Appeal number FTC/92/2012

INCOME TAX — construction industry scheme — cancellation of gross payment status — s 66 Finance Act 2004 — HMRC discretion — scope of — whether properly exercised — failure to take into account effect of cancellation on appellant — appeal allowed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Appellants

- and –

J P WHITTER (WATER WELL ENGINEERS) LIMITED

Respondent

Tribunal: Hon Mr Justice Warren
Judge Colin Bishopp

Sitting in public in London in the Rolls Building on 1 December 2014

James Rivett, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, on behalf of the Appellants

Thomas Chacko, counsel, instructed by Mr Ian Whalley, solicitor, on behalf of the Respondent

DECISION

Introduction

1. This appeal raises an issue about the scope of HMRC's power to cancel a taxpayer's registration for gross payment under the construction industry scheme. On 3 August 2011, HMRC issued a notice by which they cancelled the registration of the Respondent ("**the Company**") for that status. In their decision released on 18 October 2012 ("**the Decision**"), the First-tier Tribunal, Judge Cannan and Mr Whitehead ("**the Tribunal**"), held that HMRC should, when exercising that power, have taken into account the fact (which they found) that cancellation of the Company's registration would have a significant detrimental effect on its business. HMRC did not do so. The Tribunal held that this failure was a failure to take into account a relevant factor so that HMRC's decision "was wrong in law and susceptible to review by this Tribunal": see Decision [73]. They allowed the Company's appeal, deciding that they did not have jurisdiction to substitute their own view based on the facts found and all relevant factors.

2. HMRC now appeal against those conclusions, contending that they did not need to take account of the financial consequences for the Company when exercising their power. If that is wrong, then they contend that the Tribunal did have power to substitute their own view for that of HMRC and that we, on this appeal, have the same power which we should exercise. The Company contends that the Tribunal were right in all of their conclusions. However, so far as jurisdiction is concerned, the Company submits that if it is the case that the Tribunal had jurisdiction to substitute its own view, the appropriate course is for us to remit the matter to the First-tier Tribunal and not to decide the matter ourselves.

3. The facts as found by the Tribunal are set out in the Decision at [22] to [48]. We do not need to repeat them at length here. For present purposes, the following is a sufficient summary taken from those paragraphs:

a. The Company carries on business, as its name implies, as water well engineers. It drills boreholes and wells for water companies, commercial and agricultural businesses and the domestic market. It operates on a UK wide basis. It is very much in the nature of a family business started by Philip Whitter in 1972 and was later incorporated in the 1980s.

b. Prior to incorporation, and at all material times since, Mr Whitter and the Company have used the services of Wilds Chartered Accountants. Their services have included operating the Company's payroll system.

c. The business has grown steadily and presently has about 25 employees, including a number of family members on the administration side. In the three years to 2011 the business had a turnover of approximately £4.4 million making a net profit over the same period of about £180,000. Approximately £1.9 million of that turnover derived from contracts with United Utilities. Other major well known customers accounted for a further £900,000.

d. Employees of the Company are paid weekly. Each Monday time sheets are collected and sent to Wilds who prepare pay slips and payments are made by BACS transfer on the Wednesday. On or shortly after the 5th of each month Wilds send details to the Company of amounts due to be paid to HMRC in relation to PAYE and national insurance contributions. Historically payments have been made to HMRC either by BACS transfer or by cheque. Often payments have been late. This is because of the procedure operated for paying suppliers rather than any particular cash flow shortage.

e. It was inevitable that the system would cause payments to HMRC which fell due either on the 19th or 22nd of each month to be made late. That had been the position for many years and HMRC had never chased payment or indeed expressed any concern that PAYE payments were late.

f. The Company's registration for gross payments as with other registered taxpayers was subject to ongoing review by HMRC to ensure compliance with the conditions described above. Such reviews were generally carried out by computer on an annual basis. In August 2008 a review was performed and the results were satisfactory. On 29 July 2009 a review was performed and the Company failed. The Tribunal said that they had no direct evidence as to the reason for this failure but they inferred and found as a fact that it was because of late payment of PAYE. The failure led to cancellation of the Company's registration by letter dated 6 August 2009. The letter identified the reason for withdrawal of the Company's gross payment status as the late payment of PAYE on nine occasions between October 2008 and June 2009; the Tribunal's inference was therefore correct.

g. Wilds responded to HMRC on behalf of the Company by letter dated 2 October 2009. The Tribunal found that the relevant individual in the Company, Ms Whitter, was not aware of the seriousness of the position and no steps were taken to improve compliance. In particular, Wilds did not explain to her that the Company was not complying with its PAYE obligations and that future payments must be made on time. Nonetheless, the Tribunal considered that she ought to have realised the seriousness of the matter: it was unreasonable of her not to have taken steps to improve compliance in 2009.

h. On 12 November 2009 HMRC wrote to Wilds to say that their appeal had been upheld. At the same time however HMRC made clear that the company had a responsibility to make payments on time whilst recognising that it had taken steps to improve compliance. The letter stated that the rules would in future be applied strictly and that there was no scope to allow for "minor and technical" failures. The letter identified the "reasonable excuse" provisions and the possibility of seeking a time to pay arrangement which if granted would not affect registration.

i. The Tribunal found as a fact that Mr Nash, of Wilds, would have discussed the contents of this letter with Ms Whitter.

j. On 29 June 2010 there was another annual review which the Company failed due to late payment of PAYE. The Company's registration was again cancelled. Wilds appealed by letter dated 8 July 2010. We do not set out the contents of the letter which can be found at Decision [33]. Ms Whitter was not copied in with this letter nor shown a copy prior to its being sent. However she did fairly accept that Mr Nash would have discussed the position with her. The Tribunal found that he did so, and in particular held that the Company agreed to make future PAYE payments on time. Again, however the Company failed to take any steps to improve compliance at this stage.

k. There was some confusion on the part of HMRC whether this appeal had been lodged in time. It clearly was in time. By letter dated 20 August 2010 HMRC replied apologising for their earlier confusion and stated:

> "On this occasion I am prepared to overlook these failures, your appeal is upheld and the company will retain gross payment status."

l. Again the letter included a warning about future compliance, and also about the PAYE penalty regime that had been introduced in tax year 2010-11.

m. On 30 May 2011 there was another annual review which the Company again failed due to late payment of PAYE. On this occasion, prior to cancellation of the registration, HMRC wrote to the Company identifying the defaults and giving the Company an opportunity to advise whether it had entered into a formal time to pay arrangement or to produce evidence in support of a reasonable excuse.

n. The Tribunal found as a fact that the following late payments of PAYE had been made:

Due Date	Date Paid	Period Late
22 Aug 2010	1 Oct 2010	40 days
22 Sept 2010	6 Oct 2010	14 days
22 Oct 2010	29 Oct 2010	7 days
22 Nov 2010	26 Nov 2010	4 days
22 Jan 2011	28 Jan 2011	6 days
22 Feb 2011	After 20 June 2011	At least 118 days
22 Mar 2011	31 Mar 2011	9 days

Although we have transcribed the Tribunal's table accurately, we think there are errors in the last two entries. Nothing, however, turns on this.

o. In her reply to HMRC, Ms Whitter apologised for the late payments which she said were due to "administrative oversights". She continued:

> "Whilst admitting to these oversights, which we will endeavour to prevent in future, we would point out that losing our gross status would prevent us tendering for contract work and thus cause the company to cease trading. I am sure you will agree that removing gross status will cause great hardship which is disproportionate to the level of the oversights discussed above."

p. The Tribunal did not accept that the PAYE non-compliance in late 2010 and 2011 could fairly be described as an "administrative oversight". The Company was well aware of the non-compliance drawn to its attention in 2009 and 2010. It must have chosen, for whatever reason, not to address the matter and did not improve the system for making payment to HMRC until after July 2011. We agree with that assessment.

q. After July 2011 the Company changed its systems significantly to ensure that PAYE was paid on time. Since then PAYE payments have always been made on time.

r. HMRC wrote to the Company on 3 August 2011 stating that they were unable to accept the explanation for compliance failures. The letter also noted that this was the third failed review and that assurances as to future compliance had previously been given. This is the letter which effectively evidences HMRC's decision to cancel the Company's registration.

s. Wilds appealed the decision. The material part of their letter is set out in Decision [44]. In essence, they asserted the disproportionate effect of cancellation of gross status namely the loss of the Company's major customer with resulting redundancies. They asked for the decision to be reconsidered.

t. By a letter dated 15 September 2011 HMRC refused the Company's appeal. It was pointed out that it would be necessary to demonstrate a "reasonable excuse". Nothing now turns on this since it is accepted by the Company that it did not have a reasonable excuse for the purposes of the legislation.

u. Wilds replied by letter dated 23 September 2011 and noted that whilst HMRC did not accept that there was a reasonable excuse, Wilds were aware of other cases where gross status had been allowed to continue on the basis of disproportionate hardship. They asked for a statutory review of the decision. That review was concluded on 12 December 2011 and the decision was upheld. The reviewing officer clearly considered that there was no reasonable excuse for the defaults.

v. The Tribunal accepted the evidence of Ms Whitter that United Utilities and other major customers would be likely to withdraw work from the Company if it lost its gross payment status registration, noting that Mr Birtles (who appeared for HMRC) accepted that large contractors do refuse to deal with sub-contractors who do not have gross payment status. Further the Tribunal accepted the evidence (which was not, in any case, challenged by Mr Birtles) that the effect of losing such customers would be a fall of some 63% in turnover and profits. The company would likely shrink to some 5 or 6 employees from the current 25. It would not be able to tender for any utility or large commercial work. Even if the registration was lost and regained 12 months later the nature of the work was so specialised they would not be able to recruit suitable employees. It would take the Company 10 years or so to get back to where it is now.

The tax legislation

4. The legislation relevant to the present appeal is found in Chapter 3 Part 3 Finance Act 2004 and the Income Tax (Construction Industry Scheme) Regulations 2005 ("**FA 2004**" and "**the Regulations**") respectively. These relate to what is known as the "Construction Industry Scheme" ("**the CIS**").

5. Under the CIS, payments by affected contractors to sub-contractors must be made under deduction on account of tax unless the sub-contractor is registered to receive gross payments. The background to the CIS was described by Ferris J in *Shaw (Inspector of Taxes) v Vicky Construction Ltd* [2002] EWHC 2659 (Ch), [2002] STC 1544 ("***Vicky***") in a now well-known passage at [3] to [8] of his judgment, cited with approval by Lewison J in *Barnes (Inspector of Taxes) v Hilton Main Construction* [2005] EWHC 1355 (Ch), [2005] STC 1532 ("***Hilton***") at [2] of his judgment. It is unnecessary to repeat the passage yet again. We need only observe that the CIS was introduced to deal with the problem of the "disappearance" of many subcontractors engaged in the construction industry without settling their tax liabilities. Under the CIS, a contractor is obliged, except in the case of a sub-contractor registered for gross payment, to deduct and pay over to HMRC a proportion of all payments made to the sub-contractor in respect of the labour content of any sub-contract. This can cause commercial difficulties for a sub-contractor who does not enjoy such status, as the finding of fact recorded at paragraph 3.v. above demonstrates in the present case.

6. We set out the relevant provisions of FA 2004 and the Regulations in the Annex to this decision. References to section numbers below are to those sections of FA 2004. The structure of the CIS is set out in summary in the following paragraphs.

7. Section 57 to 59 introduce the CIS and describe who are sub-contractors and contractors.

8. Section 60 describes what are "contract payments", essentially contractual payments made under a construction contract by the contractor to a sub-contractor. A payment is not a "contract payment" if the person to whom the payment is made is registered for gross payment. That is important because section 61(1) provides for the making of deduction on the making of a contract

payment. There is no obligation to deduct, therefore, where a contractor makes a payment to a sub-contractor who is registered for gross payment. Section 62 is not relevant to the present appeal; it provides for how deductions made are to be treated.

9. Section 63 deals with the registration of sub-contractors. There are two types of registration: registration for gross payment and registration for payment under deduction. In either case, certain documentation and information must be provided under section 63(1): nothing turns on that for the purposes of this appeal.

10. Subject to that, HMRC must, in the case of a company applying for registration, register it for gross payment if they are satisfied that the requirements of section 64(4) are satisfied. This in turn requires the conditions of Part 3 Schedule 11 FA 2004 to be satisfied. Part 3 comprises paragraphs 9 to 12. Paragraph 9, it can be seen, provides that the conditions set out must be satisfied by the company if it is to be registered for gross payment. The CIS is therefore very prescriptive in providing that HMRC *must* register for gross payment if those conditions are satisfied (see section 63(2)) but may do so *only if* those conditions are satisfied (see paragraph 9).

11. Paragraph 10 lays down the business use test and paragraph 11 lays down the turnover test. Nothing turns on those provisions; at all times, the Company has fulfilled those conditions.

12. Paragraph 12 lays down the compliance test. For present purposes, it is necessary only to note that, under paragraph 12(1), a company applying for registration for gross payment must, subject to certain exceptions, have complied with all of its obligations under the Tax Acts or the Taxes Management Act during "the qualifying period" and with all requests by HMRC for accounts and other information.

13. There are two important exceptions to that which we take in reverse order from that appearing in paragraph 12:

a. One (see paragraph 12(3)) is that the company had a reasonable excuse for failure to comply.

b. The other (see paragraph 12(2)) is that the company's failure to comply relates to obligations or requests which are prescribed in regulations made by HMRC. In prescribed circumstances, the company is to be treated as satisfying the condition in paragraph 12(1) notwithstanding actual non-compliance with the prescribed obligations or requests.

14. Paragraph 32 of the Regulations sets out the prescribed obligations and requests and the prescribed circumstances. It can be seen that the prescribed obligations include certain obligations to make returns, payments and to meet requests. The prescribed circumstances all relate to late compliance with the relevant obligation or request, with, in the main part, various periods of grace being allowed although in the case of non-compliance by reason of late returns, there is no time-limit (although the return must in fact have been submitted). These provisions replace the more general exception which was found in the predecessor legislation, for instance section 565(4) Income and Corporation Taxes Act 1988 ("**ICTA**") where the condition was treated as satisfied if the Board were

of the opinion that "the failure is minor and technical and does not give reason to doubt that the [relevant condition] will be satisfied".

15. Cancellation of registration for gross payment is provided for in section 66. Subsection (1) is central to the appeal and we set it out here again:

> "The Board of Inland Revenue [now HMRC] may at any time make a determination cancelling a person's registration for gross payment if it appears to them that
>
> (a) if an application to register the person for gross payment were to be made at that time, the Board would refuse so to register him,
>
> (b) he has made an incorrect return or provided incorrect information (whether as a contractor or as a subcontractor) under any provision of this Chapter or of regulations made under it, or
>
> (c) he has failed to comply (whether as a contractor or as a sub-contractor) with any such provision."

16. It is common ground that at the time when HMRC cancelled the Company's registration for gross payment, the circumstances fell within paragraph (a) of section 66(1): in other words, if the Company had applied for registration for gross payment at that time, the application would have been refused. This was on the basis that the Company's defaults did not fall with the circumstances prescribed in the Regulations and that there was no reasonable excuse for them.

17. The defaults were all late payments of PAYE. The first late payment was not excepted under regulation 32; and those of the subsequent late payments which, in isolation, would have been excepted because they were not very late, were nonetheless *not* excepted because of the prior late payments. There were no defaults within paragraphs (b) or (c) of s 66(1) or, if there were, they were not relied on by HMRC.

18. Appeals are dealt with in section 67. A person aggrieved by the cancellation of his registration for gross payment may appeal. The jurisdiction of the F-tT includes jurisdiction "to review any relevant decision taken by [HMRC] in the exercise of their functions under section … 66". The area of dispute here, as we have explained, is whether the First-tier Tribunal has power to substitute its own view if it decides that HMRC's exercise of their power under section 66 was flawed.

Human rights

19. Article 1 of the First Protocol to the European Convention on Human Rights and Fundamental Freedoms 1950 ("**A1P1**"), incorporated into domestic law by section 1 of the Human Rights Act 1998 and set out in Schedule 1 to that Act, provides as follows:

> *Protection of property*
>
> Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.
>
> The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of

property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

20. In *Vicky*, Ferris J accepted (see [44] of his judgment) that a certificate under the CIS legislation (ICTA) as it then stood was a possession. Under those provisions, a person was not registered for gross payment. Instead, he obtained a certificate under section 561 of that Act, the possession of which exempted the holder from the requirements of section 559 to make deductions from payments made under construction contracts. It was not, we think, so much the certificate as such which was a possession, but the rights which attached to the certificate. We see no real distinction, for the purposes of identifying a possession, between a certificate under the old legislation and registration for gross payment under the legislation applicable in the present case.

21. The case before Ferris J did not, however, concern the revocation of an existing certificate but rather its renewal once it had expired. Accordingly, the case did not concern the exercise of the discretionary power found in section 561(8) ICTA (to which section 66(1) corresponds) but was instead to be judged by the same criteria as applied to an original application. It was submitted that an expectation of renewal was also a possession but Ferris J rejected that proposition. However, he did accept the argument (see [47] of his judgment) to the following effect. Absent a certificate, the contractor would pay money to the Revenue which would otherwise have been payable to Vicky. Under the general law of contract, Vicky would be entitled to receive from the contractor the full contract price at the time and in the manner provided for in the contract without any deduction in respect of tax for which Vicky would be liable. Vicky's contractual right to receive such payment and the money paid when received were Vicky's property and thus "possessions". Where there is no certificate, the effect of section 559(4) (the provision requiring deduction to be made) would be to interfere with this.

22. He went on to consider the second paragraph (the third sentence as he referred to it) of A1P1 concluding that, to use modern language, the CIS was a proportionate response to the "notorious practice of sub-contractors being paid gross and then never accounting for their tax liabilities". There was therefore no breach of Vicky's human rights.

23. In *Hilton*, Lewison J was again concerned with the renewal, not the cancellation, of a certificate. He did not address the correctness or otherwise of Ferris J's decision that the certificate was a possession. However, he noted that, unless he declined to follow Ferris J in relation to the sub-contractor's *chose in action* being a possession, then it must follow that the taxpayer's rights under A1P1 had not been infringed (see [13] of his judgment). He did not, however, blindly follow Ferris J but carried out his own analysis before reaching the same conclusion.

24. The taxpayer's argument (see [13]) was that refusal to renew the certificate might have consequences disproportionate to the reasons for the refusal, relying on the findings of the General Commissioners (similar to those of the Tribunal in the present case) that the business would close and that this would be a disproportionate result. In addressing that argument, Lewison J was prepared to assume, without deciding, that a right to payment in gross under a contract is a possession. But that might well depend on the terms of the contract itself since

some building contracts cater expressly for deduction from payments made to sub-contractors and there was no evidence of any particular contract placed before the General Commissioners. The same is true in the present case: insofar as we are aware, there was no evidence before the Tribunal of the terms of any contract, in particular the contracts with the Company's major contractor.

25. On that assumption, Lewison J held that the possession had been interfered with (see [15]). He rejected the Revenue's argument that it was an incident of the CIS that payments to sub-contractors suffer deduction and that therefore there is either no possession at all or, if there is, there is no interference.

26. In [16*ff*], Lewison J considered whether the interference was justified. After citation from the decision of the European Court of Human Rights in *National and Provincial Building Society v United Kingdom* [1997] STC 1466, 25 EHRR 127, he said this in [18] to [23]:

> "[18] The taxpayer emphasises that it is the scheme as a whole that I must consider. The taxpayer says that the reference to the margin of appreciation is inappropriate where it is a national court considering national legislation. It may well be that the phrase itself is inappropriate, but the concept of deferring to the legislature when it has adopted one out of a variety of solutions to a perceived problem remains the same. Under our constitution Parliament is entrusted with the primary role of devising solutions to national, economic and social problems. The court's task is limited to that of review.
>
> [19] Ferris J in the *Vicky* case came to the conclusion that the package of measures has an objectively justifiable aim, namely to recover tax from those engaged in the construction industry. One possible solution to the problem would have been to require all contractors to submit to tax deductions when being paid by an employer. That might have been legislative overkill. Another might have been to require all sub-contractors to submit to deduction, but Parliament did not do that. Instead it provided a route by which sub-contractors who could demonstrate a good track record would be permitted to receive payment in gross. Even then Parliament did not say that any failure to comply with obligations would prevent the sub-contractor from receiving payment in gross. Minor and technical failures do not count if the taxpayer can also show that minor and technical failures give rise to no doubt about future compliance.
>
> [20] So there is in my judgment already a considerable measure of proportionality inherent in the scheme. First, there is the possibility of exemption from the default position. Second, the mere fact of non-compliance with tax obligations does not of itself rule out the grant of exemption. Third, there is the inevitable imprecision of the phrase 'minor and technical'. Fourth, the statutory question is not whether the failures are minor and technical, but whether in the board's opinion they are minor and technical. Fifth, although the language of section 561(9) suggests that the function of the Commissioners on appeal is merely to review the Board's opinion (since the statutory question is not whether the failures are minor and technical but whether in the Board's opinion they are), Lightman J has held that the Commissioners are in fact free to substitute their own view. I am not invited to depart from that decision. Sixth, the refusal of the certificate is not final. The taxpayer can always apply again if its performance has improved. Can I say that this scheme is devoid of

reasonable foundation? I am clear that I cannot. My conclusion therefore is the same as that of Ferris J.

[21] The taxpayer relies heavily on the General Commissioners' finding in paragraph 9(7) that their decision is disproportionate. However, the taxpayer's broad argument based on proportionality has to have as its starting point a Convention right that has been infringed. If there is no such right, then there is no peg on which to hang the argument based on proportionality. Since I consider that no Convention right has been infringed there is no occasion to resort to section 3 of the Human Rights Act.

[22] I consider also that section 3 has not allowed a court to tailor the legislation to the circumstances of an individual hard case. We all know that hard cases make bad law. The court must consider the general run of cases of that kind. If the legislation were to incorporate a general test of proportionality that would place a heavy burden on tax inspectors to conduct a prospective review or forecast of the potential effect of refusal of a certificate on individual businesses. Moreover, it is not said that it will always be disproportionate to refuse a certificate if the result would be that the taxpayer would be put out of business. So there would require to be a judgment by the inspector not only whether a refusal would have that effect, but also whether that effect is proportionate to the failures.

[23] There may be social, economic and administrative arguments for and against the imposition of such a burden or there may be other solutions to perceived injustices in the statutory scheme, but they are matters for debate and legislation not for interpretation by a court. In those circumstances I consider that the General Commissioners' application of a test of proportionality was not a test that the legislation allowed them to apply. What they appear to have done is to have applied the unsuccessful submission for the taxpayer in the *Vicky* case.…"

27. It is worth noting that the decision of Lewison J was subject to an oral application to the Court of Appeal for permission to appeal which was dealt with by the Chancellor (Sir Andrew Morritt) and Lloyd LJ. Counsel for the taxpayer argued that the approach of Lewison J (accepted as correct by Lloyd LJ when refusing permission to appeal on paper) produced an unsatisfactory result and must therefore be inconsistent with the Human Rights Act and wrong in law. The unsatisfactory result is that a business which always pays its taxes but pays them late can be closed by the refusal of a certificate under section 561. The Chancellor rejected that submission:

"The unsatisfactory result to which reference is made is not just the result of the scheme, it is the result of the statutory scheme and the financial position of the company itself. The effect of the requirement, in the absence of a certificate, to deduct a percentage of payments to the subcontractor on account of his tax liability gives rise to a cash flow problem. I do not seek to minimise the importance of cash flow in the building industry, but it is not the fault of the scheme that a taxpayer who fails to get a certificate may thereby be driven out of business."

28. It is clear, therefore, that the CIS, insofar as it related to the grant and renewal of a certificate involved no breach of A1P1.

29. The same is equally true, in our view, of the initial registration of a person for gross payment under the CIS operated in accordance with FA 2004. There are

differences, of course, between the old scheme and the current scheme, in particular that the somewhat vague "minor and technical" exception is replaced by the focused circumstances prescribed in regulation 32.

The impact of A1P1 on the power to cancel registration for gross payment under section 66

30. Mr Chacko, who appears for the Company, does not challenge the proposition that the CIS in its new form is compliant with A1P1 so far as concerns the initial registration of a person for gross payment. What he says is that the discretion under section 66 must itself be exercised in a way which is compliant with A1P1. A similar question would have arisen under the predecessor provisions, for instance under section 561(8) ICTA. He is right to say that this question has not been directly answered by the authorities. We do not consider that any of the cases, in particular *Vicky* and *Hilton*, are authorities which compel us to reject that submission and to accept HMRC's submissions.

31. However, we do think that the reasoning which led Ferris J and Lewison J to their conclusions in relation to renewal of certificates would apply equally to the cancellation of a person's registration for gross payment had section 66 expressly provided for the mandatory cancellation of registration at any time if HMRC formed the view that they were not satisfied that the circumstances described in paragraph (a) of section 66(1) were present; or, to put it another way, had the word "may" in section 66(1) been replaced by the word "must", so far as concerns paragraph (a). We can see no material difference, for the purpose of A1P1, between the requirement of HMRC under the old provisions to refuse to renew a certificate and its obligation under the hypothetical express provision just discussed to cancel a registration. In neither case would the scheme give rise to a breach of taxpayer's rights under A1P1. It follows, *a fortiori*, that there would be no breach if, instead of being under a duty to cancel a registration, HMRC were given a power to do so which was exercisable only subject to constraints. In particular, if the power conferred by section 66(1) expressly stated that the financial consequences for the taxpayer of cancellation of their registration were not to be taken into account by HMRC when deciding whether or not to exercise the power, the CIS would nonetheless be Convention compliant and there would be no breach of A1P1 when HMRC exercised the power without taking those consequences into account.

32. We would mention one other decision concerning the refusal to issue a certificate. It is the decision of Hart J in *Templeton v Transform Shop Office and Bar Fitters Ltd* [2005] EWHC 1558, [2006] STC 900 ("***Transform Shop***"). This was another case where the inspector had refused to issue a certificate because of failures by the taxpayer to comply with its PAYE obligations. The Special Commissioners allowed the taxpayer's appeal. The outcome of the appeal to the High Court turned, ultimately, on whether the Special Commissioners could properly have come to the conclusion that the non-compliance on the part of the taxpayer was "minor and technical".

33. At [15] of his judgment, Hart J referred to the decision which the inspector was charged with making as "momentous". In saying that, he must have accepted that the consequences of refusing the certificate might be severe. But he did not rely on that as a reason why the discretion given to the inspector could or should

be exercised in favour of issuing a certificate. Rather, he saw the assessment of what was minor and technical as one to be made having regard to the unusual circumstances of the taxpayer's relationship with its local PAYE office The momentous decision and the severity of the consequences were relevant in assessing whether there had been a relevant non-compliance not in deciding how to exercise the discretion.

Proportionality

34. We now turn to the decision of the Supreme Court in *Bank Mellat v HM Treasury (No 2)* [2013] UKSC 39, [2014] AC 700. Both Lord Sumption and Lord Reed JJSC had something to say about the concept of proportionality under EU law and as applied in our own courts. The facts of that case are, of course, as far away from the facts of the present case as one could imagine, being concerned with restrictions on Bank Mellat in the context of counter-terrorism and Iran's nuclear programme. Nonetheless, some interesting general principles are expounded. We refer in particular [20] and [21] of Lord Sumption's judgment and to paragraphs [68] to [76] of Lord Reed's judgment, both of which repay reading.

35. So far as Lord Sumption's judgment is concerned, he pointed out that the requirements of rationality and proportionality, as applied to decisions engaging the human rights of applicants, inevitably overlap. He summarised the effect of the authorities by saying that the question depends on an exacting analysis of the factual case advanced in defence of the measure, in order to determine (i) whether its objective is sufficiently important to justify the limitation of a fundamental right; (ii) whether it is rationally connected to the objective; (iii) whether a less intrusive measure could have been used; and (iv) whether, having regard to these matters and to the severity of the consequences, a fair balance has been struck between the rights of the individual and the interests of the community. These four requirements are logically separate, but in practice they inevitably overlap because the same facts are likely to be relevant to more than one of them. Although disagreeing with Lord Reed on the application of the test in the case before the Supreme Court, he agreed with Lord Reed's formulation of the concept of proportionality in [68] to [76].

36. We do not propose to include lengthy citation from those paragraphs in this decision. They provide a very helpful discussion of how the concept of proportionality is applied, noting differences in approach between different jurisdictions, in particular between the European Court of Human Rights and our own courts. Lord Reed referred with approval to the decision of Dickson CJ in *R v Oakes* [1986] 1 SCR 103. It is worth setting out [74] and [75]:

> "[74] The judgment of Dickson CJ in *Oakes* provides the clearest and most influential judicial analysis of proportionality within the common law tradition of legal reasoning. Its attraction as a heuristic tool is that, by breaking down an assessment of proportionality into distinct elements, it can clarify different aspects of such an assessment, and make value judgments more explicit. The approach adopted in *Oakes* can be summarised by saying that it is necessary to determine (1) whether the objective of the measure is sufficiently important to justify the limitation of a protected right, (2) whether the measure is rationally connected to the objective, (3) whether a less intrusive measure could have been used without unacceptably compromising the achievement of the objective, and (4) whether, balancing

> the severity of the measure's effects on the rights of the persons to whom it applies against the importance of the objective, to the extent that the measure will contribute to its achievement, the former outweighs the latter. The first three of these are the criteria listed by Lord Clyde in *de Freitas*, and the fourth reflects the additional observation made in *Huang*. I have formulated the fourth criterion in greater detail than Lord Sumption JSC, but there is no difference of substance. In essence, the question at step four is whether the impact of the rights infringement is disproportionate to the likely benefit of the impugned measure.
>
> [75] In relation to the third of these criteria, Dickson CJ made clear in *R v Edwards Books and Art Ltd* [1986] 2 SCR 713, 781–782 that the limitation of the protected right must be one that 'it was reasonable for the legislature to impose', and that the courts were 'not called on to substitute judicial opinions for legislative ones as to the place at which to draw a precise line'. This approach is unavoidable, if there is to be any real prospect of a limitation on rights being justified: as Blackmun J once observed, a judge would be unimaginative indeed if he could not come up with something a little less drastic or a little less restrictive in almost any situation, and thereby enable himself to vote to strike legislation down (*Illinois State Board of Elections v Socialist Workers Party* (1979) 440 US 173, 188–189); especially, one might add, if he is unaware of the relevant practicalities and indifferent to considerations of cost. To allow the legislature a margin of appreciation is also essential if a federal system such as that of Canada, or a devolved system such as that of the United Kingdom, is to work, since a strict application of a 'least restrictive means' test would allow only one legislative response to an objective that involved limiting a protected right."

37. There is nothing in *Bank Mellat* which, in our view, casts any doubt on the correctness of the decisions of Ferris J in *Vicky* or of Lewison J in *Hilton*. Indeed, what Lord Reed said in [75] underlines the margin of appreciation which a national legislature is to have. This is important when it comes to consideration of the part played by a discretion afforded by a statute to a public authority such as HMRC. Parliament might lay down a scheme (for instance, a scheme to counter certain sorts of tax avoidance) which is, on the face of it, non-compliant with some Convention right (for instance rights under A1P1). In order to meet that potential complaint, a discretion might be given to the decision maker to qualify its decisions in some way in order to allow a decision to be made which is proportionate to the problem which the legislation addresses. If the presence of the discretion is necessary to make the scheme Convention-compliant, then clearly the actual exercise of the discretion in the case of a particular taxpayer must be effected in such a way as to give effect to that taxpayer's Convention rights. In contrast, if the scheme would be Convention-compliant in the absence of any such discretion, then there is no need impose any constraint on the manner of exercise of the discretion in order to give effect to a person's Convention rights. Nor is there any reason to take Convention rights into account when it comes to the ascertainment of the scope of the power or the identification of the matters which may, or must, be taken into account or not be taken into account in its exercise. These are matters of purely domestic law. The decision-maker must make any decision about the exercise of the discretion conferred by the legislative scheme in a way which complies with the ordinary rules of domestic law; but there is, in our view, no scope for imposition of further constraints on the exercise of the discretion based on Convention rights.

38. In the present case, for reasons which we have given, the CIS would be Convention-compliant even if section 66 imposed a mandatory requirement on HMRC to cancel the registration of a person for gross payment whenever the requirements of paragraph (a) of section 66(1) are satisfied. It follows from our discussion in the preceding paragraph that HMRC must exercise its power under section 66(1) in accordance with the ordinary principles of public law but the exercise of that power is not further constrained by the impact of A1P1. The question whether or not HMRC must take into account (and if so, how) the financial consequences for the Company of the cancellation of its registration for gross payment is a matter of domestic law untrammelled by A1P1.

39. Mr Chacko has referred us to the immigration case of *R (Razgar) v SoS for the Home Office* [2004] UKHL 27, 3 WLR 58 at [17] to [20]. This is another case which demonstrates the need for the interference with a person's Convention rights—in that case the interference with the applicant's right to respect for his private or family life (*ie* his Article 8 rights)—to be proportionate to the legitimate public end sought to be achieved. We do not consider that it says anything which we have not taken account of in considering the other authorities.

40. Accordingly, the conclusion we reach so far is that A1P1 has no part to play in the manner of exercise of the power under section 66. Nor does it have any part to play in the ascertainment of the scope of that power or in the identification of the matters which may, or must, be taken into account or not be taken into account.

The scope of the power to cancel registration for gross payment under section 66

41. In *Scofield v HMRC* [2011] UKFTT 199 (TC) ("***Scofield***"), the First-tier Tribunal (Judge Brannan and Ms Redston) carried out a lengthy analysis of the nature of HMRC's power under section 66. Without necessarily agreeing with all of their reasoning, we agree with their conclusions (i) that section 66 gives HMRC a discretion whether or not to cancel registration for gross payment so that "may" is not to be read as "must" and (ii) that "may" does not qualify simply the words "at any time" but goes to the substance of the power. The first of those conclusions is not now challenged by HMRC: Mr Rivett (who appears for HMRC) accepts that HMRC have a power which they do not have to exercise whenever the conditions of one or more of paragraphs (a), (b) and (c) of section 66(1) are met: the provision is permissive and does not impose a mandatory requirement on HMRC.

42. As to the second of those conclusions (the rejection of the proposition that "may" goes to the substance of the power and not merely to the timing of its exercise), we agree with the tribunal in *Scofield* for the reasons which they gave in [57] to [59] of their decision. We agree that to read "may" as referring principally to "at any time" is not a natural way of reading section 66(1). There is nothing, in our view, in the context of section 66(1) or in the CIS as a whole, which points to the construction for which HMRC contend.

43. It does not follow from HMRC's acceptance that section 66(1) confers a power rather than imposes a mandatory requirement that they also accept that the power confers a wide discretion requiring them to take into account a wide range

of factors including, in particular, the financial consequences for the taxpayer of cancellation of registration for gross payment. They consider that the tribunal in *Scofield* was wrong in seeing Parliament as having provided for an element of discretion to be applied in the light of the difficulties to which cancellation of registration would give rise.

44. In [127] of their decision, the tribunal in *Scofield* considered that the conferring of a discretion (in the course of which account would be taken of the financial consequences) would not lead to an absurd or perverse result; on the contrary, they regarded that a sensible result. They did not regard this result as a reward for non-compliance. HMRC disagree with those conclusions.

HMRC's case

45. Mr Rivett starts with two important general points which need to be borne in mind when addressing the scope of the power in section 66(1). The first is that the default position is that a taxpayer is not registered for gross payment: an application has to be made and the criteria are strict, allowing for no real element of discretion. The second is that the CIS is not a scheme imposing any tax charge; rather, it is a collection scheme designed to counter a serious problem of tax evasion.

46. It is common ground that the Company would have failed the compliance test at the time when HMRC purported to cancel its registration. It is also common ground that HMRC did not take the financial consequences of cancellation into account when deciding to cancel that registration. We note that it is no part of HMRC's argument before us in the present case (in contrast with *Scofield*) that the manner in which HMRC's computers have been programmed to issue, automatically, cancellation notices reflects a policy decision to ignore the financial consequences. On HMRC's case, this is not because it is a policy decision to ignore those consequences but because those consequences simply do not fall to be taken into account when exercising the power.

47. It is certainly correct, as Mr Rivett says, that the financial consequences of a refusal to register a person for gross payment are not taken into account in relation to an initial application under section 63. His principal argument is that it would be extraordinary to take those consequences into account when deciding whether or not to exercise the power to cancel the registration. Indeed, his more general proposition is that it would be extraordinary to take into account any factor which was not to be taken into account in relation to the initial registration. He submits that the power is circumscribed; the element of discretion involved relates to the circumstances which explain why the strict requirements of the scheme (after allowing for the exceptions contained in regulation 32) have not been complied with. The central feature of the CIS is past compliance and the expectation of future compliance. The exercise of the discretion rests on the central feature and has nothing to do with the consequences of non-compliance.

48. The Decision, it is said, does great violence to the regime of the CIS. A bad (*ie* non-compliant) business which had previously been compliant and obtained registration for gross payment does better than a new business which may be less seriously non-compliant but cannot obtain registration because of its non-

compliance. This results in an element of unfairness and a distortion of competition.

49. There is nothing in the CIS which expressly refers to the financial consequences of cancellation of registration for gross payment. One might, therefore, find two taxpayers each defaulting in the same way (*eg* three significantly late returns). On the Company's approach, one might have its registration cancelled because, in HMRC's assessment (subject to an admissible appeal), the financial consequences would not be so significant as to lead them to conclude that the registration should not be cancelled but the other might escape cancellation because its business would otherwise be destroyed. This would create unfairness of treatment between the two traders.

50. Further, the criteria by reference to which the seriousness of the financial consequences are to be assessed are completely undefined. The questions arising would include the following: Would it be necessary to show a risk of the complete destruction of a business? Or is there to be an estimate of the loss of turnover in absolute, or perhaps percentage, terms? Is there to be an assessment of the number, or perhaps proportion, of jobs lost? Is it really the case that HMRC must, in every case, enter into an enquiry on the facts of each individual case to ascertain the financial consequences to see whether they would be serious enough to warrant a decision not to cancel the registration? A positive answer to that last question would (to reflect the language of [22] of Lewison J's judgment in *Hilton*) "place a heavy burden on tax inspectors to conduct a prospective review or forecast of the potential effect of [cancellation of registration] on individual businesses".

51. Moreover, the Company is not unique in finding itself in a situation where its business would be adversely affected by the cancellation of its registration. Its own case is that doing business with a contractor who is not registered for gross payment can be less attractive for a head contractor in many situations than doing business with a contractor who is so registered. The same point was made by Ferris J in *Vicky* when he said that the provision of a certificate would "tend to make the sub-contractor holding the certificate a more attractive party for the contractor to deal with" and that it would "improve the sub-contractor's cash flow". Thus it is a feature of the CIS that a sub-contractor will suffer adverse financial consequences in the absence of registration for gross payment. The consequence, as Mr Rivett puts it in his skeleton argument, would be that the circumstances in which gross payment status could be withdrawn would in practice be narrowly circumscribed. That cannot be what Parliament intended.

52. And so, according to Mr Rivett, the financial consequences of cancellation is not a factor which falls to be taken into account in a decision concerning the exercise of the power in section 66(1). Alternatively, it is submitted, as we understand the argument, that there is no obligation on HMRC to do so. We do not think that this alternative approach adds anything to the debate. In our view, if HMRC are entitled to take the financial consequences into account, and if those consequences are not obviously of no importance or relevance to a particular case, then those consequences must be taken into account. We understand the argument that financial consequences are simply irrelevant and not to be taken into account; but if that is wrong, we do not understand how it can be said that HMRC can

nonetheless ignore them. This is not to say anything about the weight which must then be attached to this factor. Nor is it to say that HMRC could not adopt a policy that the financial consequences are not to be taken into account; but that has not been done.

The Company's case

53. Mr Chacko submits that HMRC are intended to have a choice under section 66(1) (and indeed under section 66(3)) whether or not to cancel registration for gross payment. As will be apparent, HMRC do not disagree with that as a statement; where the parties disagree is about what can or may be taken into account in making the choice. Mr Chacko rejects Mr Rivett's submission that it would be extraordinary if HMRC were to be able to take account of certain matters when exercising their power to cancel registration which they could not have taken account of when deciding whether to grant registration in the first place.

54. Mr Chacko submits that this is not remarkable but follows from the structure of the CIS itself. HMRC have no power to cancel registration under section 66(1) unless they have already decided that it would not be granted if applied for at that time: this includes, he says, consideration of whether there was a reasonable excuse for any compliance failures. If there is a reasonable excuse then the compliance test is satisfied so that registration would be granted with the result that the existing registration cannot be cancelled. That is not quite correct: there are alternative routes to de-registration found in paragraphs (b) and (c) of section 66(1). However, if neither of those routes is available to HMRC, what Mr Chacko says is correct.

55. He then goes on to say that the factors which are included in a decision to grant registration for gross payment are therefore taken into account before HMRC are given the choice whether or not to cancel registration. If HMRC are right that they are the only factors relevant to section 66(1), then Parliament would have used mandatory, not discretionary, language.

56. Mr Chacko submits that the likely reason that HMRC is given discretion under section 66(1) and (3) but not under section 63 is that Parliament has acknowledged that more disruption is likely to occur to a sub-contractor who is registered for gross payment but whose registration is cancelled than would occur to a sub-contractor who is applying for registration. Once it is accepted that HMRC have some element of discretion, requiring HMRC to consider whether or not to cancel registration for gross payment, in the light of the disruption this may cause to the taxpayer, may slightly increase HMRC's workload but does not in any way contradict the legislative purpose.

57. Mr Chacko relies further on [60] of the Decision where the Tribunal said that, leaving aside questions of proportionality, HMRC had a general unfettered discretion which at least involved taking into account the effect on a business of losing its registration. He goes as far as to say that even a policy decision to ignore the financial consequences would be invalid: that would be to fetter, unlawfully, the discretion which is given. We doubt the correctness of that but it does not arise in the present case since reliance is not placed on any such policy of which there is no evidence. We say no more about it.

58. Mr Chacko asserts that the financial consequences of cancellation of registration for gross payment are obviously significant. It is not only the severity of the taxpayer's failures and the circumstances which led to them which should be taken into account.

59. As if to head off the difficult question of how HMRC would attach appropriate weight to the financial consequences, he contrasts the position of a business which has a large number of customers who are prepared to put up with deducting tax with the position of the Company. In the case of the former, the effect will be a mere inconvenience and loss of cash flow advantage. But for the Company, which has a few, very significant customers who have made clear that they will use only sub-contractors who can be paid gross, the effect will be catastrophic.

60. Mr Chacko also rejects HMRC's submissions that his approach would narrowly circumscribe HMRC's powers. They already look, he says, at the particular circumstances of each case and exercise their discretion accordingly.

61. In further support of his case, Mr Chacko invokes the benefit which might, in some cases, accrue to HMRC in the furtherance of its duties to collect tax. It would sometimes be sensible, he suggests, to choose not to destroy a profitable and stable business which has failed the compliance test because of delays in payment where destroying that business would reduce the amount of tax collected by HMRC by an amount far greater than the amount lost through the delays.

Discussion of scope of power to cancel registration for gross payment

62. We are faced with what is, ultimately, a short point of construction. In our view, HMRC's position is to be preferred. We will address in a moment the detailed arguments recorded above. But before we do that, there are two matters we wish to mention.

63. The first is to emphasise the purpose of the power to cancel a subsisting registration for gross payment. We have already mentioned the helpful explanation of the introduction of the CIS provided by Ferris J in his judgment in *Vicky* namely, in essence, to counter the systematic abuse of sub-contractors disappearing without having met their tax liabilities. The CIS is, as Mr Rivett submits, a collection scheme and not a scheme for the imposition of tax. The strict conditions which apply in order for a person to obtain registration for gross payment reflect the balance which Parliament considered appropriate to ensure the effective collection of tax: a sub-contractor is to be entitled to receive payment gross if but only if he can, to use Lewison J's words, show a good track record.

64. Similarly, it seems to us that a person should retain his registration only if he continues to display an adequate track record. The power to cancel registration is there principally to ensure compliance with the substance of the CIS. In other words, the idea is that persons who retain their registration should comply with the requirements of the regime. There may, however, be circumstances where, notwithstanding non-compliance, a taxpayer should not suffer, immediately, the disadvantages of cancellation of their registration. For instance, the failure might be the late filing of annual accounts at Companies House (see the requirement set out in paragraph 12(5)(a) Schedule 11). Notwithstanding that this would be sufficient to preclude the grant of registration for gross payment, HMRC might

form the view that the failure would not be repeated and that there was no need to cancel the registration. Or to take another example, the failure might be the late filing of a contractor's return in circumstances where there is no reasonable excuse but where HMRC are satisfied, by reason of changes of internal procedures within the taxpayer company, that there will be no repeat of the failure.

65. In contrast, the financial consequences of a decision to cancel registration for gross status are irrelevant to any issue of future compliance. Indeed, where the financial consequences are relied on by a taxpayer as a reason for not exercising the power to cancel the registration when otherwise it would be exercised, for HMRC to take those consequences into account to decide not to cancel the registration would have precisely the opposite effect from that which the power is there to achieve, namely that those registered for gross payment should be those who are, or can be expected to be, compliant.

66. The second matter is that all sub-contractors who are registered for gross payment know, or must be taken to know, of the risk of cancellation of their registration if, among other matters, they do not comply with the requirements of the compliance test. It cannot be that a taxpayer, whose business will be destroyed by cancellation of its registration for gross payment, can repeatedly fail in its compliance obligations and rely on that inevitable destruction as a ground for challenging a decision to cancel its registration. Even the Company would, no doubt, accept that, arguing that although in such a case *even taking the financial consequences into account* it would be a proper exercise of the power to cancel registration given the repeated breaches, nonetheless those consequences still have to be taken into account but carry no weight.

67. Subject to the detailed arguments which Mr Chacko has raised, the two matters just discussed lead us to conclude that the financial consequences of cancellation of a taxpayer's registration for gross payment are not a relevant factor to be taken into account by HMRC when deciding how to exercise the discretion conferred by section 66(1). We turn now to the arguments submitted by Mr Chacko, but, as will be seen, they do not cause us to doubt that conclusion.

68. First, his submission that the factors which are included in a decision to grant registration for gross payment are taken into account before HMRC are given the choice whether or not to cancel registration; and that if HMRC are right that they are the only factors relevant to section 66(1), then Parliament would have used mandatory, not discretionary, language. We do not agree with that line of argument. It is true that, if a taxpayer is entitled to and obtains registration for gross payment, the factors set out in the compliance test will have been taken into account. But that is not what Mr Rivett means when he says that HMRC can only take into account factors relevant to the grant of registration. What he means is that factors of the type which are taken into account on the grant of registration are the only factors to be taken into account when considering whether not to cancel registration. For example, it will be taken into account whether an applicant has complied with the obligations to deduct tax under section 61. If he has not complied then, subject to regulation 32, registration will not be granted. But it does not necessarily follow that, having obtained registration because he was wholly compliant at that stage, a delay in payment of the full amount of tax

due under section 61, for instance payment within 21 days instead of the 14 days allowed under regulation 32, will result in cancellation of registration even in the absence of a reasonable excuse.

69. Next, his submission that the likely reason that HMRC is given discretion under section 66(1) and (3) but not under section 63 is that Parliament has acknowledged that more disruption is likely to occur to a sub-contractor who is registered for gross payment but whose registration is cancelled than would occur to a sub-contractor who is applying for registration. We see this as pure speculation and not supported by any of the relevant evidential material or to be spelled out of the legislation itself.

70. Next his submission that the slight increase in HMRC's workload would not in any way contradict the legislative purpose. As to that, there is no evidence about the increase in HMRC's workload. We suggest that it is more likely that the workload would be significantly increased rather than only slightly increased if an investigation has to be carried out into the financial circumstances of a taxpayer before a decision is made.

71. Mr Chacko is right, of course, that there is nothing express in the legislation to suggest that the financial consequences of the cancellation of registration for gross payment should be ignored. That, however, is to beg the question at issue. The question is not whether the financial consequences are significant to a taxpayer: they obviously are in the case of the Company. The question is whether they are a material factor in the exercise by HMRC of their power under section 66(1).

72. As to the attempt to head off the difficult question of how HMRC would attach appropriate weight to the financial consequences, we would point out that it cannot possibly be suggested that HMRC could never cancel registration whenever the result of doing so would be to destroy the business. That possibility is inherent in the CIS and to hold otherwise would be a fundamental departure from the structure of the CIS. Mr Chacko's submissions lead to difficult questions about what weight to attach to the financial consequences and how that weight is to be reflected in the ultimate decision. If Parliament had intended such consequences to be taken into account, we think that the legislation would have contained, or authorised secondary legislation which contained, some method of ascertaining the principles by which they fall to be taken into account.

73. As to Mr Chacko's invocation of the benefit which might, in some cases, accrue to HMRC in the furtherance of its duties to collect tax we observe that HMRC's tax collection duties are precisely that, namely to collect tax which has fallen due for payment. It is no part of their function to afford taxpayers an opportunity to earn profits which would be taxable when otherwise they would not have that opportunity. On this argument, it would be appropriate to allow a taxpayer to retain registration indefinitely notwithstanding non-compliance provided that tax was regularly paid, albeit consistently late.

74. It has not been suggested by Mr Chacko that, if HMRC were entitled to make a decision whether or not to cancel the Company's registration for gross payment without regard to the financial consequences of such cancellation, the decision was not one which HMRC could not make. His arguments on A1P1 and proportionality generally were directed at whether those consequences had to be

taken into account. It is not suggested that the decision which was made by the inspector was one which no rational and reasonable inspector could make: the decision is not attacked on *Edwards v Bairstow* or *Wednesbury* principles. Nor, assuming the correctness of our decision on the financial consequences point, has it been suggested that the decision was, of itself, open to challenge at common law as disproportionate. Given our discussion of the issue of proportionality in the context of A1P1, we do not consider that any such challenge could succeed.

75. That is enough to dispose of the criticism of HMRC. But that is not an end of the matter because an issue arises in relation to the nature of an appeal under section 67.

Jurisdiction

76. The question of the jurisdiction of the First-tier Tribunal was considered by the Tribunal at [17] to [21] of the Decision. Under the predecessor provisions, Lightman J held in *Hudson v JDC Services Limited* [2004] STC 834 that the General Commissioners had a full appellate jurisdiction and that they were free to substitute their own decision for that of HMRC. This power for the Commissioners to review and substitute their own decision for that of the Board applied, as we read his decision, even though the decision of the relevant inspector displayed no error of law. Hart J applied the same approach in *Transform Shop* but he did so repeating on a number of occasions that this was assuming Lightman J's decision to have been correct. So far as one can tell from the report, neither side suggested that Lightman J's decision was wrong.

77. Lightman J's decision addressed the right of appeal in relation to the grant of a certificate under section 561 ICTA. The provision giving that right of appeal, section 561(9), applied also to appeals against cancellation of certificates but Lightman J did not take that into account in his analysis. The First-tier Tribunal has addressed the issue of jurisdiction in a number of cases in the context of the provision of the CIS found in Finance Act 2004. Two of the cases are referred to in the Decision at [18]: *Piers Consulting Ltd v HMRC* [2011] UKFTT 613 (TC) and *Cardiff Lift Company v HMRC* [2011] UKFTT 628 (TC). As the Tribunal said, in each of those cases, the First-tier Tribunal held that it did not have jurisdiction to substitute its own decision for that of HMRC. Effectively the Tribunal has a supervisory jurisdiction which is what might be expected in a case where HMRC are exercising a discretion, in this case the discretion to cancel a registration. In each of those cases the appeal was allowed because no proper decision had been made. But the Tribunal did not substitute its own decision.

78. In *Scofield* (itself another case of the failure to exercise the discretion), HMRC accepted, and the First-tier Tribunal held, that it had full appellate jurisdiction and could substitute its own view for that of HMRC. As the Tribunal in the present case observed, the point does not appear to have been argued. The Tribunal preferred the view in *Piers Consulting* and *Cardiff Lift* to that expressed in *Scofield*.

79. We agree with the Tribunal on this point for the reasons given in those two cases (both decisions of Judge Hellier and Mr Corke following from hearings on the same day).

80. Judge Hellier and Mr Corke divided the issue into three questions. First, whether the tribunal has the power to consider the exercise of the discretion. Secondly, if it does, whether it is entitled to substitute its own judgment for that of HMRC or whether it is merely required to determine, in a manner similar to that on judicial review, whether the discretion has been "reasonably" exercised or exercised at all. Thirdly, if it has that power and has decided that the discretion has not been properly exercised, whether it must remit the decision to be made by HMRC or must simply allow the appeal.

81. We agree with them that the tribunal has the power to consider the exercise of the discretion. It is not suggested otherwise by either of the parties before us. The words of section 67(4) are, we agree, clear in providing such a power.

82. Judge Hellier and Mr Corke considered the answer to the second question to be less clear. They concluded that the tribunal had a purely supervisory function limited to upholding or striking down the decision. Their reasons, with which we agree and on which we cannot improve, were, to quote [48] of their decision in *Cardiff Lift*, as follows:

> "(1) Lightman J says, in relation to the legislative history that it was unlikely that the [1980] amendment was 'merely' intended to provide for a *Wednesbury* type judicial review. But the extension of the jurisdiction effectively to consider the question as to whether or not the conditions were fulfilled leaves the possibility that a review jurisdiction was at least retained in relation to the exercise of any discretion;
>
> (2) Lightman J's discussion in subpara (b) of his reasons reveals that his decision as to full appellate jurisdiction was in the context of the operation of the statute where there was no discretion. It is clear that he regarded the presence of any statutory discretion as being at least potentially indicative of a limited jurisdiction, and also clear that his decision as to full jurisdiction does not determine the tribunal's jurisdiction in an appeal against the cancellation of a certificate (or thus of registration);
>
> (3) Although, as Lightman J notes at [20] a 'review' jurisdiction may encompass a full appellate jurisdiction, the use of the phrase 'include jurisdiction to review' indicates to us that a review should be something in addition to a full appellate consideration of the operation of the relevant conditions. Indeed Lightman J recognises this possibility in his reason (a);
>
> (4) Where a discretion is conferred by statute there is some recognition that there may be policies developed by the body to which the power is given which may influence the exercise of that power. A body given a power may rightly take into consideration the need to act fairly as regards a wide body of taxpayers. The development of such policies would be precluded if the tribunal had the jurisdiction to substitute its own. The issues in relation to CIS certificate are ones in which it would be reasonable to suppose that such policies could be applied."

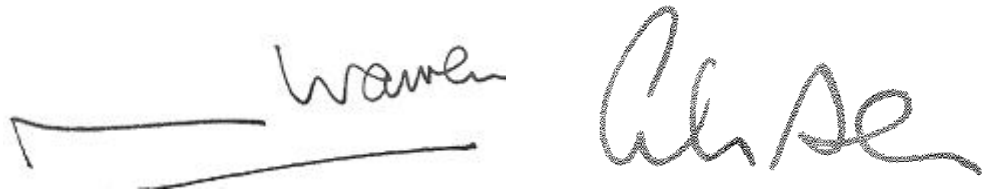
83. Their answer to the third question they posed was that the appeal should either be allowed or dismissed and that an express power would need to be found for the First-tier Tribunal to remit the matter to HMRC to remake the decision in the event that the original decision was held not to have been properly made. It will not always be the case that a decision which has not been properly made should be quashed rather than remitted (see for instance the decision of one of us,

Mr Justice Warren, in *HMRC v GB Housley Ltd* [2015] UKUT 0071 (TCC)). But in the case of the CIS, we agree with Judge Hellier and Mr Corke that a decision by HMRC to cancel a person's registration for gross payment which has not been properly made should ordinarily simply be quashed and not remitted. We say ordinarily because there may be exceptional circumstances in which remitter would be the appropriate remedy, but we cannot at present think of an example where that would be so.

84. Having rejected Mr Chacko's submissions on the substantive matter concerning the relevance of the financial consequences of cancelling the Company's registration for gross payment and having decided that the jurisdiction of the First-tier Tribunal is supervisory only, it follows that HMRC's appeal must be allowed and the notice of cancellation reinstated. Had we decided the substantive matter in the Company's favour, we do not consider that this would have been a case where we could be confident that HMRC would inevitably have reached the same conclusion about cancellation of the Company's registration had it taken the financial consequences into account. We would then have upheld the decision of the Tribunal and dismissed the appeal to us.

Disposition

85. HMRC's appeal is allowed and the cancellation notice is reinstated.



Mr Justice Warren **Judge Colin Bishopp**

Release date: 13 July 2015

ANNEX

Relevant legislation

Finance Act 2004

57 Introduction

(1) This Chapter provides for certain payments (see section 60) under construction contracts to be made under deduction of sums on account of tax (see sections 61 and 62).

(2) In this Chapter "construction contract" means a contract relating to construction operations (see section 74) which is not a contract of employment but where—

(a) one party to the contract is a sub-contractor (see section 58); and

(b) another party to the contract ("the contractor") either—

(i) is a sub-contractor under another such contract relating to all or any of the construction operations, or

(ii) is a person to whom section 59 applies.

(3) In sections 60 and 61 "the contractor" has the meaning given by this section.

(4) In this Chapter—

(a) references to registration for gross payment are to registration under section 63(2),

(b) references to registration for payment under deduction are to registration under section 63(3), and

(c) references to registration under section 63 are to registration for gross payment or registration for payment under deduction.

(5) To the extent that any provision of this Chapter would not, apart from this subsection, form part of the Tax Acts, it shall be taken to form part of those Acts.

58 Sub-contractors

For the purposes of this Chapter a party to a contract relating to construction operations is a sub-contractor if, under the contract—

(a) he is under a duty to the contractor to carry out the operations, or to furnish his own labour (in the case of a company, the labour of employees or officers of the company) or the labour of others in the carrying out of the operations or to arrange for the labour of others to be furnished in the carrying out of the operations; or

(b) he is answerable to the contractor for the carrying out of the operations by others, whether under a contract or under other arrangements made or to be made by him.

59 Contractors

(1) This section applies to the following bodies or persons—

(a) any person carrying on a business which includes construction operations; …

60 Contract payments

(1) In this Chapter "contract payment" means any payment which is made under a construction contract and is so made by the contractor (see section 57(3)) to—

(a) the sub-contractor,

(b) a person nominated by the sub-contractor or the contractor, or

(c) a person nominated by a person who is a sub-contractor under another such contract relating to all or any of the construction operations.

(2) But a payment made under a construction contract is not a contract payment if any of the following exceptions applies in relation to it.…

(4) This exception applies if the person to whom the payment is made or, in the case of a payment made to a nominee, each of the following persons—

(a) the nominee,

(b) the person who nominated him, and

(c) the person for whose labour (or, where that person is a company, for whose employees' or officers' labour) the payment is made,

is registered for gross payment when the payment is made. But this is subject to subsections (5) and (6).

(5) Where a person is registered for gross payment as a partner in a firm (see section 64), subsection (4) applies only in relation to payments made under contracts under which—

(a) the firm is a sub-contractor, or

(b) where a person has nominated the firm to receive payments, the person who has nominated the firm is a sub-contractor.

(6) Where a person is registered for gross payment otherwise than as a partner in a firm but he is or becomes a partner in a firm, subsection (4) does not apply in relation to payments made under contracts under which—

(a) the firm is a sub-contractor, or

(b) where a person has nominated the firm to receive payments, the person who has nominated the firm is a sub-contractor.…

61 Deductions on account of tax from contract payments

(1) On making a contract payment the contractor (see section 57(3)) must deduct from it a sum equal to the relevant percentage of so much of the payment as is not shown to represent the direct cost to any other person of materials used or to be used in carrying out the construction operations to which the contract under which the payment is to be made relates.

(2) In subsection (1) "the relevant percentage" means such percentage as the Treasury may by order determine.…

63 Registration for gross payment or for payment under deduction

(1) If the Board of Inland Revenue are satisfied, on the application of an individual or a company, that the applicant has provided—

(a) such documents, records and information as may be required by or in accordance with regulations made by the Board, and

(b) such additional documents, records and information as may be required by the Inland Revenue in connection with the application,

the Board must register the individual or company under this section.

(2) If the Board are satisfied that the requirements of subsection (2), (3) or (4) of section 64 are met, the Board must register—

(a) the individual or company, or

(b) in a case falling within subsection (3) of that section, the individual or company as a partner in the firm in question,

for gross payment.

(3) In any other case, the Board must register the individual or company for payment under deduction.

66 Cancellation of registration for gross payment

(1) The Board of Inland Revenue may at any time make a determination cancelling a person's registration for gross payment if it appears to them that—

(a) if an application to register the person for gross payment were to be made at that time, the Board would refuse so to register him,

(b) he has made an incorrect return or provided incorrect information (whether as a contractor or as a sub-contractor) under any provision of this Chapter or of regulations made under it, or

(c) he has failed to comply (whether as a contractor or as a sub-contractor) with any such provision.

(2) Where the Board make a determination under subsection (1), the person's registration for gross payment is cancelled with effect from the end of a prescribed period after the making of the determination (but see section 67(5)).

(3) The Board of Inland Revenue may at any time make a determination cancelling a person's registration for gross payment if they have reasonable grounds to suspect that the person—

(a) became registered for gross payment on the basis of information which was false,

(b) has fraudulently made an incorrect return or provided incorrect information (whether as a contractor or as a sub-contractor) under any provision of this Chapter or of regulations made under it, or

(c) has knowingly failed to comply (whether as a contractor or as a sub-contractor) with any such provision.

(4) Where the Board make a determination under subsection (3), the person's registration for gross payment is cancelled with immediate effect.

(5) On making a determination under this section cancelling a person's registration for gross payment, the Board must without delay give the person notice stating the reasons for the cancellation.

(6) Where a person's registration for gross payment is cancelled by virtue of a determination under subsection (1), the person must be registered for payment under deduction.

(7) Where a person's registration for gross payment is cancelled by virtue of a determination under subsection (3), the person may, if the Board thinks fit, be registered for payment under deduction.

(8) A person whose registration for gross payment is cancelled under this section may not, within the period of one year after the cancellation takes effect (see subsections (2) and (4) and section 67(5)), apply for registration for gross payment.

(9) In this section "a prescribed period" means a period prescribed by regulations made by the Board.

67 Registration for gross payment: appeals

(1) A person aggrieved by—

(a) the refusal of an application for registration for gross payment, or

(b) the cancellation of his registration for gross payment,

may by notice appeal.

(2) The notice must be given to the Board of Inland Revenue within 30 days after the refusal or cancellation.

(3) The notice must state the person's reasons for believing that—

(a) the application should not have been refused, or

(b) his registration for gross payment should not have been cancelled.

(4) The jurisdiction of the tribunal on such an appeal that is notified to the tribunal shall include jurisdiction to review any relevant decision taken by the Board of Inland Revenue in the exercise of their functions under section 63, 64, 65 or 66.

(5) Where a person appeals against the cancellation of his registration for gross payment by virtue of a determination under section 66(1), the cancellation of his registration does not take effect until whichever is the latest of the following—

(a) the abandonment of the appeal,

(b) the determination of the appeal by the tribunal, or

(c) the determination of the appeal by the Upper Tribunal or a court.

Sch 11, Part 3

9—General

In the case of an application for a company to be registered for gross payment (whether as a partner in a firm or otherwise), the following conditions must be satisfied by the company.

10—The business test

The company must satisfy the Inland Revenue, by such evidence as may be prescribed in regulations made by the Board of Inland Revenue, that—

(a) it is carrying on (whether or not in partnership) a business in the United Kingdom, and

(b) that business satisfies the conditions mentioned in paragraph 2(a) and (b).

11—The turnover test

(1) The company must either—

(a) satisfy the Inland Revenue, by such evidence as may be prescribed in regulations made by the Board of Inland Revenue, that the carrying on of its business is likely to involve the receipt in the year following the making of the application of an aggregate amount by way of relevant payments which is not less than the amount which is the minimum turnover for the purposes of this sub-paragraph …

12—The compliance test

(1) The company must, subject to sub-paragraphs (2) and (3), have complied with—

(a) all obligations imposed on it in the qualifying period (see paragraph 14) by or under the Tax Acts or the Taxes Management Act 1970 (c 9); and

(b) all requests made in the qualifying period to supply to the Inland Revenue accounts of, or other information about, its business.

(2) A company that has failed to comply with such an obligation or request as—

(a) is referred to in sub-paragraph (1), and

(b) is of a kind prescribed by regulations made by the Board of Inland Revenue,

is, in such circumstances as may be prescribed by the regulations, to be treated as satisfying the condition in that sub-paragraph as regards that obligation or request.

(3) A company that has failed to comply with such an obligation or request as is referred to in sub-paragraph (1) is to be treated as satisfying the condition in that sub-paragraph as regards that obligation or request if the Board of Inland Revenue are of the opinion that—

(a) the company had a reasonable excuse for the failure to comply, and

(b) if the excuse ceased, it complied with the obligation or request without unreasonable delay after the excuse had ceased.

(4) The company must, if any contribution has at any time during the qualifying period become due from the company under—

(a) Part 1 of the Social Security Contributions and Benefits Act 1992 (c 4), or

(b) Part 1 of the Social Security Contributions and Benefits (Northern Ireland) Act 1992 (c 7),

have paid the contribution when it became due.

(5) The company must have complied with any obligations imposed on it by [listed] provisions of the Companies Act 1985 in so far as those obligations fell to be complied with within the qualifying period …

Income Tax (Construction Industry Scheme) Regulations 2005, SI 2005/2045

32—Exceptions from compliance obligations

(1) The obligations and requests prescribed for the purposes of paragraphs … 12(2) of Schedule 11 to the Act are given in column 1 of Table 3.

(2) The circumstances prescribed in which the applicant or company is to be treated as satisfying the conditions in paragraphs 4(1), 8(1) or 12(1) of Schedule 11 to the Act as regards each of the prescribed obligations are given in column 2 of Table 3.

Table 3

1. Prescribed obligations	*2. Prescribed circumstances*
Obligation to submit monthly contractor return within the required period.	(1) Return is submitted not later than 28 days after the due date, and (2) the applicant or company— (a) has not otherwise failed to comply with this obligation within the previous 12 months, or (b) has failed to comply with this obligation on not more than two occasions within the previous 12 months.
Obligation to pay— (a) the amount liable to be deducted under section 61 of the Act from payments made during that tax period, or (b) tax liable to be deducted under the PAYE Regulations.	(1) Payment is made not later than 14 days after the due date, and (2) the applicant or company— (a) has not otherwise failed to comply with this obligation within the previous 12 months, or (b) has failed to comply with this obligation on not more than two occasions within the previous 12 months.
Obligation to pay income tax.	(1) Payment is made not later than 28 days after the due date, and (2) the applicant has not otherwise failed to

	comply with this obligation within the previous 12 months.
Obligation to submit a return under regulation 85 of the PAYE Regulations (annual return of other earnings) within the required period.	Return is submitted after the due date.
Obligation to pay corporation tax for which the applicant or company is liable.	(1) Payment is made not later than 28 days after the due date, and (2) any shortfall in that payment has incurred an interest charge but no penalty.
Obligation to submit a self-assessment return within the required period.	Return is submitted after the due date.
Obligations and requests referred to in paragraphs 4(1), 8(1) and 12(1) of Schedule 11 to the Act.	The failure to comply occurred before the appointed day and was within section 562(10), 564(4) or 565(4) of ICTA (conditions to be satisfied: minor and technical failures).
Obligation to make a payment under the Tax Acts or Taxes Management Act 1970.	Late, or non-payment of an amount under £100.