[2018] UKFTT 0685 (TC)

TC06831

Appeal number: TC/2017/05624

CONSTRUCTION INDUSTRY SCHEME - penalties for late filing of returns – whether Appellant was a 'Contractor' engaged in a 'Construction contract' within the meaning of the ss 57 & 59 FA 2004 –- and as such required to file CIS returns - Mundial considered - no - appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

THORNTON HEATH LLP **Appellant**

- and -

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

TRIBUNAL: JUDGE MICHAEL CONNELL
MEMBER DAVID EARLE

Sitting in public at Taylor House, Rosebery Avenue, London EC1R 4QU on 17 October 2017

Ms Emma Brocklehurst for the Appellant

Ms Sadia Siddiqui, Officer of HM Revenue and Customs, for the Respondents

DECISION

The Appeal

1. This is an appeal by Thornton Heath LLP ("the Appellant") against penalties of £3,700, imposed by HMRC under Schedule 55 Finance Act 2009 for the Appellant's failure to make monthly returns by the due dates under the Construction Industry Scheme ("CIS") for the period March 2015 to April 2016 inclusive.

2. The issue before us is whether the Appellant was 'a contractor, carrying on a business which includes construction operations', and as such obliged to file monthly returns. If so, whether it has a reasonable excuse for making the late returns.

3. The appeal was heard on 17 October 2017. At the hearing, issues arose that had not been addressed in any substantive detail by either party but in respect of which both wished to prepare and put forward submissions:

- The first issue is whether the Appellant operates as a property development business or a property investment business, for the purpose of the CIS, with particular reference to a conversion of a building at 348/352 Norwood Road, West Norwood, London.

- The second issue is whether the Respondents had raised the penalties under the correct legislation, and as such, as a matter of law, was the Appellant obliged to file CIS contractors monthly returns, and if so whether the penalties have been correctly calculated.

Both parties put forward their submissions. They agreed that there was no necessity for a further hearing and that the matter could be decided on the original evidence bundle, as supplemented by the additional representations and submissions.

The CIS penalty regime

4. The CIS is a tax compliance scheme for businesses operating in the construction industry. This is an industry that often involves "cash in hand" transactions. Historically, this resulted in a significant loss of tax and National Insurance contributions, because many sub-contractors engaged in the industry "disappeared" without settling their tax liabilities, with a consequential loss of revenue to the Exchequer.

5. The legal basis of the current CIS regime, in force from 1 November 2011, is Finance Act 2009, Schedule 55 paragraphs 1, 8-13 and 23 ("FA 2009"); ss 57 -77 of the Finance Act 2004 ("FA 2004") and the Income Tax (Construction Industry Scheme) Regulations 2005 (SI 2005/2045) (the "2005 Regulations").

6. Sections 57-59 FA 2004 replaced the provisions of sections 559-561 of the Income and Corporation Taxes Act 1988 with regard (inter alia) to the definition of 'contractors' and a 'construction contract'.

7. The CIS requires certain payments by contractors to sub-contractors to be made subject to deduction of tax. The sub-contractors are entitled to claim credit for tax withheld under CIS against their tax liability for the tax year in question.

8. Contractors are required to make a return no later than 14 days after the end of every tax month (a "monthly return") (s 70 FA 2004 and reg 4 of the 2005 Regulations). For these purposes, a tax month means the period beginning with the 6th day of a calendar month and ending on the 5th day of the following month. A monthly return must therefore be received by HMRC no later than the 19th day of the month. Nil returns were required (s 70 FA 2004 and reg 4(10) of the 2005 Regulations), but this is no longer the case (see paragraph 19 below).

9. If a monthly return is received after the filing date, it will be treated as late and the contractor will be liable to a penalty under Schedule 55 FA 2009:

(i) Pre 1 November 2011 if a return was not made, or was late, the following penalties became chargeable:

- £100 for each month or part of a month (up to 12) during which the failure continued...
- If a return remains outstanding after twelve months an additional final penalty in the range of £300 - £3,000 becomes chargeable. The amount of the penalty depended on how many other final penalties had been charged in the previous 12 months
- If the failure continued beyond twelve months an additional penalty of the amount payable for the tax year to which the return related, which remained unpaid, at 19 April following that year

(ii) From 1 November 2011 the penalty regime is as follows:

- An initial penalty of £100 is charged if a return is filed after the 19th on the relevant month
- A further penalty of £200 is charged if the return is after the due date
- A tax penalty becomes due if the return is still outstanding six months after the due date. The penalty is the greater of
  - 5% of any deduction shown on the outstanding return or
  - £300
- A second tax penalty becomes due if the return is outstanding more than twelve months after the due date. The penalty of the greater of 100% of any deductions shown on the return or £3,000

(iii) For new contractors who file their first returns late under the new rules, any fixed penalties, that is the £100 or £200 penalties will be subject to a total cap of £3,000.

10. Paragraph 23 of Schedule 55 makes provision as to what may or may not constitute a reasonable excuse.

'23(1) Liability to a penalty under any paragraph of this Schedule does not arise in relation to a failure to make a return if P satisfies HMRC or (on appeal) the First-tier Tribunal or Upper Tribunal that there is a reasonable excuse for the failure.

(2) For the purposes of sub-paragraph (1)-
(a) an insufficiency of funds is not a reasonable excuse, unless attributable to events outside P's control,
(b) where P relies on any other person to do anything, that is not a reasonable excuse unless P took reasonable care to avoid the failure, and
(c) where P had a reasonable excuse for the failure but the excuse has ceased, P is to be treated as having continued to have the excuse if the failure is remedied without unreasonable delay after the excuse ceased'.

11. Section 57(2) FA 2004, states that:

'(2) In this section 'Construction Contract' means a contract relating to construction operations, which is not a contract of employment but where

(a) One party to the contract is a subcontractor and

(b) Another party to the contract ('the contractor') is either –

(a) …

(b) Is a person to whom s 59 applies.'

12. Section 59 (1) (a) FA 2004 provides that:

'Contractors

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

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

(b) to (k)……

(l) a person carrying on a business at any time if -
(i) his average annual expenditure on construction operations in the period of three years ending with the end of the last period of account before that time exceeds £1,000,000, or
(ii) where he was not carrying on the business at the beginning of that period of three years, one-third of his total expenditure on construction operations for the part of that period during which he has been carrying on the business exceeds £1,000,000.'

13. HMRC's manual - CISR12080 "Contractors: Property Developers And Property Investment Businesses" provides some guidance:

Property developers

Property developers are included within the meaning of mainstream contractors because their business activity is the creation of new buildings, or the renovation or conversion of existing buildings, or other civil engineering works. The same is true of a speculative builder.

Property investment businesses

A ‘property investment business’ is not the same thing as a ‘property developer’. A property investment business acquires and disposes of buildings for capital gain or uses the buildings for rental; it need not be involved in the construction, alteration or extension of buildings. Even so, if its property estate is substantial enough, its expenditure on construction operations may well cause it to fall within the meaning of a ‘deemed contractor’ (see CISR12050).

Where a business that is ordinarily a property investor undertakes some activities attributed to those of ‘property development’, they will not usually be considered a mainstream contractor during the period of that development. This is because the usual nature of the business is “property investment” and not “property development”.

Where the property investment business enters into multiple or substantial contracts relating to construction operations for the purposes of development of one or more properties, you will need to decide if the nature of that business has now changed from “property investor” to “property developer”, in which case they would now, be considered to be mainstream contractors as the nature of their business has changed. Where, at a future date, they revert to property investment activities only, then their status as a deemed contractor should be applicable once again. If their expenditure is likely to remain below £1m annually, then deregistration from CIS may also be considered appropriate.

However, where it is clear that further property development is likely to be undertaken in the future, it may be more appropriate for the business to remain registered for CIS. Where property development appears to be a regular and substantial activity of any business purporting to be a property investment business, then they are likely to be a property developer and therefore a mainstream contractor within CIS.

EXAMPLE

A property investment business acquires a number of properties which it intends to let, but before letting, minor refurbishment is required to bring the properties up to a suitable standard to be able to let them. For CIS purposes we would see this as the normal activities of a property investor. [However] Where the average annual expenditure on such activities exceeds £1m then CIS applies.

The property investment business then acquires a large dilapidated hotel to add to its portfolio, and decides to convert the building into a series of flats which it will then individually let out. As a result, substantial development is required to the property to change the building to its new use. In respect of this particular development and contract we would regard the property investment business as having taken on the mantle of a mainstream contractor as its business activity is now that of construction operations.

Background Facts

14. The Appellant acquired property at 348-352 Norwood Road, West Norwood, London (“the Property”) on 27th July 2007. At the time of purchase the Property was let to two tenants, Iceland Foods and Norwood Leisure Ltd. Iceland Foods utilised the

ground floor as a convenience store and Northwood Leisure operated the first and second floors as a snooker club.

15. Following the expiry of the lease to Norwood Leisure on 8th August 2014 the first and second floor snooker hall and ancillary offices were re-developed into 9 residential apartments. A contract with ARJ Construction Ltd was entered into on 9 February 2015 to carry out the work. Practical completion of the scheme occurred on 27 April 2016.

16. The Appellant retained the freehold interest in the Property and continued to operate as an investment vehicle. Iceland Foods continued to operate from the ground floor and the intention of the Appellant is to renew the Iceland lease when it expires in 2023. The residential units were all sold under long leases and the tenants pay ground rent to Thornton Heath LLP, as landlord.

17. The Appellant did not consider it necessary to register the partnership for CIS as, in the management's opinion, it was not considered to be 'a developer'; its primary activity being property investment. The partnership says that it holds no other property and this was the only development it had undertaken.

18. On 26th April 2016 HMRC advised the Appellant to register itself for the CIS as a contractor and operate within the CIS legislation because it was considered that:

> "The Conversion from office space to residential units is not considered to be a minor refurbishment to bring the properties up to a suitable standard to be able to let them. It is a substantial development required to change the building to its new use. …we would regard your property investment business as having taken on the mantle of a mainstream contractor as its business activity is now that of construction operations".

19. Under Regulation 4(10) of the 2005 Regulations, a CIS contractor was under an obligation to make a nil return if they had not made any payments under a construction contract during a tax month. In this case, the payments were made in gross and no tax was deducted because the contractor, ARJ Constructions held gross status. Regulation 4(10) was revoked by SI 2015/429 from 6 April 2015. Nil returns were not required from that date, although the taxpayer must notify HMRC that no return is due.

20. On 13th June 2016 the Appellant registered the partnership under the CIS and submitted backdated returns for the period March 2015 to April 2016.

21. On 7 March 2017, as the monthly returns had been filed late, twenty-five fixed late filing penalties were retrospectively issued by HMRC, totalling £3,700 under Schedule 55 FA 2009. The Appellant was notified that any appeal had to be made within 30 days.

22. The Appellant deregistered from CIS as it did not intend to undertake any further development.

23. In June 2017, the Appellant lodged a late appeal with HMRC against the penalties.

24. The appeal was rejected on 27 June 2017 as being out of time. A review was not offered as the appeal was filed late. The Appellant explains that the delay in appealing was due to Emma Brocklehurst, their head of finance being on maternity leave for the period 19 December 2016 to 21 June 2017. She was the only in-house accountant. Although the Appellant's bookkeepers were providing maternity cover, this matter was outside their remit and not dealt with until her return.

25. The Appellant lodged its Notice of Appeal with the Tribunal on 10 July 2017.

The Appellant's case

26. The Appellant's grounds of appeal are that it acquired the Property as an investment and it continues to be an investment. The nine residential units were a one-off development and no further developments were intended. The Appellant is not a 'contractor' within the meaning of s 59 FA 2004. ARJ Construction Ltd was the contractor. The Appellant was the principal. ARJ Construction Ltd was contracted to undertake the Property alterations. The Appellant partnership operates a property investment business. It is not a property developer and did not engage in 'construction operations' within the meaning of s 57 FA 2004.

27. The Appellant asserts that even if obliged to file CIS returns, it was not obliged to file nil returns and that in any event the penalties have been incorrectly calculated under regulations which were superseded from 6 April 2015.

HMRC's case

28. All contractors within the new CIS are required to register with HMRC when they engage their first subcontractor. Every contractor must send a monthly return with details of these payments to HMRC.

29. HMRC contend that the Appellant, as a contractor, entered into a 'Construction Contract' with ARJ Construction Ltd (a sub-contractor) to convert the first and second floors of the Property into residential flats.

30. HMRC refer to the High Court case of *Mundial Invest SA Ltd V Moore* (Inspector of Taxes) 2005 in which the same issue was explored. The case concerned sections 559-561 of the Income and Corporation Taxes Act 1988 which was replaced by sections 57-59 of the FA 2004, but included the exact same wording being that – a contractor is 'any person carrying on a business, which includes construction operations'. The facts of *Mundial* were that:

> Mundial owned two substantial properties: one was a property known as No Man's Land Fort, Spithead, off Portsmouth; and another was Hastings Pier, Hastings, East Sussex. Since acquiring No Man's Land Fort, the company had carried out a variety of operations by engaging other enterprises to perform them. There were one or more

contracts between Mundial and a person or persons who would be a sub-contractor for the purposes of the legislation.

The assessments appealed against had been made on the footing that the company, as a contractor, had incurred expenditure in payments to sub-contractors without being able to show that the requirements for certification of the sub-contractors had been satisfied.

The question was whether the company was a contractor to whom s 560(2)2 of the 1988 Act applied. That subsection included '(a) any person carrying on a business which includes construction operations'. Paragraph (f) went on to set certain threshold requirements for annual expenditure on construction operations. The question was whether the company came within either para (a) or (f).

It was accepted that the company was not within para (f) because there was no affirmative evidence that the turnover thresholds specified in that paragraph had been exceeded.

The company contended that it could not be a contractor within para (a) unless its business in the construction field was part of its core business or was substantial. Otherwise, it would make the inclusion of para (f) anomalous, because it was difficult to conceive of a party falling within para (f) who would not also fall within para (a); thus producing, in effect, duplication in the legislation. The inspector of taxes contended that, beyond the exclusion of persons whose construction operations were de minimis, para (a) was not subject to any qualification.

It was held that Paragraph (a) had to be taken to exclude persons whose construction operations, though carried on by way of business, were de minimis. Beyond that, it was not subject to any qualification. The argument based on overlap between para (a) and (f) carried limited weight.

31. HMRC say that as the conversion of 348-352 Norwood Road required substantial development to change the building to its new use as residential flats, the Appellant was required to register its business for the Contractors Industry Scheme and deliver its monthly tax returns to HMRC. The construction contract commenced on 9 February 2015, however the Appellant made no attempt to comply with its tax obligations until 13 June 2016.

32. ARJ Construction Ltd was registered to receive gross payments under s 63 FA 2004, and therefore the Appellant was not required to make any tax deductions under s 61 FA 2004. However, this did not exempt the Appellant from submitting nil monthly returns under the CIS.

33. Section 23 of Schedule 55 of FA 2009 provides statutory protection from a penalty if the contractor had a reasonable excuse for failing to file their return on time.

34. Reasonable excuse is not defined in the legislation, but it is generally accepted that the term must be given its normal everyday meaning. HMRC take this to mean that it is an unexpected or unusual event, either unforeseeable or beyond the person's control, which prevents him from complying with an obligation when he otherwise would have done. It is then necessary to consider the actions of the taxpayer from the

perspective of a prudent taxpayer exercising reasonable foresight and due diligence, having proper regard for their responsibilities under the taxes acts.

35. Whether a person has a reasonable excuse depends on the particular circumstances in which the failure occurred, as well as the particular abilities of the person who has failed in their obligation. The test is to consider what a reasonable person, who wanted to meet their tax obligations, would have done in the circumstances and decide if the action of the person met that standard.

36. Reasonable excuse, therefore "is a matter to be considered in the light of all the circumstances of the particular case" (*Rowland v HMRC* [2006] STC (SCD) 536 at paragraph 18). This was confirmed by the First-tier Tribunal, in *Anthony Wood trading as Propaye v HMRC* (2011 UK FTT 136 TC 0010101.

37. Having considered the Appellant's behaviour, HMRC assert that there was no reasonable excuse for submitting late CIS monthly returns. The Appellant's construction contract with ARJ Construction Ltd commenced on 9 February 2015 and completed on 27 April 2016 but the Appellant failed to make any enquiry with HMRC regarding CIS registration until 15 April 2016. Further, despite HMRC's advice on 26 April 2016, it did not register itself and submit returns until 13 June 2016.

38. The Appellant has not provided any reasonable excuse for its failure. It is argued that the actions of the Appellant do not demonstrate that it has acted as a prudent person, exercising reasonable foresight and due diligence, having proper regard for its responsibilities under the Tax Acts. It is argued that a reasonable taxpayer and prudent person would have made an enquiry with the Respondents before the commencement of the construction contract.

Conclusion

39. This appeal relates to the imposition of penalties by HMRC. The onus is therefore on HMRC to show that the penalties have been correctly raised. The burden of proof is on HMRC to show that the Appellant falls within the definition of a person carrying on a business which includes construction operations. Once that onus has been satisfied the burden shifts to the Appellant to show that it has a reasonable excuse (for any failure to file CIS returns).

40. The first issue in this case is whether the Appellant was a 'contractor' within the meaning of s 57 FA 2004, and carrying on a 'business which includes construction operations'. If so, the second issue is whether HMRC have correctly raised the CIS penalties and whether those penalties have been correctly calculated.

41. Other than interpreting the word 'contractor' as defined by sections 57 and 59 FA 2004 and then by construing the words 'business which includes construction operations', by adopting what one would regard as their normal everyday meaning, we are reliant upon case law guidance for which, save for *Mundial*, there is a paucity of precedent.

42. In *Mundial,* the onus had been on the Appellant to overturn assessments (for CIS tax not deducted at source), of £3 million accrued over a period of six years whilst it was engaged in the development of two major projects, which formed part of Mundial's property portfolio.

43. In *Mundial,* both before the Commissioners for the General Purposes of Income Tax (for the Division of Portsmouth and Havant), and in the High Court (Chancery Division) – before Sir Francis Ferris, sitting as a Deputy Judge, no Officer for the Appellant attended and no oral evidence was called on its behalf. The Commissioners said in their 'Case Stated' [at paragraph 11], that " … we (therefore) received the contentions of the Appellant as comment. We are clear that, insofar as such comments were incompatible with the contentions of the Revenue, we accepted the contentions of the Inland Revenue."

44. *Mundial* largely turned on the Appellant's argument that Mundial SA was not a contractor. The judge said:

> "within the definition contained in para (a) unless its business in the construction field was, as it is put, part of its 'core business', or 'substantive' (which I take to mean the same as 'substantial'), it seems to be suggested that unless some such qualification be imported into para (a), the paragraph would be much too wide and would catch a whole range of parties, which it cannot have been intended to catch. Moreover, it would make the inclusion of para (f) anomalous, because it is difficult to conceive of a party falling within para (f) who would not also fall within para (a), thus producing, in effect, duplication in the legislation" [Paragraph 9]

HMRC said that Paragraph (a) must be taken to exclude a person whose construction operations, although carried on by way of business, are de minimis. Sir Ferris agreed and said that it would be "illegitimate in the process of statutory construction, to bring in Paragraph (a), words of qualification which are simply not there".

45. Mundial SA was assessed in respect of the major development of two properties from its property portfolio undertaken over a period of nine years. Both in terms of scale and cost, the developments far exceeded those in the present appeal, though that is not to imply that there are any legislative constrictions as to what amounts to a construction contract, other than the supplementing provisions of s 59 (1)(l) FA 2004.

46. The Appellant asserts that its *ordinary* course of business is that of property investment and not that of construction operations. This was not disputed by HMRC.

47. HMRC's guidance in CISR12080 states:

> "*where a business that is ordinarily a property investor undertakes some activities attributed to those of 'property development', they will not usually be considered a mainstream contractor during the period of that development. This is because the usual nature of the business is "property' investment" and not "property development".*
>
> *Where a property investment business enters into multiple or substantial contracts relating to construction operations for the purposes of development of one or more properties, the business will need to decide if the nature of its business has changed*

from "property investor" to "property developer", in which case they would be considered to be mainstream contractors as the nature of their business has changed."

48. We note the use by HMRC, of the words 'not usually' and 'usual nature', when referring to the person's ordinary business. In *Mundial* the company owned a number of properties and over several years having substantially developed one of them, embarked upon the development of another, engaging other enterprises no doubt in multiple or substantial contracts relating to construction operations, to perform them. It is a question of fact and degree whether the usual nature of its business is that of property development. Mundial's development and conversion of the two properties in the court's view amounted to 'construction operations' which formed part of the company's usual business and therefore Mundial SA fell within the definition of "contractors".

49. It is clear from HMRC's guidance that the qualification referred to in *Mundial* as a de minimis exception should in their view be interpreted as not normally including a one-off conversion of part of a building.

50. This is not to say that a person is not contractor within s 59 FA 2004, unless its business in the construction field is part of its core business, or is substantive. ICTA s 560(2)(a) was not subject to any qualification and neither is s 59 FA 2004, but the definition of 'carrying on a business which includes construction operations' necessarily needs interpretation particularly in the instance of one-off development work by a person not ordinarily engaged in the construction industry.

51. In *Mundial,* in the appeal from the Commissioners, the Court did not consider the facts as found at first instance. The nature and scope of the construction operations were neither considered nor argued in any detail.

52. Neither did the Court specifically consider the definition of 'contractor' under ICTA 1988, and the extent to which it is may be a matter of fact and degree whether the person is carrying on *a business which includes construction operations*, within the meaning of s 560 ICTA 1988, that is specifically in terms of the works undertaken, or whether the nature of the business should be construed in terms of its ordinary course of business.

53. In this case the Appellant was carrying on an investment business prior to conversion of the Property. That is not in dispute. The issue is whether it's usual business changed when it undertook the conversion of the Property so that it was '*carrying on a business which includes construction operations'.*

54. HMRC referred, in correspondence with the Appellant, to the "conversion from office space", whereas in fact the upper floors were used as a snooker hall. HMRC also referred to the conversion being a "substantial development required to change the building to its new use", whereas in fact the ground floor remained unchanged and continued to be let out under a commercial lease.

55. HMRC's guidance supplements the findings of *Mundial* and its interpretation of the relevant legislation. The court did not have to address the scale and extent of the

works undertaken, (the Appellant in that case not having adduced any oral evidence or detailed specifications of the works.) HMRC's guidance does not in our view contradict *Mundial* and has no doubt been published because of the understandable uncertainty that will exist particularly when an entity embarks upon the redevelopment of its own property, for its own purposes and appoints a contractor to undertake the works.

56. In our view, the Appellant in this appeal was, as owner of the Property, acting as a principal and appointed ARJ Construction Ltd, as the main contractor. The Appellant did not itself act as a contractor. ARJ probably engaged subcontractors. The contract between the Appellant and ARJ Construction Ltd was therefore not a 'construction contract' under s 57(2) of the 2004 Act and was not caught by the exception in s 57(2)(b)(ii).

57. Accordingly the Appellant was not obliged make monthly returns under the Construction Industry Scheme for the period March 2015 to April 2016 inclusive.

58. For the above reasons we find that the penalties of £3,700 were not correctly charged, although we would mention that the penalties (if they had been properly imposed) were incorrectly calculated by HMRC and did not take into account the capping provisions introduced in November 2011, under which the penalties would have been capped at £3,000 in total. Nor did HMRC consider the possibility that post 6 April 2015 monthly returns were not required if no payments were made in the tax month.

59. The appeal is allowed and the penalties are discharged.

59. 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.

MICHAEL CONNELL
TRIBUNAL JUDGE

RELEASE DATE: 20 NOVEMBER 2018