[2019] UKFTT 274 (TC)

TC07113

PROCEDURE – whether appeal to be accepted out of time - yes

CONSTRUCTION INDUSTRY SCHEME – failure to implement notification of tax treatment change – determination issued - penalty imposed – whether appeal out of time – no – whether reasonable care taken – yes – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2017/05982

BETWEEN

GROUND FORCE CONSTRUCTION LIMITED **Appellant**

-and-

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

TRIBUNAL: JUDGE AMANDA BROWN
IAN PERRY

Sitting in public at Centre City Tower, 5-7 Hill Street, Birmingham B5 4UU on 5 April 2019

Mr J Vaghela, of Vaghela & Co (Services) Ltd for the Appellant

Mr M Khan, litigator of HM Revenue and Customs' Solicitor's Office, for the Respondents

DECISION

INTRODUCTION

1. This appeal concerns the issue of a determination and associated penalty by HM Revenue and Customs ("**HMRC**") to Ground Force Construction Limited ("**the Appellant**") under the Construction Industry Scheme ("**CIS**") as a consequence of a failure by the Appellant to implement a change of tax treatment notification received in connection with one of its subcontractors, Virenda Construction Limited ("**Virenda**").

2. The Tribunal was also required to determine whether the appeal was made out of time.

BACKGROUND TO BUSINESS

3. The Appellant is engaged in business providing labour for large scale construction projects across the UK. The Appellant has a limited number of employees and supplements its contracts for the labour through subcontracting arrangements.

4. One of those subcontractors is Virenda.

5. The business is said to be run by its sole director Mrs H K Bhandal who also works approx. 24 hours per week as a senior support worker in a care home.

6. Mrs Bhandal's life partner has experience in the construction industry and provides what was described as support and advice to Mrs Bhandal but it is said is not actively involved in the business.

7. By reference to documents available to the Tribunal the business is significant in size. The bank statements available indicate that in the period from 8 March 2016 to 5 August 2016 turnover exceeding £2.5m.

CHRONOLOGY

8. By letter dated 8 June 2016 HMRC sent the Appellant a "Notification of tax treatment change for a subcontractor", Virenda. The Appellant was informed:

> "The above subcontractor's tax treatment is changing with effect from 08 JUNE 2016. From that date any payments that you make to this subcontractor, including any payments for work done before that date, must be made net,with tax deducted at 20%."

9. It is clear from a computer generated log of contact between HMRC and the Appellant that the letter was created and sent on 8 June 2016.

10. The Appellant asserts that this letter was not received until 6 July 2016.

11. The Appellant received and paid a large number of invoices from Virenda over the critical period as set out in the table below:

Invoice date	Invoice number	Value of services	VAT	Tax	Total	Date paid
18/05/16	GFCL15	£22,236.00	£4,447.20		£26,683.20	10/06/16
18/05/16	GFCL16	£11,719.50	£2,343.90		£14,063.40	10/06/16
18/05/16	GFCL17	£10,076.68	£2,015.34		£12,092.02	10/06/16
18/05/16	GFCL18	£17,292.00	£3,458.40		£20,750.40	10/06/16 17/06/16*
18/05/16	GFCL19	£7,602.50	£1,520.50		£9,123.00	10/06/16

18/05/16	GFCL20	£17,898.00	£3,579.60		£21,477.60	20/06/16
18/05/16	GFCL21	£11,055.14	£2,211.03		£13,266.17	20/06/16
18/05/16	GFCL22	£13,135.00	£2,627.00		£15,762.00	20/06/16
18/05/16	GFCL23	£9,858.50	£1,971.70		£11,830.20	20/06/16 21/06/16 23/06/16*
18/05/16	GFCL24	£9,779.00	£1,955.80		£11,734.80	23/06/16
18/05/16	GFCL25	£32,212.50	£6,442.50		£38,655.00	23/06/16
18/05/16	GFCL26	£12,791.50	£2,558.30		£15,349.80	24/06/16
18/05/16	GFCL27	£5,622.25	£1,124.45		£6,746.70	24/06/16
18/05/16	GFCL28	£13,170.75	£2,634.15		£15,804.90	24/06/16
30/05/16	GFCL29	£28,106.25	£5,621.25		£33,727.50	24/06/16
30/05/16	GFCL30	£19,300.00	£3,860.00		£23,160.00	24/06/16
30/05/16	GFCL31	£18,766.00	£3,753.20		£22,519.20	29/06/16
30/05/16	GFCL32	£7,736.50	£1,547.30		£9,283.80	04/07/16
30/05/16	GFCL33	£20,725.25	£4,145.05		£24,870.30	01/07/16
30/05/16	GFCL34	£15,081.88	£3,016.28		£18,098.25	01/07/16
30/05/16	GFCL35	£10,641.00	£2,128.20		£12,769.20	01/07/16
10/06/16	GFCL36	£6,453.75	£1,290.75	£1,290.75	£6,453.75	11/07/16
10/06/16	GFCL37	£3,462.00	£692.40	£692.40	£3,462.00	11/07/16
10/06/16	GFCL38	£5,159.50	£1,031.90	£1,031.90	£5,159.50	14/07/16
10/06/16	GFCL39	£10,700.00	£2,140.00	£2,140.00	£10,700.00	15/07/16

12. * denotes part payments By letter dated 22 July 2016 HMRC wrote to the Appellant in the following terms:

> "Ground Force's CIS300 for month ending 5/7/16 recorded gross payments to Virenda Construction Ltd in the sum of £314806-00. Please provide copy purchase invoices supporting this figure along with payment details. As this sub-contractor's CIS Gross Payment Status was cancelled on 8/6/16 I'd like to know why the CIS300 didn't record any deductions"

13. On 25 August 2016 HMRC issued a notice to provide information and produce documents pursuant to Schedule 36 Taxes Management Act 1970 ("**TMA**") compelling the production of the information requested in their letter of 22 July 2016.

14. On behalf of the Appellant the Appellant's representative responded to HMRC's letter of 22 July 2016:

> "At the time of filing CIS300 for the month ended 5 July 2016, our client company had not received your Notice that Virenda Construction Ltd.'s CIS gross payment status was cancelled on 8 June 2016. However, we would advise CIS300 for the month ended 5 August 2016 does show £5,155.05 tax deduction from payments of £25,775.00 to this subcontractor. Our client

company wonders if the cancellation was carried out retrospectively from 8 June 2016?"

15. On 7 September 2016 HMRC requested the Appellant provide further information and documentation regarding Virenda. In response to the question raised by the Appellant's representative HMRC replied:

> "Your client has enquired about "retrospective" cancellation of Virenda's Gross Payment Status. I can state that one of my office colleagues effected the action on 8/6/16 and HMRC records indicate that the Tax Treatment Change Notification instruction was sent to your client on the same day."

16. Absent a response to their letter of 7 September 2016, on 28 September 2016 HMRC issued a regulation 13 determination warning letter. By this letter HMRC indicated an intention to determine a sum of £62,961 as due under the Income Tax (Construction Industry Scheme) Regulations 2005 ("**CIS Regs**"). The letter also advised that the CIS Regs provided (in regulations 9(3) and (4)) that a contractor may be relieved of the liability to account for sums required to have been deducted in respect of payments to subcontractors where either it can be shown that the error in failing to deduct arose in good faith or as a consequence of a genuine belief that the payments did not fall within the scope of CIS or where it could be shown that the subcontractor in question (in this case Virenda) had already returned and paid the tax on the income which was the subject of the payments.

17. The Appellant's representative acknowledged both the letter of 7 September 2016 and 28 September 2016 on 5 October 2016 (stating that the letter of 28 September 2016 had only been received that day). No response or comment was made in relation to the warning letter other than to acknowledge receipt.

18. By letter dated 6 October 2016 the Appellant's representative provided the information requested regarding the supplies made by Virenda. The letter again raised the concern as to retrospectivity of the revocation of the gross payment status of Virenda:

> "Our client Company is more than convinced that Virenda Construction Ltd's gross payment status was retrospectively revoked from 8 June 2016, which they did not know about until 6 July 2016, when they received the attached HMRC envelope containing notification letter. Naturally payments to Virenda Construction Ltd after 6 July 2016 were subjected to 20% tax deduction and a sum of £5,155.05 tax was paid to HMRC by our client Company. …
>
> Please treat this letter as our client Company's formal OBJECTION to your intended proposals. Our client Company contends that all payments were made under the Construction Industry Scheme Rules and Regulations for bona fide labour supplied and invoiced by Virenda Construction Ltd to our client Company.
>
> Further, as explained above, the payments had already been made before our client Company became aware of the retrospective cancellation of Virenda Constructions Ltd gross payment status by HM Revenue & Customs.
>
> Under the circumstances, our client Company feels it is unjust, unreasonable and unfair to penalise them for whatever Virenda Construction did or did not do as far as their duties and/or responsibilities to HM Revenue & Customs are concerned."

19. In their response dated 26 October 2016 HMRC acknowledge that the Appellant's representative had experienced delays in receiving communications from HMRC but they rejected the contention that the notification of change of tax status was received almost a month

after it was sent. HMRC allowed a 7 day period of grace after the issue of the notification of change of status removing from the scope of the proposed determination the five payments made by the Appellant to Virenda on 10 June 2016. Revised figures for the determination were issued in respect of payments made after 15 June 2016 (including two payments identified as relating to the payment of GLCL21 but exceeding the value of the invoice which had been paid in full as identified in the table above). The letter gave the Appellant an opportunity to make a claim to be relieved under regulation 9(3) or (4) CIS Regs.

20. The Appellant's representative responded on 25 November 2016 identifying a calculation error in the schedules and reiterating that the Appellant had not received the change of status notification until 6 July, requesting HMRC to verify the date of posting. The letter restated that the Appellant had made payments to Virenda in good faith and on the strict understanding that they held gross payment status.

21. On 1 December 2016 Notice of Determination under reg 13 CIS Regs was issued in the sum of £51,456. A further warning letter was issued in respect of payments recorded as cash payment which HMRC considered were off record payments to unverified subcontractors, attracting a requirement to deduct at 30% of gross payments. These payments and the associated warning were for an additional sum of £3,450.

22. The Appellant's representative's letter was acknowledged on 14 December 2016 and treated as a claim under regulation 9(3) CIS Regs to be relieved from a requirement to pay.

23. On 21 December 2016 HMRC responded to the regulation 9(3) CIS Regs claim. For the first time in correspondence, HMRC pointed out that in order for regulation 9(3) CIS Regs to apply not only must the error as to non-deduction have been made in good faith the taxpayer making the claim must also show that they took reasonable care. The letter recognises that when the Appellant first used, and sought verification as to status of, Virenda on 2 February 2016 they had held gross payment status. HMRC confirmed that as the Appellant had been a contractor which had made payments to Virenda they had been issued with the change of status notification. HMRC emphasised that the Appellant had submitted its CIS return to 5 July 2016 on 13 July 2016 notifying payments without deduction after, even on the Appellant's own case, it had received the change of status notification. HMRC acknowledged that the change of notification status correspondence had been noted as received (in handwriting) on 6 July 2016 but questioned by whom and when it had been so annotated. HMRC considered that the 7 day grace period was sufficient recognition as, in their view, it had been incumbent on the Appellant to make contact immediately upon the purported late receipt of the change of status notification and failure to have does so showed a lack of prudence particularly in circumstances when payments made to Virenda were significant. The letter also acknowledged that change of status notification letters had previously been issued to the Appellant and all had been acted upon immediately. For all these reasons HMRC considered the Appellant had failed to show reasonable care and the notice of determination should stand.

24. The refusal of claim under regulation 9(3) CIS Regs was formally notified on 21 December 2016.

25. The Appellant's representative acknowledged receipt of the communications of 21 December 2016 on 15 January and sought a 30 day extension to respond to 17 February 2017.

26. By letter dated 15 February 2017 the Appellant's representatives restated the Appellant's case that it had taken reasonable care on the basis that the change of status notification was not received until 6 July 2017, that as soon as the letter was received all subsequent payments were made on a net basis and that the return submitted on 13 July 2016 reflected the gross payments that had already been made prior to the receipt of the change of status notification as evidenced by the bank statements.

27. That letter was treated as an appeal against the determination.

28. In response, on 1 March 2017, HMRC issued their view of the matter. HMRC considered that any reasonably prudent business receiving a change of status notification a month after it had been issued and having made substantial payments to the contractor concerned would have been "extremely concerned and perplexed" and would therefore have contacted HMRC to question the delay and what needed to be done as a consequence of the payments unwittingly made on a gross basis. HMRC considered that as the Appellant business had the advantage of having a direct contact point with HMRC (as a consequence of being the subject of a routine inspection process) a reasonable course of conduct would have been to make contact with that officer. HMRC restated Mrs Bhandal's circumstances (working part time, having little experience in the construction industry and learning along the way) thereby questioning whether the change of status notification had simply been received on time but without its significance being appreciated. On the basis of these factors HMRC considered that the Appellants failed to take reasonable care. A review of that conclusion was offered.

29. On 13 April 2016, absent any request for review, HMRC notified the Appellant that the appeal had been treated as settled. The sum due for collection was however notified as reduced from £51,456 to £50,173.

30. By letter dated 18 April 2017 the Appellant's representative notified a request for review of the decision.

31. HMRC replied on 4 May 2017 refusing to undertake the review on the basis that it had been requested out of time and confirming that, by operation of section 49C(4) TMA the appeal was settled.

32. Correspondence then ensued as to the reasons for the delayed request for review. HMRC maintained their position that the appeal was settled and any appeal to the Tribunal would be out of time but rejected that the justification for the delay (principally the ill health of the Appellant's representative) constituted a reasonable cause for delay.

33. On 8 June 2017 HMRC issued a penalty warning letter notifying of an intention to issue a careless prompted penalty pursuant to Schedule 24 Finance Act 2007 ("**FA 2007**") with an intention to apply a 35% reduction reflecting the assistance given to HMRC in understanding the error and access to records. The consequence of applying the reduction to the nature of penalty resulted in a penalty assessment equal to 24.75% of the determined tax giving a penalty of £12,417.81. The penalty was issued on 13 July 2017.

34. The penalty was appealed to HMRC by letter dated 24 July 2017 and HMRC upheld the penalty by letter dated 1 August 2017 but agreed to undertake a review of the decision.

35. The Appellant lodged its appeal with the Tribunal on 15 August 2017 in respect of both the determination and the penalty assessment. HMRC objected to any extension of time in which to appeal the determination on the basis that the appeal had been treated as settled in accordance with section 49C(4) and section 54(1) TMA.

36. On 1 September 2017 HMRC completed its review of the penalty assessment and again upheld it on the basis that: (1) the tax error (gross payments made to Virenda resulting in a failure to account to HMRC under the CIS for payments made between 17 June 2016 and 11 July 2017) had effectively been accepted by the Appellant as the Appellant had made a claim under regulation 9(3) CIS Regs which is predicated on a substantive liability to deduction; and (2) the error had occurred through the carelessness of the Appellant which had not given sufficient attention or thought to avoiding the error and/or had failed to take reasonable care judged by reference to the standards of a prudent and reasonable taxpayer. HMRC also refused to suspend the penalty as there was no systemic issue that had led to the error capable of

forming the basis of a suitable suspension condition. HMRC also highlighted that a number of disclosure notices had been issued to the Appellant and on that basis it was concluded that it was "not entirely clear whether [suspension conditions] would have the desired effect".

OUT OF TIME

37. HMRC asserted that the Appellant was not entitled to bring any appeal in relation to the determination on the basis that having missed the time in which to request a review following HMRC's view of the matter letter dated 1 March 2017, the appeal had been settled.

Legislation

38. The legislation relevant to the out of time issue is contained in section 49C, 49F, 49H and 54 TMA.

39. The relevant parts of section 49C provides:

> (1) Subsections (2) to (6) apply if HMRC notify the appellant of an offer to review the matter in question.
>
> (2) When HMRC notify the appellant of the offer, HMRC must also notify the appellant of HMRC's view of the matter in question.
>
> (3) If, within the acceptance period the appellant notifies HMRC of acceptance of the offer, HMRC must review the matter in question in accordance with section 49E.
>
> (4) If the appellant does not give HMRC such a notification within the acceptance period, HMRC's view of the matter in question is to be treated as if it were contained in an agreement in writing under section 54(1) for the settlement of the matter.
>
> (5) The appellant may not give notice under section 54(2) (desire to repudiate from agreement) in a case where subsection (2) applies.
>
> (6) Subsection (4) does not apply to the matter in question if, or to the extent that, the appellant notifies the appeal to the tribunal under section 49H.

40. So far as is relevant section 49H provides:

> (1) This section applies if:-
>
> (a) HMRC have offered to review the matter in question (see section 49C, and
>
> (b) the appellant has not accepted the offer.
>
> (2) The appellant may notify the appeal to the tribunal within the acceptance period
>
> (3) But if the acceptance period has ended, the appellant may notify the appeal to the tribunal only if the tribunal has given permission.
>
> (4) If the appellant notifies the appeal to the tribunal, the tribunal is to determine the matter in question.

41. So far as material section 54 provides:

> (1) Subject to the provisions of this section, where a person gives notice of appeal and, before the appeal is determined by the tribunal, the inspector or other proper officer of the Crown and the appellant come to an agreement, whether in writing or otherwise, that the assessment or decision under appeal should be treated as upheld without variation, or as varied in a particular manner or as discharged or cancelled, the like consequences shall ensue for all purposes as would have ensued if, at the time when the agreement was

> come to, the tribunal had determined the appeal and had upheld the assessment without variation, or as varied in a particular manner or as discharged or cancelled it, as the case may be.
>
> (2) Subsection (1) of this section shall not apply where, within thirty days from the date of the agreement was come to, the appellant gives notice in writing to the inspector or other proper officer of the Crown that he desires to repudiate or resile from the agreement.

Discussion

42. HMRC contended that the Appellant's appeal in relation to the determination had been settled by virtue of section 49C and section 54. They contended by reference to the judgment of the Upper Tribunal in *Martland v HMRC* [2018] UKUT 178 ("**Martland**") that permission to appeal should only be granted exceptionally and by reference to the three stage process identified in *Denton v White* [2014] EWCA 906.

43. The three stage process requires the Tribunal to: (1) establish the length of the delay, (2) the reason or reasons for the why the default occurred; and then (3) by reference to all of the circumstances undertake a balancing exercise assessing the merits of the reason for the delay and the prejudice to the parties caused by granting permission.

44. HMRC considered that the Appellant had given no substantive reason justifying an out of time appeal.

45. The Appellant asserted that the short delay had arisen as a consequence of the illness of the Appellant's representative and the Easter break.

46. The Tribunal notes that in Martland the Upper Tribunal considered that if the length of the delay was very short justifying a conclusion that the breach was nether serious nor significant, in the absence of unusual circumstances, it is unlikely that the Tribunal would need to spend much time considering the second and third stages.

47. In the present case the Appellant requested a review only 18 days late. It is true that the consequence of that delay caused the appeal to be settled and (contrary to an initial view taken by the Tribunal on the basis of the limited excerpt of sections 49C made available to it) the Appellant was precluded from resiling from that settlement under section 54(2) TMA. However, the delay is unquestionably short. Regular and timely correspondence ensued between the parties and the Appellant notified its appeal against the determination and the penalty together comfortably within time limit for appeal against the penalty.

48. Given the length of the delay the Tribunal considers that it is largely unnecessary to consider at any length the reasons for the delay or undertake a balancing exercise of the merits. However, for completeness the Tribunal considers that the reasons given for the delay certainly could not have justified a lengthier delay. The Appellant's representative explained that it was his business practice to reply within 28 days, that he had no staff capable of attending to the correspondence of the practice and due to illness and the Easter holidays the deadline had been missed. These cannot provide substantive justification for a failure to meet a deadline.

49. That said had the Tribunal been required to undertake the balancing exercise confirmed in Martland the Tribunal would, on balance have granted permission pursuant to section 49H(3) TMA. The delay was only 18 days and the Appellant's representatives had repeatedly set out the basis on which the Appellant challenged the determination. Given the voracity and persistence of the arguments presented it was unlikely, in the face of a requirement to pay to HMRC £50,173 which they had already paid on a gross basis to Virenda, they were going to simply allow the matter to settle. The prejudice to the Appellant of making the payment to HMRC and having to then recover the sums from Virenda would therefore, on the potential

merits of the case, have given the Tribunal sufficient grounds to have determined the application for permission to appeal, despite the expiry of the review period and statutory settlement of the appeal.

50. The Tribunal therefore determines to grant permission for the Appellant to prosecute its appeal pursuant to section 49H(3).

REGULATION 13 DETERMINATION

51. The Appellant has been issued with a determination under regulation 13 CIS Regs to remit to HMRC the amended sum of £50,173. This sum represents 20% of the payments made by the Appellant to Virenda in the period from 15 June 2016 – 1 July 2016 HMRC having allowed 7 days grace from the date of the change of tax status.

52. HMRC refused to apply the provisions of regulation 9 CIS Regs to shift the liability for recovery from the Appellant as contractor to Virenda as subcontractor.

Legislation

53. The legislation relevant to the issue of the determination is contained in Chapter 3 Finance Act 2004 ("**FA 2004**") and CIS Regs.

54. A brief summary of the relevant provisions is provided below. The specific language of the provision is provided where necessary.

(1) Section 60 and 61 FA 2004 provide the default position regarding the collection of income tax on payments earned by a construction subcontractor (excluding sums charged by him/it for materials): under section 61 the contractor is required to deduct 20% (in the case of subcontractors registered under the Construction Industry Scheme ("**CIS**") for payments under deduction) or 30% (in the case of those not registered under CIS) of sums due to the subcontractor. The contractor is not required to make such a deduction where the subcontractor is registered under CIS to receive gross payments. By virtue of section 62 such payments to HMRC are on account of income tax of the subcontractor.

(2) FA 2004 Sections 63 – 68 FA 2004 provide the statutory basis for subcontractors to register under CIS either for gross payment or payment under deduction. Where registered for gross payment the subcontractor must satisfy certain conditions but is then entitled to receive payment from contractors on a gross basis. If a subcontractor is unable to satisfy the conditions for gross payment they may be registered for payment under deduction. Section 66 provides for the circumstances in which a CIS registration for gross payment may be cancelled. Cancellation may occur from a prospective date in a range of circumstances but will occur with immediate effect where HMRC have reasonable grounds to suspect that the subcontractor was registered on the basis of false information or has fraudulently made incorrect returns.

(3) Sections 69 – 72 provide for the statutory infrastructure by reference to which contractors may verify the status of the subcontractors engaged and the making of returns etc. Regulation 6 CIS Regs (made pursuant to these provisions) provides that the before making a payment to a subcontractor a contractor must verify that the subcontractor is registered under CIS and if so whether it is entitled to receive gross payments or payments under deduction. Once verified the contractor may continue rely on the verification and make payments in accordance with the status of the subcontractor as so verified unless a period of 2 years elapses between payments or until notified by HMRC that the payment status has changed.

(4) Regulation 9 CIS Regs sets out the circumstances in which the primary obligation arising under section 61 to account for deductions is shifted from the contractor to the subcontractor. Regulation 9(5) provides that HMRC may direct that the contractor is not liable to make payment to them for the deduction in the circumstances prescribed under the regulation. Namely, where it appears to HMRC that the amount required to be deducted by the contractor exceeds the amount that has been deducted (i.e. there has been a shortfall in deduction either because the payments have been made on a gross basis rather than payment under deduction or higher rate should have been used and standard rate has in fact been used but the failure to deduct arises in the circumstances set out in either regulation 9(3) (Condition A) or (4) (Condition B). Condition B is not relevant for present purposes but regulation 9(3) provides:

> (3) Condition A is that the contractor satisfies an officer of Revenue and Customs:
>
> (a) that he took reasonable care to comply with section 61 of the Act and these Regulations, and
>
> (b) that:
>
> (i) the failure to deduct the excess was due to an error made in good faith, or
>
> (ii) he held a genuine belief that section 61 of the Act did not apply to the payment.

(5) Pursuant to regulation 13(1)(b) CIS Regs where HMRC have reason to believe that an amount payable by a contractor has not been paid regulation 13(2) CIS Regs provides for HMRC to determine the amount which, to the best of their judgment, a contractor is liable and serve on him a notice of determination. Regulation 13(3) CIS Regs requires that such a determination must not include an amount in respect of which regulation 9(5) direction applies.

(6) Regulations 9 and 13 CIS Regs both provide for an appeal to the Tribunal (the appeal under 9 being restricted to the application of 9(3) and (5)).

Evidence and findings of fact

55. The Tribunal had before it a bundle of documents running to 404 pages and took sworn testimony from Mrs Bhandal during which she was subject to cross examination. The Tribunal found Mrs Bhandal's evidence to be inconsistent but did not consider that she actively sought to mislead the Tribunal.

56. From the evidence given the Tribunal finds the facts as set out in paragraphs [57] – [82] below.

57. The Appellant business was established on 26 March 2015 and provides construction labour to contractors constructing roads, carparks, schools, hospitals and other major construction projects. Such labour largely being sourced through subcontracting.

58. On 12 November 2015 HMRC wrote to the Appellant proposing to undertake a check of employer and CIS records. There is nothing to indicate this was anything other than a routine check. The proposed date for the visit was 30 November 2015. By the letter HMRC notified the Appellant of the documents which were required to be available at the visit, including all records showing how the business calculated pay, NI, benefits and expenses, payments to subcontractors, how CIS was operated, and purchase invoices. The letter did not call for advanced production of the information and documentation.

59. On 25 November 2015, as a consequence of a call between HMRC and the Appellant's representative, the meeting was rearranged to 12 January 2016 and this was confirmed by letter of the same date. In addition, and by way of separate letter, HMRC issued a formal notice to provide information and produce documents pursuant to Schedule 36 FA 2007. The letter stated "I have not received any of [the documents requesters by letter of 12 November 2015]. Because of this, I am now issuing this notice. The attached schedule shows what I still need." The records requested were all statutory records, all books of account, payments of benefits and expenses, sales and purchase invoices, bank statements, PAYE and CIS records. Names and addresses of subcontractors.

60. At the visit on 12 January 2016 only the Appellant's representative was present as Mrs Bhandal was called away to her sister. The meeting lasted 3 hours and a minute of the meeting was produced which identifies that various documents were produced at the meeting, including bank statements, wage records for 10 employees, sales and purchase invoices and time sheets relating to 4 subcontractors: Amto Civil Engineering Ltd ("**Amto**"), D Goraya Ltd ("**Goraya**"), Graystone Construction Ltd and C Mann Construction Ltd. There is nothing in the note to indicate that the documents and information requested in the Schedule 36 notice was not provided at the meeting as requested.

61. HMRC arranged a further meeting for 1 March 2016 with the Appellant, acting through Mrs Bhandal, and the Appellant's representative. The meeting note for that meeting indicates that Mrs Bhandal gave an account of the running of the business confirming she was the sole director and prior to 2015 had no experience in the building industry but that her partner helped her to learn as he had 18 years' experience in the sector. She confirmed that she employed a contracts manager until the end of June 2016. She also worked part time as a care support worker for approx. 24 hours per week. All these facts were reiterated by Mrs Bhandal in oral evidence and the Tribunal finds them as facts.

62. In oral evidence Mrs Bhandal expanded on information contained in the documents stating that she sources contracts and connections with subcontractors by word of mouth and through relationships that her partner has. She quotes for projects, and during the relevant period, relied on her partner and the contracts manager to ensure that the quotes would be profitable through the margin it makes on the cost of the subcontracted and employed labour. The Tribunal finds that Mrs Bhandal is actively involved in the business but in practice is heavily dependent upon the experience, advice and guidance, received from her partner and, prior to his departure at the end of June 2016, the contract manager. The Tribunal would not have accepted an assertion that she has the skill and competence to properly price and contract for these significant construction projects or labour subcontracts without significant input from others.

63. Again, consistent with the oral evidence of Mrs Bhandal, the note indicates that when using subcontractors the Appellant undertakes the necessary verification processes in order to determine their CIS status.

64. At the time of the visit the four contractors identified in paragraph [60] above were discussed in addition to Jas V Ltd ("**Jas V**").

65. On 8 April 2016 certain additional information and documentation relating to all 5 subcontractors was requested. Documents relating to one contractor were delivered to HMRC on 8 May 2016. The absence of the requested documents relating to the remaining 4 subcontractors prompted HMRC to issue a second Schedule 36 notice to provide information and documents on 10 May 2016. The notice issued stated that it required production by 10 April 2016 if a penalty was to be avoided. That was corrected by a reissued notice issued on the same date setting a deadline for production as 23 May 2016. The Appellant's representative

responded providing a further partial response on 16 May 2016. HMRC did not penalise the failure to fully comply with the note.

66. As set out in paragraph [12] above HMRC sent a further letter on 22 July 2016 reconfirming the requirement to produce the missing documents and adding to the requested list of documentation documents relating to Virenda. Absent the production of the documentation requested a further Schedule 36 Notice of production was issued on 25 August 2016. However, the documentation was supplied under cover of a letter from the Appellant's representatives dated 24 August 2016.

67. On the basis of paragraphs [59] [60] [65] and [66] the Tribunal finds that the first notice to produce dated 25 November 2015 was not issued as a consequence of any failure in compliance by the Appellant (at the hearing this was accepted by HMRC). Those issued on 10 May 2016 and 25 August 2016 were as a consequence of a failure in compliance on the part of the Appellant. Thus indicating there was some pattern of non-compliance by the Appellant.

68. As previously indicated the Appellant subcontracts some of its labour contracts. Over the period from May 2015 to mid-2016 the Appellant had engaged 5 subcontractors. It appears that when verified by the Appellant each of the 5 subcontractors was registered to receive gross payments. However, on 24 November 2015 the Appellant was notified that Amto was no longer so authorised. HMRC's records show that whilst payments had been made in the period immediately prior to the change of payment status notification, no further payments were made by the Appellant to Amto after they were notified of the change in payment status. On 27 January 2016 the gross payment status of Goraya was changed and notified to the Appellant, again despite payments being made in the period immediately prior to the change no further payments were made by the Appellant. The same position occurred when the Appellant was notified of the change to payment status for Jas V on 18 April 2016. A further change of payment status notification was issued for a further contractor SSB Services ("**SSB**") post June 2016 which, again the Appellant acted upon.

69. Mrs Bhandal explained that she ceased using these contractors because the quality of labour was substandard. The Tribunal had no direct evidential basis on which to disbelieve the evidence and HMRC did not cross examine her on it. The Tribunal found it slightly surprising that the timing of the decision to cease using the contractors coincided so consistently with receipt of a change of payment status notification if the basis for ceasing the relationship was purely quality of labour. This was particularly in light of the evidence given that the subcontractors had been used for approx. a year prior to the withdrawal of their gross payment status (a statement which cannot have been held to be accurate for any of the subcontractors as each relationship ceased within 12 months of the Appellant commencing in business). Mrs Bhandal did not recollect receipt of the change of payment notification for SSB until it was put to her in cross examination.

70. In oral testimony Mrs Bhandal gave a reasonably coherent general understanding of the CIS scheme and the difference between gross payment and payment under deduction. She was unable to provide a detailed understanding. She was able, after a little initial confusion to identify that the Virenda invoices issued to the Appellant prior to 8 June 2016 were issued on a gross payment basis and those post that date on a payment under deduction basis. On the basis of her testimony the Tribunal was satisfied that she had sufficient understanding of CIS and in particular a clear understanding that payment under deduction v gross payment had no economic consequence for her and the Appellant, 20% of the gross payment was either paid to the subcontractor or HMRC.

71. The critical factual issue in the present appeal centres on the date on which the change of payment status notification for Virenda was received by the Appellant.

72. The Tribunal is entirely satisfied that the document was generated by the HMRC computer system on 8 June 2016 and would have been posted, second class, on that date. HMRC are entitled to rely on the normal operation of the postal service and, in accordance with the provisions of the Interpretation Act 1978, the letter was deemed to have been received (and thereby notification effected) within 4 working days. That is unless the contrary is proved.

73. The correspondence with the Appellant's representatives is illustrative that HMRC post rarely arrives within the assumed 4 days. Almost every letter received and acknowledged by the Appellant's representative indicates that second class postal deliveries from HMRC take 6 – 7 working days. However, the Appellant contends that the change of payment status for Virenda was not received until 6 July 2016 and therefore 4 weeks after it was posted.

74. The Tribunal were shown a photocopy of the envelope. There is no question that it is the envelope which contained the notice of change of payment status as the label on the envelope bears a reference identical to the letter itself. On the envelope is written "Date received 6 7 16". The envelope is addressed to the correct correspondence address for the Appellant. Beneath the label are the printed numbers "P47 58631 346" and a series of different length vertical lines of between 3 and 7mm in length. The envelope appears to have been opened in the conventional way (i.e. using a finger) rather than a letter opener. The envelope is in reasonable condition.

75. Mrs Bhandal explained that her post management process involves writing the date of receipt of all post on the front of the envelope and attaching the letter to the envelope until the post is actioned. The envelope will be binned when the correspondence is filed.

76. Mrs Bhandal was passionately adamant that she received the change of payment status notification on 6 July 2016 and followed exactly the same process as with all other post writing the date of receipt on the front. Whilst her recollection of events generally in June/July 2016 were not clear she stated that she specifically recollected the late arrival of the change of payment status notification because it was so late. She confirmed that she passed the letter to her representative as it concerned tax matters. She explained that she has engaged the representative on a retainer basis paying him £500 per month she can therefore use him on a call off basis.

77. She stated that she had taken the letter to the representative once it was opened. She was unclear as to whether she had made contact with HMRC concerning the late arrival, but she did not assert that she had made contact with them.

78. It is apparent to the Tribunal that in the period from November 2015 HMRC maintained a good contact log with the Appellant and that file notes were maintained of calls made with either Mrs Bhandal or the Appellant's representative. The Tribunal finds that the Appellant did not make contact with HMRC at any point concerning the late arrival of the change of payment status notification until the Appellant's representative's letter dated 24 August 2016.

79. By reference to the invoices and the bank statements Mrs Bhandal confirmed that all payments made to Virenda made after 6 July 2016 (the first of which was on 11 July 2016) were made on a payment deduction basis. She accepted that the payments made on 11 July 2016 were as against invoices raised by Virenda post 8 June 2016 all of which showed the tax to be deducted. All invoices paid prior to that date were raised by Virenda prior to 8 June 2016 and were on a gross payments basis. Mrs Bhandal's evidence was that invoices were received from Virenda within a few days of the work being complete and were subject to payment terms that she could not precisely recollect.

80. The challenge for the Tribunal is that their impression of the evidence of Mrs Bhandal is that it was inconsistent on some important issues i.e. the use of other subcontractors and the

justification for ceasing to use them but that inconsistency could be explained by the passage of time. Inconsistency is very different to an attempt to deliberately mislead.

81. HMRC's hypothesis was that the notice of change of payment status had been received by Mrs Bhandal shortly after 8 June 2016 but that its significance had been missed by her until HMRC questioned the treatment adopted by their letter of 22 July 2016. It was at least implicit in their hypothesis that all that had happened was that Mrs Bhandal had paid the Virenda invoices as raised. The return for the period to 5 August 2016 being prepared on the correct basis only because the change in status had, by then been communicated to the Appellant's representative.

82. The Tribunal cannot accept that hypothesis. The Tribunal does not consider that Mrs Bhandal was a dishonest witness and had that hypothesis been accurate it would be somewhat astonishing that Mrs Bhandal would have retained the envelope and, at some point after receipt of the letter of 22 July 2016, would have dishonestly written on it an incorrect date which conveniently fitted with the payments made. The Tribunal therefore accepts that the date of receipt of the notice was 6 July 2016.

Submissions

HMRC

83. It was HMRC's position that the Appellant had failed to take reasonable care when making payments on a gross basis to Virenda and subsequently failing to account to HMRC, on the return to 5 July 2016, for deductions which should have been made post 8 June 2016.

84. Although primarily focused on the lack of reasonable care in the context of the penalty (because HMRC considered the appeal to the Tribunal in relation to the determination and/or the refusal to make a direction under regulation 9(5) CIS Regs were out of time) HMRC asserted that reasonable care had not been taken as evidenced by:

(1) A change of payment status had been issued to the Appellant on 8 June 2016

(2) The change of payment status had clearly been received by the Appellant

(3) It is the obligation of the Appellant to ensure that the CIS is correctly applied

(4) The handwritten note on the envelope is not evidence that the notice was received on that date

(5) The Appellant has a pattern of non-compliance as evidenced by the issue of Schedule 36 information notices

(6) The Appellant did not make contact with HMRC when it purportedly received the notice but before it had submitted its CIS return for the period ended 5 July 2016 on 13 July 2016.

Appellant

85. The Appellant's case was almost entirely dependent on the premise that as the notice of change of payment status had not been received until 6 July 2016 the Appellant cannot have failed to take reasonable care when not making the relevant section 61 FA 2004 deduction from contract payments made to Virenda.

Discussion

86. Regulation 13(3) CIS Regs provides that a determination of sums to which a contractor is liable under section 61 FA 2004 and the CIS Regs shall not include an amount which HMRC direct under regulation 9(5) CIS Regs is to be collected from the subcontractor rather than the contractor. So far as is relevant in this appeal such a direction may be made by HMRC where they are satisfied that the contractor took reasonable care to comply with the obligations arising

under section 61 FA 2004 and acted in good faith or held a genuine belief that section 61 FA 2004 did not apply to the payment.

87. The Appellant had obtained verification that Virenda was registered under CIS and entitled to receive contract payments on a gross basis. The Appellant had the statutory right to continue to pay on a gross basis until notified that Virenda's payment status had changed.

88. The Tribunal has found that the Appellant did not receive the payment status change notification until 6 July 2016 and thus there can be no question that the Appellant had acted in good faith and held a genuine belief that it was not required to make a section 61 deduction in relation to the payments made prior to receipt of the notification.

89. However, as asserted by HMRC good faith is not enough the Appellant must also show that they took reasonable care.

90. The burden of establishing that reasonable care has been taken falls on the Appellant.

91. Neither party referred the Tribunal to any case law concerning circumstances in which the courts and tribunals have considered the exercise of reasonable care in connection with the operation of the CIS.

92. In the appeal of *Mr B Mabe* [2016] UKFTT 340 the sole issue for determination by the tribunal was whether Mr Mabe had exercised reasonable care (it being accepted that he had acted in good faith) in circumstances in which it was asserted that Mr Mabe had taken reasonable care by appointing an accountant to advise him on and ensure compliance with his obligations

> "[27] In determining what is reasonable it is well established that this involves the application of an impersonal, and objective, legal standard to a particular set of facts and circumstances. We can do no better than to quote the words of Judge Berner in the First-tier Tribunal in *Barrett v Commissioners for Her Majesty's Revenue and Customs* [2015] UKFTT 329 (TC) at [154]. He said that "The test is to determine what a reasonable taxpayer in the position of the taxpayer would have done in those circumstances, and by reference to that test to determine whether the conduct of the taxpayer can be regarded as conforming to that standard. …
>
> [33] Again quoting Judge Berner in *Barrett* at [161] "The test is one of reasonableness. No higher (or lower) standard should be applied. The mere fact that something that could have been done has not been done does not of itself necessarily mean that an individual's conduct in failing to act in a particular way is to be regarded as unreasonable. It is a question of degree having regard to all the circumstances, including the particular circumstances of the individual taxpayer. There can be no universal rule. What might be considered an unreasonable failure on the part of one taxpayer in one set of circumstances might be regarded as not unreasonable in the case of another whose circumstances are different. …
>
> [35] In our judgment, in the circumstances of this case, it was not unreasonable for Mr Mabe to have been unaware of the filing obligations in question, and by appointing a chartered accountant in the way that he did Mr Mabe acted as a reasonable taxpayer, who was very aware of his own limitations in tax and accounting matters, would have done. It was not unreasonable for such a taxpayer to have assumed that [his accountant] was able to, and would, advise him on any relevant tax obligation that was apparent from the information provided to him. Nor was it unreasonable for a taxpayer such as Mr Mabe, having received from [his accountant] no indication that any filing obligation had been incurred in respect of his use of sub-

> contractors, not to have raised the question himself whether there might be a filing obligation of which he was unaware, either with [his accountant] or HMRC."

93. In the case of *PDF Electrical Limited* [2012] UKFTT 708 paragraph [18], and followed in *Maypine Construction Limited* [2017] UKFTT 833 paragraph [80] it was determined that:

> "The standard required by Regulation 9 is that the business must take reasonable care in its compliance with the CIS. It does not require that mistakes must never be made. We consider that the standard of "reasonable care" is one that must be appropriate and proportionate to the particular contractor's business. The compliance systems to be expected of a substantial multi-national contractor with a large and sophisticated accounting department are very different from the systems to be adopted by a small business."

94. It is also pertinent to note that, in relation to a change to a subcontractors payment status HMRC's guidance "Construction Industry Scheme: a guide for contractors and subcontractors (CIS 340)" provides only:

> "**3.10 Changing a subcontractors payment status**
>
> When we need to change a subcontractor's payment status from gross payment to payment under deduction, we'll write to tell them, giving 90 days' notice of any change to allow them to appeal, if required.
>
> We'll also contact all contractors who have verified or used the subcontractor in the current period or previous 2 tax years. We'll give contractors 35 days' notice of the change. Payments they make to the subcontractor after the notified date of change must be made under deduction. If the subcontractor's recent invoice has already been processed in the contractor's accounting system we wouldn't expect the contractor to reprocess it if it' difficult or time consuming, but would expect the changes to be applied to the next payment.
>
> **4.17 Action we'll take if contractors don't operate the scheme correctly**
>
> If a contractor fails to operate the scheme correctly, we may cancel the contractors own gross payment status if the contractor also operates as a subcontractor.

As is clear the guidance is silent on the situation of immediate change of payment status of a subcontractor the guidance implying that contractors will be given 35 days' notice of a change.

95. As is apparent from the chronology at paragraphs [8] to [36] and the findings of fact, in particular paragraphs [72], [78] and [82] the Tribunal has determined:

(1) The law entitled the Appellant to continue to assume that Virenda was entitled to receive payments on a gross basis until notified to the contrary.

(2) Whilst HMRC have the power to change a subcontractor's payment status both on notice and with immediate effect their guidance covers only on notice changes.

(3) The change of payment status notification was sent on 8 June 2016.

(4) It was clearly received by Virenda on or soon after that date as on 10 June 2016 it issued invoices GFCL36 – 39 claiming payment on a payment deduction basis rather than a gross payment basis.

(5) Those invoices were likely to have been received by the Appellant shortly after 10 June 2016 and in any event before 17 June 2016.

(6) Whilst the invoices were not immediately due for payment the Appellant could have noticed the change in format of the invoicing.

(7) Mrs Bhandal apparently understands the implication of the invoice format changes but it is not clear whether she did so when she received them.

(8) The Appellant continued to pay the invoices issued prior to 10 June 2016 on a gross payment basis without deduction.

(9) HMRC have allowed a week's grace which therefore removed from the scope of the determination all payments made by the Appellant prior to the receipt of the invoices prepared in a payment deduction basis.

(10) The Appellant received the notification of change of status on 6 July 2016.

(11) When the Appellant received the change of payment status notification it was readily apparent that the notice itself bore a date of 8 June 2016 and, by her own admission, Mrs Bhandal recognised that there was an inconsistency between the date shown and the date of receipt but she did not at that time make contact with HMRC to question the position.

(12) All payments made following 6 July 2016 were made on a payment deduction basis.

(13) Mrs Bhandal is the sole director of the Appellant company and has little experience in the construction industry but has access to advice from her partner.

(14) By 8 June 2016 the Appellant had previously received 3 other change of payment status notifications and apparently acted upon their receipt, ceasing relationships with those subcontractors.

(15) The Appellant's business has a turnover in the period of approximately £500k per month so was not insubstantial.

(16) The Appellant made no financial gain in making the payments on a gross basis but will suffer a financial detriment if it is unable to collect the payments made to HMRC on the determination from Virenda.

96. The Tribunal must assess what a reasonably prudent business of the size and complexity of the Appellant would have done in the circumstances faced by the Appellant.

97. The provisions of regulation 9 CIS Regs apply to payments, not to the account made of those payments. Regulation 9(2) CIS Regs defines the deductible amount and the amount actually deducted for the purpose of determining the excess by reference to individual contact payments. Regulation 9(5) CIS Regs references a liability to the excess with the consequence that the reasonable care criteria under Condition A in regulation 9(3) CIS Regs must also be determined on a payment by payment basis.

98. Whilst it might be said that a prudent and reasonable business would have questioned why it had started to receive invoices on a payment deduction basis as a matter of law it was entitled to continue to make payments on a gross basis until it received notification from HMRC which the Tribunal has found did not occur until 6 July 2016. It was therefore reasonable that payments were so made.

99. The Tribunal entirely agrees with HMRC that a reasonable taxpayer, on receipt of a letter which is apparently dated almost a month earlier than it was received, particularly when faced with the hitherto unexplained change in invoicing would have contacted HMRC and seek guidance on an appropriate course of action. But by then the payments had been made and payment under deduction could not retrospectively take place. If, as the Tribunal has found,

reasonable care was exercised at the point at which the payment was made, unreasonable conduct later should not retrospectively reverse the position.

100. Similarly, the inference of lack of reasonable care arising from a general lack of compliance leading to the issue of information disclosure requests cannot be considered to be pertinent. Condition A is clear, it is a lack of reasonable care in complying with section 61 FA 2004 and not a lack of reasonable care generally.

101. Though not clear cut, on balance, the Tribunal considers that the Appellant did show reasonable care to comply with section 61 FA 2004 vis a vis each of the payment made in respect of invoices GFCL 15 – 35 such that it was unreasonable of HMRC to refuse to make a direction under regulation 9(5) CIS Regs. The Appellant's claim for such a direction therefore succeeds.

102. As regulation 13(3) CIS Regs precludes the issue of a determination including payments in respect of which a direction under regulation 9(5) CIS Regs has been issued the appeal against the determination must also succeed.

PENALTY

103. On the basis that the appeal against the direction and determination succeed the penalty too must fall away.

DETERMINATION

104. For the reasons stated above the Tribunal determines that:

(1) The Appellant be granted permission to appeal in accordance with regulation 9(7) CIS Regs against HMRC's refusal to exercise their powers under regulation 9(5) CIS Regs that the Appellant is not liable under section 61 FA 2004 in respect of payments made to Virenda between 10 June 2016 and 4 July 2016.

(2) In relation to that appeal that the appeal be allowed the Appellant having shown, in accordance with regulation 9(3) CIS Regs that it exercised reasonable care to comply with its s61 FA 2004 obligations in relation to the payments made to Virenda between 10 June 2016 and 4 July 2016 and that the payments were made in good faith.

(3) The Appellant be granted permission to appeal out of time in relation to the issue of the determination dated 1 December 2016 and amended on 13 April 2017.

(4) In relation to that appeal that the appeal be allowed, the Appellant having succeeded on its appeal in respect of a claim for direction under regulation 9(5) CIS Regs.

(5) The appeal against the penalty be allowed on the basis that the appeal against the determination was allowed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

105. 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.

AMANDA BROWN
TRIBUNAL JUDGE

RELEASE DATE: 25 APRIL 2019