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Jigsaw puzzle

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Keith Gordon revisits the validity of £10 daily penalty notices for late tax return

What is the issue?

The Court had to consider whether, notwithstanding the omission of any reference to a period, the penalty notice was 'in substance and effect in conformity with or according to the intent and meaning of the Taxes Acts'.

What does it mean for me?

It was held that Mr Donaldson would not have been misled or confused by the omission

What can I take away?

This verdict stretches the meaning of section 114(1) far too far to say that it could rescue the penalty notice issued to Mr Donaldson

In my article 'La Peine Quotidienne [1]', Tax Adviser, February 2015, I discussed the penalty rules for late tax returns, as set out in Finance Act 2009, Schedule 55 in the light of the Upper Tribunal's decision in the appeal by a Mr Donaldson. Mr Donaldson has since appealed against the Upper Tribunal's decision and, in July 2016, the Court of Appeal gave its decision in the case, *Donaldson v HMRC* [2016] EWCA Civ 761.

The facts of the case

The taxpayer, Mr Donaldson, was issued with a notice to submit a tax return for the 2010/11 tax year. The return was eventually submitted (in paper form) on 1 May 2012. As the return was in paper form, it was deemed to have been due on 31 October 2011.

However, as no return had by then been submitted, the HMRC computer issued him with a reminder on 18 December 2011. According to the Court's decision, that reminder advised Mr Donaldson that a paper return would now attract a £100 penalty and that failure to file a return by 31 January 2012 would lead to a daily £10 penalty for up to 90 days.

The Court of Appeal's judgment report suggests that a further reminder was issued on 6 January 2012 suggesting that Mr Donaldson was already liable for a £100 penalty under FA 2009, Schedule 55, paragraph 3 (although the earlier Upper Tribunal's decision suggests that the Court has over-simplified the wording of the relevant notice). This reminder also noted the risk of daily penalties from 1 February 2012.

In due course, a further penalty notice was duly issued showing that he had incurred penalties totalling £1,200 (90 daily £10 penalties for the period starting 1 February 2012 by which time the return was more than three months late, and a fixed £300 penalty as the return was more than six months late (just)). (Mr Donaldson had also incurred a £100 penalty as the return was submitted after 31 October 2011.)

The First-tier Tribunal had allowed Mr Donaldson's appeal against the daily penalties on a technicality, but the Upper Tribunal overturned that decision and held that the daily penalties were in fact payable. The Upper Tribunal did point out that there was probably another defect which rendered the daily penalties invalid but, as that matter was not formally before the Tribunal, they would not strike down the penalties on that basis. Nevertheless, Mr Donaldson was able to raise all matters on his appeal to the Court of Appeal.

These matters were:

- whether HMRC had taken a decision within the meaning of FA 2009, Schedule 55, paragraph 4(1)(b), as required before a daily penalty could be imposed;
- whether HMRC had given Mr Donaldson a valid notice specifying the date from which daily penalties would be payable; and
- whether (as the Upper Tribunal had provisionally found) the penalty notice itself was defective for non-statement of the period in respect of which the penalty is assessed (as required by paragraph 18(1)(c)).

In respect of the first two grounds of appeal, the relevant statutory provision is paragraph 4(1) which reads as follows:

P is liable to a penalty under this paragraph if (and only if) –

1. P's failure continues after the end of the period of 3 months beginning with the penalty date,
2. HMRC decide that such a penalty should be payable, and
3. HMRC give notice to P specifying the date from which the penalty is payable.

The Court's decision

The appeal came before the Master of the Rolls (Lord Dyson) in one of his last cases before retirement, together with Lord Justices Kitchin and Hamblen.

Had HMRC taken a decision (paragraph 4(1)(b))?

It was accepted by HMRC that there had been no decision taken by any officer specifically in relation to Mr Donaldson relating to his delayed 2011 tax return. Indeed, the issue of the penalty notice was a fully automated process which involved no human element.

Instead, HMRC relied upon the fact that, in June 2010, some nine months before the legislation had even come into effect, a policy decision had been taken at a high level within HMRC that penalties should be issued to all taxpayers who were more than three months late with their tax returns. In the alternative, HMRC argued that the decision to program the HMRC computer to reflect the high-level decision taken in June 2010 was the effective decision for the purposes of paragraph 4(1)(b).

The Court accepted the first of HMRC's arguments, largely for the reasons previously given by the Upper Tribunal. The

Court considered that the Parliamentary language did not support the taxpayer's arguments that an individual decision ought to be taken on a case-by-case basis since (so the Court suggested) individual circumstances are catered for by a subsequent provision in Schedule 55 (being reasonable excuse in paragraph 23). Furthermore, the Court rejected the argument put forward on behalf of Mr Donaldson being that the various conditions in paragraph 4(1) ought to be satisfied in chronological order. In other words, a decision (made here in June 2010) could satisfy the test in paragraph 4(1)(b) even though paragraph 4(1)(a) was not satisfied until early 2012.

Had HMRC given notice specifying the date from which the penalty was payable (paragraph 4(1)(c))?

It is assumed to be uncontroversial that a daily penalty is encouraged both to penalise late compliance and to deter the prolonged rectification of any previous failure. In other words, there will be clear policy reasons for telling a taxpayer that the late return is now accruing £10 daily penalties so that, if the return is submitted quickly, those daily penalties will be less than would otherwise be the case.

However, the Court of Appeal concluded that this was not necessary in the light of the statutory provisions under review. In particular, they considered that the warnings received by Mr Donaldson before 31 January 2012 were sufficient to satisfy the statutory requirement.

Was the notice of penalty assessment defective because of failure to comply with paragraph 18(1)(c)?

In view of the first two limbs of the Court's decision, Mr Donaldson was therefore liable to a penalty. His only remaining hope was that the Court would uphold the provisional views of the Upper Tribunal in relation to the statutory procedures for the issue of a notice of penalty assessment.

The relevant provision is found in paragraph 18(1) and reads as follows:

18(1) Where P is liable for a penalty under any paragraph of this Schedule HMRC must –
(a) assess the penalty,
(b) notify P, and
(c) state in the notice the period in respect of which the penalty is assessed.

The case turned on the third of these requirements and whether the notice did or did not 'state … the period in respect of which the penalty is assessed'.

In fact, as the Court acknowledged, 'it failed to state any period at all … the notice should have stated both the number of days in respect of which the penalty was assessed and the start and end dates of the period'. HMRC had tried to argue that reference in the notice to the tax year (2011/12) was sufficient to satisfy the requirements of paragraph 18(1)(c), but this was quickly rejected. As the Court concluded, a taxpayer needs to know how a daily penalty has been calculated.

All that the notice stated was that penalties amounting to £900 had been incurred, calculated as at £10 per day. As a result, the taxpayer could (probably) easily determine that the penalties were calculated over a 90-day period, but there was no indication as to when the three month started (or finished). For this reason, the Court held that the condition in paragraph 18(1)(c) was not met.

However, the Court then proceeded to consider whether the defect was cured by section 114(1) of the Taxes Management Act 1970 (TMA). That reads as follows:

An assessment or determination, warrant or other proceeding which purports to be made in pursuance of any provision of the Taxes Acts shall not be quashed, or deemed to be void or voidable, for want of form, or be affected by reason of

a mistake, defect or omission therein, if the same is in substance and effect in conformity with or according to the intent and meaning of the Taxes Acts, and if the person or property charged or intended to be charged or affected thereby is designated therein according to common intent and understanding.

In essence the Court had to consider whether, notwithstanding the omission of any reference to a period, the notice was 'in substance and effect in conformity with or according to the intent and meaning of the Taxes Acts'. The Court considered that:

- the notice identified the tax year as 2010/11;
- the previous reminders had told Mr Donaldson that the due date (for a paper return) was 31 October 2011 and that daily penalties would run if the return was still not submitted by 31 January 2012;
- Mr Donaldson would therefore have known that the penalty period started on 1 February 2012 and continued for 90 days.

For these reasons, the Court held that Mr Donaldson would not have been misled or confused by the omission and therefore the defect was rectified by section 114(1).

Thus, Mr Donaldson's appeal was dismissed.

Commentary

I will categorically state that I am disturbed by the Court's decision in this case and I consider that the Court has taken a wrong turn here, specifically with section 114.

Of course, one can understand why the judiciary might have had little sympathy towards Mr Donaldson. After all, Mr Donaldson appears to have blithely ignored at least two reminders to submit his tax return (which was already late at that stage) ahead of the date from which daily penalties would start to be incurred. Mr Donaldson's apparently lackadaisical approach seems to have been compounded by his extremely passive participation in the appeal process (particularly before the First-tier and Upper Tribunals).

Nevertheless, all Mr Donaldson has done wrong is failed to comply with a set of rules (the statutory code which includes obligations requiring him to have filed a return). Consequently, it is fully accepted that he rendered himself liable to a penalty in accordance with those same rules. (I should add that, although these rules are determined by Parliament which can hear representations from taxpayers and HMRC alike, in practice HMRC gets to determine the form and content of those rules.) It is only fair, therefore, that if the penalty does not comply with the statutory code, HMRC have only themselves to blame. Indeed, not only can HMRC more or less design the rules to suit their own convenience but they also have access to an almost unlimited supply of legal assistance (in house and externally) to ensure that their statutory notices are in fact compliant with the relevant statute.

I agree with the Court of Appeal that section 114 can be invoked in cases where a statutory document fails to include something that ought to be included. However, I consider it to be stretching the meaning of section 114(1) far too far to say that it could rescue the penalty notice issued to Mr Donaldson. As the Court noted, the relevant question was whether the notice was 'in substance and effect in conformity with or according to the intent and meaning of the Taxes Act'. Taking the last of those words first, 'the intent and meaning of the Taxes Act' was that the penalty notice should state the period in respect of which the penalty was assessed. If the period was not stated in any way, then the notice simply cannot even start to be in substance and effect in conformity with or according to the statutory intention. Had the notice mentioned the start day of 1 February 2012 (or, better still, the fact that it also consisted of 90 days) then one can see an argument to suggest that any remaining omission might be overcome. However, this notice was completely silent so far as what it was supposed to convey to the taxpayer.

Indeed, the Court has implicitly acknowledged this by bringing into the notice earlier documents that Mr Donaldson was deemed to have seen. This is, with respect, simply unacceptable. According to the statute, the penalty notice has to convey certain information: it is inadequate to point to earlier (or even later) documents that might have included certain pieces of the jigsaw puzzle. Indeed, it was for this reason that the First-tier Tribunal had, in another case turning on section 114(1), concluded that 'a Penalty Notice that failed to record that time correctly cannot in substance and effect conform with or accord to the intent and meaning of the Taxes Acts' (*Sokoya v HMRC* [2009] UKFTT 163 (TC) at [20]). Indeed, given that the statement of the wrong period is sufficient to render invalid a statutory notice (even with section 114(1)), it is odd that the complete omission of any such statement can be any less fatal (see also a decision of a differently constituted Court of Appeal in *Baylis (HM Inspector of Taxes) v Gregory* [1989] 1 AC 398). What's more, whilst the Court in the present case considered that Mr Donaldson would not have been misled or confused by the error, in *Gregory*, the taxpayer's immediate awareness that the wrong year had been cited was not sufficient to rescue the assessment. Furthermore, in Gregory, the Court of Appeal had held that the period was 'an integral, fundamental part' of the statutory notice.

For these reasons, I would respectfully consider that the Court was wrong to say that the omission in this case was not 'too fundamental or gross to fall within the scope of [section 114(1)]'. Indeed, those words came from the High Court decision in the case of *Pipe v HMRC* [2008] STC 1911 where Mr Justice Henderson had actually (echoing Gregory) recognised that 'specifying the correct dates is something HMRC must get right'.
I am also uncomfortable with the decision in relation to paragraph 4(1). I accept that the statutory language supports the idea that a decision to impose a penalty can be taken at a high level and on a generic basis. However, the Court appears to have overlooked that HMRC should exercise a discretion before issuing a penalty (and not do so automatically) so that, even if the taxpayer has no reasonable excuse, it should not be a foregone conclusion that a penalty would be imposed. Such a fetter would be contrary to basic public law principles. Furthermore, the interpretation of paragraph 4(1)(c) appears to go against the true purpose of the legislation, even though it falls within the literal meaning.

Finally, it should be noted that, in relation to the argument on paragraph 4(1)(b), the Court provisionally rejected HMRC's reserve argument (being that the programming of the computer amounted to the effective decision). Given that the Court had already concluded that a relevant decision had already taken place then HMRC did not need to succeed on this point. However, the Court's provisional findings do throw light on the correct interpretation of the predecessor legislation in the TMA, section 100(1). I have been involved in a number of cases where automated penalties were challenged as non-compliant with section 100. Although HMRC ultimately withdrew the penalties in each such case (presumably because they realised that they were on a rather sticky wicket), they did nevertheless suggest that the decision to program the computer in a particular way amounted to the relevant determination for the purposes of section 100(1). The Court of Appeal's decision in *Donaldson* does suggest that this rather weak argument would not even have got off the ground.
