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In this week's edition of the tax update we look at:

1. VAT default surcharge penalties will be strictly enforced.
2. Tax avoidance receiving more adverse publicity.
3. First Tier Tribunal decides that mandatory electronic filing is unreasonable.
4. Employment NIC allowance announcement.

1. VAT default surcharge penalties will be strictly enforced

Penalties which are punitive may be civil penalties but they engage with the Human Rights Act and give protection to those accused of becoming liable. It also means that the penalty must be clearly understood by the wrongdoer and proportionate to the offence.

In **Gielly Green v Revenue & Customs [2013] UKFTT 509**, the company claimed to have a reasonable excuse for being late with the payment but a surcharge was calculated at 15% of the VAT due of £35,928.23 creating a liability to a default surcharge of £5,389.23. Now default surcharge starts with a notice (a surcharge liability notice (SLN)) but it takes five defaults (or more) before it rises to 15%. So this company has a poor compliance record and should be aware of the consequence of delay.

The company had a due date of 7 October, 2012 for electronic VAT Payments and Returns. The VAT Return was received electronically by HMRC on 27 September, 2012. The company paid their VAT by way of a BACS transaction which was received by HMRC on 8 October, 2012. As the payment was received after the due date (07 October 2012), the surcharge was correctly imposed unless the company had a reasonable excuse or the surcharge was disproportionate.

The company claimed to have a reasonable excuse because it had made every effort to pay its VAT liability on time and the reason the payment was received three days later (after being instructed on 05 October 2012) by HMRC was due to a banking error beyond the appellant's control. Enquiries have been made of HSBC to establish why the payment was not processed on 06 October, when it was instructed by the company to pay on 05 October but without success. The onus here lies with the company and its failure to provide evidence from the bank denies it the argument of a reasonable excuse.

But that leaves the issue of whether imposing a surcharge of £5389.23 (15%) is disproportionate. The tribunal does not really consider this although it is implicit in the decision that the tribunal thinks such a large penalty is proportionate. The company had a poor compliance history and had been in the VAT default surcharge regime for some time (at least 2 years). The proprietors of the company would have been aware of the deadline for payment and the consequences of late payment. As stated in **VATA 1994 s71(1)(b)** where reliance is placed on any other person to perform any task, neither the fact of that reliance, nor any dilatoriness or inaccuracy on the part of the person relied upon is a reasonable excuse. The company therefore cannot rely on any delay caused by the bank, unless it can also show that the delay was caused by events entirely outside its own control. The company failed to introduce any evidence or explanation.

Given that the VAT payment was made at or after normal banking hours by the director, the company cannot suggest it is blameless for the delay that occurred.

The company has therefore not shown a reasonable excuse for the late payment. It was held liable to pay the surcharge in full.

2. Tax Avoidance receiving more adverse publicity

As the **Guardian**, and many papers, reported recently: Alliance Boots, which became Britain's biggest private equity buyout in 2007, is alleged to have avoided paying tax by more than

£1.1 bn. The conversation and political commentary has been very poor and it is a worrying feature that the debate is so poorly informed.

In principle, everyone should pay the right tax at the right time. The problem is that different people have different definitions of what is the right amount of tax. Tax should be clear, certain and collectable but our politicians have repeatedly failed to enact decent tax laws with the result that we have a complex, voluminous and expensive tax system which is really not appropriate for a self-assessment regime such as we have in the UK. However, two wrongs do not make a right. What needs to happen is that there should be a mature debate about our tax system and, in particular, whether the tax laws should be redesigned to facilitate the collection of tax.

A different way of expressing that is to ask the question whether the complexity that results from enacting special reliefs and sometimes using tax as a lever for social engineering is appropriate. In addition, the political theatre that politicians desire when they announce change needs to stop. Would it not be better if a clear sustainable tax regime were enacted which would improve certainty and confidence and reduce the cost of compliance?

A report, commissioned by Unite, War on Want and US union group Change to Win, found that Alliance Boots generated UK taxable profits, before interest costs, of £4.5bn between 2008 and 2013. But it also incurred financing costs of £4.2bn over the same period, reducing its UK taxable profits to just £313m.

The three organisations are calling for action from the UK government to modernise the outdated tax system, which allows companies to manipulate their profits to avoid taxes, and to make transparent significant public contracts through which major corporations profit from the public purse. They call for:

- Alliance Boots to disclose key tax and financial information
- An investigation into Alliance Boots' tax practices
- Modernisation of taxation of private equity-backed businesses
- Reform of taxation in British Overseas Territories
- Transparency and accountability for public contracts undertaken by private companies.

I understand that Alliance Boots reduced its taxable profit by paying massive amounts of interest on its considerable debt. The UK already has anti avoidance legislation to tackle abuse of artificial debt structures. Do we really want more legislation?

Sensible planning to meet commercial objectives is an appropriate exercise. Indeed, earlier this year the Mehjoo decision was delivered and an accountant was ordered by the courts to pay compensatory damages to his client for failing to direct the client towards an aggressive tax avoidance scheme that might have saved him considerable tax. In other words, tax advisers are damned if they do and damned if they don't give advice on legitimate ways to avoid tax.

My recommendation would be to look carefully at the contract established by the engagement letter and limit the exposure. But I also recommend that interested parties should debate whether or not we could simplify and improve the UK tax system.

3. First Tier Tribunal (FTT) decides that mandatory electronic filing and payment is unreasonable

In what is a test case for many people, Barbara Mosedale judged at the FTT, that electronic filing may be a breach of human rights and the way that HMRC had imposed it was unreasonable. In **LH Bishop Electrical Co Ltd A F Sheldon (t/a Aztec Distributors) v Revenue & Customs [2013] UKFTT 522,** the lawfulness of HMRC's requirement that they file VAT returns on-line and, in one appeal, the obligation to make payments electronically was challenged

Approximately 100 taxpayers have filed appeals against notices to file online, mostly in VAT cases but also in PAYE cases. The joint appellants' case is that HMRC acted in breach of its public law duties in failing to exercise a discretion which the regulations gave them.

This is a very lengthy decision because first the tribunal had to decide it had jurisdiction to hear the cases. It did. Then it had to decide whether HMRC's decision to refuse other methods of filing and payment was reasonable. Personally, I think that HMRC's decision to pursue these exceptions lacked common sense but what HMRC was doing was applying a law that Parliament had enacted. Our tax law is badly written and produces all sorts of unintended consequences and this is an example of HMRC applying bad law but doing so in order to achieve economies and staff reductions.

In this joint appeal, several of the appellants had severe disabilities and did not have convenient access to computers. HMRC's response to this was that the appellants could ask friends and family for help and also they could use HMRC's telephone service. The first means a loss of independence and the second was at the time a dreadful service often with HMRC not answering the phones despite the caller letting it ring for considerable periods. That loss of independence and loss of privacy is a breach of Human rights.

The tribunal criticised the HMRC research on internet filing and payment for failing to take account of persons who might have difficulties in filing online due to old age, computer illiteracy, disability or lack of reliable internet access.

There is a great deal of analysis in this judgement and consideration of the individual circumstances and evidence. It takes determination and perseverance to read this decision but by pargraph 510 it concludes on the telephone filing concession: "..it is unlawful to act as HMRC have done and give a concession but fail to publish it. It is a fundamental principle that HMRC should treat taxpayers equally. They cannot do this if the concession is unpublished and in effect only communicated to those who happened to be the lead appellants in the litigation or those who phoned a helpline. In this HMRC have acted as no reasonable taxing authority could have acted."

Even worse the judgement criticises HMRC which ought to have considered the relative costs to HMRC of paper and telephone filing. The evidence strongly suggests that telephone filing costs HMRC (in HMRC officer time) more than paper filing and it is only viable because so few people are offered it.

The possible methods of compliance discussed at the hearing were as follows:

a) The taxpayer could use his own computer and internet link. For taxpayers without an online computer this would involve capital expenditure on the purchase of hardware and software and income expenditure on a monthly contract for broadband or dial-up link to the internet The FTT Found "If the appellant did not own an online computer, compelling the taxpayer to buy one in order to file its VAT return would in my view be a breach of A1P1 as it would be an interference with the possessions of the taxpayer beyond the margin of appreciation allowed to governments because it would be out of all proportion to the cost benefit to HMRC and discriminatory against persons who were old as they are less likely to know how to use a computer and therefore to own one; in any event it would also be a breach of A1P1 combined with A14 for the same reason.

b) The taxpayer could use an online computer belonging to a friend or family member assuming that friend or family member gave permission. This would not be expected to involve expenditure on the part of the taxpayer. This is a breach of privacy and Article 8

c) The taxpayer could use a public computer free of charge at a public library. The discrimination is against elderly persons, and those who live remotely. This is because by reason of old age, an elderly person is less likely to own a computer.

They are therefore the persons who would be obliged to use a public library to file. This therefore is discrimination against elderly persons. The regulations fail to accord to elderly persons the same right to confidentiality that younger, computer owning and computer literate persons are given by the Government. This is a breach of A8 combined with A14.

d) The taxpayer could engage a professional agent to make the online submission on behalf of the taxpayer. This is a breach of A1P1 alone or in conjunction with A14 because of its discriminatory nature in so far as it applies to those who are computer illiterate due to their age, persons who are too disabled to use a computer reliably or without pain, and those who live remotely

e) At the request of the taxpayer, a friend or family member could make the online return submission on behalf of the taxpayer. This fails article 8

f) The taxpayer could use HMRC's "phone filing" facility. The judge mentions this option but she has already determined that HMRC cannot rely on it in these proceedings, so it is irrelevant as an option

g) The taxpayer could use free of charge a dedicated stand-alone computer at an HMRC enquiry centre but the judge has already determined that HMRC cannot rely on this option in these proceedings, (because HMRC have already announced the closure of enquiry centres), so it is irrelevant as an option.

The judgement made findings of fact on the savings to HMRC (see § 375) and the costs to the appellants (§ 378). In summary the cost saving to HMRC appears to be less than £8 per return (ie less than £32 per year). The cost to the appellants who don't have a computer of buying an online computer is many multiples higher than this (£200-£400 per year). The FTT ruled that it was satisfied that this would be an excessive burden on those individuals (§ 603). But, as there were other means available such as taxpayers could comply by employing an agent at an annual cost of about £60 or more per annum – (see §383) which is significantly less the burden is within the margin of appreciation available to the state.

The judgement finds that mandatory filing and payment causes indirect discrimination against old persons, who because of their age were computer illiterate, and against disabled persons, who due to their disability were unable to use a computer or only able to use one with difficulty. There was also discrimination against those who lived in too remote an area for broadband access.

While the regulations can be justified, the failure to make exemptions for these three classes of persons cannot be justified for the reasons given.

This is a 933 paragraph judgement and it deals with some very complex arguments examining the extent of administrative law and the interaction of tax law and human rights. It is a must read for all practitioners.

4. Employment NIC allowance announcement

The Chancellor announced the creation of a **NICs Employment Allowance** in the 2013 Budget. This is planned to start on 6 April 2014 and moved a step closer to becoming law with the **First Reading of the Bill on 14 October 2013.**

Businesses, Charities and Community Amateur Sports Clubs will be able to reduce their Employer Class 1 NICs bill by up to £2,000 per year. The Employment Allowance will be straightforward to claim using standard payroll software. You can read more on this at:

The measure is expected to have a positive impact on businesses and civil society organisations by reducing their employer NICs bill. Up to 1.25 million employers will benefit, with over 90 per cent of the benefit going to small businesses with fewer than 250 employees. As a result 450,000 small employers will no longer pay Class 1 secondary NICs in 2014-15

and, on average, employers with fewer than ten employees over the course of the year will see their employer NICs bill reduced by 80 per cent.

Derek Allen
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The views expressed in these podcasts are Derek Allen's personal views and do not necessarily represent AAT policy or strategy.