



Appeal number: TC/2011/02613

NATIONAL INSURANCE class 2 contributions - failure to pay - whether failure to pay attributable to ignorance or error; whether ignorance or error due to failure to exercise due care and diligence - appellant took care to appoint a recommended accountant to deal with the NIC matters - accountant failed to correctly advise appellant - appeal allowed.

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

DR JEREMY SCHONFIELD

Appellant

- and -

**THE COMMISSIONERS FOR HER MAJESTY'S Respondents
REVENUE & CUSTOMS**

**TRIBUNAL: JUDGE SANDY RADFORD
ANTHONY HUGHES**

Sitting in public at Bedford Square, London on 7 December 2012

Mr Chacko for the Appellant

Mrs Storey, officer of HMRC, for the Respondents

DECISION

1. This is an appeal against HMRC's decision that the appellant's failure to pay Class 2 National Insurance contributions for the period 28 March 1988 to 5 April 2003 within the prescribed period was attributable to the appellant's ignorance or error and that such ignorance or error was due to the appellant's failure to exercise due care and diligence.
2. HMRC admitted that they had incorrectly quoted the start date as 28 March 1988 when in fact the appellant commenced self employment on 1 December 1986.
3. As a result of HMRC 's decision any National Insurance contributions paid by the appellant from 1 December 1986 to 5 April 2003 could not be treated as paid at an earlier date.
4. The appellant wished to pay these contributions so that he would qualify for a full State Pension when he retires. Paragraph 5A of Schedule 3 to the Social Security (Contributions and Benefits) Act 1992 provided that, for the appellant to receive a full pension, he needed to have paid sufficient Class 1, 2 or 3 contributions in a total of 30 years.
5. The appellant and his wife and Mr Greenshields of HMRC provided witness statements and gave oral evidence.

Legislation

6. Section 7(1) of the Social Security Act 1975 which was consolidated by section 11(1) of the Social Security Contributions and Benefits Act 1992 ("the Act") provides that every self-employed earner who is over the age of 16 is liable to pay Class 2 National Insurance (NI) contributions for each week in which they are self-employed.
7. In accordance with Regulation 53A of the Social Security (Contributions) Regulations 1979 and Regulation 87 of the Social Security (Contributions) Regulations 2001, every person who becomes or ceases to be liable to pay a class 2 contribution shall immediately notify the relevant date to the Board in writing or by such means of electronic communication as may be approved.
8. Originally payment was made by affixing a Class 2 stamp of the appropriate value to a contribution card not later than the last day in the week in respect of which the NI Contribution was due. This was in accordance with regulations 54(1) and (2) of the Social Security (Contributions) Regulations 1979. From 6 April 1975 a person could choose instead to pay every month by direct debit from their bank account and from 11 April 1993, payment by stamped card was abolished and was replaced by a system where the self-employed person would be sent bills every 13 weeks.
9. The stamped contribution card had to be returned to the Department of Social Security either by posting it to or handing it in at one of the Department's local offices

within six days after the end of the period covered by the card. This was in accordance with regulation 52(2) of the Social Security (Contributions) Regulations 1979.

5 10. There are strict time limits within which contributions must be paid. Under regulation 4(3) of the Social Security (Crediting and Treatment of Contributions and National Insurance Numbers) Regulations 2001, to count for State Pension, Class 2 contributions due for the period from 6 April 1983 have to be paid before the end of the sixth tax year following that in which they were due.

10 11. In accordance with section 12(3) of the Act Class 2 contributions due for periods from 6 April 1983 which are not paid until after the end of the tax year following the one in which they were due, are payable at the highest rate in force during the period from the week in which the contribution is payable to the date the contribution is paid.

15 12. The time limits are necessary because without them there would be nothing to prevent contributors in general from exercising options against the NI fund by delaying the payment of contributions until the event against which cover is sought has already occurred. This would be contrary to the principles of the "pay as you go" system on which the NI scheme is based and unfair to the majority of contributors whose contributions are deducted regularly from their earnings.

20 13. Regulation 4(3) of the Social Security (Crediting and Treatment of Contributions, and National Insurance Numbers) Regulations 2001, provides that for the purpose of entitlement to any contributory benefit, a Class 2 NI contribution payable for a contribution week after 6 April 1983 if paid after the end of the sixth year following the year in which liability for that contribution arises, is treated as not paid ; but if paid before the end of the sixth year, is treated as paid on the date on
25 which payment of the contribution is made.

30 14. Regulation 6 of the Social Security (Crediting and Treatment of Contributions and National Insurance Numbers) Regulations 2001 provides that contributions paid outside the time limits prescribed in legislation may only be treated as having been paid on an earlier date if it can be shown to the satisfaction of the board that failure to pay within the prescribed period is attributable to ignorance or error on the part of the insured person and that ignorance or error was not due on to any failure on his/her part to exercise due care and diligence.

Background and facts

35 15. From around 1986, the appellant did an increasing amount of freelance academic work, and decided to become self-employed as a freelance academic. He consulted an accountant, George Dub of Dub & Co, who was recommended to him, as to what he needed to do. The appellant confirmed that Mr Dub seemed to be doing a good job and was thorough and solicitous.

40 16. As a self-employed person, the appellant is and was liable to pay two kinds of NIC: graduated Class 4 contributions under section 15 of the Social Security

(Contributions and Benefits) Act 1992, collected by the Inland Revenue and (now) by HMRC; and significantly lower flat-rate Class 2 contributions under section 11 of that Act, collected originally by the Department of Health and Social Security ("DHSS"), its precursors and successors, but since 1999 by the Inland Revenue and then HMRC.

- 5 17. On 28 March 1988 Mr Dub wrote on the appellant's behalf to HMRC to register as self-employed. However, no-one wrote to the DHSS or its equivalent at the time.
18. Between then and 2009, the appellant and his wife properly paid tax and Class 4 NICs to HMRC. They used Dub & Co to prepare their tax returns. The appellant, however, did not pay Class 2 NICs. He was never asked for them because the DHSS
10 and subsequently the Department of Social Security, who were responsible for their collection, were unaware that he was self-employed.
19. In 1999, responsibility for collection of Class 2 NICs was transferred to the Inland Revenue. While the Inland Revenue would normally have sent out reminders to people like the appellant who were not making contributions this was not done in
15 this case.
20. This was because the appellant's National Insurance record stated that he was abroad. It is not known why the record stated this as it was clear from the appellant's statement of account that from 1979 to 1988 the Class 1 NICs were recorded as paid because of his employment in the UK.
- 20 21. In 2009, the appellant's wife Tamar, who is and was also self-employed, received a letter from HMRC telling her that when she ceased to receive child benefit she would cease to be credited with Class 2 NICs, and that she ought therefore to make arrangements to pay them.
22. The appellant and his wife had not previously been aware that they might be
25 required to pay Class 2 as well as Class 4 NICs, and consulted George Dub. He wrote on their behalf to register to pay Class 2 NICs and to pay the outstanding contributions. He was told that only the last six years' contributions could be counted towards benefits, and he paid those contributions.
23. The appellant registered his self-employment for National Insurance purposes
30 on 12 January 2010. He provided a start date of 2 April 2000 at that time.
24. When HMRC received the completed registration form, the appellant's National Insurance record held an "open abroad" notation on it.
25. HMRC wrote to the appellant to ascertain the date of his return to the UK and amended his record accordingly.
- 35 26. HMRC noted the appellant's National Insurance record of his self-employment start date and sent a bill on 2 February 2010 for outstanding Class 2 contributions from 2 April 2000 to 6 February 2010. The appellant commenced paying by direct debit from 7 February 2010.

27. The appellant made a payment of £858.05 on 3 March 2010 which covered the period 6 April 2003 to 6 February 2010. He did not pay the outstanding amount for the period 2 April 2000 to 5 April 2003 as he had been made aware that this would not count towards his state pension entitlement.

5 28. HMRC subsequently waived this period and informed the appellant of this on 12 April 2012.

29. The appellant disputed that he was out of time to pay from 2 April 2000 to 5 April 2003 stating he did not receive notification that he had to pay.

10 30. Following a number of letters of explanation, HMRC sent a formal decision to the appellant on 24 November 2010 covering the 2000-2001 to 2002-2003 tax years.

31. During the course of correspondence that followed the appellant told HMRC that his accountant had contacted the Tax Office on 28 March 1988 to advise that he had commenced self-employment on 1 December 1986.

15 32. Following his appeal to the Tribunals Service on 3 April 2011, Dr Schonfield applied for a stay in proceeding to seek legal advice.

33. As a result, he asked HMRC to extend the period covered in the formal decision to include the period from 28 March 1988.

34. HMRC issued the varied decision, subject of this appeal, on 20 December 2011.

Appellant's submissions

20 35. Mr Chacko submitted that the question before the Tribunal was whether the appellant failed to exercise due care and diligence. In Mr Chacko's submission, it was clear that he did exercise due care and diligence because he acted responsibly given his limited knowledge of the tax and social security system.

25 36. Mr Chacko submitted that whilst HMRC had referred to a number of cases, since the decision of the Court of Appeal in *HMRC v. Kearney* [2010] S.T.C. 1137, these older cases should be seen as illustrative rather than as laying down rules about the meaning of "due care and diligence".

37. He submitted that in *Kearney Arden*, LJ had explained the test as follows:

30 [27]... lack of care means lack of concern, whereas diligence means a failure to apply oneself to the issue... it is not possible to define all the circumstances that will meet the second condition [being the requirement to exercise due care and diligence]. In part what is due care and diligence in any set of circumstances will depend on the obligations of the person being considered.

35 [29] ... there is at least in general a duty to make some enquiries and in appropriate circumstances to follow them up... these enquiries need not necessarily be made of the NICO [National Insurance Contributions Office, now

HMRC]. The enquiries might be sufficiently made if they were made of the employer or a trade union.”

5 38. The appellant’s failure to pay Class 2 NICs was not due to any lack of concern on his part as to whether or not he paid the correct contributions. When he discovered that there was a possibility that he had been failing to make payments, he promptly sought advice and informed HMRC.

10 39. Mr Chacko submitted that neither had the appellant failed to apply himself. As he had no financial or legal expertise, he enquired of a professional advisor as to what he needed to do, choosing this advisor on the basis of favourable recommendation. He submitted that this was exactly the sort of thing a diligent taxpayer without relevant legal knowledge ought to have done.

15 40. He submitted that from then until 2009, the appellant had no reason to suspect a problem with his NIC payment. While the notes accompanying his self assessment returns mention Class 2 NICs, the appellant was paying an accountant to sort out his tax returns and therefore would pass this information on to Dub & Co. In the circumstances, it would have been surprising for the appellant to read through the full notes to his tax return.

20 41. Mr Chacko submitted that if HMRC had written to the appellant indicating that there could be a problem with his contributions or tax, this would have been responded to promptly. This is exactly what happened when the appellant’s wife received a letter mentioning her Class 2 contributions record. No such letters were sent. HMRC’s National Insurance Manual guidance on “care and diligence” at NIM23005 states that whether or not HMRC has sent warnings about the consequences of late payment is a matter relevant to whether or not a taxpayer has acted with care and diligence, and this was approved by Arden LJ in *Kearney*.

30 42. Mr Chacko submitted that the appellant was aware of the need to make national insurance contributions, but thought that he was doing so as he was paying Class 4 NICs (in much larger amounts than the Class 2 NICs he was failing to pay). Therefore there was no reason for him to be suspicious about his contribution position.

35 43. Mr Chacko referred to HMRC’s citing of the case of *Walsh v. Secretary of State* (28 March 1994, unreported), where Mr Walsh, who was self employed but had failed to pay Class 2 NICs, claimed that he thought that he was only required to pay Class 4 NICs and Owen J held that he had not exercised due care and diligence. Mr Chacko stated however that in that case Mr Walsh had known that he was obliged to pay Class 2 NICs, having worked on national insurance in the Civil Service and had in fact been stamping his National Insurance card (which was the way at the time that contributions were recorded) until he lost it. Mr Walsh was only ignorant of his obligation because he had forgotten about it. In those circumstances, the fact that he was paying Class 4 NICs was not a satisfactory explanation for his belief that he was paying all the NICs he was supposed to pay. Mr Chacko submitted that the appellant’s case was quite different.

44. He submitted that the appellant knew that he did not understand his tax and national insurance obligations. He therefore sought advice from a professional advisor, and relied upon that. He had no reason to suspect that he was not properly paying NICs. This is entirely diligent behaviour for a self-employed person with no legal or financial background.

45. He submitted that there could be no requirement that advice be sought from HMRC (or, previously, the DHSS or the Contributions Office). In *Kearney* at paragraph 29 Arden LJ made this point. In as much as HMRC contended that due care and diligence require advice to be checked with HMRC, he submitted that this could not be correct.

46. He submitted therefore that the appellant's ignorance of the requirement that he pay Class 2 NICs did not stem from failure to exercise due care and diligence on his part, and the appeal should be allowed.

47. Alternatively he submitted that if the appellant did fail to exercise due care and diligence, he should still be permitted to pay Class 2 NICs for the 2001-2 and 2002-3 tax years under Regulation 6B. This allows late payment to have effect for contributions purposes where the contribution "was paid after the due date by virtue of an official error...."

48. He submitted that the official error was that HMRC had mistakenly failed to send letters to the appellant at the end of each of the years 2000-1, 2001-2 and 2002-3, to tell him that there was a shortfall in his contributions. They did this because they believed, in error, that the appellant was abroad despite his regular payment of Class 4 NICs. Had HMRC not made this mistake, they would have told the appellant of his failure to make payment, and after that date the appellant would have paid his Class 2 NICs as they fell due.

49. Mr Chacko submitted that therefore the appellant's appeal should be allowed in respect of the period after HMRC would have sent him a letter reminding him of his liability, if they had not been in error as to whether or not he was in the UK.

HMRC's submissions

50. HMRC submitted that the appellant was self employed from 1 December 1986 and liable to pay a Class 2 NI contribution as a self-employed earner in accordance with section 7(1) of the Social Security Act 1975 which was consolidated by section 11(1) of the Social Security Contributions and Benefits Act 1992.

51. HMRC submitted that the appellant should have notified the then Department of Health and Social Security (DHSS) immediately that he had started self-employment in December 1986 in accordance with Regulation 53A of the Social Security (Contributions) Regulations 1979 but he failed to do so.

52. HMRC submitted that before April 1996, a person was required to register separately for both tax and NI purposes. For NI a person had to complete form CF11.

Although the appellant registered for tax purposes, he did not register for NI before 2010.

53. HMRC submitted that there were numerous leaflets available at all DHSS offices at the time the appellant became self-employed. These provided guidance for the self-employed and explained what NI they needed to pay. The Inland Revenue also ran a number of publicity campaigns to inform the self-employed of the need to register their liability to pay Class 2 NI.

54. HMRC submitted that the appellant had assumed that by paying Class 4 NI, he was doing all that was required. Had he contacted the Department of Social Security to confirm his assumption he would have been told he had to register to pay Class 2 NI before he did so in January 2010.

55. HMRC submitted that when the appellant registered for tax purposes he would have received notes and guidance with his tax return and from 1996-97 with his self assessment return. The notes included information about Class 2 NI contributions and advised of the need to register with the DSS.

56. HMRC contended that whilst the appellant may have been ignorant of the need to pay Class 2 NICs when he became self-employed, there was sufficient information given or available to him to alert him to his liability or at least direct him to make enquiries about his position.

57. HMRC submitted that the appellant relied upon advice sought for and given by his accountant. HMRC submitted that the appellant did not check that the advice given was accurate and now appeared to be asserting that the advice he was given by his accountant was incomplete or incorrect. HMRC had seen no response from the accountant to explain this and HMRC submitted that the appellant might wish to seek an explanation from his accountant which was the route suggested by Judge Reid in *HMRC v Thacker*.

58. HMRC referred to the case of *Bernard David James Walsh v Secretary of State for Social Security* in which Mr Justice Owen stated in his decision:

“It is pointed out that there is no corresponding duty on the Secretary of State to ensure that payments are made. In these circumstances it is argued (in my judgement correctly) that the primary liability to pay is on the self-employed earner”

59. HMRC referred to the case of *In Philip Langley Rose v HMRC* – in which Dr David Williams stated in his decision:

“The evidence is that Dr Rose was aware at the time of his choices, or at least he would have been aware of them had he read the leaflets he was sent and had he made the reasonable enquiries that those leaflets should have prompted. He chose at that time not to enquire or not to pay. In the current context of the current question of protecting his NI record, he chose not to exercise due care and diligence in protecting his contribution record”

60. HMRC also cited the cases of *HMRC v Thompson* 2005 EWHC 3388 (Ch) and *Adojutelegan v Clark* SCD SpC 430J in which Special Commissioner Avery Jones stated that:

5 “Exercising due diligence involves the positive step of making enquiries. Mr Williams contended that while the National Insurance authorities try to keep a contributor informed of what he needs to know to maintain his contribution record, it can do this effectively only if the contributor personally contacts them. The Appellant had failed to make any enquiries and therefore had not exercised due care and diligence”.

10 “Doing nothing is not the exercise of due care and diligence. Had she made an enquiry she would have been told there was a six-year time limit for paying contributions. Her ignorance of this was due to her failure to make enquiries, which is a failure to exercise due care and diligence.”

15 61. HMRC submitted that although Mr Chacko had suggested that the case law cited by HMRC should be seen as illustrative rather than as laying down the rules about the meaning of due care and diligence, HMRC contended that whilst the facts varied, the test on due care and diligence had remained consistent in each case.

20 62. HMRC submitted that although Mr Chacko had quoted Lady Justice Arden’s explanation of the test on due care and diligence in the Court of Appeal case *Mr John Joseph Kearney v HMRC*, it was clear from Lady Justice Arden’s explanation that there was a requirement to make some enquiries in order to exercise diligence. In her summing up Lady Justice Arden stated:

25 “I would observe that the result of this case should not be thought to reduce the importance of the duties imposed on those who are liable to pay NICs or who have the option to do so. Ignorance is not an excuse save in limited circumstances. It is a person’s own responsibility to pay NICs and, if he or she fails to do so at the right time, he or she may lose the chance to pay them later on the basis of ignorance at the appropriate time of the need to pay. The facts of this case are unusual, and, while of course this judgement deals only with this appeal, I would observe that facts like
30 these may not often occur.”

35 63. Finally HMRC contended that there was no error made which prevented the appellant from meeting his liability. Had he registered his self employment or contacted the Department for advice he would have been told about his liability and would have been issued with a card or billed accordingly. HMRC submitted that it could not be held responsible for the appellant’s failure to meet his legal obligation.

40 64. HMRC submitted that the appellant had provided no evidence to show that he made enquiries about his National Insurance liability and has stated that he made no attempt to confirm that his assumptions about the payment of NI were correct. As Lady Justice Arden pointed out, it is a person’s own responsibility to pay NICs and it is clear that the appellant failed to meet that liability.

Findings

65. We found the appellant and his wife sincere and honest when providing their evidence.

5 66. We found that on becoming self employed the appellant exercised due care and diligence by appointing an accountant to deal with all matters which arose in connection with his self employment.

67. We found that before appointing Mr Dub the appellant exercised due care and diligence by seeking a recommendation as to which accountant was most competent to deal with these matters.

10 68. We found that as a result of the appellant seeking professional help, it was most unlikely that he would research the matter further himself. We found that there was not sufficient information given to him to alert him to his liability or direct him to make enquiries about his position.

15 69. We found that unusually HMRC did not send out any reminders because their records were faulty and showed that the appellant was abroad although HMRC at the same time were receiving Class 1 NIC's from the appellant.

20 70. We found therefore that the appellant's failure to pay Class 2 National Insurance contributions from the start of his self employment to 5 April 2003 was attributable to the appellant's ignorance which was not due to his failure to exercise due care and diligence.

Decision

71. The appeal is allowed.

25 72. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

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35 **TRIBUNAL JUDGE**
RELEASE DATE: 18/04/13