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Is the objective of the Construction Industry Scheme to ensure compliance or to impose a penalty for non-compliance?

This week's newsletter concerns the Construction Industry Scheme ("CIS"), in particular the case of *RMF Construction Services Ltd v HMRC* [2021] UKFTT 9 (TC) which sought to appeal HMRC's decision to withdraw gross payment status under the CIS. The full judgement can be found here.

Taxpayers working within the industry will be aware of the scheme and its administration - including the ramifications of the loss of gross payment status, such as cash flow problems and quite often a loss of business due to main contractors preferring to deal with subcontractors who have gross payment status.

Background

As the name suggests, RMF Construction Services Ltd undertakes construction work and was previously registered for gross payment status under the CIS. In September 2011, the company failed a Tax Treatment Qualification Test ("TTQT") undertaken by HMRC, during which three failures were identified.

RMF received a letter from HMRC on 27th September 2011 which requested an explanation for the failures and, where applicable, documentary evidence to support the reasons provided.

Following correspondence from the company's agent (at that time) outlining the reasons for failing to submit the returns, HMRC rejected them and subsequently withdrew RMF's gross payment status (under s.66 Finance Act 2004) on 16th November 2011.

An appeal against the withdrawal was initially lodged with HMRC on 29th November 2011 but then resubmitted on 30th March 2012 as HMRC did not receive the appeal. The appeal was then rejected on the basis that the Corporation Tax return was still outstanding.

In August 2012, HMRC accepted that RMF had a reasonable excuse for failing to submit its Contractor Returns. However, HMRC noted a further five compliance failures which involved the company's Corporation Tax returns and P35. It found that the company did not have a reasonable excuse for some of its compliance failures. In light of this, HMRC had reason to doubt whether the company would continue to meet its tax obligations.

Following a review of the decision, the withdrawal of gross payment status was upheld. RMF lodged an appeal at the First-tier Tribunal (FTT).

At the request of HMRC, the appeal was stayed behind the case of *JP Whitter (Water Well Engineers) Ltd v HMRC* [2018] STC 1394. In this case, the Supreme Court dismissed JP Whitter's appeal against HMRC's decision to remove its gross payment status, and namely, rejected the company's argument that HMRC should have taken into account the impact the removal would have on the company's business. Our commentary on the *JP Whitter* case can be found here.

Following the judgment in JP Whitter, RMF's appeal resumed in the FTT.

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RMF put forward five grounds of appeal:

1. That there had been a significant time lapse since RMF failed to comply with s.66(1) Finance Act 2004. Namely, it had been eight years since the company's appeal had been rejected by HMRC and nine years since the TTQT.
2. That the company currently satisfy the requirements to be granted gross payment status and have been in this position for the last four to five years.
3. If an application for gross payment status was made, the company would comply with its requirements and would be granted gross payment status.
4. The company accepts the outcome of the review in 2012, but they bring forward the argument that to withdraw gross payment status eight years on would not be appropriate.

The appeal grounds now included staleness and disproportionality, i.e., so much time had passed since the infringement, it would be inappropriate to cancel gross payment status due to a failure that was identified in a TTQT over 9 years ago.

The FTT stated that even though this appeal was stayed, there was no reference to staleness in *Whitter*, the legislation or relevant case law.

The FTT also considered Lord Carnwath's suggestion in *Whitter* that the tribunal should, however, exercise some flexibility when exercising s.66 Finance Act 2004 to withdraw gross payment status for a limited or temporary failure. In applying this, the FTT found that the significance of RMF's delay in making their Corporation Tax Return was not such a *limited or temporary failure*.

In addition, you will note that RMF did not put forward a reasonable excuse argument against the failures identified in the original TTQT. This was largely due to the length of time since the failure as RMF had since changed agents twice and were unable to gather information surrounding the events that led to the failure. As a result, the FTT did not consider the question of reasonable excuse.

On the matter of proportionality, the FTT drew on a recent decision discussing the issue of proportionality in *Barry Edwards v HMRC* [2019] UKUT 131 (TCC), whereby the tribunal found that the imposition of what amounts to a penalty in this case would be *"not merely harsh but plainly unfair"* (a principle established in other similar appeals on the grounds of proportionality).

The judge commented on the objective of the CIS which is to ensure compliance, and it is not to impose a penalty for non-compliance. Therefore, in his view, the compliance objective had been achieved by the mere threat of withdrawing gross payment status and to carry on with this threat nearly eight years on, where the company have been compliant since that time, would be disproportionate. The company's appeal was allowed.

Whilst the appeal was allowed, the judge also observed that withdrawal of RMF's gross payment status would serve no purpose whatsoever as RMF *would be able to reapply for Gross Status immediately, which,…, would be granted*. We believe there is an oversight here as a taxpayer is not able to reapply for gross payment status having lost it for a period of one year after the cancellation takes effect (which is when the appeal is abandoned by the taxpayer or determined by the Tribunal). HMRC may well seek to appeal the judgment based on this error alone.

Commentary

The FTT focussed on the significant delay between the original compliance failure and the appeal finally being heard in the FTT. It was clear, at the time the case was eventually heard, that RMF had made every attempt and had successfully complied with its relevant tax obligations to continue to keep its gross payment status and it seemed plainly unfair for RMF to lose its gross status so many years after the original failure.

There was also no reason for HMRC not to request a stay in proceedings at the time of the original appeal until such time as the tribunal passed judgment on the *Whitter* case (we understand that a number of gross payment status cases with similar circumstances were stayed behind *Whitter*).

With that said, following this judgment, it would seem the length of stay in itself may have an impact on the tribunal's decision on each such appeal. Despite this being an FTT judgment, other cases that are yet to be heard on this matter could well put forward a similar argument on disproportionality. However, as always, the facts of each case are key, and we suspect other cases will hinge on whether the taxpayer has complied with their tax obligations in order to continue to maintain their gross payment status.

The judgment and its reasoning is unexpected, and we will be very surprised if HMRC do not appeal to the Upper Tribunal due to the number of cases that were stayed behind Whitter and the obvious ground of appeal available to HMRC on a point of law.