TC02126

Appeal number: TC/2011/06725

Late filing of corporation tax return for accounting period ended 30 April 2009 – Cash flow difficulties meant company could not pay for audited accounts – Failure to produce estimated accounts – Whether reasonable excuse – No, appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

WARDSIDE HOUSE LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE PETER R SHEPPARD FCIB, FCIS, AIIT
KENNETH MURE, QC

Sitting in public at George House, 126 George Street, Edinburgh on 20 June 2012.

Gordon Armour of Scott-Moncrieff for the Appellant

William Kelly, for the Respondents

DECISION

1. This decision concerns an Appeal dated 29 August 2011 by Wardside House Limited (WHL) against a penalty of £6,295.26 imposed by the Respondents (HMRC) for the late filing of the WHL's corporation tax return for the accounting period ended 30 April 2009.

2. WHL is the trading subsidiary of Wardside Holdings Ltd (Holdings). It operates a high quality nursing home for the elderly based in Muthill, Perthsire. The directors of both Holdings and WHL are David Burt and Mrs Marjorie Burt.

3. The return was due on 30 April 2010 but it was not delivered until 28 February 2011 when HMRC received it electronically, a period of default of 304 days. This lateness triggered penalties. An initial notice of a flat rate penalty determination in the amount of £100 was issued on 25 May 2010 with a notice of further flat rate penalty determination increasing the amount to £200 on 17 August 2010. WHL is not appealing the flat rate penalties.

4. On 16 November 2010 HMRC issued a revenue determination estimating the corporation tax due at £38,850 and a 10% tax related penalty of £3,885 was issued at the same time.

5. A company can supersede a revenue determination by making a self-assessment return. The return that was submitted on 28 February 2011 showed the corporation tax liability as £62,952.60. HMRC therefore revised the penalty to 10% of that sum ie £6,295.26 and accordingly issued an amended penalty notice on 16 March 2011. On 20 April 2011 WHL's agent appealed against the tax related penalty on the grounds that because of the company's cash-flow difficulties the return could not have been lodged any earlier. On 20 May 2011 HMRC issued a letter giving their views and offering a review. The agent requested a review on 17 June 2011. The result of that review was a letter dated 3 August 2011 upholding the original decision. The agent had lodged an Appeal to the Tribunal dated 29 April 2011 considering that WHL had a reasonable excuse for the late return.

6. Neither party introduced any witnesses.

7. The relevant legislation is the Finance Act 1998, Schedule 18 Parts I and II paragraphs 2, 3, 14, 17(2), 17(30) and 18(2).

8. In addition the Tribunal was referred to High Court of Justice, Chancery Division, decision in the case of *Dunk* v *General Commissioners* CIR51 TC 519.

9. On the morning of the hearing and less than 30 minutes before the hearing was due to start the Tribunal received a bundle of documents from Mr Armour. Whilst the Tribunal accepted the documents and the Chairman quickly read through them before the hearing it was not possible for the other Tribunal member to do so.

Accordingly Mr Armour was asked to identify all relevant material in these in the course of his submissions The Tribunal observes that it cannot have been in his client's best interests for Mr Armour to introduce documents at such a late stage and it was gracious of Mr Kelly to accept them.

10. No argument was advanced by Mr Armour that the penalty had been levied incorrectly or the amount of the penalty calculated inaccurately.

11. Mr Armour accepted that the return had not been made on time but he advanced three arguments to support his view that WHL had reasonable excuse for the late returns. He said that WHL had experienced severe cash flow difficulties. In order for its agent to complete an audit of the accounts and submit its tax return the auditors needed to be paid for the previous year's audit. Mr Armour drew the Tribunal's attention to the Auditing Practices Board "Ethical Standard 4 (Revised 2008), Remuneration and evaluation policies, litigation, gifts and hospitality", and in particular to paragraphs 24, 25, 26, 27 and 29.

12. Paragraph 27 states "Where fees due from an audited entity, whether for audit, or non-audit services, remain unpaid for a long time – and, in particular, where a significant part is not paid before the auditor's report on the financial statements for the following year is due to be issued – a self-interest threat to the auditor's objectivity and independence is created because the issue of an unqualified audit report may enhance the audit firm's prospects of securing payment of such overdue fees."

13. Mr Armour said that Scott-Moncrieff as agent and auditors of WHL found that these rules came into effect in their situation so they could not complete an audit or submit the tax return for WHL until they had been paid amounts due to them. Therefore it was necessary for WHL to negotiate increased borrowing facilities with its bankers, Royal Bank of Scotland (RBS). In April 2010 WHL entered into negotiations with RBS. In previous years this had been straight-forward as RBS had agreed to increase its lending on the strength of the value of the assets of the company. However on this occasion RBS decided that it could no longer provide support without a formal agreement being put in place. RBS decided to involve its Global Restructuring Group (formerly Specialised Lending Unit). This involved the preparation by David Higgins CA of a document entitled "Summary Review prepared by David Higgins on behalf of Global Restructuring Group – RBS" dated May 2010 (The Review). The Review included recommendations that the short term overdraft facility be increased to allow payment of PAYE arrears, and an increased borrowing facility be agreed to deal with other outstanding creditors including the auditors. Negotiation of the formal agreement became protracted and it was not until 18 February 2011 that the loan agreements were signed. The audit was then undertaken and the audit report signed on 28 February 2011. The return was then immediately sent to HMRC.

14. Mr Armour therefore contended that until those agreements were in place the audit could not be undertaken and therefore the accounts for the period ending 30 April 2009 could not be finalised and a tax return completed.

15. In respect of the possibility of sending an estimated return Mr Armour said that there was a difficulty in deciding on what basis this could be done when there was a doubt about the going concern position of WHL. He said his firm had little or no experience of submitting estimates and he considered these were more usual in personal returns. He pointed out that page 7 of the Guidance Notes accompanying the return on the subject of estimated returns said "A company may be liable for a penalty for an incorrect return where an estimated figure is not the best estimate based on all the information available at the time the return is made, …". It also gives further warnings of penalties for false statements and understated figures. However he had had no discussion with HMRC on the matter.

16. So WHL considered it was in the position of either not being able to pay for audited accounts and so suffer a penalty for submitting a late return or alternatively submitting an estimated return on time but ran the risk of being penalised for providing understatements or poor estimates.

17. Mr Armour anticipating that HMRC would raise the decision in the *Dunk* case commented in his statement of case that the case was decided in 1976 in respect of years 1970-71 and 1971-72. He said that the rules and regulations surrounding corporation tax self-assessment in 2009 and 2010 are totally different from those relating to income tax some 40 years earlier. He put forward the view that Goulding J seemed to give weight to the availability of a "personal interview with the Inspector or an appropriate member of his staff". He said that in his firm's experience such an interview would have been impossible to arrange in 2010 so he considered the decision in the *Dunk* case of limited relevance now.

18. In considering The Review the Tribunal also noted that it contained comments about loans by WHL to the directors. The Review noted that in the six month period 30 April to 31 October 2009 the balances on the directors loan accounts increased by £80,426. During this period the directors also received £57,429 from WHL by way of emoluments, dividends and pension contributions.

19. The Review in Section 3 contains the following:

> "However, attention is also drawn to Section 5 below where the level of directors' emoluments and loan advances gives cause for concern.
>
> Its ability to service further debt is dependent upon directors restricting their withdrawal of company resources and increasing its occupancy level."

20. Section 5 contains the following:

> "The nature of the transactions within the loan account were not examined but is believed to be personal expenditure of the directors met by the company.
>
> While such balances are not unusual in privately owned and managed businesses the owners do need to be aware of the difficult financial situation of the company and assess whether the company should continue to make such payments on their behalf.
>
> It is considered that the magnitude of the sums advanced via the directors' loan account is excessive, given the financial situation of the company and for the foreseeable future no further advances be made."

21. Mr Armour's second argument was that WHL relied on full occupancy of its rooms to maximise profits. He said that The Review showed that in the period the occupancy of the 32 rooms had dropped to 28. When someone dies it is company policy to refurbish the room. This had affected the company's cash flow.

22. Mr Armour's third argument was that "holdings" had similarly been charged with a late filing penalty (of £452) for its corporation tax return for the accounting period ended 30 April 2009. This had been appealed on the same basis as WHL. On reconsideration HMRC had reduced this penalty to nil. Mr Armour contended that he could see no difference between the two appeals and therefore the penalty in WHL should also be reduced to nil. When asked for more details of the "Holdings" appeal and decisions Mr Armour was unable to assist the Tribunal.

23. Mr Kelly began his presentation by drawing attention to a document in the bundle of papers submitted that morning namely an e-mail dated 16 April 2010 from James Fennessey of Scott-Moncrieff to Nigel Smith of the RBS. It had been copied to Mr Armour. The e-mail was on the subject of WHL seeking a term loan facility from RBS but Mr Kelly pointed out that it contained the following:

> "The arrears of tax has come about as a result of more being drawn by the directors than the company was in fact able to cope with in terms of both profits and cashflow."

24. Mr Kelly considered that this was indicative of the attitude of the directors towards WHL's tax responsibilities.

25. Mr Kelly observed that it was accepted that WHL had not fulfilled its obligation to submit its tax return by the due date. There had been an acceptance of the fixed rate penalties and there had been no submissions that the tax related penalty had been levied incorrectly or the amount of the penalty calculated inaccurately. Therefore he said the company must establish that it had a reasonable excuse for the late return. In answer to Mr Armour's first argument for a reasonable excuse Mr Kelly said that it was WHL's responsibility to ensure that the regulations are followed and returns filed by their due dates. This responsibility cannot be transferred or removed by the engaging of an agent.

26. He relied on a passage from the decision of Goulding J in the case of *Dunk* v *General Commissioners* which he said had some similarities with the argument being made in the present case. The passage of particular relevance in this case is as follows:

> *"So the Appellant says, 'either I do not complete a return in the statutory form, in which case I am liable to the indefinite repetition of such penalties as those which are before the court today, or if I do make a return, it may turn out to be false and I shall be prosecuted for that.'"*
>
> *"In my view, that is not a real dilemma imposed by law. What the tax payer has to declare is 'that the return is to the best of his knowledge correct and complete'. If … a taxpayer finds particular circumstances that make the best of his knowledge more than usually unreliable, it is open to him to put against his figure for a particular item of income such words as 'Estimated', 'See accompanying memorandum' or something of that kind, and explain the circumstances. If he has done his best - and, of course, he is under a duty to use all proper sources of knowledge - he will not, in my view, be guilty of making a false statement providing, as I say, he puts in a genuine estimate and, if necessary, explains that it is not very reliable".*

27. Mr Kelly pointed out that on page 1 of the company tax return there is provided a box in which the taxpayer should place an "X" if the return includes estimated figures. He also pointed out that the guidance notes accompanying the return state on page 4 "If you think you may be late in delivering the return … deliver as much information as you can by the filing date. Where necessary estimate an entry rather than delay delivering the return (see the note about estimated figures under 'About this return')". On page 7 of the notes there is a paragraph on the subject of estimated figures giving guidance on their use.

28. Mr Kelly submitted that the return and guidance notes indicated that it would have been possible for WHL to submit its return using estimated figures. This they had not done. He also pointed out that WHL did not have to use an agent to submit its return.

29. In respect of Mr Armour's second argument on room occupancy Mr Kelly made little comment.

30. In respect of the third argument Mr Kelly said that this Appeal concerned WHL and the case should be treated on its own merits. He had no instructions or information concerning "Holdings".

Decision

31. In respect of Mr Armour's first argument the law is clear that lack of funds is not a reasonable excuse. The Tribunal accepts that the reason for the lack of funds might constitute a reasonable excuse. The reason Mr Armour gave for the lack of

funds was that unexpectedly RBS would not lend any more money immediately. This does not really answer the question of what was the reason for the lack of funds. It merely poses a further question ie what was the reason WHL found it necessary to approach RBS for an increase in its overdraft and borrowing? It is apparent from The Review and the e-mail of 16 April 2010 that the real reason for the cash flow difficulties which ultimately made it necessary to approach RBS was that more was being withdrawn from the business by the directors than the company was able to cope with.

32. It was open to WHL or its agent to submit an estimated return. It was also open to WHL or its agent to discuss its difficulties with HMRC but they did neither of these things. The Tribunal does not accept that it would have been impossible to arrange an interview with an HMRC representative.

33. For these reasons the Tribunal cannot accept that the points made in Mr Armour's first argument give WHL a reasonable excuse for not submitting its tax return on time.

34. The Tribunal considers that the paragraphs quoted above from the case of *Dunk* support its view.

35. In respect of Mr Armour's second argument there is no legal definition of what constitutes a reasonable excuse. Sadly an unpleasant side of running a nursing home for the elderly is that from time to time residents die. A prudent person would be aware of this possibility and plan the business's financial affairs accordingly. He would not expect full residency throughout each year. The Tribunal considers that the lack of full occupancy is something that could well happen every year. It is not therefore a reasonable excuse for failing to submit a tax return on time.

36. In respect of Mr Armour's third argument insufficient evidence was given to support the contentions. The onus lies with the Appellant to provide the information necessary to support its argument. The Tribunal must treat each case on its own merits. Just because HMRC saw fit to reduce the penalty on Holdings to nil it does not follow that this imposes on them the obligation to do the same for WHL.

37. In the Tribunal's view none of the arguments submitted by Mr Armour established that WHL had a reasonable excuse for the late submission of their tax return for the accounting period ended 30 April 2009.

38. The Appeal is therefore dismissed and the penalty stands.

39. 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.

PETER R SHEPHARD
TRIBUNAL JUDGE

RELEASE DATE: 10 July 2012