Crimes or civil misdemeanours?

Management of taxes



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Keith Gordon looks at a case which considers whether civil penalties charged by HMRC are criminal in nature for human rights purposes

Key Points

What is the issue?

Omagh Minerals Ltd v HMRC considers whether civil penalties charged by HMRC are criminal in nature for human rights purposes.

What does it mean to me?

This conclusion has some wide-reaching repercussions which need to be considered by advisers. If tax penalties attract the full protections under Article 6, then ECHR case law tells us that taxpayers are afforded the right not to incriminate themselves. Accordingly, this could give rise to a ground of challenge against a Schedule 36 notice.

What can I take away?

Advisers should therefore be particularly acute to the possibility that information requests by HMRC could be resisted on human rights grounds where a tax penalty is potentially in contemplation. If in doubt, seek specialist advice.

Background

I am not sure that I have ever covered a case on Aggregates Levy before. Although this might therefore represent a first, I suggest you do not get too excited. This is because the levy is merely the backdrop to the decision I am reviewing; the focus of the decision and my article is on a penalty charged by HMRC in relation to two allegedly erroneous Aggregates Levy returns.

Facts of the case

The case is *Omagh Minerals Ltd v HMRC* [2018] UKFTT 697 (TC). Omagh extracted rock from its opencast gold mine in 2008 and 2009. HMRC contend that the rock removed consisted of mica schist and quartz, whereas the Omagh says that the rock consisted of shale or slate. The key difference (for non-geologists) is that the former attracts the aggregates levy whereas the latter is exempted by the Finance Act 2001, section 17(4). As well as assessing over £300,000 in relation to under-assessed Aggregates Levy and interest of over £4,000, HMRC have imposed a penalty of over £15,000 (amounting to 5% of the alleged under-declaration) in accordance with former paragraph 9 of Schedule 6 to FA 2001.
Omagh has appealed against the assessment and the penalty. As a preliminary issue, the Tribunal was asked to consider whether or not the appeal proceedings constitute proceedings of a criminal nature such that the provisions of Article 6 of the European Convention for Human Rights are engaged.

The effect of Article 6

In its first paragraph, Article 6 ensures that ‘everyone is entitled to a fair and public hearing’ in the determination of his/her (or even its) ‘civil rights and obligations or of any criminal charge’. There are further protections in relation to persons charged with a criminal offence.

For reasons that I really cannot fathom, the Grand Chamber of the European Court of Human Rights decided in the case of *Ferrazzini v Italy* [2001] STC 1314 that tax disputes do not constitute the determination of a person’s ‘civil rights and obligations’. Accordingly, no-one under European Human Rights law is entitled to a fair trial in relation to tax disputes. The ECHR’s decision was not unanimous – there were, as the Tribunal noted, six of the sixteen judges who ‘delivered a powerful dissenting opinion’. Furthermore, whilst *Ferrazzini* has been relied upon by the UK Courts (in its classification of tax disputes as outside the scope of Article 6), I would find it surprising if the UK judiciary were to start to say that taxpayers were not entitled to a fair trial.

However, even if appeals against assessments are not governed by Article 6, this was not necessarily the case in relation to the penalties. And that was the focus of the Tribunal’s deliberations.

The Tribunal’s decision

The case came before Judge Guy Brannan. Having considered the *Ferrazzini* decision (in respect of which the Judge added a footnote which could be interpreted as suggesting that the Judge is unconvinced about the correctness of the ECHR’s decision), he proceeded to consider the case of *Jussila v Finland* [2007] 45 EHRR 39, a case concerning a 10% penalty in relation to under-declared VAT. *Jussila* endorsed the following three criteria (often known as the Engel criteria) for determining whether a matter is criminal in nature. It should be emphasised that the criteria are not cumulative.

The first criterion focuses on whether the offence in question is categorised as criminal in domestic legislation, although that analysis is not determinative and represents only a starting point.

The second criterion is the very nature of the offence. This is considered to be ‘a factor of greater import’. The third considers the severity of the punishment that the person is potentially exposed to.

When analysing *Jussila*, Judge Brannan made the point that the tax in issue was just over €3,000 and, the penalty at stake was a mere €308.80 (therefore, presumably, less than £300). Yet, that was still held to amount to a criminal charge. Accordingly, Jussila is clear authority for the proposition that even small tax penalties are classified as criminal in nature. As the Judge made clear, the Engel criteria are to be followed and the fact that the penalty might prove to be modest in amount does not change the analysis.

Applying the approach laid down in *Jussila*, the Judge considered that the purpose of the penalty in paragraph 9 is to punish and deter and that this single factor is sufficient to make the penalty criminal in nature. He expressly rejected HMRC’s arguments that the categorisation of a penalty is determined by whether or not the penalty is a large percentage of the (allegedly) underpaid tax. For the avoidance of doubt, the Judge also made it clear that the absolute amount of the penalty does not need to be large for a penalty to be criminal in nature.

In short, the Judge concluded that the penalty amounted to a criminal charge for the purposes of Article 6.

This conclusion, however, led to a consequential question: given that the penalty and assessment appeals are being dealt with in the same hearing, does Article 6 apply to the entirety of the proceedings?

The Judge noted that the penalty was, to some extent, parasitical on the assessment and also the fact that some signatories to the Convention would separate penalty and assessment proceedings (and also the fact that some UK appeals concern only a penalty because the substantive tax liability is not in dispute). He thought it would be inappropriate to reach a conclusion in which the categorisation of a substantive tax appeal would be determined by whether or not it was being held at the same time as a penalty appeal.

The Judge therefore concluded that Article 6 is engaged solely in relation to those parts of the proceedings which involve the penalty.

Commentary

I fully endorse the Judge's conclusion in relation to the criminal nature of the penalty appeal. I understand that HMRC have previously tried to argue that most tax penalties fall outside the protections of Article 6 (by suggesting that there are thresholds etc which need to be crossed). As this case puts in clear terms, that approach is entirely inconsistent with the leading case law from the European Court (*Jussila*).

This conclusion has some wide-reaching repercussions which need to be considered by advisers. If tax penalties attract the full protections under Article 6, then ECHR case law tells us that this means that taxpayers are afforded the right not to incriminate themselves (*Saunders v UK*). Accordingly, this could give rise to a ground of challenge against a Schedule 36 notice, especially when HMRC are seeking information specifically relevant to a potential penalty, notwithstanding the provision in paragraph 64(1)(b) of Schedule 36 which includes the possibility of penalties within the definition of 'checking a person's tax position'.

Another consequence of treating a penalty as criminal for Article 6 purposes is the qualified right to legal aid. The word 'qualified' is important and I therefore think that a taxpayer will have great difficulty in persuading any Court that he or she needs to instruct a lawyer (to be paid out of public funds) for a typical £100 penalty for a late tax return. However, there is no doubt a spectrum and the location of the boundary is likely to be tested at some stage.

Where I did find some difficulty with the Judge's decision was in respect of the question as to whether Article 6 should apply to the entirety of the proceedings. At the heart of the Judge's decision was the point (with which I do not quibble) that it is for taxpayers to disprove a tax assessment. However, as the Judge also pointed out, a penalty is subsidiary (I used the word 'parasitical' above) to the assessment. In the Judge's view, this permitted one to treat the assessment as a discrete part of the proceedings, outside any additional protections conferred by Article 6.

However, my concern is that this could then undermine a key part of Article 6. If it is for a taxpayer to disprove an assessment, the absence of any argument or evidence by the taxpayer will mean that the assessment is upheld. However, should that upholding of the assessment lead to the automatic assumption that the penalty has been correctly calculated? In my respectful opinion, the presumption of innocence (one of the protections conferred by Article 6) must surely mean that a taxpayer's silence in respect of the assessment cannot lead to one component of the penalty

being assumed to be proved.

Furthermore, I consider the fact that some penalty proceedings are held on their own to be a distraction. If a penalty is in contemplation (whether with or without an appeal against the substantive assessment) then it should be for HMRC to prove every component that needs to be established. It is in my view only if no penalty is in contemplation that HMRC should be entitled to require the taxpayer to prove the assessment wrong. This analysis explains why HMRC do not (and in my view should not) generally pursue penalty proceedings after the determination of any substantive appeal.

What to do next

Advisers should therefore be particularly acute to the possibility that information requests by HMRC could be resisted on human rights grounds where a tax penalty is potentially in contemplation. If in doubt, seek specialist advice.

Relevance of Brexit

Finally, it is worth making the point that the European Convention of Human Rights pre-dated the European Economic Community (now the EU). The convention parties include many more countries than those currently within the EU. Consequently, if (which at the time of writing is far from clear) the UK leaves the EU in late March, that single fact will have no immediate impact on the application of human rights law.