Appeal number FTC/44/2009

PAYE – employer deducting tax at basic rate – liability of employee to underpayment of tax – Income Tax (Employments) Regulations 1993

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

MICHAEL BURTON **Appellant**

- and -

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

TRIBUNAL: Judge Colin Bishopp
Judge Nicholas Aleksander

Sitting in public in London on 30 June 2010

Paul Yerbury of Fasken Martineau LLP for the Appellant

Jonathan Davey of counsel instructed by the General Counsel and Solicitor to HM Revenue and Customs for the Respondents

DECISION

Introduction

1. This is an appeal by the Appellant, Mr Michael Burton, against the decision of the Tax Chamber of the First-tier Tribunal (Judge Roger Berner) released on 18 November 2009. The First-tier Tribunal dismissed Mr Burton's appeal against an assessment in respect of the tax year 2000/01, and against amendments to Mr Burton's self assessments under section 28A TMA for the tax years 2001/02 and 2002/03. The issue before the First-tier Tribunal was whether Mr Burton was liable for income tax on employment income to the extent that tax was not deducted under PAYE.

2. Before the Upper Tribunal Mr Burton was represented by Mr Paul Yerbury and HMRC were represented by Mr Jonathan Davey.

Decision of First-tier Tribunal

3. The facts as found by the First-tier Tribunal so far as relevant to this appeal are as follows:

> (1) On 2 February 2001 Mr Burton became an employee of Iris Financial Engineering & Systems (Europe) Limited ("Iris").
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> (2) Iris did not handle PAYE administration in-house, but outsourced this function to Grant Thornton UK LLP ("Grant Thornton").
>
> (3) It is unclear whether Mr Burton's former employer provided him with a P45, but, if it did, the First Tier-Tribunal found that Mr Burton did not give it to either Iris or Grant Thornton.
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> (4) Grant Thornton provided Iris with form P46 to give to Mr Burton for him to complete. It is unclear whether this form was passed on to Mr Burton. In any event, at no point was form P46 submitted to HMRC, and certainly no blank (i.e. uncompleted) P46 was sent to HMRC on the first occasion a salary payment was made to Mr Burton by Iris.
>
> (5) Throughout Mr Burton's employment with Iris his PAYE coding remained at BR (the basic rate coding), and income tax was withheld from payments of salary and commission at basic rate only (although on one occasion, when commissions were paid direct from Iris' head office in the US, Mr Burton had taken steps to seek to ensure that tax at the higher rate of 40% would be deducted).
>
> (6) It was only on 20 October 2003 that Mr Burton first became aware that basic rate (and not higher rate) tax had been deducted from payments of salary.

(7) Mr Burton's tax returns for each of the years ended 5 April 2001 and 5 April 2002 were received by HMRC on 19 June 2003.

4. The relevant legislation is quoted at length in the First-tier Tribunal's Decision Notice, and we do not repeat it here. We note that the statement mentioned in regulation 23(3) of the Income Tax (Employment) Regulations 1992 is the "P45", the document mentioned in regulation 28(1A)(a) is the "P46", and the particulars mentioned in regulation 43(2) are contained in the "P14". References in this decision to "Regulations", are references to the regulations of the Income Tax (Employment) Regulations 1993.

5. The decision of the First Tier-tribunal was that Iris properly deducted and accounted for income tax on salary and commission paid to Mr Burton. Normally a new employee would provide his employer with Form P45 on the commencement of his new employment. Under Regulation 25(9), the PAYE code shown on the P45 would be adopted by the new employer, and PAYE deducted in accordance with that code. As Mr Burton had not provided Iris with a P45, and HMRC never issued Iris with a PAYE code under Regulation 6, Regulation 31 applied. Regulation 31 required income tax to be deducted at basic rate from payments of salary and commission. Any difference between the amount deducted under the PAYE Regulations, and the amount of income tax due on the salary and commission was payable under self-assessment under section 59B(1) Taxes Management Act 1970 ("TMA").

This Appeal

6. Mr Burton challenges the decision of the First-tier Tribunal on two grounds:

(1) That there has to be compliance with the PAYE Regulations by either or both of the employer and HMRC before HMRC can claim under self-assessment from an employee

(2) That the learned judge failed to construe the Regulations purposively.

Compliance Failures

7. Regulation 101A relieves an employee from having to pay income tax on his employment income in certain circumstances. Mr Yerbury submits that where PAYE has not been deducted "in accordance with" the Regulations, then Regulation 101A prevents HMRC from collecting through self-assessment any income tax not deducted under PAYE.

8. Mr Yerbury contends that in Mr Burton's case there was failure to comply with the PAYE Regulations in at least two respects. First, there was failure by Iris to provide HMRC with the form P46 on making the first payment of salary to Mr Burton, as required by Regulation 28. Secondly, HMRC failed to issue Iris with a PAYE code in respect of Mr Burton under Regulation 6 as they were duty bound so to do. Mr Yerbury also contends that Iris were under a duty to use all reasonable endeavours to draw to the attention of HMRC the fact that Mr Burton was a higher

rate taxpayer, but was only suffering deduction at basic rate from salary and commissions.

9. It is acknowledged that there was a failure by Iris to submit a P46. We doubt that HMRC were under a duty to provide a PAYE code for Mr Burton in the circumstances of this case, or that Iris was under a duty to draw to HMRC's attention the fact that only basic rate tax was being deducted from payments. We make no findings in these respects. But even if they were subject to such duties and were in breach, we do not accept Mr Yerbury's submissions as to the effect of Regulation 101A.

10. Regulation 101A(1) provides that for the purpose of determining the amount of the "difference" mentioned in section 59B(1) TMA, "any necessary adjustments in respect of the matters prescribed by paragraph (2) shall be made to the amount of tax deducted at source *in accordance with* these Regulations ..." (our emphasis).

11. Mr Yerbury submits that any breach of the Regulations by the employer or by HMRC means that tax would not have been deducted "in accordance with" the Regulations, and in consequence HMRC cannot seek to collect any further tax through self-assessment under section 59B(1) TMA.

12. We disagree. It is clear from the initial words of Regulation 101A(1) that its effect is limited solely to the matters prescribed by Regulation 101A(2). The prescribed matters under Regulation 101A(2) include "(b) the like matters as are specified in paragraph (4) of Regulation 101 ...". Regulation 101(4) in turn provides that the matters "specified in this paragraph" include "(a) any tax which the employer was liable to deduct from the employee's emoluments but failed so to deduct".

13. The net effect of Regulations 101 and 101A is therefore as follows. When determining the amount of income tax recoverable under self-assessment under section 59B(1) TMA, the amount treated as having been deducted at source under PAYE is the amount that should have been deducted under the Regulations. So if an employer fails to deduct all the tax that it ought to have deducted, the employee is not penalised for the employer's mistakes.

14. Regulations 101 and 101A do not provide relief to the employee for all failures by employers (or HMRC) under the Regulations. The relief is limited to the difference between the amount actually deducted and the amount which the employer was liable to deduct. For these Regulations to be brought into play, there must be a "difference" between these two figures. Breaches of the Regulations which do not give rise to a "difference" do not give rise to any relief from tax. Thus, for example, the late filing by an employer of end-of-year returns does not bring Regulations 101 or 101A into play, as the breach does not give rise to a "difference". Similarly the failure by Iris to file a P46, or the failure by HMRC to provide a code did not give rise to a "difference" between the amount of tax Iris actually deducted and the amount of tax it ought to have deducted (given that no code had been issued).

15. It is possible to postulate that if a P46 had been filed by Iris, or had HMRC taken account of the information available to it, a PAYE code would in due course have been issued, and higher rate tax would then have been deducted from Mr Burton's salary and commission. However, the actual code would depend on circumstances possibly known only to HMRC and not necessarily known to Iris (for example, Mr Burton's marital status). Iris is therefore in no position to guess what that code might be. Unless and until a code is actually issued, Iris was correct to deduct tax at basic rate under Regulation 31.

16. In the circumstances of this case, the amount of tax actually deducted by Iris and the amount of tax that ought to have been deducted by Iris were the same, and so there is no "difference" to which Regulations 101 and 101A can apply.

17. We therefore decide that in the circumstances of this case, any failure in compliance by HMRC or by Iris does not prevent income tax being claimed from Mr Burton under self-assessment.

Purposive construction

18. The second ground of appeal is that the First-tier Tribunal did not adopt a purposive approach to the construction of the legislation. Mr Yerbury submits that the proper construction of the Regulations is that they should be interpreted so that the correct amount of tax is deducted in a given year. Mr Yerbury did not state in terms precisely which provision of the Regulations were not construed purposively by the First-tier Tribunal, nor did he put forward with any particularity how a purposive interpretation would differ from the interpretation adopted by the First-tier Tribunal (other than that his client should not be liable to pay tax under self-assessment).

19. A formulation of the requirement to interpret tax legislation purposively which found favour with the House of Lords in *Barclays Mercantile Finance Limited v Mawson* [2005] 1 AC 684 was that given by Ribeiro PJ in *Collector of Stamp Revenue v Arrowtown Assets Limited* [2003] HKCFA 46 (a decision of the Hong Kong Court of Final Appeal – which was quoted in *Barclays Mercantile* but was not specifically cited by the parties to this Appeal): "The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically."

20. It is not in dispute that the underlying aim of the legislation is to deduct the "correct" amount of tax from payments of emoluments – and indeed it appears to achieve this in the overwhelming majority of cases. However there will always be a minority of cases where this legislative aim cannot be achieved. There are specific provisions in the legislation to address circumstances where the "correct" amount of tax has not been (or cannot be) deducted from payments (for example the direct collection provisions in section 203(2)(c) Income and Corporation Taxes Act 1988 and the provisions of section 59B(1) TMA dealing with the interaction of self-assessment and PAYE). The existence of these provisions means that the legislative purpose must include the collection of tax from taxpayers in circumstances where it was not deducted under PAYE. A purposive approach to the construction of the

legislation must therefore include dealing with circumstances where – for whatever reason – the "correct" amount of tax had not been deducted from payments of emoluments. In our view, neither of Regulations 101 nor 101A – construed purposively – were intended to relieve Mr Burton of his liability to tax in excess of basic rate, viewing realistically the circumstances under which he received his emoluments.

21. We agree with the interpretation adopted by the First-tier Tribunal, and decide that it did not fail to construe the Regulations purposively.

Other matters

22. Mr Yerbury raised two other matters before us.

23. The first was that the finding of fact by the First-tier Tribunal that Mr Burton had not provided Iris with a P45 was wrong. In support of this submission Mr Yerbury drew our attention to a letter from HMRC dated 16 August 2005 in which they state that they believe a P45 may have been issued. Grant Thornton address the lack of a P45 in their reply, and the issue is not raised again by HMRC.

24. Appeals from the First-tier Tribunal to the Upper Tribunal may only be made on issues of law. However there may be circumstances where a finding of fact by the First-tier Tribunal is perverse - in other words the evidence was such that no reasonable tribunal could have reached such a finding. In such a case there may be an appealable error of law (see *Edwards v Bairstow & Harrison* (HL) [1956] AC 14).

25. We note that the application for permission to appeal did not raise an *Edwards v Bairstow* argument in relation to the findings of fact by the First-tier Tribunal, and therefore permission to appeal was never granted on these grounds. Even if permission had been so granted, the single letter of 16 August 2005 does not even come close to demonstrating that the First-tier Tribunal's finding was perverse and that it made an error of law in determining that no P45 had been submitted.

26. The second issue relates to the motivation of HMRC in pursuing Mr Burton. Mr Yerbury submits that the normal practice in cases such as these is for HMRC to pursue the employer and not the employee – and that the only reason why HMRC pursued Mr Burton for the underpayment of tax was the fact that Iris had ceased to trade and would be unable to pay any tax due. Mr Yerbury therefore asserts that HMRC used their power to collect tax from Mr Burton for an improper purpose.

27. As with the *Edwards v Bairstow* point, this was not an issue raised in the application for permission to appeal. Even if permission to appeal on this ground had been granted, we would have found that it is utterly without foundation. First, there is no evidence to support this assertion. The fact that Iris had ceased trading and was insolvent was brought to the attention of HMRC in a telephone conversation with Grant Thornton on 16 July 2004 – yet HMRC were still considering the liability of Iris to account for the tax in August 2005, as evidenced by correspondence with Iris at that time. It was only after Grant Thornton had explained all the circumstances and

the reasons why only basic rate tax had been deducted that HMRC turned their attention to collection of the tax due by self-assessment. This order of events suggests that the insolvency of Iris was not the motivation for HMRC pursuing Mr Burton personally for his higher rate tax liability.

28. Further, there is no discretion available to HMRC in these circumstances, and therefore no possibility of their having exercised any discretion. As Iris had correctly deducted only basic rate tax under Regulation 31, it follows automatically that Mr Burton's liability for higher rate tax had to be paid under self-assessment under section 59B(1) TMA, and there was no discretion for HMRC to exercise (properly or improperly).

29. As permission to appeal had not been given in respect of either of these two matters, these issues cannot be brought before us, and we therefore make no findings in respect of these two matters. If however we are wrong in this conclusion, and findings are required, we would find that (i) there was no error of law in the finding by the First-tier Tribunal that no P45 had been submitted and (ii) that HMRC did not improperly exercise any discretion available to them.

Conclusions

30. We uphold the decision of the First-tier Tribunal in all respects and dismiss the appeal.

Costs and other matters

31. We would ordinarily have made an award of costs in favour of HMRC on our own initiative under rule 10(4) of the Tribunal Procedure (Upper Tribunal) Rules 2008. However we note that where the "paying person" is an individual, rule 10(7)(b) requires us to take account of his financial means. We also note that HMRC's Response to the Notice of Appeal indicated that they sought the dismissal of the appeal without any order for costs. We did not hear any argument as to whether that statement has any binding effect on HMRC. In the circumstances we consider that any decision relating to costs should be considered in a separate hearing before a single judge.

32. We therefore direct that the Respondents have leave to make written application for an order for costs. Any such application must be made in accordance with rule 10(5) within one month of the date on which this Decision is released and must, as required by the Rules, be accompanied by a schedule of the costs claimed sufficient to allow summary assessment by the Upper Tribunal. A copy of the application and schedule must be delivered to the Appellant at the same time as it is delivered to the Upper Tribunal. If such an application is made, the Upper Tribunal shall make further directions in order to allow the Appellant to make representations and to allow for consideration of the Appellant's financial means.

33. The Appellant has a right to apply for permission to appeal against this decision in accordance with rules 44 and 46 of the Tribunal Procedure (Upper Tribunal) Rules

2008. Any such application must be made in writing and sent or delivered to the office of the Upper Tribunal so that it is received within one month after the date on which this decision is released.

Colin Bishopp

Nicholas Aleksander
JUDGES OF THE UPPER TRIBUNAL
RELEASE DATE: 22 July 2010

Cases mentioned referred to in argument but not mentioned in this decision:

Bernard & Shaw Ltd v Shaw [1951] 2 All ER 267
Bibby v Prudential Assurance [2000] STC 459
Employee v Revenue & Customs Commissioners [2008] STC (SCD) 688
IRC v McGuckian [1997] 1 WLR 991
Langham v Veltma 76 TC 259
MacNiven v Westmoreland Investments [2001] STC 237
McCarthy v McCarthy & Stone [2006] 4 All ER 1127 (Ch D)
McCarthy v McCarthy & Stone [2008] 1 All ER 221 (CA)
Nicholson v Morris 51 TC 95
Pepper v Hart [1993] AC 593
Ramsey v IRC [1981] STC 174
R v Montila [2005] 1 All ER 113 HL