

WHY CARE IS NEEDED IN APPLYING THE *HOK* CASE¹

by Laurent Sykes

The First-tier Tribunal came under a barrage of criticism by the Upper Tribunal in *Revenue and Customs Commissioners v Hok Ltd* [2013] STC 225 for having allowed the taxpayer's appeal against penalties.

The Upper Tribunal decided that the First-tier Tribunal had been wrong to allow the taxpayer's appeal against fixed penalties under s.98A TMA 1970 in relation to the late filing of an employer return by a company. In essence the complaint, which was upheld by the First-tier Tribunal before it was reversed by the Upper Tribunal, is that it was unfair that HMRC had delayed in notifying the taxpayer that there was a default because, in the interim, penalties were mounting and these could have been avoided had notification been made in a more timely manner.

Since that case, *Hok* has been routinely cited, mantra-like, by the First-tier Tribunal in dismissing appeals against penalties.

It is unfortunate that the taxpayer was not represented in *Hok* whereas HMRC was. The tone of the Upper Tribunal judgment, and the treatment of the First-tier Tribunal, must also be somewhat intimidating for a First-tier Tribunal faced with a similar question. That is also unfortunate in its practical consequences.

The purpose of this article is to show that *Hok* does **not** mean that a taxpayer never has a defence where penalties have been incurred in cases where HMRC have failed to notify the

1 The author is grateful to Chris Knight for helpful discussions on this topic. The views expressed are however the author's own.

taxpayer that a penalty has been incurred, and, as a result of that failure, further penalties are incurred. More detailed consideration is needed and this may show that the taxpayer does have a valid defence.

Let us take tax-gearred penalties for late payment of PAYE and CIS tax under paragraphs 5 and 6 Schedule 56 FA 2009.

There is a strong case that these are criminal penalties for the purposes of the Human Rights Act 1998, having regard to the jurisprudence of the European Court of Human Rights (see in particular *Jussila v Finland* [2009] STC 29). The analysis on this point is similar to that set out by the First-tier Tribunal in the case of *Anthony Bosher* [2012] UKFTT 631 (which is under appeal) dealing with the not dissimilar predecessor regime. The Tribunal held:

“that the penalties imposed under CIS are intended to punish non-compliance and accordingly are criminal in nature for the purposes of art 6 of the Convention. Although the underlying purpose of the legislation may be to encourage compliance and the filing of timely returns, the legislation (or at least this aspect) operates by way of a stick, rather than a carrot – the penalties are intended to deter non-compliance rather than to encourage compliance. The penalties are punitive in nature, and therefore engage art 6.”

Article 6(3)(a) of Schedule 1 of the Human Rights Act 1998 states that everyone charged with a criminal offence has the right:

“to be informed promptly, in a language he understands and in detail, of the nature and cause of the accusation against him.”

In *Bosher*, HMRC had complied with article 6(3)(a) (albeit the taxpayer succeeded on the grounds of proportionality – only for the decision to be reversed by the Upper Tribunal). The Tribunal stated in relation to article 6:

“102. However, we consider that Mr Bosher’s rights under

art 6 have not been breached. In the circumstances of this case, the only right that might be in point is his right under art 6(3)(a) to be informed promptly. **We have found that Mr Boshier was notified of the imposition of each penalty by a penalty notice sent through the post. The fact that the penalty notices were issued within one month of the penalty arising, we consider to be sufficiently prompt for the purposes of Mr Boshier's Convention rights in this case.**" [Emphasis added].

But suppose the notification has occurred many months after the default in question and, in the interim, further penalties have been incurred? The *Boshier* line of argument is an interesting one worthy of further thought (in particular does the charge for article 6(3)(a) purposes arise when the default occurs or when the assessment is issued?). But perhaps this line of argument is not one on which it is necessary to rely in the context of penalties under paragraphs 5 and 6 Schedule 56. The answer may lie on more traditional territory.

Paragraph 11(1) states that where a person is liable for a penalty under any paragraph of Schedule 56 HMRC must (a) assess the penalty, (b) notify the person and (c) state in the notice the period in respect of which the penalty is assessed. The first default does not attract a penalty, perhaps because it is assumed that the taxpayer will be given a warning, but subsequent defaults do attract a penalty, and this increases the more defaults there are. The taxpayer will therefore become liable to a penalty on the second default. Should the taxpayer not be advised of liability to that penalty, under paragraph 11(1)? One would have thought, as a matter of common sense and on a plain reading of that sub-paragraph, that they should be.

In the Schedule 56 context, the First-tier Tribunal decided in the case of *Dina Foods Ltd* TC01546 that it was not a reasonable excuse to the build up of penalties that HMRC had failed to

inform the taxpayer that penalties were accruing and had been incurred, so that the taxpayer did not get the opportunity to change their behavior to avoid further penalties accruing. It was said by the Tribunal that assessments could not as a practical matter be issued until after the year had ended when the final amount of penalty would be known. This view is not, in the author's opinion, a correct reading of paragraph 11(1), as paragraph 11(5) Schedule 56 makes clear. This provides for supplementary assessments where a further default increases the penalty on an earlier default. Of course there is a generous time limit for HMRC to issue assessments so there is no guarantee that HMRC would, if they were acting in compliance with paragraph 11(1), have issued an assessment, after the first penalty-incurring default, in time for the penny to drop and for subsequent defaults to be avoided. However this is a question of evidence. It may be that subsequent defaults would have been avoided and, accordingly, the taxpayer may have a defence to those subsequent defaults being taken into account in increasing the penalty.

The issues with the penalty provisions under consideration have, it appears in some cases at least, been compounded by problems with HMRC's "BROCS" system which is responsible for issuing warning letters. These problems are indeed alluded to in section 48001 of the PAYE Manual and have meant that warning letters sent after the first default have not always reached the correct address (because, it is understood, the updating of the "EBS" system for a change of address does not always filter through to the BROCS system).

If the purpose of a punitive penalty regime is deterrence and not the raising of revenue, the taxpayer must be informed promptly to allow him or her to change their behavior. This is, after all, surely what Parliament must have intended in legislating for that punitive regime. The decision in *Hok* simply does not deal with these points.