



TC04182

Appeal number: TC/2014/01435

VAT – default surcharge - whether reasonable excuse – section 59(7) Value Added Tax Act 1994 –appellant designs and organises manufacture of garments to clothing retailers - financial difficulties caused variously by major customer changing terms of business, and defective product run – appeal allowed in part

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

PLAYFUL PROMISES LTD

Appellant

- and -

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

**TRIBUNAL: JUDGE SWAMI RAGHAVAN
 MS ELIZABETH BRIDGE**

Sitting in public at 45 Bedford Square on 26 August 2014

Emma Parker, director of the Appellant for the Appellant

Lynne Ratnett, HMRC officer for the Respondents

DECISION

Introduction

- 5 1. This is an appeal against a default surcharge issued by HMRC under section 59 Value Added Tax Act 1994 (“VATA 1994”) for the late payment of VAT in the periods 01/12, 04/12, 07/12, 04/13 and 07/13. The amount of surcharges total £15,294.48. There is no dispute that the VAT payments were made late or in the calculation of the surcharge further details of which are set out below at [19].
- 10 2. The issue in the appeal is whether the appellant had a reasonable excuse within the meaning of s59(7) VATA 1994.
3. We had before us a documents bundle prepared by HMRC which included correspondence between the parties, details of certain of HMRC phone records of conversations with the appellant. We also heard oral evidence from Emma Parker, the director of the appellant. Ms Parker’s evidence was cross-examined by HMRC and she also answered the Tribunal’s questions. We found Ms Parker to be a credible witness.
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The law

4. Section 59(7) VATA 1994 provides:
- 20 ‘(7) If a person who apart from this sub-section would be liable to a surcharge under sub-section (4) above satisfies the Commissioners or, on appeal, a Tribunal that in the case of a default which is material to the surcharge –
- 25 (a) the return or as the case may be, the VAT shown on the return was despatched at such a time and in such a manner that it was reasonable to expect that it would be received by the commissioners within the appropriate time limit, or
- 30 (b) there is a reasonable excuse for the return or VAT not having been so despatched then he shall not be liable to the surcharge and for the purposes of the preceding provisions of this section he shall be treated as not having been in default in respect of the prescribed accounting period in question (and, accordingly, any surcharge liability notice the service of which depended on that default shall be deemed not to have been served)’
- 35 5. Section 71 VATA 1994 provides:
- ‘(1) For the purposes of any provision of section 59 which refers to a reasonable excuse for any conduct -
- (a) any insufficiency of funds to pay any VAT due is not a reasonable excuse.’

6. The provisions underlying what the parties referred to as “time to pay” agreements or arrangements are set out at Section 108 Finance Act 2009 which provides where relevant:

- 5 “108 Suspension of penalties during currency of agreement for deferred payment
- (1) This section applies if—
- (a) a person (“P”) fails to pay an amount of tax falling within the Table in subsection (5) when it becomes due and payable,
- 10 (b) P makes a request to an officer of Revenue and Customs that payment of the amount of tax be deferred, and
- (c) an officer of Revenue and Customs agrees that payment of that amount may be deferred for a period (“the deferral period”).
- (2) P is not liable to a penalty for failing to pay the amount mentioned in subsection (1) if—
- 15 (a) the penalty falls within the Table [*which at paragraph (5) refers to “Value added tax Surcharge under section 59(4)”*], and
- (b) P would (apart from this subsection) become liable to it between the date on which P makes the request and the end of the deferral period.
- 20 ...”

Facts

7. The appellant is a company based in the UK which designs and organises the manufacture of lingerie and swimwear in factories in China for sale to major retailers in the UK. Its main customers at the relevant time were Top Shop, Anne Summers
25 and ASOS. It also sells retail through its own website but this is a tiny proportion (2%) of its main business. It currently has eight employees. Ms Parker is its director. She has 10 years experience in the garment industry. We set out below the findings of fact we were able to make from Ms Parker’s oral evidence and the documents which are relevant to the parties’ arguments on reasonable excuse.

30 8. In the period August to October 2008 the appellant suffered a burglary at its warehouse. As well as stock, the appellant’s records were taken.

9. No time to pay agreement was reached in this period.

10. The appellant was subject to a VAT inspection which started in November 2011 and was completed in September 2012. The appellant had to go back through four
35 years of bank statements and organise re-issue of invoices. Ms Parker said this was a very stressful time for the business. The original VAT liability which HMRC had said was due under an officer assessment of around £56,000 was reduced to around £18,000. The £18,000 represented the amount that could not be accounted for from the reconstitution of records. The appellant had not budgeted to pay for this sum. The
40 £18,000 was paid in September 2012 under a time to pay arrangement over 6 months.

11. Ms Parker had previously asked whether a time to pay agreement was possible but was told by the VAT inspector she was dealing with that there could not be a time to pay agreement while the inspection was ongoing. Ms Parker also made several
5 telephone calls to HMRC seeking a time to pay agreement.

12. During the period of the ongoing inspection, around January 2012, Top Shop, who had been a major customer of the appellant for at least five years moved from being on 30 day payment terms to 60 day payment terms without notice. Sales to Top Shop made up 30-40% of the appellant's turnover.

10 *Defective products*

13. The business model at this time was that goods were shipped directly to the customer using a third party "palletiser". The appellant had three people working for it in China on quality control. They worked with third party testing laboratories such as Intertek and SGS on fabric testing. In particular white and ivory fabrics needed to
15 have special fabric finishes to ensure they did not go yellow. The technical term for this Ms Parker told us was "phenolic" yellowing.

14. Between November 2012 / January 2013 the appellant organised a shipment by sea of £250,000 worth of product from its manufacturer, the Hon Gao factory in China, to Anne Summers. All the correct testing was carried out in advance. Samples
20 were sent to the Intertek third party testing laboratory.

15. It later turned out that some of the white bras in this shipment (around £13,000 worth) had gone yellow. The products had to be recalled and penalties had to be paid. The appellant lost Anne Summers as a client as a result. Sales to Anne Summer represented approximately 20% of turnover. The appellant also had 8-10 product lines
25 with Knickerbox. Two of these product lines were affected by the issue. The dispute took place in early January 2013 and was not resolved until May /June 2013. Top Shop fined them. The goods had to be donated to charity. The entire Topshop account was unprofitable for a year.

16. Ms Parker attempted to call HMRC to reach a time to pay agreement. In relation
30 to period 07/13 with a due date of 7 September 2013 Ms Parker was aware the due date fell on a Saturday. She did try to phone the week before but could not get through. She thought it would be ok to try on the following Monday and that this would not be a major problem.

17. To help address the financial difficulties Ms Parker used the overdraft which
35 had a limit of £25,000. The outstanding overdraft made it difficult to seek further bank loans. The appellant's employees continued to be paid. At the time the appellant had 13 employees. The appellant also paid money to get goods released at customs. Ms Parker explained that the appellant made such payments to ensure the appellant could continue to trade.

18. Ms Parker’s “right hand person” was in and out of work for stress related health reasons. She did not have a role in finance but was one of the first employees and apart from finance did everything Ms Parker did such as organising shipping, and checking quality control.

5 19. The details of the prescribed accounting periods relevant to this appeal, the relevant due dates, VAT and surcharge amounts are set out in the table below.

VAT Period	Due date (date for electronic payments)	VAT	Calculation percentage	Amount
10/11	30/11/11	£24,790.77	First default	0.00
01/12	28/2/12 (7/3/12)	£27,230.38	2%	£544.60
04/12	31/5/12 (7/6/12)	£42,316.95	5%	£2,115.84
07/12	31/08/12 (7/9/12)	£20,409.15	10%	£2,040.91
04/13	31/05/13 (7/6/12)	£6,788.60	15%	£1,081.29
07/13	31/08/13 (7/9/13)	£63,832.31	15%	£9,574.84

The parties’ arguments

10 20. Ms Parker referred to various factors which she argues caused the appellant unexpected cash flow issues. These were:

- (1) changes in terms of payment by supplier

5 (2) The fact a time to pay arrangement was not made available to her because of technicalities and the unwillingness of HMRC, in particular being told that such an arrangement was not possible while a VAT inspection was ongoing. This was exceptional and against what Parliament intended when creating the VAT penalty surcharge regime and the time to pay scheme.

(3) The payment of £18,000 VAT which the appellant says arose because they were unable to reconstitute all of their records following a burglary.

(4) Large scale production issues with a factory in China despite quality assurance steps having been taken.

10 (5) Difficulties with getting through to HMRC prior to the payment deadline in order to be able to set up a time to pay arrangement.

21. HMRC disagree that any of these factors amount to a reasonable excuse. In relation to the VAT inspection the routine VAT inspection did not in fact preclude the appellant from contacting HMRC to discuss a time to pay arrangement for current
15 liabilities and the appellant having used the services before would have been aware of the conditions and time limits attached to arranging a time to pay arrangement. The appellant's evidence on the changes in supplier terms, timing of the charge backs and fines caused by production issues and how they impacted on which VAT liabilities was insufficient. Product quality issues and the recognition of them were a normal
20 hazard of trade and were not entirely unexpected. HMRC ask us to note that the £18,000 VAT assessment was issued in September 2012, and that the VAT returns and payments for periods 01/12, 04/12 and 07/12 were all due prior to that date and that insufficiency of funds does not constitute a reasonable excuse.

Discussion

25 22. In relation to the relevant legal approach to take, the appellant referred us to the case of *Electrical Installation Solutions Limited v HMRC* [2013] UKFTT (TC) which highlighted the need to have regard to the majority decision in *CCE v Steptoe* [1992] STC 757 rather than the dissenting opinion of Lord Scott. The test expressed by Lord Donaldson MR which we apply here is:

30 “... [I]f the exercise of reasonable foresight and of due diligence and a proper regard for the fact that the tax would become due on a particular date would not have avoided the insufficiency of funds which led to the default, then the taxpayer may well have a reasonable excuse for non-payment, but that excuse will be exhausted by the date on which
35 such foresight, diligence and regard would have overcome the insufficiency of funds.”

23. With that test in mind we consider below whether the various events the appellant referred to gave rise to a reasonable excuse for each of the default charges in issue.

40 24. We think the appellant had a reasonable excuse for late payment for 01/12. Top Shop was a major customer, and the change in terms from 30 days to 60 days was not something that could be planned for. It adversely affected the appellant's cashflow.

5 However we think this excuse was exhausted in advance of the due date for 04/12 (7 June 2012 for electronic payments) because by that time the appellant would have had sufficient time to take account of the change in terms in getting ready to make its payments for 04/12. The change in supplier terms does not provide a reasonable excuse for 04/12.

10 25. HMRC maintain a time to pay agreement would have been possible in principle even if a VAT inspection was ongoing. There appears to be no legal bar to the time to pay agreement operating but we note that this is a matter of HMRC's discretion. We accept that based on what she had been told and her conversations with HMRC (the note kept by HMRC would not necessarily have needed to be fully comprehensive) that Ms Parker thought she could not have a time to pay agreement. It seems likely to us that her conversations with the inspector would have been on the subject of time to pay in relation to the sum to be settled rather than current liabilities. But, we accept her account, on the basis of its plausibility, that when she spoke to HMRC on the phone she had been left with the impression that the VAT arising from the initial officer assessment had been added to the due amount on HMRC's systems so it did not seem to her that a time to pay agreement was possible given the total current liabilities at the time.

20 26. Nevertheless we think the appellant's argument in relation time to pay does not assist her and does not provide a reasonable excuse for the period 04/12. This is because it would not have been reasonable in our view to have assumed that a time to pay agreement would have been reached even if Ms Parker had thought a time to pay agreement was available in principle and even if she had pressed HMRC with a request for it.

25 27. Being subject to a VAT inspection in circumstances where underlying records had been lost due to a burglary was unforeseen. While the impact of paying a sum of £18,000 which was due when the matter finally settled would not have been one which was foreseen the adverse effect of that in terms of meeting the due date for 07/12 of 7 September 2012 would we think have been mitigated by the fact that the appellant was able to agree to pay the amount of £18,000 over 6 months. Taking account of the way that sum was allowed to be paid; we were not satisfied that the payment of the sum led to the appellant not being able to pay its VAT on time. We do not think the sum provided a reasonable excuse for not paying the sum due on 7 September 2012 on time.

35 28. In relation to the circumstances surrounding the product recall for the yellowing bras we agree with the appellant that this was an unexpected turn of events. We are satisfied the appellant acted reasonably in its due diligence of its manufacturer and its supplier. The product recall was not, as HMRC suggest, a normal hazard of business because we were satisfied reasonable systems of due diligence had been put in place and operated. The financial losses in the form of penalties ran into tens of thousands and had an adverse impact on cashflow in the period of the dispute (January to June 40 2013) which led to the appellant not being able to pay its VAT on time. The fact the appellant continued to pay employees during this period in order to continue as a going concern does not preclude the appellant from having a reasonable excuse. We

agree that this “debacle”, as Ms Parker put it, provided the appellant with a reasonable excuse for period 04/13 (due date 7 June 2013).

29. However the dispute was then resolved in June 2013 and although Ms Parker told us that it took the appellant over a year to recover, we think, with the exercise of reasonable foresight, due diligence and proper regard to payment deadlines, a company in the appellant’s position would by the due date for 07/13 (7 September 2013), have set about reorganising its finances so as to take account any ongoing impact the penalties would have had in order to make the required VAT payment on time. The reasonable excuse relating to the product recall was exhausted and did not provide a reasonable excuse for the period 07/13. The fact that it was left as late as a week before the deadline to seek a time to pay agreement suggests that to the extent the appellant was facing ongoing financial difficulties from the fallout from the defective products issue, it was not being as proactive as it might have been in addressing those.

30. We accept Ms Parker did try to call HMRC in the week before the deadline for 07/13 for a time to pay agreement but as above we do not think this can be a reasonable excuse. She could not have reasonably assumed that a time to pay agreement would necessarily have been reached. We find there is therefore no reasonable excuse for the period 07/13.

31. While the parties did not make any detailed submissions on proportionality at the hearing given there was some brief reference to such arguments in preceding correspondence in the papers before us we ought to record that we did not find the amounts of any of the surcharges (set out at [19] above) to be ones which were not proportionate.

Conclusion

32. The appellant had a reasonable excuse in relation to periods 01/12 and 04/13 and the penalty surcharges £544.60 and £1,018.29 respectively for those periods are discharged. There was no reasonable excuse for the periods under appeal 04/12, 07/12 and 07/13.

33. Given 1) our conclusions on 01/12 and 04/13, 2) the fact that the default for the period 10/11 (which is a default which is material to the surcharge) remains as a first default (there being no reasonable excuse made out for it) and 3) the fact that despite the notices for 04/12 and 07/12 falling away, the remaining surcharges for 04/12 and 07/13 remain within the anniversary dates of the end of the accounting period in relation to which the last preceding liability notice was served, while the liability for default surcharge for the periods 04/12, 07/12 and 07/13 remain in place, the percentage amounts by which they are calculated change downwards as follows:

- (1) For 04/12 from 5% to 2%. The amount is therefore £846.34.
- (2) For 07/12 from 10% to 5%. The amount is therefore £1,020.46.
- (3) For 07/13 from 15% to 10%. The amount is therefore £6,383.23.

34. The appellant's appeal is therefore allowed in part.

35. 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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**SWAMI RAGHAVAN
TRIBUNAL JUDGE**

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RELEASE DATE: 12 December 2014