Faculty of Taxation

TAXREP 24/03

APPEALS AGAINST DIRECTIONS UNDER PAYE REGULATIONS 42 AND 49 AND NIC EQUIVALENT

Memorandum submitted in July 2003 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to a technical paper issued in April 2003 by the Revenue

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GENERAL COMMENTS

1. We welcome the opportunity to comment on the proposals in the technical paper issued on 16 April by the Revenue on their website at http://www.inlandrevenue.gov.uk/consult_new/regs42_49.pdf

2. We have long considered that there should be an appeal mechanism via the Commissioners to avoid the need for judicial review or County Court proceedings and are delighted that the aim of the technical paper is to redress this lacuna. However, as explained below, we are concerned that the solutions suggested by the Revenue do not address the need comprehensively, especially as concerns the extent to which the Revenue have to prove that an employer has acted in good faith and exercised reasonable care, and balance the interests of employers, employees and the Exchequer.

DETAILED COMMENTS

Introduction

3. We reproduce below the Revenue's questions in arial typeface.

Part I - PAYE

Regulations 42(3) and 49(5)

4. Paragraph 8.3 suggests that there is no need for a right of appeal for employers. Whilst we accept that Regulations 42 does not impose a liability on an employer so an appeal would appear to be not in point, in any such dispute the employer and the employee might be on opposing sides, especially for example where the employee has left and the company is trying to transfer a liability to him or vice versa. We consider that the employer must have a right to information and representation in any such appeal, since the employer and employee may prefer different outcomes.

9.1 Do you agree there is a need for a right of appeal by the employee in relation to a direction under regulation 42(3) or 49(5)?

5. Yes we do. Denying the right of appeal to an employee may mean that an employment income tax debt will be enforced unexpectedly where the employee had every reason to assume that his tax affairs were in order. This contrasts unfavourably with Revenue policy in other areas, for example as set out in Extra Statutory Concession A19: Giving up tax where there are Revenue delays in using information.

6. The employee might have a case that the employer did not act in good faith, or did not take reasonable care: he should be allowed to argue it. Or he might wish to appeal against the amount being charged under PAYE. In addition, the employee should be allowed to argue that even if the employer did act in good faith, he (the employee)

should not be landed with an unexpected burden when he had no way of knowing that PAYE was not being operated in the proper way. Whilst we acknowledge that judicial review is available in the absence of a formal appeal mechanism, the cost to the ordinary employee is so prohibitive, and the test of reasonableness so stringent, that it is hardly a realistic appeal option.

9.2 Do you have any comments on the proposals for how such a right of appeal would operate (as in paragraph 8.5)?

7. Obviously in operating any appeal procedure, the Revenue should deal fairly with the employer and employee. Para. 8.5, appeal mechanism in reg 42(3) and 49(5) cases, states: 'a warning letter is sent to the employee ... asking for any evidence that tax was deducted'. We would welcome clarification of what evidence the employee would be expected to produce: presumably the payslip would normally be sufficient.

8. In para. 8.11, the Revenue indicate that they are unwilling to prove underlying issues regarding knowledge and wilful default (para 8.8) on grounds of expense. However, we question how they can avoid being put to the proof on these issues, at the very least on Human Rights Act grounds (see below). If the Revenue are alleging wilful failure to deduct on the part of the employer, or that the employee received income knowing that the employer had wilfully failed to deduct PAYE, then wilful default and knowledge are precisely the issues which will need to be examined in any appeal proceedings. The Revenue cannot just make allegations and then not be required to prove them on the ground that it would be too expensive to do so.

9. There is an argument that this kind of wilful default is potentially 'criminal' in nature under European human rights jurisprudence, which would bring Article 6 of the Convention into play, and that in turn reflects the 'golden thread' within the web of English Criminal Law referred to in the judgement of Viscount Sankey LC in *Woolmington v DPP*, 1935 AC 462 (at p481) that an accused person is innocent until proved guilty.

10. As a separate point, where an underpayment was by a company which has defaulted and there is a new company in its place, the Revenue should pursue the old company management rather than that of the new company.

9.3 Do you agree that there is no need for a right of appeal by the employer in relation to a direction under regulation 42(3) or 49(5) (other than as already provided in relation to a determination under regulation 49)?

11. We do not agree. We consider that an employer should at least have rights of information and intervention: see comments above.

9.4 Do you have any comments on the proposals for a right of appeal for employees in relation to directions under regulation 42(3) or 49(5)?

12. See replies to foregoing questions.

Regulation 42(2)

13. Regarding para 11.5, whilst certainty for employers is always desirable, the overarching certainty is that they know that they have to operate PAYE in accordance with the law. We therefore see no reason why the employee should not have the opportunity to challenge a direction and if he is successful there is no reason why liability should not be made to revert back to the employer in appropriate cases, even if the employer has become insolvent.

14. Regarding para 12.5, the statement that the outcome would always be that the employee gets tax-free income is questionable and over-presumptive.

13.1 Do you agree there should be a right of appeal for employers against refusal of a collector to make a direction under regulation 42(2)?

15. Yes we do.

13.2 Do you have any comments on the proposals for how an employer's appeal right under regulation 42(2) would operate (as in paragraph 10.4)?

16. We are content with the proposals.

13.3 Do you agree that it would not be appropriate for employees also to have a right of appeal against a direction under regulation 42(2)?

17. No we do not: see comments above.

13.4 Do you agree that, if both the employer and employee enjoy appeal rights, the employee should be enjoined in an employer's appeal (and vice versa), and where an appeal succeeds the liability will transfer to the other?

18. Yes we do.

13.5 If there is an appeal for employees should the employer be indemnified against a successful appeal?

19. No, we see no need for an indemnity.

Part II - NICs

Mirroring regulations 42(3) and 49(5) for NICs

20. Regarding para 16.7, where there have been underpayments of both PAYE income tax and NIC, there may be two appeals (ie tax and NIC) concerning the same income. We would welcome confirmation that the Commissioners would be empowered to hear both appeals together.

21. Regarding para 17.2, in some cases there could be overlap between what is proposed and the personal liability notice procedure.

18.2 Do you agree that the provision to transfer liability for payment of tax to an employee under the provisions of regulations 42(3) and 49(5) should be mirrored for primary NICs?

22. In broad terms, we do agree.

18.3 Do you have any comments on the proposals for the procedures that would operate when both tax and NICs were to be transferred?

23. Our comments under PAYE apply here, mutatis mutandis, although we recognise that the NIC appeals regime already makes provision for both primary and secondary contributor to be advised and involved.

Mirroring regulation 42(2) for NICs

24. Regarding para 20.1, consideration needs to be given to situations where there has been an underpayment and the employee has subsequently left the employment. In these cases it looks as if the liability will revert to the employer. We suggest that the NIC rules should be adapted to mirror to some degree the income tax rules or to allow the employer a right of recovery against a former employee who was responsible for a default in respect of his own earnings.

20.2 Do you agree that there should <u>not</u> be a new NICs provision introduced which exactly mirrors regulation 42(2) by allowing the transfer of employee NICs liability from employer to employee after the year-end?

25. Yes, we do agree that any new NIC provision should <u>not</u> exactly mirror regulation 42(2). NIC is different from tax in that it has benefit implications and so certainty as to liability is required relatively quickly so that contribution records are reliable. We consider that the length of time that recovery from an employee of underpaid NIC can take place should be restricted to the current tax year and the year immediately following.

20.3 Do you agree that, where underpayments of employees' NICs arise out of an employer's "good faith error", although the liability to make good that underpayment at the due time should remain with the employer, the period allowing them to recover the underpayment from the employee should be extended into the next tax year?

26. Yes we do, as noted in the answer to the preceding question. This will allow for recovery in the early months of a new tax year of unpaid NIC arising in the last month of the previous tax year.

27. It should be recognised that this situation can arise not just through good faith errors, but straightforward compliance with inadequate Revenue instructions. For example, employers may follow the Revenue's instructions on FURBS as stated in June 2003 Tax Bulletin issue 65, despite the fact that in reality there is no Class 1 liability. If a FURBS contribution is made on 5 April and normal salary payments are on the last day of the calendar month, then this will give rise to an under payment of at least (currently) 1% NIC. This does not arise because of an error made by the employer, rather an error in construction of the NIC system by the tax authorities. The provisions need to embrace natural operation of the system, and not merely errors that an employer may make.

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