TC02177

Appeal number: TC/2011/04170

VALUE ADDED TAX – Security – Poor compliance record and director's involvement in previous failed company – Whether Commissioners' decision reasonable – Yes – Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

STURMINSTER CONSTRUCTION LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE TIMOTHY HERRINGTON
JOHN CHERRY FCA

Sitting in public at 45 Bedford Square, London WC1 on 11 July 2012

Mr Gary Suttle, G M Suttle & Co Limited, Accountants, for the Appellant

Mrs Cheryl Payne-Dwyer, Presenting Officer, Appeals and Reviews, for the Respondents

DECISION

Introduction

1. This is an appeal by Sturminster Construction Limited ("Sturminster") against the decision of the Respondents ("HMRC") to serve a Notice of Requirement (the "Notice") to provide security under paragraph 4(2)(a) of Schedule 11 to the Value Added Tax Act 1994 ("the Act"). The Notice was dated 4 March 2011 and required Sturminster to pay an amount of £55,136.57 by way of security, or the lesser sum of £47,608.93 should Sturminster choose to submit monthly instead of quarterly returns. The decision was reviewed at the request of Sturminster and in a letter dated 26 April 2011 the reviewing officer upheld the original decision.

2. We heard oral evidence on behalf of HMRC from Mr Nigel Bishop ("Mr Bishop") who made the decision set out in the Notice and Mr Ian Pumfrey ("Mr Pumfrey"), who carried out the review of the decision. No oral evidence was given on behalf of Sturminster but submissions on its behalf were made by its accountant, Mr Gary Suttle.

The Facts

3. Based on the evidence that we heard and the documents put before us, we find the following facts.

4. Sturminster carries on the business of joinery installation and shop fitting and was registered for VAT with effect from 10 September 2007. Mr Ben Smith is the sole director of Sturminster, having been appointed on 3 September 2007. Mr Ben Smith was also the sole director of BTS Services Limited ("BTS") which traded in shop fitting and refurbishment. BTS had a poor VAT compliance record towards the end of the time that it traded, having three VAT returns outstanding and a significant VAT debt outstanding when it went into creditors' voluntary liquidation on 14 May 2008. At the date of the Notice, BTS's outstanding VAT debt amounted to £135,492.54 in total.

5. Sturminster's own record of compliance as at the date of the Notice showed that its first three quarterly returns were submitted on time and the VAT due was also paid on time. Its next two returns (in respect of the periods 10/08 and 01/09) were significantly late, at 72 and 54 days respectively and the payments due were similarly late. The next two returns (in respect of the periods 04/09 and 07/09) were submitted more or less on time, although the VAT payable in respect of them was 339 and 290 days late respectively. The next return in respect of the period 10/09 was 11 days late. Thereafter, as at the date of the Notice, returns were outstanding for the periods 01/10, 04/10, 07/10, and 10/10. None of the VAT due in respect of those periods (which was

estimated by HMRC in the absence of returns) and the VAT due in respect of the period 10/09 had been paid at the date of the Notice. The total amount of VAT due was £32,553.64.

6. It was against this background that Mr Bishop decided that security was required. He formed the view that revenue was at risk by reason of the fact that the current sole director of Sturminster, Mr Ben Smith, was also the sole director of BTS which had gone into liquidation leaving significant VAT debts, and that Sturminster was showing a similar pattern of poor VAT compliance. Mr Bishop explained that the amount of VAT security deposit requested was based on the last four available VAT returns at the time of consideration (that is the last four that had been filed by Sturminster) from which a security amount equal to the average VAT liability for six months (if quarterly returns were submitted) and four months (if monthly returns were submitted) was calculated. The total VAT payable in respect of those four returns was £45,165.86, so that the average VAT liability for six months would be £22,582.93 and for four months £15,055.29. To those figures were added the outstanding VAT at the time of the Notice, namely £32,553.64, giving the figures of £55,136.57 (for quarterly returns) and £47,608.93 (for monthly returns) referred to in the Notice.

7. In cross-examination, Mr Bishop confirmed that before serving the Notice he had not spoken to Sturminster. He had therefore not discussed with the company its current trading activities and the reason why its returns were late. Neither had Mr Bishop scrutinised HMRC's systems to see whether other divisions of HMRC owed Sturminster money at the time, or investigated further the circumstances which had led to BTS's liquidation or the reasons why its returns were late. We therefore find that Mr Bishop's decision was based solely on the compliance records of BTS and Sturminster and their VAT debts at the time the Notice was issued, as well as the fact of the connection between the two companies through the common directorship of Mr Ben Smith.

8. On 1 April 2011 G M Suttle & Co Limited ("Suttle"), Sturminster's accountants, wrote to HMRC requesting that Mr Bishop's decision be reviewed. Suttle drew HMRC's attention to four pieces of information that they said HMRC would not be aware of. The relevant part of Suttle's letter stated:

> "The company has been implementing a new Sage Accounting Scheme and due to difficulties has been unable to move the previous information to the new system and have therefore re-written their business records from commencement. Hence the late returns.
> CIS tax deducted from this company is large and is greater than the amount of tax deducted by them from sub-contractors and partially pays the VAT outstanding.

> In September 2010 the company suffered a £285,000 bad debt and as such the relief on this coupled with the recovery of CIS tax will enable them to bring themselves up to date."

The reference to the CIS tax is the amount that Sturminster suffered by way of deductions from their income, made by their customers in respect of the construction services they provided under the Construction Industry Scheme. In this letter Suttle indicated that there would be a significant recovery in respect of CIS overpayments that could be set off against the VAT due.

9. The review requested by Sturminster was carried out by Mr Pumfrey. Mr Pumfrey set out his conclusions in a letter dated 26 April 2011, which was that Mr Bishop's decision should be upheld. The letter set out Mr Pumfrey's reasons as follows:

> "The company has demonstrated chronic poor compliance in the submission and payment of its VAT Returns, from P.10/08 onwards, when it first entered the Default Surcharge regime. Neither that particular VAT Return nor any of the following 4 Returns were submitted and paid in full on time. Subsequent to that, the following 5 VAT Returns have not been submitted at all and there is a current VAT debt on file in the amount of £46,953.73.
>
> We cannot consider withdrawal or reduction of the amount of security required until all the outstanding VAT Returns have been completed and submitted. I note your comments regarding the re-writing of company records but would point out that the oldest of the outstanding VAT Returns, P.01/10, was due approximately 14 months ago, which should have been ample time for any re-write to have been undertaken and completed.
>
> With reference to any potential claim in respect of CIS deductions, once a claim has been submitted and verified, it can be offset against any other tax due, at the formal written request of the company Directors and Shareholders. Until such time as this occurs, the current VAT debt is due and payable.
>
> Similarly, there can be no credit given for potential Bad Debt Relief, without the submission of the outstanding VAT Returns.
>
> A period of seven weeks has already elapsed since the issue of the Notice and I note that as of today's date, your client has not rendered any of the 5 outstanding VAT Returns and has made no payment against the VAT arrears. The commissioners are not prepared to sanction any further delay in submission and payment of these Returns.
>
> I have considered the information available to Mr Bishop, at the time of his decision and can find no grounds upon which to alter or withdraw that decision. I agree that this continued non compliance, along with your client's inability to discharge its debts, leaves HMRC seriously exposed without a security in place."

10. Mr Pumfrey explained in his oral evidence that in carrying out the review he first of all considered all the information made available to Mr Bishop at the time of the original decision, as well as the additional material available after that time, in particular the information contained in Suttle's letter of 1 April 2011. He explained that he concentrated the review in particular on the current state of compliance, which at the time showed four outstanding returns with nine consecutive defaults from the period 10/08 onwards. Mr Pumfrey stated that the method of calculation of the security deposit was based on the current information and reflected the standard method used in these circumstances.

11. In relation to the information contained in Suttle's letter of 1 April 2011 Mr Pumfrey confirmed the view set out in his letter of 26 April to the effect that the implementation of the new accounting system was not sufficient to excuse the submission of the oldest outstanding return that should have been made over 14 months ago, which was sufficient time to have implemented a rewrite of Sturminster's records. He also reiterated the position set out in his letter on the bad debt claim. With regard to the potential claim in respect of CIS deductions, Mr Pumfrey told us that he had contacted HMRC's local employer section to ask if there was a credit awaiting repayment, and was told that there was not. Mr Pumfrey did confirm that as of 21 April 2011, a few days before his letter was sent, a claim for credit in respect of CIS deductions for the tax year 2008/09 had been verified. A letter from HMRC dated 26 June 2012 to Mr Suttle was produced at the hearing which indicates that as of that date overpayments were due on Sturminster's PAYE/CIS account as follows:

£	35,036.25
£	120,990.34
£	10,218.66
£	39,893.58
£	206,138.83

12. Mr Suttle submitted that at the time Mr Pumfrey's letter was sent a sum in respect of £166,245.25 would have been due to Sturminster, representing the total of the overpayments due in respect of the years 2008/09, 2009/10 and 2010/11. HMRC have confirmed that the figures for 2008/09 had been verified at the time of Mr Pumfrey's letter but not the other years. Mr Pumfrey stated in the course of his cross-examination that he was unaware at the time of his enquiry to HMRC's local employer section that at that time Sturminster had, as asserted by Mr Suttle, been in contact with HMRC regarding the total of the outstanding claims and seeking repayment, not just for 2008/09 but also 2009/10.

13. We accept that on 21 April 2011 the sum due in respect of the year 2008/09 in respect of Sturminster's CIS Account had been verified. It is not clear from the evidence, and Mr Pumfrey cannot recall, whether Mr Pumfrey's contact with the local employer centre was made before or after that date. However, we found Mr Pumfrey to be a truthful witness doing his best to recall the events in question, and accept his

evidence that he was told during his call that there was no credit for overpayment of CIS to be applied at that time. Whether or not that was because Mr Pumfrey was misinformed or because the credit had not at that time been verified we cannot determine. We also accept Mr Pumfrey's evidence that when he wrote his letter on 26 April, he was unaware of the fact that Sturminster was chasing HMRC to repay the significant sums due in respect of CIS overpayments for 2009/10 which as we can see from HMRC's letter of 26 June 2012, were subsequently verified. Mr Pumfrey declined to speculate, in answer to a question from Mr Suttle, as to whether his decision would have been different had he known the full picture regarding the CIS overpayments at the time he wrote his letter on 26 April 2011.

The Law

14, Under paragraph 4(2) of schedule 11 to the Act HMRC may "require a taxable person, as a condition of his supplying or being supplied with goods or services under a taxable supply, to give security, or further security, for the payment of any VAT that is or may become due from" him "if they think it necessary for the protection of the revenue".

15. The jurisdiction of the Tribunal in an appeal against a requirement to provide security was described by Dyson J (as he then was) in *Customs and Excise Commissioners v Peachtree Enterprises Ltd* [1994] STC 747 where he said, at 751:

> "It is important to start by stating that it is common ground that the jurisdiction of the tribunal is only supervisory. The appeal before the tribunal is not by way of a rehearing (see, for example *Customs and Excise Commrs v J H Corbitt (Numismatists) Ltd* [1980] STC 231 at 239, [1981] AC 22 at 60 per Lord Lane). This was accepted in the present case by the chairman himself. He put the matter clearly and, in my view, accurately in his decision in these terms:
>
> > 'The jurisdiction of the tribunal in cases such as this where the Commissioners are exercising discretionary powers has been clearly established in previous cases. It is, for instance, clear that the tribunal cannot substitute its own discretion for that of the Commissioners for the tribunal has no discretion in these matters. If it is alleged that the Commissioners have reached a wrong decision then there can be a question of law but only of a limited character. The question would be whether their decision was unreasonable in the sense that no reasonable panel of Commissioners properly directing themselves could reasonably reach that decision. To enable the tribunal to interfere with the Commissioners' decision it would have to be shown that they took into account some irrelevant matter or had disregarded something to which they should have given weight.'

> In my judgment, in exercising its supervisory jurisdiction the tribunal must limit itself to considering facts and matters which existed at the time the challenged decision of the commissioners was taken. Facts and matters which arise after that time cannot in law vitiate an exercise of discretion which was reasonable and lawful at the time that it was effected".

Submissions

16. Mr Suttle submitted that had HMRC paid Sturminster the monies it owed in respect of the CIS overpayments in a timely fashion there would have been no reason why Sturminster would have fallen into arrears with its VAT debts. He submitted that Sturminster had been pressing over a period of three years for the overpayments to be repaid, or set off against other tax liabilities, including the VAT due and it was only on 26 June 2012 that they received confirmation of the overpayments due and that they would be set off against other tax liabilities. Mr Suttle submitted that after Sturminster's claim for statutory interest on the sums due, and other sums now becoming due in respect of the current tax year, overall Sturminster were in credit with HMRC.

17. Mr Suttle contended that the decisions made by Mr Bishop and Mr Pumfrey did not take full account of the circumstances in which BTS became insolvent, which arose out of a single bad debt owed by a customer. The VAT debt claimed was an estimate, revised upwards to take account of the figures in BTS's statement of affairs submitted in relation to its insolvency proceedings. Mr Suttle submitted that such estimates were notoriously unreliable.

18. Mr Suttle contended that the problems with the accounting system that had led to the returns being late had now been resolved.

19. In addition, Mr Suttle submitted that it was unreasonable to compare the position of BTS with Sturminster. BTS operated purely as a refurbisher of shops and nightclubs, whereas Sturminster's business focussed largely on fitting out shops for Lidl, the supermarket chain, and its business was more stable. He therefore submitted that HMRC had failed to take into account the different trading patterns of the two companies.

20. For all these reasons, Mr Suttle submitted that the decision to require security was unreasonable.

21. HMRC submitted that the Notice was fully merited at the time of its issue because of the risk to the revenue arising from Sturminster's poor compliance history and that of BTS which had the same sole director. On the basis of the evidence before them, it was reasonable for both Mr Bishop and Mr Pumfrey to have made their decisions without taking into account any claim for set-off in respect of the CIS overpayments. HMRC submitted that Sturminster's submissions were based on material that came to light after the relevant decisions were made.

Discussion

22. We emphasise the point, as discussed in *Peachtree Enterprises* which we refer to in paragraph 15 above, that the jurisdiction of the Tribunal is limited to considering the reasonableness of the Commissioners' decision to require security. It is only if that decision was one which no reasonable body of Commissioners could have made that the appeal can succeed. In considering this question, the Tribunal considers the factors which were taken into account, ensuring that they were all relevant and were given due weight; to any factors which were not considered but which should have been and finally to whether or not there was any error of law in the approach by the officers.

23. Although the initial decision was made by Mr Bishop, the decision to require security is a composite process involving not only the original decision but the review decision by Mr Pumfrey. We therefore have to consider both Mr Bishop's and Mr Pumfrey's decisions.

24. It is clear that both officers were predominantly motivated by the compliance record of Sturminster, which by the time the Notice was issued was poor, and the fact of the connection with Mr Ben Smith, who was also the sole director of BTS which had failed after a long history of poor compliance leaving a substantial VAT debt. It is right that both Mr Bishop and Mr Pumfrey gave strong weight to these factors and reasonable for them to rely on the estimate of the VAT debt contained in BTS's statement of affairs in the absence of any other better information from BTS itself.

25. We come to look now at any factors which were not taken into account but should have been or which were given little weight by HMRC. It was not unreasonable that both Mr Bishop and Mr Pumfrey did not enquire in any further detail as to the reason why BTS failed and why the returns and payments of both BTS and Sturminster were consistently overdue. It was open to both companies at all times to have given explanations as to the circumstances which had led to the poor compliance, but they failed to do so, until Mr Suttle's letter of 1 April which we will come to later. In the absence of any communication from the companies concerned in our view it was reasonable for both Mr Bishop and Mr Pumfrey to rely on the seriousness of the non-compliance and then to draw the inference, as they did, that

there was a similar pattern of behaviour of non-compliance between the two companies which were linked by a common sole director.

26. Nor was it unreasonable on the part of Mr Bishop and Mr Pumfrey not to have inquired further as to the difference in business models of the two companies, as suggested by Mr Suttle. Again, these are matters that could have been brought to HMRC's attention but were not. It was reasonable for the two HMRC officers to rely on the fact that both companies were involved in the same general business area, namely shop fitting and installation.

27. In any event, Sturminster had the opportunity to bring more detailed information to HMRC's attention when asking for a review. The letter accompanying the Notice invited Sturminster to provide any further information that it wished HMRC to consider. In response, the only information provided was that set out in Mr Suttle's letter of 1 April 2011. That contained very little detail. In particular:

(a) It provided no information concerning the reasons BTS became insolvent or why it was late with its returns and payments;

(b) It provided no information as to why Sturminster did not notify HMRC of its difficulties with its accounting system and thus an explanation as to why its returns were late;

(c) It gave no detail as to the extent of the CIS claims in respect of overpayment or any explanation as to the difficulties Sturminster was having in obtaining repayment from HMRC. Nor did it seek to enter into a formal arrangement which would allow these sums to be set off against the VAT due.

(d) It gave no detail as to the bad debt of £285,000 and the likelihood of relief being available.

28. In the light of this, in our view the action Mr Pumfrey took in considering this information was reasonable in the circumstances. In our view, he was right to place little weight on the issue regarding the accounting system, bearing in mind the time it took to resolve that issue, without any communication of the difficulties having been made to HMRC.

29. In our view Mr Pumfrey was right to give little weight to the bad debt issue in the absence of the outstanding VAT returns being submitted.

30. With respect to the CIS overpayment issue, in our view the steps that Mr Pumfrey took were reasonable in the circumstances. There was no onus on him to

undertake a detailed investigation of the circumstances underlying Suttle's statement in their letter of 1 April. As indicated above, had more detail been provided it would have been reasonable for Mr Pumfrey to check that detail with the HMRC local employer office, but on the basis of what he was told, in our view it was reasonable for him merely to ask the local office, as he did, whether there was a credit due to Sturminster, and if the answer was that there was not, which again we found to be the case, he was entitled to rely on that information without further investigation.

31. In any event, there is no obligation on HMRC to apply or set off other payments due from HMRC against the VAT liabilities in the absence of a formal arrangement. The inferences we draw from the evidence and Mr Suttle's submission on this issue was that Sturminster took the decision that it would fund its VAT liabilities out of the monies due to it in respect of the CIS overpayments, hence its delay in making VAT payments until the CIS overpayments had been received. There is no legal basis for such unilateral action and therefore it was reasonable for HMRC to take the position that the VAT liabilities stood alone, as Mr Pumfrey did, as set out in the third paragraph of the extract from his letter of 26 April 2011 quoted at paragraph 9 above.

31. We accept HMRC's submission that the material regarding the current state of account between HMRC as a whole and Sturminster, as set out in HMRC's letter of 26 June 2012 post-dates Mr Bishop's and Mr Pumfrey's decisions, as does the information concerning the resolution of the accounting issues. As the *Peachtree Enterprise* case to which we refer to in paragraph 15 above makes clear, we must limit ourselves to considering facts and matters which existed at the time the challenged decisions were made, and we therefore place no weight on these matters.

Conclusion

32. We find that the decision of HMRC to require security from Sturminster was entirely reasonable in the circumstances which existed at the time the relevant decisions were made. The factors that were taken into account were correctly considered and given proper weight. There were no other factors that should have been taken into account but were not considered when the relevant decisions were made. The basis on which the security deposit was calculated and the actual calculation was not challenged and the methodology used was entirely reasonable. There was no error of law in the approach taken by the HMRC officers. The appeal is therefore dismissed.

33. 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.

TIMOTHY HERRINGTON
TRIBUNAL JUDGE

RELEASE DATE: 8 August 2012