[2016] AACR 46

(SP v Her Majesty's Revenue and Customs (TC)
[2016] UKUT 238 (AAC))

Judge Levenson **CTC/1260/2015**
17 May 2016

Tax credits – penalties – proper approach when imposing non-fixed penalties

The claimant was awarded child tax credit (CTC) for the financial year 2012/2013 assessed on the basis of her declared income of £11,000. Her Majesty's Revenue and Customs (HMRC) wrote to her in October 2013 to say that her actual income had been £22,797 and later in December 2013 to say that it would amend her award of CTC accordingly. In February 2014 HMRC wrote to the claimant again to say that in its view she had been negligent when making her claim and that it had therefore decided to impose a penalty of £1,360. The claimant's appeal against that decision was dismissed by the First-tier Tribunal (F-tT). Among the issues before the Upper Tribunal (UT) was whether a penalty was appropriate and if so the amount, given that the prescribed maximum for the offence was £3,000 and the general legal approach, when imposing non-fixed penalties, of reserving the maximum penalty for the worst offences.

Held, allowing the appeal, that:

1. the F-tT had failed to consider whether, and how, to exercise its discretion as to whether a penalty should be imposed nor had it given any consideration as to how the penalty was to be calculated, nor any indication that it had considered whether there had been any mitigating (or aggravating) factors (paragraph 22);

2. it was proper for HMRC to adopt guidance both to explain its actions and to help ensure consistency in its decisions and for the First-tier Tribunal to adopt that guidance as its starting point, provided that it had understood and explained that that was what it was doing. It was not reasonable (or lawful) for it to follow slavishly the decision of HMRC as to the amount of the penalty (paragraphs 23).

The judge provided detailed propositions summarising the correct approach for the HMRC and tribunals to adopt when considering cases involving tax credit penalties (paragraph 25). He set aside the decision of the F-tT and remitted the appeal to a differently constituted tribunal to be re-decided in accordance with his directions.

DECISION OF THE UPPER TRIBUNAL
(ADMINISTRATIVE APPEALS CHAMBER)

Decision and hearing

1. **This appeal by the claimant succeeds**. In accordance with the provisions of section 12(2)(b)(i) of the Tribunals, Courts and Enforcement Act 2007 I set aside the decision of the First-tier Tribunal sitting in Fox Court (London) and made on 26 September 2014 under reference SC242/14/03683. I refer the matter to a completely differently constituted panel in the Social Entitlement Chamber of the First-tier Tribunal for a fresh hearing and decision in accordance with the directions given below.

2. I held an oral hearing of this appeal at Field House (London) on 12 April 2016. The claimant attended in person but was not represented. Her Majesty's Revenue and Customs (HMRC) was represented by Tom Rainsbury of counsel and Ben Brzezicki, solicitor. I am grateful to them for their assistance.

Background and procedure

3. The claimant is a woman who was born on 27 September 1970. At the relevant times she was claiming child tax credit (CTC). The amount of entitlement to this depends on the claimant's income and the number and circumstances of the claimant's children. Tax credit is dealt with in

respect of tax years. At the start of entitlement HMRC makes an initial decision based on estimated entitlement during the whole of a tax year (which is often based on that of the previous year), or during the rest of the tax year, depending on when the claim was made. A revised decision may be made during the tax year if circumstances change. A final decision is made after the end of the tax year when entitlement can be calculated on the basis of what actually happened rather than on what was predicted for the purposes of the initial decision.

4. I set out the facts as I understand them to be but I am not to be taken as making any finding of fact on any undisputed matter. It seems that the claimant was awarded £7,494.85 tax credit for the tax year 2012–2013. On 22 May 2013 HMRC sent her a form asking her to confirm her circumstances for the tax year 2012–2013. This was the "Tax Credits Annual Declaration – year ended 5 April 2013". On 25 June 2013 the claimant replied to the effect that her income during 2012–2013 had been £11,000.

5. I observe at this stage that in small type at the foot of page 3 of the form there is a declaration that a claimant is asked to sign which includes the statement: "I understand that … this form is my claim to any tax credits due for 2013–2014 unless I've asked or agreed to be withdrawn from tax credits or my award ceased in 2012–2013". However, so far as I can see on the form, the financial questions relate to reporting what happened in 2012–2013 rather than predicting what would happen in 2013–2014.

6. At some stage HMRC collated the information that it had received in respect of the claimant and on 3 October 2013 wrote to her to say that it held information that her income for 2012–13 had in fact been £22,797 rather than £11,000. This consisted of £365 employment and support allowance (ESA) in respect of a brief period of unemployment, and the income from three separate part time jobs. On 14 October 2013 the claimant had a phone conversation with an HMRC official during which she agreed with those figures. On 10 December 2013 HMRC again wrote to the claimant, stating as follows (page 7 of the Upper Tribunal file):

> "Thank you for letting me know that you agree with the information we hold. I am able to accept your explanation for the difference between the income we hold and that given by you. I will amend your tax credits award for the year to 5 April 2013 using this information. I will also amend your tax credit payments for 2013–2014".

Of course it was wrong to refer to "the income we hold". Presumably the letter was intended to refer to the information about the income that was held.

7. Notwithstanding the contents of the letter of 10 December 2013, on 19 February 2014 HMRC wrote to the claimant to say (page 9 of the Upper Tribunal file), "In our opinion, you were negligent when you made this claim [for tax credits for 2013–2014]. You underestimated your income when there was no basis for the amount of income declared". The letter indicated that a penalty of £1,360 had been imposed and had to be paid by the claimant.

8. On 3 March 2014 the claimant appealed to the First-tier Tribunal against the decision to impose a penalty. HMRC responded on 25 April 2014 (page 12), referring to a letter of 10 December 2014 (which cannot be correct) and indicating that a new award notice had been issued on 16 December (year unspecified). I have not seen that award notice. In the letter of 25 April 2014 HMRC declined to change its decision on the penalty, and again declined to do so in a letter of 14 May 2014 (page 18), and the appeal continued. Subsequently there were some misleading and mistaken references to a "carer's credit appeal" which are probably best ignored.

9. On 1 September 2014 the claimant wrote to the First-tier Tribunal (page 61) to say that she would not be able to attend the hearing but that she had never knowingly falsified a tax credit claim, that the nature of the claim was to estimate income for the year and verify it after the end of the year, and that having three different jobs and a period of unemployment meant that when she made her claim she could not know accurately her projected income. She also complained that (apparently as acknowledged by HMRC) the wrong figures had been used in relation to recovery of the overpayment, but of course that is not the subject of this appeal to the First-tier Tribunal or the Upper Tribunal.

10. The First-tier Tribunal considered the matter in the absence of both parties on 26 September 2014. It seems to me that it was remiss of HMRC not to attend when it was seeking to uphold a penalty of this size and it bore the burden of proof. The tribunal confirmed the decision of HMRC. The claimant applied for the decision to be set aside because the First-tier Tribunal had not seen evidence that she wished it to have seen. On 21 November 2014 a District Tribunal Judge of the First-tier Tribunal (referring incorrectly to the original decision as having been issued on 26 September 2009) accepted that grounds for setting aside were present but declined to set the decision aside, on the basis that those documents would have made no difference to the outcome. However, he did direct that a statement of reasons be issued by the original judge. This was done and the statement was signed on 2 December 2014. On 17 February 2015 yet another judge of the First-tier Tribunal refused to give the claimant permission to appeal to the Upper Tribunal against the decision of the First-tier Tribunal. She now appeals by my permission given on 3 September 2015 after an oral hearing at which the claimant represented herself and HMRC were represented by one of its employed solicitors. Final written submissions were not received until 3 November 2015. On 5 November 2015, at the request of both parties, I directed that there be an oral hearing of the substantive appeal but it was not possible for this to be listed until 12 April 2016. HMRC opposes the appeal and supports the decision of the First-tier Tribunal.

The relevant law

11. So far as is relevant, section 31 of the Tax Credits Act 2002 provides as follows:

> "**31–**(1) Where a person fraudulently or negligently –
>
> > (a) makes an incorrect statement or declaration in or in connection with a claim for tax credit or a notification of a change of circumstances given in accordance with regulations … or in response to [certain] notice[s], or
> >
> > (b) gives incorrect information or evidence in response to [certain] requirement[s] …
>
> a penalty not exceeding £3000 may be imposed on him."

12. Other provisions deal with the power of HMRC (sometimes referred to as "the Board") to impose the penalty and create a right of appeal to the First-tier Tribunal in cases such as the present one. Schedule 2 to the 2002 Act empowers the First-tier Tribunal to set aside or confirm the penalty or reduce or increase the amount. On appeal to it, the Upper Tribunal may also change the amount, even in the absence of an error of law.

13. There is no statutory guidance as to how or on what basis HMRC should calculate the amount of a tax credit penalty, neither is there any specific statutory requirement on HMRC to formulate or adopt or publish such guidance in relation to penalties in tax credit cases. However, it has done so and a copy of the guidance (apparently as at December 2013) has been produced to me on pages 134 to 177 of the Upper Tribunal file. It was not produced to the First-tier Tribunal. I understand that it is publicly available on the internet.

The First-tier Tribunal decision

14. The First-tier Tribunal found that the income of £11,000 initially declared by the claimant for 2012–2013 was "used as part of the calculation" for her 2013–2014 award. It noted (paragraph 10 of its statement of reasons) that the claimant did not disagree with the new figures "but stated that the discrepancy had arisen as she had only estimated her income for the year [the First-tier Tribunal did nor specify which year] because she had 3 different jobs and a period of unemployment and that her projected income was not clear when she made her claim. She denied negligence when completing the end of the year declaration".

15. The essence of the First-tier Tribunal's reasoning is in paragraphs 13 and 14 of its Statement of Reasons:

> "13. Given the evidence the Tribunal found that the discrepancy was so great that [the claimant]'s explanation as to why the figure supplied by her as income for the relevant period was not accurate was simply not credible. Furthermore, the Tribunal found that by the time she sent the end of year declaration to the respondent she would have a very good idea as to what she had earned over the previous tax year.
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> 14. The Tribunal found that [the claimant] had acted negligently in making an incorrect statement as to her income for 2012–2013. She either knew her statement to be untrue or she did not check as to its accuracy. In either of these circumstances the respondent is entitled by law to apply a penalty."

16. In giving permission to appeal on 3 September 2015 I stated:

> "It is arguable that the First-tier Tribunal was in error in not explaining the basis of its assessment of the appropriate penalty, in not seeking direct evidence of the figures eventually taken by HMRC for the appropriate income, and not establishing a factual basis for its finding of negligence, which is arguably inadequately reasoned. This is not intended to restrict points of law that may be argued in this appeal."

17. I accept that, on the second point, the claimant did not challenge the figures eventually taken as her income for 2012–2013. However, insofar as those figures form a basis for the calculation of any penalty, the new panel must satisfy itself that those figures are accurate, and cite the evidence on which its findings are based.

18. On the third point the only reason given by the First-tier Tribunal for finding that the claimant had been negligent was that she had made an incorrect statement. The tribunal gave no consideration to, and made no finding in respect of, whether the claimant acted reasonably. HMRC has addressed a great deal of argument to me in support of its position that the claimant was negligent, but at this stage this is a matter for the new panel of the First-tier Tribunal, to whom such arguments should be addressed.

19. On the issue of the assessment of the appropriate penalty, HMRC argued before me that the appeal to the First-tier Tribunal was not about that but about whether the claimant had indeed been negligent. This is wrong. The appeal to the First-tier Tribunal was against the outcome decision to impose a penalty. In its very nature the appeal encompassed both an appeal against there being any penalty and an appeal against the calculation of the penalty. This is consistent with the powers specifically conferred on the First-tier Tribunal in such an appeal, with the inquisitorial function of the First-tier Tribunal, with the fact that on an appeal the First-tier Tribunal stands in the shoes of the decision-maker (here HMRC) and with the absence of any statutory indication as to what the penalty should be (other then the prescribed £3,000 maximum). There is absolutely no indication that the claimant said anything like: "O well, if you have to impose a penalty I agree that it should be £1,360".

The penalty

20. In *VT v Secretary of State for Work and Pensions (IS)* [2016] UKUT 178 (AAC); [2016] AACR 42 Upper Tribunal Judge Rowland considered an appeal against a penalty imposed in an income support case. His decision was issued on 11 April 2016 and was not made available at the oral hearing of the appeal in the present case.

21. Penalties in income support specifically and social security generally are governed by a totally different legal regime from that applicable to tax credits and in the former there is no discretion as to the amount of the penalty. However, the legislation in that case stated that "A penalty of a prescribed amount may be imposed on a person by the appropriate authority where …" (Social Security Administration Act 1992 section 115D(1)). In paragraph 13 of his decision Judge Rowland said:

> "13. … However, the Secretary of State now concedes that in Section 115D of the Administration Act the word 'may' should be given its ordinary meaning, connoting the existence of a discretion. I agree. … it is quite reasonable that there should be a discretion as to whether to impose a penalty. Social security claimants often have low incomes and find it difficult enough to repay an overpayment without a penalty being added and there are cases where, although a claimant is partly to blame for an overpayment and does not have a reasonable excuse for failing to provide information or to notify a change of circumstances, nonetheless the Department has also acted (or failed to act) in a way that has contributed to the overpayment being made. In such a case it might be considered that to impose a penalty on the claimant when none is imposed on the Department is both unfair and also unlikely to encourage the Department to avoid overpayments … ."

Similar comments can be made in relation to the tax credit system and in respect of many tax credit claimants.

22. In the present case the First-tier Tribunal failed to consider whether and how to exercise its discretion, gave no consideration as to how the penalty was calculated, and gave no indication that it considered whether there were any mitigating (or aggravating) factors. The maximum penalty is £3,000 (apparently taken by HMRC as being in relation to each tax year). The general approach of the law to non-fixed penalties is that the maximum penalty is reserved for the worst offences. The First-tier Tribunal gave no consideration to this principle. For example is this case really almost halfway up the scale of seriousness?

23. It is not unreasonable, and is probably quite sensible, for HMRC to adopt guidance both to explain what they are doing and to help ensure consistency in their decisions. It is also reasonable for the First-tier Tribunal to adopt that guidance as its starting point, provided that it understands and explains that that is what it is doing. It is not reasonable (or, in my view, lawful) for it to follow slavishly the decision of HMRC as to the amount of the penalty.

Conclusions

24. For the above reasons I find that the decision of the First-tier Tribunal involved the making of errors of law in relation to its failure to give adequate reasons for its decision, and accordingly this appeal by the claimant succeeds.

25. In summary the following propositions represent what, in my view, is the correct approach to tax credit penalties. This is not intended to be an exhaustive list and, of course, much will depend on the circumstances of the particular case. However, by following this kind of approach tribunals are less likely to fall into error of law.

(a) The imposition of any penalty involves the exercise of a discretion whether or not to impose any penalty at all or a penalty of a particular amount.

(b) It is proper for HMRC to adopt guidance even though there is no statutory requirement to do so.

(c) It is proper for the First-tier Tribunal to take that guidance as a starting point for the calculation of any penalty.

(d) In applying the guidance, the First-tier Tribunal must be satisfied as to the underlying facts on which the calculation of the penalty is based, including the amount of any overpayment said to have been made. It must also be satisfied that any incorrect statement can in fact be attributed to the period in respect of which the penalty is being considered. A distinction will usually need to be made between past reports and future predictions – the design of HMRC forms is not always very helpful on this matter.

(e) In most cases it will be relevant for the First-tier Tribunal to find whether the claimant acted innocently and/or reasonably, or negligently (that is, with a lack of due care), or fraudulently.

(f) Having identified the amount of penalty that the guidance would produce, the First-tier Tribunal must consider whether there are any aggravating or mitigating factors and must take into account the principle that the maximum penalty is reserved for the worst offences.

(g) At each stage the First-tier Tribunal must give reasons for its conclusions.