[2013] UKUT 0499 (TCC)

Appeal number FTC/39/2012

National Insurance Contributions – Personal Liability Notice – decision on preliminary issue – personal liability to pay NICs which the company has failed to pay – whether attributable to the "neglect" of the company's officer – meaning of "neglect" – whether a subjective or objective test – held by FTT that it is a subjective test – in consequence, medical evidence excluded at earlier directions hearing to be readmitted for consideration by the Tribunal – held allowing the appeal that it is an objective test – but matter to be remitted back to the Tribunal for further directions, given relevance of medical evidence to plea of fraud

UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Appellants**

- and -

MR CHARLES MICHAEL O'RORKE **Respondent**

TRIBUNAL: MR JUSTICE HILDYARD

Sitting in public at the Rolls Building, London EC4A 1NL on 12 & 13 April 2013

Ms Elizabeth Wilson, instructed by the General Counsel and Solicitor to HM Revenue and Customs for the Appellants

The Respondent in person

DECISION

Mr Justice Hildyard :

The issue on appeal

1. In this appeal from a decision of the First Tier Tribunal ("the FTT", constituted in this case by Sir Stephen Oliver QC and Ms Anne Redston) the sole issue (which was directed to be heard as a preliminary issue) is as to the meaning of the term "neglect" in section 121C of the Social Security Administration Act 1992 ("SSAA 1992").

2. The preliminary issue arises in the context and course of a substantive appeal by the Respondent ("Mr O'Rorke") against a personal liability notice issued to him on 3 September 2009 under that section 121C ("the main proceedings").

3. Put very shortly, and as amplified later, section 121C SSAA 1992 creates an ancillary (but alternative) personal liability for payment of NIC for certain officers of a company where that company is primarily liable but has failed to pay the contributions in question in consequence of a relevant officer's "fraud or neglect".

Procedural background and context in which the issue arises

4. In the main proceedings, a differently constituted FTT (comprised of Judge Nicholas Aleksander) made a case management direction (dated 24 June 2010) that Mr O'Rorke should not be permitted to rely on expert medical evidence (nor certain correspondence relating to it) on the ground that the term "neglect" imports an objective test, the standard being what the reasonable and prudent man of business would have done. On that basis, Judge Aleksander considered that the proposed expert evidence as to the subjective state of mind and condition of Mr O'Rorke could be of no assistance and he refused its admission.

5. However, Mr O'Rorke then caused the issue to be referred to a differently constituted FTT; and upon that reference, Sir Stephen Oliver QC and Ms Redston, both noted experts in the field, did not agree with Judge Aleksander. On 11 March 2011, after submissions on a preliminary issue as to the true meaning of the term "neglect", they resolved the issue in favour of Mr O'Rorke. They set aside Judge Aleksander's direction accordingly under Rule 5(2) of the Tribunal Procedure (First Tier Tribunal) (Tax Chamber) Rules 2009.

6. Sir Stephen Oliver QC and Ms Redston (to whom I shall from now on refer to together as "the FTT") considered that section 121C is penal in nature, and that the *mens rea* of the individual forms an essential ingredient of assessing liability under it: in other words, the test of neglect for the purposes of section 121C is subjective (see paragraph 117 of their reserved decision, "the FTT Judgment"). The proposed medical evidence was thus ruled relevant and admissible.

7. By a Decision Notice dated March 2012 Sir Stephen Oliver QC granted HMRC permission to appeal to the Upper Tribunal. The main proceedings have been stayed pending the outcome of this appeal.

Summary of my conclusions

8. Perhaps unsurprisingly, given the disagreement within the FTT and the problems in other contexts of determining whether a condition of mind is to be tested objectively or subjectively, I have found the issue a difficult one. I have eventually concluded that there is nothing sufficient in the context to displace the ordinary objective test of neglect and that this appeal should be allowed.

Key facts

9. The key facts relevant to this appeal are not substantially in issue and may be stated shortly.

10. The personal liability notice ("PLN") was issued to Mr O'Rorke further to the failure of L Wear & Co Limited ("the Company"), of which Mr O'Rorke was the Finance Director, to pay National Insurance Contributions ("NIC") in the sum of £290,307.60 for the period 6 May 2006 (the start of the Company's trading) to 5 April 2007 (the end of the period in which the Company ceased trading).

11. The Company had entered into administration on 5 March 2007 with those NIC as yet unpaid. Subsequently, with effect from 20 August 2007, the Company had gone into Creditors' Voluntary Liquidation.

12. On 11 January 2010 the joint liquidators (two partners in Baker Tilly Restructuring and Recovery LLP) satisfied the company's NIC liability in part. Following a review by HMRC, and pursuant to section 121C(7)(a), the PLN was reissued on 25 June 2010 in the reduced amount of £218,593.77. The reduction also took into account the fact that Mr O'Rorke had resigned as director prior to the end of the period of non-payment and it was accepted that

he could not be made liable for a period during which he was not an officer of the Company.

13. The (re-issued) PLN was issued to Mr O'Rorke on the basis that the non-payment was attributable to fraud or neglect (the two are put forward compositely) on his part as an officer of the Company (a "culpable officer" within the meaning of section 121C(1)(b) SSAA 1992) during the relevant period.

14. Neither the original PLN (dated 3 September 2009) nor the amended PLN (dated 25 June 2010) makes clear whether it is based on fraud, or neglect, or both. However, HMRC's Statement of Case makes clear that both are asserted; and it is stated in paragraph 3.16 of the Statement of Case that

> "In concluding that the failure to pay the contributions due was at least in part attributable to the fraudulent actions of the appellant, due regard was given to the fact that the appellant had been found guilty at Southwark Crown Court in July 2007 on four counts of theft and four counts of false accounting and had received a 20-month jail sentence in respect of his actions while Finance Director of L Wear Ltd [HMRC Bundle, Folios 08-09]."

15. This gives rise to a question as to the utility of the preliminary issue: there can be no doubt that the test of fraud is ultimately subjective, requiring proof of *mens rea* (though HMRC have advised the court, after seeing a draft of this judgment, that they may in the future wish to argue that in appropriate circumstances there is an objective aspect to fraud, as explained in ***R v Ghosh*** [1982] QB 1053). This appears to render moot whether evidence should be excluded altogether as if only neglect were alleged.

16. I return to this wrinkle later; suffice it for the present to note that the FTT couched the preliminary issue to which this appeal relates as if only neglect were in issue; they formulated the issue as being (see paragraph 9 of the FTT judgment):

> "whether the test in s.121(D)(2)(b) is subjective or objective."

17. This formulation, though apt in the context of neglect, does not appear to be apt in the context of fraud. Nevertheless, since (a) it is that question on which the appeal is founded and (b) in the end, fraud may not be established and an issue could arise as to the proper approach to the alternative limb of "neglect", I have concluded that I should address the issue as put to me.

Mr O'Rorke's appeal against the PLN

18. Mr O'Rorke appealed against the PLN on two main grounds. First, he claimed not to have been an officer of the Company for part of the time for which payment was sought: this was accepted, and explains the revision of the original PLN. Secondly, he denied that he was guilty of "fraud or neglect": he contended that his actions, at the time of the Company's failure to pay NICs, were severely affected by mental illness (in the form of an addiction) that he was suffering from as a result of childhood trauma; this, he argued, ought to be considered when assessing whether he was culpable in the carrying out of his duties. As indicated above, Mr O'Rorke sought to introduce medical evidence to substantiate his mental illness and its effects and in support of his case that he should not be held responsible or accountable for his actions in failing to pay NIC.

19. Judge Aleksander dealt with the matter on paper: his directions excluded the medical evidence as being irrelevant.

20. When the issue came before the differently constituted FTT, the matter was again dealt with on paper after written submissions: neither side was given the opportunity to make oral submissions, despite both parties separately requesting an oral hearing before the Tribunal if it was minded to decide the point against that party. The hearing before me was thus the first occasion of oral argument.

21. The oral hearing before me, at which HMRC were represented by Counsel (Ms Elizabeth Wilson) and Mr O'Rorke represented himself, took two days. There was substantial citation of authority. I address the legal issues below. As is appropriate on an appeal, I start with the judgment of the FTT which is its subject.

The FTT's decision in summary

22. As stated above, the FTT (comprised of Sir Stephen Oliver QC and Ms Anne Redston), in a 123-paragraph decision, rejected HMRC's submission that the test of neglect is objective.

23. They accepted that this departed from the more usual meaning of the word "neglect" "familiar to practitioners of tort law", which imported an objective standard of conduct as summarised long ago by Alderson B in *Blyth v Birmingham Waterworks Co* (1856) 11 Exch. 781 at 786:

> "Negligence is the omission to do something which a reasonable man, guided upon those considerations which ordinarily regulate the conduct of human affairs, would do, or doing something which a prudent and reasonable man would not do. The defendants might be liable for negligence, if, unintentionally, they omitted to do that which a reasonable person would have done, or did that which a person taking reasonable precautions would not have done."

24. The FTT further accepted that:

> "The consequence of this interpretation is that liability attaches, even where the officer is suffering from a mental disability: see *Morriss v Marsden* [1952] 1 All ER 925. The *ratio* of that decision, as summarised in the headnote, is that 'the defendant knew the nature and quality of his tortious act, he was liable for damages for it even though he did not know that what he was doing was wrong'."

25. Nevertheless, they considered that, set in context, and construing section 121C purposively and in a way which is compatible with the European Convention on Human Rights, *"neglect"* imported a subjective standard and should be read as requiring proof that the relevant officer had acted knowingly and deliberately, or (in ancient hallowed words) with *mens rea*.

26. Fundamental to the FTT's approach (which, naturally, Mr O'Rorke adopted on appeal) was its characterisation of section 121C as (a) forming part of wider code almost exclusively concerned with criminal proceedings and penalties against defaulters (b) itself providing for punishment of a "culpable" director by (in effect) transferring from the company to the director the onerous obligation of repaying NICs and (c) constituting in such circumstances a "criminal" provision for the purposes of the Convention and "penal in nature" for the purposes of domestic English law.

27. The FTT considered that in construing such a provision there is a common law presumption that a mental element, traditionally labelled *mens rea*, must be established, unless Parliament has indicated a contrary intention, either expressly or by necessary implication. The FTT primarily concluded that there was nothing to evince any contrary intention, and thus that "the common law requires that the test be subjective, not objective" (see paragraph 15 of the FTT's summary of reasons).

28. In reaching that decision, the FTT itself considered there to be no real ambiguity (see paragraph 16 of the summary of reasons). However, they

recognised that the sustained disagreement between the parties, and the views expressed by Judge Aleksander, might suggest a sustainable argument to the contrary. So the FTT went on to consider *Hansard* upon the basis that there was such an ambiguity that such reference to the relevant parliamentary debate was permissible in accordance with the guidelines established by the decision in *Pepper v Hart.* In particular, the FTT referred to and for the purposes of this alternative approach relied upon a statement made by Lord Haskel during the debates on the section that *"only those shown to have acted knowingly and deliberately will be penalised"*.

29. The FTT concluded that that statement exposed the true intended meaning of the section, rather than (as HMRC contended) being merely a reference to the way in which HMRC would in practice administer and apply the powers conferred upon them under that section.

The FTT's analysis in more detail

30. The FTT pointed especially to the following features of section 121C and the statutory provisions of which it forms part:

(1) its place within Part VI of the SSAA 1992, which is headed "Enforcement";

(2) its inclusion in a series of sections in the same part and under the same heading which otherwise for the most part provide for criminal proceedings and penalties against defaulters, that is to say, sections 114, 116 – 117A (penalty for non-compliance enforced via the magistrates or Crown Court, and the procedure to be adopted), sections 118, 119 and 120 (dealing, respectively, with what evidence of non-payment is required in a criminal court, the process for recovery after a successful prosecution, and the admissibility of previous convictions) to be accepted; and section 121 A, which sets out a procedure under which Justices of the Peace may issue warrants allowing HMRC to collect unpaid contributions by distraining upon goods and chattels of a "person in default" and for entering into his home "by force if necessary";

(3) the context in which the word "neglect" sits in the section itself , and the language deployed (in particular, the word "culpable", which the Oxford English Dictionary defines as "guilty, criminal, deserving punishment or condemnation", and is to be distinguished semantically from expressions that might otherwise have been more

appropriate such as "accountable officers" or "the officers responsible");

(4) the provision in section 121C(4) allowing HMRC, when assessing an officer's "culpability" in comparison to that of other officers, to "have regard both to the gravity of the officer's fraud or neglect and to the consequences of it";

(5) the punitive nature of the consequences: the transfer of liability from the body corporate to officers who would not in law otherwise be liable.

31. The FTT also considered what would be the characterisation of section 121C for the purposes of the ECHR, by reference to what have become known as the *Engel* criteria (*Engel v The Netherlands (no. 1)* (1976) 1 EHRR 647), and (in the application of those criteria to fiscal provisions) the guidance given by the ECtHR (Grand Chamber) in *Jussila v Finland* [2006] 9 ITLR 662 ("*Jussila*"), a case concerning surcharges imposed (so it was held) as a deterrent punishment on a taxpayer for errors discovered by the Finnish fiscal authorities.

32. More particularly, they considered whether the liability prescribed should be categorised as "criminal" by reference to three factors, that is:

(1) the classification of the proceedings under national law (i.e. whether the procedure is classed as a civil or a criminal one);

(2) the "essential" nature of the offence;

(3) the degree of severity of the penalty that the person risks incurring.

33. Applying these criteria the FTT considered that:

(1) the first was not met: the proceedings are classed as civil and not criminal under UK law;

(2) however, taking into account the further analysis in *Jussila*, which concluded that surcharges imposed by a rule whose purpose was deterrent and punitive "establishes the criminal nature of the

offence", the provision for transfer of the original NIC liability from the body corporate to one or more officers is punitive;

(3) although there is no statutory *de minimis* limit, HMRC confirmed that the provisions would only be deployed when the amounts involved are significant;

(4) especially given the applicability of the second criteria, the provisions should be regarded as imposing "criminal" liability.

34. The FTT accepted that such a characterisation for the purposes of the Convention, which entitles the defendant to the safeguards provided by Article 6, does not necessarily mean that they must be so characterised for domestic law purposes. This was made clear by the Court of Appeal in *CIR v Han* [2001] STC 1188 (see paragraphs [84] (Potter LJ) and [88] (Mance LJ). However, the FTT in this case plainly considered the Convention classification to constitute further support both for treating the purpose of the provision as penal for the purposes of domestic law and for reading in a requirement of *mens rea*.

35. Turning then to *Hansard*, the FTT cited and relied especially on the following statement by Lord Haskel (as the Minister responsible for introducing section 121C into statute) in the parliamentary debate on the provisions in the House of Lords on 30 March 1998:

> *"I thank noble Lords for their general support of the principle even though there is some disagreement as to the way in which it will be carried out. The noble lord, Lord Higgins, asked which directors are culpable. The investigation of each director's responsibility and knowledge will be carried out so that only those shown to have acted knowingly and deliberately will be penalised." (Col 80).*

36. In addition, the FTT quoted the following statements by Lord Haskel on the same occasion:

> *"The total debt, which includes any associated penalty and interest, will be apportioned between the culpable directors in proportion to their degree of culpability without taking account of each individual's ability to pay. Thus no 'innocent' director will be pursued simply because he has not disposed of his assets." (Col 77)*

> *"I hope that both this Committee and legitimate businesses will welcome a measure aimed at dealing with the unscrupulous minority of directors who abuse their positions and ignore their responsibilities." (Col 78)*

> *"The principle of limited liability…is not really intended to protect fraudsters and those who are seriously negligent in carrying out their responsibilities." (Col 81)*

37. The FTT rejected HMRC's reading of these extracts as merely providing administrative guidance as to how the legislative provisions should be carried out in practice, and considered them, rather, to be intended to elucidate the meaning of the word "neglect", and to make clear that in the context "Parliament intended that the PLN procedure should be used only where the officer had acted 'knowingly and deliberately'".

38. In summary, and for all these reasons, the FTT put its conclusion in this way (in paragraph 110 of its decision):

> "As a result, we find that the word "neglect" does not have the objective meaning familiar to practitioners of tort law, but must be read as requiring *mens rea."*

HMRC's approach and submissions

39. HMRC's view of the legislation as described in its Statement of Case in the main proceedings (at paragraphs 2.10 to 2.17) is broad in its interpretation but more restrictive in its ordinary application:

> "2.10 The legislation at Section 121C…is broad in its effect in that it provides that a Personal Liability Notice may be issued whenever contributions are unpaid because of the fraud or neglect of an individual who was an officer of the company during the period in question.
>
> 2.11 Under the legislation any failure to pay on time could constitute neglect as a taxpayer who knows of an obligation – in this case the statutory obligation to pay National Insurance Contributions by a prescribed date – and fails to fulfil that obligation could be regarded as being to some degree negligent.
>
> 2.12 However, it is very important that HMRC acts to protect, from the scope of this legislation, directors of genuinely failed businesses and those regarded to

have taken all reasonable steps to minimise the company National Insurance Contributions debt. Therefore HMRC follows clear and robust internal guidelines and procedures to ensure that the legislation is applied fairly and appropriately only to those cases where we believe there is sufficient evidence to show that the failure to pay was attributable to fraud or more serious levels of neglect.

2.13 Our actions are consistent with statements made by Lord Haskel, on behalf of the government, during the House of Lords debate on the introduction of this legislation, where he stated, "*The government propose to take action to make culpable directors personally liable for national insurance debts where the failure of the company to pay is due to serious negligence or fraud on their part.*"

2.14 The legislation itself provides further safeguards to genuinely failed companies at paragraph (4) of section 121D…stating that on appeal the burden of proof as to any matter raised by the appeal will be with HMRC.

2.15 In order to identify only those cases where the failure to pay…is attributable to fraud or more serious neglect of an individual officer of the company, a comprehensive and detailed enquiry to establish the facts and circumstances behind the company failure to pay the contributions due is carried out by a small specialised team prior to any decision to serve a Personal Liability Notice.

2.16 A thorough enquiry will include reviewing the available company books and records and inviting voluntary representations from the directors. The officers in question are given every reasonable opportunity to provide any information they feel is relevant to the failure to pay the contributions due and to address HMRC's concerns.

2.17 For a Personal Liability Notice to be issued a senior authorising officer must be satisfied 'on the balance of probabilities' that the failure to pay the contributions due was attributable to the fraudulent or more serious negligent conduct of one or more officers of the company."

40. HMRC submit that the word *"neglect"* in the phrase *"fraud or neglect"* as it appears in Section 121C SSAA 1992 bears its familiar meaning of "an omission to do what one should do" as an officer of the company.

41. They contend that "what must be shown is that the individual should have done something which expressly falls, or should be held to fall, within the scope of the office which he holds (and that he has not done it, negligently)".

42. They accept that, in addition, "the company's non-compliance" [with the obligation to make NIC] must be shown to be *"attributable"* to the individual's neglect. This is a question of fact. There must be a chain of causation. Where the company's non-payment is attributable to more than one "officer", section 121C(3)(b), (4) enables the liability to be distributed (fairly and rationally) by reference to the "relative degrees of culpability".

43. They make the further points that

(1) "the words "wilful" and "wrongful" do not appear in section 121C and there is no rational basis to imply them";

(2) "in section 121A(1)(b) (recovery of contributions), the term "neglect" is used in contrast to "refuse", indicating that…Parliament did not regard "neglect" as something wilful";

(3) "neglect" does not connote any intent to do wrong.

44. HMRC especially relied upon the following in the judgment of the Lord Justice-General (Emslie) in the High Court of Justiciary in Scotland in *Wotherspoon v HM Advocate* [1978] JC 74 at 78, addressing the meaning of "neglect" in section 37(1) of the Health and Safety at Work etc. Act 1974. That section, not unlike section 121C here, involves consideration of the secondary or ancillary liability of an officer of a company where the primary liability falls upon the company. Section 37 draws a distinction between consent and connivance (subjective) and neglect:

> "… the word 'neglect' in its natural meaning pre-supposes the existence of some obligation or duty on the part of the person charged with neglect. Where that word appears in section 37(1) it is associated with certain specified officers of a body corporate or with persons 'purporting to act in any such capacity'. It is any neglect on their part to which the commission of an offence within a specified category by a body

> corporate is attributable which attracts the penal sanction. As we read the subsection and also section 37(2) which deals with the case of a body corporate, the affairs of which are managed by its members, it seems clear that the section as a whole is concerned primarily to provide a penal sanction against those persons charged with functions of management who can be shown to have been responsible for the commission of a relevant offence by an artificial persona, a body corporate. Accordingly, in considering in a given case whether there has been neglect within the meaning of section 37(1) on the part of a particular director or other particular officer charged, the search must be to discover whether the accused has failed to take some steps to prevent the commission of an offence by the corporation to which he belongs if the taking of those steps either expressly falls or should be held to fall within the scope of the functions of the office which he holds. In all cases accordingly the functions of the office of a person charged with a contravention of section 37(1) will be a highly relevant consideration for any judge or jury and the question whether there was on his part, as the holder of his particular office, a failure to take a step which he could and should have taken will fall to be answered in the light of the whole circumstances of the case including his state of knowledge of the need for action, or the existence of a state of fact requiring action to be taken of which he ought to have been aware."

45. *Wotherspoon* was cited with approval by the Court of Appeal (Criminal Division) in *Regina v P* [2007] EWCA Crim 1937. That was another case under section 37 of the Health and Safety at Work Act 1974. At first instance, the judge (basing himself on certain passages in a ruling given by MacKay J in the context of the prosecution of those who were said to have been responsible for the Hatfield rail crash) had concluded that the test of liability ("ought to have been aware") imported a subjective test,

> "in the sense of turning a blind eye in circumstances where the defendant had suspicion or belief as to the material facts but, because he feared the answer might be unpalatable, he did not want to know more. This is the sense in which it is described in *Manifest Shipping v Uni-Polaris Insurance Co Limited* [2003] 1 AC 46. It is a subjective test and not equivalent to inadvertence, laziness or even gross negligence…"

46. Latham LJ (with whom the others agreed) rejected this approach. He said this (at paragraphs 12 and 13):

> "12. With great respect to MacKay J, it seems to us that he places the burden too high. The section in the Act does not refer, for example, to wilful neglect. Nor did Wotherspoon in any way suggest that the question is whether the defendant in question ought to have been aware in the sense that he had "turned a blind eye". That equates the test in relation to neglect into the same test that is to be applied when the allegation is connivance. Parliament has chosen quite plainly that there should be a distinction between consent, connivance and neglect.
>
> 13. The question, at the end of the day, will always be, as the Lord Justice General said in Wotherspoon, whether or not it is proper, where there is no actual knowledge of the state of facts, nonetheless the officer in question of the company should have, by reason of the surrounding circumstances, been put on enquiry so as to require him to have taken steps to determine whether or not the appropriate safety requirements were in place…"

47. HMRC cited, in addition, *R v Chargot Ltd (trading as Contract Services) and others* [2008] UKHL 73, where Lord Hope endorsed the approach of both Latham LJ and Lord Justice-General Emslie, noting also (at paragraph 33) that

> "The fact that the penalties that may be imposed for a breach of this section have been increased does not require any alteration in this test. On the contrary, it emphasises the importance that is attached, in the public interest, to the importance of the duty that section 37 imposes on the officer."

48. HMRC also referred me to a decision of Judge Aleksander sitting as a Special Commissioner in *Peter Inzani v R&C Comrs* [2006] STC SCD 279, and a decision of Mr J Gordon Reid QC in *Stephen Roberts & Alan Martin v R&C Comrs [2011] UKFTT 268 (TC)*; both appear to endorse or repeat the view that neglect denotes negligence, and imports an objective standard.

49. Lastly, HMRC submitted that

> "27. The FTT misunderstood the use of the word "culpable" in section 121C [FTT 58, 59] and the fact that the section is part of a wider penal code [FTT 53, 83]. The word "culpable" is merely the label used by the draftsman to refer to the director or officer who is

responsible. Moreover, its use in section 121C is entirely apt.

(i) Where an individual is negligent of his responsibilities as a director or similar duty-holder, and his negligence results in the company treating HMRC as an involuntary creditor (a creditor who has not negotiated the terms of its indebtedness), then he is at fault. He has done something which Parliament has determined to be blameworthy.

(ii) Such an officer is also culpable (i.e., he is personally responsible). He *'should have been put on enquiry': R v Chargot Ltd (trading as Contract Services)* (HL) [2009] 1 WLR 1 [32]-[33] *per* Lord Hope.

(iii) See also, the use of the word *"culpable"* in regulation 50 of the Social Security (Contributions) Regulations 1979 to describe an employed earner whose "act or default" led to the company's failure to pay NIC.

…

31. The extract is not admissible as an aid to construction of section 121C [FTT 95-96]. The section is unambiguous. It uses the word "neglect" consistently with section 121A and section 115. This is the same meaning as applied in at least 3 other FTT cases on s.121C (until the release of the decision in *O'Rorke*). By contrast, the Tribunal's implied test has already been qualified to include reckless conduct by another first tier tribunal (*Smith*).

…

33. In any event, HMRC's interpretation of section 121C is consistent with Lord Haskel's description of the regime. Lord Haskel repeatedly refers to "fraud or negligence" and "serious negligence". Thus, he gives the word neglect its classic meaning of negligence. There is a single reference to acting knowingly and deliberately. However, it is too imprecise to be taken as a representation about the meaning of the word neglect (and far too brief and imprecise to be taken as a

statement about the degree of mental capacity required for neglect).

…

38. The statutory test is also clear and works to identify clear cases of fraud and negligence.

39. Finally, HMRC's interpretation does not confer on HMRC a wide discretion to create a basis for taxation [FTT 112-116]. In suggesting that it did, FTT erred in law. Essentially, the FTT failed to recognize that the combination of section 121C itself, section 121D(4) (burden of proof), and section 121C(7) (the company's payment automatically reduces the PLN liability) mean that HMRC are driven to consider PLNs only in clear or serious cases. Thus, their powers are limited in scope."

Mr O'Rorke's submissions

50. Mr O'Rorke, who represented himself, and did so with moderation, focus and economy, had the benefit of the FTT's decision in his favour and largely adopted its approach and reasoning. I can, therefore, be brief in summarising his principal submissions. These were to the following effect:

51. First, he characterised the provision (section 121C) for imposing liability on "culpable directors" in respect of their company's failure to pay NIC as penal in nature, both in the manner of its expression (he relied on the use of the word "culpable") and in terms of its substantive effect (imposition of liability for the obligations of another by reason of default). He submitted also that the stipulation that the burden of proof on appeal against a notice should be on HMRC is consistent with this approach.

52. Building on this characterisation he submitted, secondly, that it is a presumption of the common law that in construing a penal provision a mental element is an essential part of the offence unless Parliament has indicated a contrary intention, either expressly or by necessary implication. He relied particularly on *Sweet v Parsley* [1970] AC 132 and *B (a minor) v DPP* [2000] 2 AC 428, and especially on the following:

(1) the speech of Lord Reid in *Sweet v Parsley* at 148-149:

"Our first duty is to consider the words of the Act: if they show a clear intention to create an absolute offence

> that is an end of the matter. But such cases are very rare. Sometimes the words of the section which creates a particular offence make it clear that mens rea is required in one form or another. Such cases are quite frequent. But in a very large number of cases there is no clear indication either way. In such cases there has for centuries been a presumption that Parliament did not intend to make criminals of persons who were in no way blameworthy for what they did. This means that whenever a section is silent as to mens rea there is a presumption that, in order to give effect to the will of Parliament, we must read in words appropriate to require mens rea…it is firmly established by a host of authorities that mens rea is an essential ingredient of every offence unless some reason can be found for holding that it is not necessary…[and]…it is a universal principle that if a penal provision is reasonably capable of two interpretations, that interpretation which is most favourable to the accused must be adopted;"

(2) the approval in *B (a minor) v DPP* of this as a governing principle and of the following extract from the judgment of the Privy Council in *Gammon (Hong Kong) Ltd. v A-G of Hong Kong* [1985] AC 1 at 14 (*per* Lord Scarman):

> "(1) there is a presumption of law that mens rea is required before a man can be held guilty of a criminal offence; (2) the presumption is particularly strong where the offence is 'truly criminal' in character; (3) the presumption applies to statutory offences, and can be displaced only if this is clearly or by necessary implication the effect of the statute; (4) the only situation in which the presumption can be displaced is where the statute is concerned with an issue of social concern, and public safety is such an issue; (5) even where a statute is concerned with such an issue, the presumption of mens rea stands unless it can be shown that the creation of strict liability will be effective to promote the objects of the statute by encouraging greater vigilance to prevent the commission of the prohibited act."

53. Mr O'Rorke submitted that there was no contrary intention evident in relation to section 121C (although, as I return to discuss more fully later) sub-paragraphs (4) and (5) of the judgment of Lord Scarman above may not assist him.

54. He submitted, thirdly, that if (which he did not accept) the provision is ambiguous, and may be read as connoting an objective standard, then either (a) the ambiguity should be resolved in favour of himself (as in the position of being an "accused", see above) or (b) reference to parliamentary debate could be had, in line with *Pepper v Hart*, and this supported his case.

Further material

55. Before turning to my own analysis, I should mention certain additional cases and other material cited to me:

(1) Counsel for HMRC referred me to The Law Commission's Consultation Paper No. 195 entitled *"Criminal Liability in Regulatory Contexts"*. As is apparent from that title, the Law Commission was there concerned with statutory provisions giving rise to criminal liability for regulatory defaults or non-compliance; in particular, it focused on (a) how best to introduce rationality and principle into the structure of the criminal law in its application to business enterprises and (b) whether there should be created a statutory power for the courts to apply a "due diligence" defence. Neither is directly in point or issue in this case. However, it is of some relevance that in the Consultation Paper the Law Commission did consider statutes imposing personal liability on a director (or equivalent person) for an offence committed by his or her company, concluding that the imposition of such liability on the basis of objective fault or neglect was *"unfair"*, especially in the context of offences giving rise to social stigma on conviction. It recommended that objective fault or neglect should no longer be sufficient. That, of course, connotes acceptance that the test of neglect, even in such a context, imports an objective standard of care and conduct, rather than a subjective test of mind.

(2) Counsel also referred me to the decision of the Upper Tribunal (Judge Bishopp) in *Moore v Revenue and Customs Commissioners* [2011] UKUT 239 (TCC). That case concerned the duty on a taxpayer to submit an accurate self-assessment return and the power given to HMRC by section 29(4) of the Taxes Management Act 1970 to re-open an assessment and impose penalties in the event of negligent conduct on the part of the taxpayer in his or her self-assessment. The UTT there agreed with the approach of Judge Berner in *Anderson (decd) v Revenue and Customs Comrs* (22 September 2009, TC00206) at paragraph 22, that the test to be applied in relation to conduct alleged to be negligent is objective: *"what a reasonable taxpayer, exercising reasonable diligence in the completion and submission of the return, would have done"*. That is

unsurprising; but it begs the question whether the context is such as nevertheless to colour the meaning of the word and import a subjective approach.

(3) Mr O'Rorke placed reliance on the decision of the Court of Appeal in *Chilcott and others v Revenue and Customs Comrs* [2011] STC 456, where Lord Neuberger MR (as he then was), in construing section 144A of the Income and Corporation Taxes Act 1988, stated as follows:

> "The fact that some might regard the operation of section 144A, according to its terms, as penal merely emphasises that the court should construe it with care and if there is a narrower construction less beneficial to the Revenue, but more beneficial to the taxpayer, available then the court should at least seriously consider it and, if appropriate, adopt it."

Again, that is not really controversial; but it still leaves the question at large.

(4) Inevitably and understandably, Mr O'Rorke also cited another decision of the FTT, namely *John Peter Smith v HMRC* (TC/2010/8375) in which Judge Aleksander and Mr Charles Baker, having considered the judgment of the FTT in this case (which was not binding upon them), stated this:

> "…we have given that decision close consideration, and are persuaded that for the purposes of section 121C, in order for HMRC to prove "neglect", they must show that Mr Smith acted with knowledge (or recklessly – not caring whether his behaviour was that of a reasonable and prudent officer)."

(5) Mr O'Rorke reminded me, of course, that this constituted something of a conversion on the part of Judge Aleksander, and he urged the decision was the more important accordingly. I was also referred in passing to two cases on a rather different test, that of unfitness for the purposes of the Company Directors Disqualification Act 1986; these are *Secretary of State for Trade & Industry v Griffiths & Ors, Re Westmid Packing Services (No. 3)* [1998] BCC 836 and *Secretary of State for Trade & Industry v Mark Goldberg and another* [2003] EWHC 2843 (Ch). In that context, a "value judgment" is called for, such as to include subjective considerations.

I am not persuaded that these cases really bear on the different context here.

My analysis and conclusions

56. As ever, it is the particular context, and not some imagined analogy or similar situation, that must guide interpretation. It is trite that words may be given colour by their context: and that is so even where the words have a settled meaning in the ordinary course. It being accepted that neglect ordinarily imports a departure from an objective standard of conduct, the question at heart is whether the context in which the word appears in section 121C (including the broader context of the Human Rights Act) is such as to colour its meaning to require proof in addition of a subjective and blameworthy state of mind which is culpable or (put another way) *mens rea*. If that special meaning is, in the context, available and there are cogent reasons for thinking that it might have been intended, then that may well incline the court to its adoption: see *Chilcott.*

57. The anchor of the FTT's approach, as I read the decision, is their characterisation of section 121C as being criminal for the purposes of the Human Rights Act and in any event essentially punitive, and as thereby attracting the common law presumption that *mens rea* is an essential ingredient of the offence (or, more accurately here, its proof is an essential pre-condition of liability). To my mind, their approach elides two separate considerations.

58. It is, in my view, important to bear in mind what the real issue was in *Jussila* and the cases there cited: this was to determine whether the provision fell under the criminal head of Article 6, in which case the essentially procedural protections (for example, of an oral hearing) afforded by Article 6 of the Human Rights Act would apply, or under its civil head, in which case they would not (see *Jussila* at paragraph 29). The question was not, in other words, concerned with the interpretation of the substantive provision, but the procedural protections to govern the process by which it was to be given effect.

59. The characterisation of the provision as "criminal" for these purposes cannot, in my judgment, provide a reliable guide to the intention of the domestic legislature (the UK Parliament) in choosing "neglect" as an alternative basis of liability. As it seems to me, the presumption cannot be based on a characterisation of the provision as criminal for the purposes of Article 6 if it would not be so characterised under domestic law.

60. The second consideration is whether, given that under domestic law (as indeed the FTT accepted) the provision would not be characterised as criminal, its depiction for the purposes of domestic law as "punitive" or "penal in nature" triggers the presumption. I do not think it does, even if that depiction is accepted.

61. Both in *Sweet v Parsley* and in *B (A Minor) v DPP* the presumption was confined to criminal offences. The characterisation of the provision as penal emphasises that the court should construe its scope with particular care, and where two interpretations are available, favour the interpretation most beneficial to the taxpayer (see *Chilcott*); but that is rather different and no presumption is thereby imported.

62. Then the question is whether, bearing in mind the need for caution, there is any proper basis why, without the importation of any presumption, "neglect" should bear anything other than its ordinary meaning of an objectively tested departure from a standard of care, as explained in *Blyth v Birmingham Waterworks Co.* In that context, the most obvious possible indication that some subjective ingredient is required is the use of the word "culpable" (which brings into mind notions of moral blameworthiness) and the provision for apportionment of liability depending on the degree of "culpability" of each officer.

63. Especially that last provision has indeed given me pause for thought. But I have reached the clear view that it does not signify any different test than that ordinarily applied in establishing neglect, and that the provision for apportionment simply reflects the possibility (even likelihood) that some officers may have had particularly relevant responsibilities, or been in a position to do more than others.

64. I should perhaps add that, to my mind, the depiction of the provision as "penal in nature" to some extent begs the question. In my view, the effect of the provision is simply to enable HMRC, upon proof of fraud or neglect on the part of an officer, to recover from the officer that which he or she could and should have procured his company to pay. That is an incident of office and a consequence of a failure to perform it: in providing this recourse the provision does not seem to me to be necessarily "penal in nature", any more than liability under the old Directors Liability Act, 1890 for false or inaccurate statements in a prospectus issued by a company was "penal": and see *Thomson v Lord Clanmorris* [1900] 1 Ch 718 at 725-6 (Court of Appeal).

65. Further, since I do not consider the words to be unclear, I do not consider that there is any basis for resorting to parliamentary debates in this case. *Pepper v*

Hart is not, in my view, engaged: I do not think the concept of neglect is ambiguous or obscure, or such as to lead to absurdity.

66. But in any event, even if the statements of Lord Haskel in the relevant parliamentary debates are taken into account, I do not consider that they justify and require the introduction of an essential ingredient of *mens rea* into the concept. I accept HMRC's submission that Lord Haskel was explaining the intended approach of HMRC in the use of the provision, not changing the meaning of "neglect".

67. The passage most relied on by the FTT, in which Lord Haskel stated that *"only those shown to have acted knowingly will be penalised"*, follows this passage (which to my mind shows that this was intended to be a description of intended approach rather than to introduce an additional (and unusual) ingredient in determining neglect):

> *"The noble Lord Higgins asked which directors are culpable. The investigation of each director's responsibility and knowledge will be carried out so that only those shown to have acted knowingly and deliberately will be penalised"*.

That seems to me to be a description of a recommended approach, not a definition of the provision.

68. In my view, the later reference by Lord Haskel to his hope that

> *"both this committee and legitimate businesses will welcome a measure aimed at dealing with the unscrupulous minority of directors who abuse their positions and ignore their responsibilities"*

as well as his references to the principle of limited liability not being

> *"really intended to protect fraudsters and those who are seriously negligent in carrying out their responsibilities"*

are in each case intended to explain and justify the erosion of the principle of limited liability which the provision represents, rather than define its extent.

Conclusion and disposition of the appeal

69. In short, in my judgment, in section 121C the word neglect is to be given its usual objective meaning: it is a standard of conduct, not a subjective state of mind. I do not consider that there is anything sufficient in the context in which the word appears to mandate a meaning which is not its ordinary meaning.

70. I do not consider that this conclusion offends any ordinary presumption; nor does it in my judgment result in any incompatibility with Convention rights (see *R (Wilkinson v IRC* [2005] 1 WLR 1718, 1724 A-C).

71. I have considered carefully the FTT's point (see paragraphs 112 to 116 of their judgment) that, if HMRC were right (as I consider them to be) as to the construction of the relevant provision, then their avowed practice of applying it only to the narrower group of officers they select as being within the guidance given by Lord Haskel goes beyond the proper ambit of their discretion and narrows at their unilateral say-so the statutory penalty regime. However, I accept that HMRC's approach is informed by the fact that the burden of proof is always upon them (section 124D(4)) and the clearest recourse is against the company (which automatically reduces any PLN liability); and in any event is not beyond their powers.

72. Accordingly, HMRC's appeal is, in my judgment, well-founded and I allow it.

73. Whether this ultimately results in the exclusion of the disputed evidence is another matter: it may be relevant to the plea of fraud. In such circumstances, I consider that this matter must be remitted to the FTT to reconsider its case management.

MR JUSTICE HILDYARD

RELEASE DATE: 4 October 2013