant's tax liability for the year was £23,758.67.

14. The tax was due to be paid on or before 31 January 2013.

20 15. At the penalty date of 3 March 2013, £23,758 of the tax liability remained unpaid. HMRC issued a notice of penalty assessment on or around 25 April 2013 in the amount of £1,187, being 5% of the tax unpaid at the penalty date, (the thirty-day penalty).

25 16. Five months after the penalty date, that is 3 August 2013, £23,758 of the tax liability remained unpaid.

17. HMRC issued a notice of penalty assessment on or around 30 January 2013 in the amount of £1,187, which is 5% of the tax unpaid five months after the penalty date, (the six-month penalty).

30 18. Eleven months after the penalty date, that is 3 February 2014, £22,580 of the tax liability remained unpaid. £1,172 had been paid off the tax debt.

19. Another £1,000 was received on 10 February 2014, but was unfortunately after the third penalty date.

35 20. HMRC issued a notice of penalty assessment on or around 3 April 2014 in the amount of £1,129, which is 5% of the tax unpaid eleven months after the penalty date, (the 12-month penalty).

21. On 11 May 2015 the Appellant appealed against the penalties, on the grounds that one of his businesses is a horticultural label manufacturer and due to poor weather the previous year the supermarkets, as the end customer in the supply chain, gave concessions to growers (these are the growers who would usually buy labels from the company) and allowed them to re-use the old labels they had in stock. This meant that customers did not purchase new labels that year and he had no income for that year.

22. The Appellant also said that Haven Business Park, comprising twenty-four industrial units of which he is the owner, had less than 50% occupancy in that year. The income received from the units was less than his mortgage payments and he was also still obliged to pay business rates on the empty units.

23. The Appellant said that he tried to subsidise the company as its bank was unwilling to help and he ended up with a £500,000 personal debt.

24. On 24 July 2015 HMRC wrote to the Appellant and advised that they could not accept the appeal against the penalties because the deadline for making the appeal had passed. He was advised that his only option was an appeal to the Tribunal.

25. On 17 August 2015 the Appellant replied and explained that his appeal was late because he did not understand there was any deadline and he did not think it was appropriate to appeal the penalties until the underlying debt was paid. He said that the penalties and interest accounted for 38% of the original tax and that this was overly harsh.

26. The Appellant said there were exceptional circumstances which caused the delay in payment of the tax, and that he considered the penalties to be disproportionate.

27. On 11 November 2015, HMRC rejected the Appellant's request to appeal out of time and explained that if he did not submit an appeal to HM Courts and Tribunals Service by 11 December 2015, then HMRC would treat the appeal as settled.

28. On 30 November 2015, the Appellant notified his appeal to the Tribunal, giving his grounds as "scale of the penalties is disproportionate to the debt; no other commercial organisation or court would be allowed to impose penal fees on this scale".

### 30 **Appellant's contentions**

29. At the hearing the Appellant reiterated much of what he had said in his correspondence with HMRC and his notice of appeal.

30. He said that he did not dispute the facts as outlined by HMRC. In his view however, he had a reasonable excuse for the late payments of income tax in 2011 and 2012 because there were exceptional circumstances in those years that caused severe cash flow problems.

31. He explained that he operated four businesses, a specialist packaging business – Kalas Packaging Limited, which supplied printed packaging to the food, horticultural

and commercial retail industries, in particular labelling to Garden Centres and DIY stores. The company was formed in 2009. His director's salary and dividends from the company made up the main source of his income. Typically the company would make a 20% profit on turnover. In an average year the company's turnover would be approximately £1.5 million generating £300,000 profit but in 2011 and 2012 turnover had decreased to £1.1 million, which disproportionately reduced profits in each year to approximately £60,000.

32. The Appellant said that he also operates Haven Pet Foods Ltd and Haven Trading Limited, both incorporated in 2010 which supply pet food, fish bait, flowers, plants, seeds and fertilizers. Both companies were only just breaking even. The Appellant stated that he draws no salary or dividends from these companies.

33. He also operates and owns Haven Business Park, an industrial estate on which he has twenty-four units. From 2008, at the start of the recession, until 2013, occupancy levels were 50% or less. He said that the rental income he received from Haven Business Park was less than the mortgage secured on the company's assets and the financial problems were further compounded by the fact that he still had to pay business rates on the empty units.

34. He was already suffering cash flow problems when he first defaulted on his income tax payments in 2011, but in the following year the position worsened when the profits of his packaging business significantly declined. He explained that in 2010, because of a wet spring and summer, growers were left with considerable unsold plants and unused labels, which meant that in 2011, Kalas Packaging's sales were massively down, as supermarkets gave the growers concessions to use up the previous year's labels before they purchased that year's designs. This resulted in significantly reduced profits and income that year. To make matters worse, in 2012, the UK suffered the wettest summer for 100 years and this again seriously affected the horticultural packaging business and exacerbated cash flow problems. Suppliers often insisted upon 30 to 60 day credit terms but the company's customers (supermarkets and garden centres) whilst imposed 90 day terms and often paid late.

35. He was unable to secure temporary funding from his bank because banks in the post-crash climate considered his financial difficulties and liabilities secured on commercial property to be "toxic debt". He had invoice discounting arrangements in place which, whilst easing cash flow problems, eroded profitability.

36. The Appellant said that every asset he had "was mortgaged to the hilt" and this resulted in him accruing over £500,000 of personal debt. He had raised as much finance as he could by way of mortgage of his house and other assets. He tried every avenue to raise further finance without success. His company bankers would not agree any form of loan or overdraft.

37. He said that his survival was only achieved with the support of his company's lenders who allowed him to draw on his director's loan account, and HMRC which allowed him time to pay outstanding VAT, PAYE and Corporation Tax. He also secured HMRC's agreement to the waiver of penalties that had been imposed. He said

that he should have declared himself bankrupt but didn't, but over a period of several years was able to manage and eventually bring all his tax dues up to date.

5 38. Between 2012 and 2015, with the assistance of time to pay arrangements agreed by HMRC and as the economy gradually improved, he paid off his tax arrears as and when he could, paying off a total of approximately £200,000. However, for reasons he could not understand HMRC would not agree a time to pay arrangement in respect of his Income Tax arrears. Ms Hickey for HMRC said that she was not aware that time to pay arrangements had been agreed in respect of VAT, PAYE and Corporation Tax.

10 39. He agreed that he had defaulted in previous years, but that was for entirely different reasons, not associated with the recession or the difficulties encountered by Kalas Packaging in 2011 and 2012.

### **HMRC's contentions**

40. An appeal against a late payment penalty will be successful where the taxpayer shows that there is a reasonable excuse for paying late.

15 41. However an insufficiency of funds is not a reasonable excuse, unless attributable to events outside the Appellant's control - paragraph 16(2)(a) Schedule 56 FA 2009.

42. Also, where the Appellant had a reasonable excuse for the failure but the excuse has ceased, the Appellant is to be treated as having continued to have the excuse if the failure is remedied without unreasonable delay after the excuse ceased.

20 43. There is no statutory definition of reasonable excuse, which "is a matter to be considered in the light of all the circumstances of the particular case" (*Rowland v HMRC* [2006] STC (SCD) 536 at paragraph 18). This was confirmed by the First-tier Tribunal, in *Anthony Wood trading as Propaye v HMRC* (2011 UK FTT 136 TC 001010). Although the decisions in these cases are not binding, HMRC's view is that  
25 the reasoning is relevant to this appeal.

44. HMRC consider that a reasonable excuse is normally an unexpected or unusual event that is either unforeseeable or beyond the taxpayer's control, and which prevents them from complying with their obligation to pay on time. However, a combination of unexpected and unforeseeable events may, when viewed together, be  
30 a reasonable excuse.

45. HMRC's view is that the actions of the taxpayer should be considered from the perspective of a prudent person, exercising reasonable foresight and due diligence, having proper regard for their responsibilities under the Tax Acts. If the taxpayer could reasonably have foreseen the event, whether or not it is within their control,  
35 HMRC would expect them to take steps to meet their obligations. If there is a reasonable excuse it must exist throughout the failure period.

46. The Appellant has been a late payer since the year ending 5 April 2000, incurring late payment penalties in 2000, 2001, 2002 and 2006, but then not again until 2011 and 2012.

47. HMRC consider that the Appellant has no reasonable excuse for the period spanning 6 April 2010 to 5 April 2012, which is a full two years. In a business which is based on seasonal production of labels for the horticultural industry, HMRC believe that a reasonable and prudent person would anticipate fluctuations in demand due to changes in the UK weather which is renowned for being unpredictable.

48. The law allows HMRC to reduce a penalty below the statutory minimum if they think it is right because of special circumstances. - Paragraph 9 Schedule 56 FA 2009. While “special circumstances” are not defined, the courts accept that for circumstances to be special they must be “exceptional, abnormal or unusual” (as per *Crabtree v Hinchcliffe*) All ER 1239[1970] Ch 628, or “something out of the ordinary run of events” (as per *Clarks of Hove Ltd v Bakers’ Union*) EAT 1978.

49. HMRC have considered special reduction, but their view is that there are no special circumstances which would allow a reduction in the penalty.

50. HMRC do not consider that the penalties are disproportionate or unduly harsh and are unable to vary the penalties as the set percentages are laid down in law.

51. The late payment penalties charged are in accordance with legislation and there is no reasonable excuse for the Appellant’s failure to pay his tax on time nor by the date the penalty arose. There are no special circumstances which would allow the penalty to be reduced.

## 20 **Relevant Legislation**

52. The legislation relating to the imposition of penalties for late payment of income tax is contained in:

Section 59 B (3) & (4) Taxes Management Act (“TMA”) 1970) - Payment of income tax and capital gains tax

25 *(3) In a case where the person-*

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

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

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

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

35 Schedule 56 FA 2009

Paragraph 1(1) & 1(4)

*(1) A penalty is payable by a person where he/she fails to pay an amount of tax payable 30 days after the date specified in section 59B(3) or (4) TMA 1970 as the date by which the amount must be paid.*

5 *(4) The penalty date in relation to an amount of tax, means the date on which a penalty is first payable for failing to pay the amount (that is to say, the day after 30 days from the date specified in section 59B(3) or (4).*

Paragraph 3(2), 3(3) & 3(4)

*(2) A person is liable to a penalty of 5% of the unpaid tax.*

10 *(3) If any amount of the tax is unpaid after the end of the period of 5 months beginning with the penalty date, a person is liable to a penalty of 5% of that amount.*

15 *(4) If any amount of the tax is unpaid after the end of the period of 11 months beginning with the penalty date, a person is liable to a penalty of 5% of that amount.*

Paragraph 9

*(1) If HMRC think it right because of special circumstances, they may reduce a penalty under any paragraph of this Schedule.*

*(2) In sub-paragraph (1) “special circumstances” does not include*

20 *(a) ability to pay, or*

*(b) the fact that a potential loss of revenue from one taxpayer is balanced by a potential over-payment by another.*

*(3) In sub-paragraph (1) the reference to reducing a penalty includes a reference to -*

25 *(a) staying a penalty, and* .

*(b) Agreeing a compromise in relation to proceedings for a penalty.*

**Decision**

53. Subject to our conclusions below, and for the sake of completeness, we reject any  
30 argument that the penalties were disproportionate. They are in accordance with  
legislation. The case of *Total Technology (Engineering) Limited v HMRC* [2012]  
UKUT 418 (TCC) was heard in the Upper Tribunal when it was held that:

(1) There is nothing in the architecture of the default surcharge system which makes it fatally flawed.



(2) The Tribunal found that the VAT default surcharge regime does not breach EU law on the principle of proportionality.

(3) In order to determine whether or not a penalty is disproportionate, the Upper Tier Tribunal addressed the following factors:

- 5
- (a) The number of days of the default
  - (b) The absolute amount of the penalty
  - (c) The ‘inexact correlation of turnover and penalty’
  - (d) The ‘absence of any power to mitigate’

10 (4) The Upper Tribunal Chamber President, Mr Justice Warren and Judge Colin Bishopp decided that none of these leads to the conclusion that the default surcharge regime infringes the principle of proportionality.

15 54. It is clear from the facts that the Appellant had done everything he could to exercise reasonable foresight, due diligence and have due regard for the fact that his income tax was payable on the due date. He had in place invoice discounting facilities. With regard to VAT, PAYE Corporation Tax and Income Tax he acted proactively in requesting time to pay arrangements and ensuring that HMRC were aware of his position.

55. For reasons which were not clear, time to pay had been agreed in respect of VAT, PAYE and Corporation Tax but not Income Tax.

20 56. HMRC argue that the causes of the insufficiency of funds were not exceptional. They say that in a business which is based on seasonal production of labels for the horticultural industry, a reasonable and prudent person would anticipate fluctuations in demand due to possible changes in the UK weather. They argue that a reduction in turnover caused by inclement weather was a foreseeable event and not an unusual hazard of a business associated with the horticultural industry. As such, they say  
25 fluctuations in trade caused by the weather should not be regarded as a reasonable excuse for the Appellant’s late payment of income tax.

30 57. However, that is to regard foreseeability as the sole criteria for determining whether a reasonable excuse has been shown and is not the correct approach. In any event it is difficult to see how the severe cash flow problems in 2011 and in particular in 2012, could have been foreseen.

35 58. Although insufficiency of funds can never of itself constitute a reasonable excuse, the cause of the insufficiency, that is, the underlying cause of the taxpayer’s default, might do so. The question is whether the late payment was “reasonably avoidable”. The Courts have recognised that if the exercise of reasonable foresight and of due diligence and a proper regard for the fact that the tax would become due on a particular date would not have avoided the insufficiency of funds which led to the default, then the taxpayer may well have a reasonable excuse for non-payment. That is the correct test to be applied.

59. Unfortunately for the Appellant, a number of factors combined which caused a significant and unusual cash flow problem. Even if we regard “foreseeability” in the context of normal everyday business hazards as the sole or primary criterion for establishing whether or not a reasonable excuse exists, the events which affected the Appellant’s business and cash flow were outside what the exercise of reasonable foresight would have allowed or enabled him to do in order to avoid the shortage of funds which led to the late payment of income tax.

60. There was a history of the Appellant taking such reasonable steps as were available to maintain his companies’ ability to discharge various tax liabilities when they fell due. It is not known why, given the time to pay arrangements which had been agreed with HMRC in respect of other taxes, a similar arrangement was not granted for Income Tax. That was course a matter entirely within the discretion of HMRC.

61. On the facts, in respect of the 2011 and 2012 defaults, it is reasonable to conclude that there would have been no insufficiency of funds if it were not for the unexpected and financial problems which beset Kalas Packaging in those years. We find that the Appellant exercised reasonable foresight, due diligence and a proper regard for the fact that the tax would become due on the due dates. For that reason we find that the Appellant has shown that he had a reasonable excuse for the late payment of his income tax in years 2011 and 2012.

62. We therefore allow the appeal and discharge the late payment penalties imposed.

63. 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.

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**MICHAEL CONNELL  
TRIBUNAL JUDGE**

**RELEASE DATE: 13 JULY 2016**

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