TC04602

Appeal number: TC/2014/05368

VAT – Default Surcharge – reasonable excuse – insufficiency of funds – whether trading conditions and economic climate relevant – Value Added Tax Act 1994, Section 71(1)(a) – No – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

TFD (SCOTLAND) LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE ANNE SCOTT, LLB, NP
JOHN ADRAIN, FCA

Sitting in public at Wellington House, 134-136 Wellington Street, Glasgow on Monday 10 August 2015

Mr Jesner of Caledonia Business Support and Mr Sandland of the Appellant, for the Appellant

Mrs E McIntyre, Officer of HMRC, for the Respondents

DECISION

Introduction

1. This is an appeal against VAT default surcharges on the basis that the recession and pressure from the appellant's bankers were the causes of the failure to pay VAT on time and that that therefore constituted a *reasonable excuse* for late payment of VAT.

Subject matter of the appeal

2. In their Statement of Case at paragraph 26 the respondents (HMRC) indicated that it was unclear which periods were under appeal and that HMRC had assumed that it was for all those periods for which a surcharge and notice remained in effect. Those periods and the amounts involved are as set out in the table below.

Periods under appeal	Amount £	Calculated @
04/11	0.00	0%
07/11	738.04	2%
01/12	1480.24	5%
04/12	2300.39	10%
07/12	4173.26	15%
10/12	5745.27	15%
01/13	5314.84	15%
04/13	7400.72	15%
07/13	9523.07	15%
10/13	6051.27	15%
01/14	5779.28	15%
04/14	6763.10	15%
07/14	9558.17	15%

In every case the return was in not only on time but often early but the payments were always late.

3. The Notice of Appeal dated 2 October 2014 indicates that the appeal is in respect of a decision dated 11 September 2014 and the amount of penalty in question is £4,518.67. Obviously that is not one of the figures in the table above. However, the letter of 11 September 2014 was a letter from HMRC to the appellant regarding the "default surcharge notices presently recorded on your account". That letter pointed out that HMRC had reviewed the default surcharge history and because there had been a time to pay agreement in place for the periods 10/10 and 01/11 HMRC had agreed to cancel the defaults for that period. HMRC then went on to amend, quite correctly, the default surcharges for the periods 04/11, 07/11, 01/12 and 04/12. Those amended defaults amounted to £4,518.67. HMRC did not then list the other nine outstanding defaults because they were all at the relevant rate of 15% and did not fall to be amended.

4. At the hearing Mr Jesner indicated that he had believed that subsequent default surcharges were also included in the appeal. Both parties agreed that there were surcharges for 10/14 of £9,941.89 and 01/15 of £6,053.36. HMRC stated that there was also a surcharge due for 04/15 but Mr Jesner disagreed. Obviously no surcharge

decisions arising after the date of the Notice of Appeal could be included in this appeal since they carry their own rights of appeal. Those would have to be the subject matter for applications for late appeals to be admitted, if appropriate. We agreed with HMRC that since no appeals had been lodged for periods after 07/14 they could not be considered at this hearing. We are therefore concerned with the periods and surcharges set out in the table in paragraph 2.

5. Up until 11 September 2014 the appellant had been in the default surcharge regime from the period 10/10 onwards. Following the review the surcharge regime was deemed to have started with effect from 04/11 period.

6. The appellant did negotiate time to pay arrangements with HMRC in 2010 but further requests in 2011 were refused. Although arguments were advanced in writing, and specifically in the letter of 17 May 2015 to HMCTS, in regard to the time to pay arrangements, it is not within the jurisdiction of this Tribunal to decide whether or not HMRC have administered the business payment support service appropriately.

7. The appellant argued that HMRC unfairly allocated payments to penalties before returns leaving larger sums of tax outstanding. The allocation of payments by HMRC is not a matter within the jurisdiction of this Tribunal. In any event, as the appellant now understands, HMRC allocate payments to the oldest debt (of whatever derivation) in the absence of an allocation by the taxpayer. In recent times, the appellant has requested allocation to specific debt and that has been honoured.

Grounds of appeal

8. The stated Grounds of Appeal are: "The company was late in making payments of VAT due, because of cash-flow issues and bank pressure resulting from the downturn in business caused by the recession. Based on the decision in *Scrimsign Micro Electronics v HMRC*[1] the company is appealing for the penalties to be cancelled".

The Law

9. The surcharges were levied under Section 59 Value Added Tax Act 1994 ("VATA"). That is set out as an Appendix to this decision.

10. Under Section 59(7) a person is not liable to a surcharge if he has a *reasonable excuse* but that is subject to the limitation set out in Section 71(1) VATA which states that insufficiency of funds is not a *reasonable excuse*. However, it is the case that the underlying cause of the insufficiency of funds may constitute a *reasonable excuse.*

11. Under Section 59(8) the *reasonable excuse* provisions apply not only to the surcharges actually levied but also to defaults "taken into account in the service of the surcharge liability notice upon which the surcharge depends".

12. There is no definition in the legislation of a *reasonable excuse*. In *Rowland v HMRC*[2] it has been held to be "a matter to be considered in light of all the circumstances of the particular case".

[1] [2014]UKFTT 866

[2] 2006 STC (SCD) 536 at 18

13. In *B & J Shopfitting Services v R & C Commrs*[3] the Tribunal held that "an excuse is likely to be reasonable where the taxpayer acts in the same way as someone who seriously intends to honour their tax liabilities and obligations would act". We agree with that analysis.

The issue

14. The issue for the Tribunal was to decide whether or not the appellant had a reasonable excuse for the failure to pay VAT on time. HMRC argue that Judge Medd in *The Clean Car Company Ltd v HMRC*[4] set out very clearly what amounts to a *reasonable excuse*, namely:-

> "… the question of whether a particular trader had a reasonable excuse should be judged by the standards of reasonableness which one would expect to be exhibited by a taxpayer who had a responsible attitude to his duties as a taxpayer … such a taxpayer would give a reasonable priority to complying with his duties in regard to tax and would conscientiously seek to ensure that his returns were accurate and made timeously … many other facts, may all have a bearing on whether, in acting as he did, he acted reasonably and so had a reasonable excuse".

The arguments

HMRC

15. No appropriate priority was given to payment of tax debt. HMRC pointed out that the appellant accounted for VAT on an invoice basis which meant that they were able to reclaim VAT before themselves paying it which provided a cash flow advantage.

16. Approximately 40% of the appellant's clients are retail clients who pay cash on delivery.

17. The reduction in overdraft facilities would be a normal hazard of the business.

18. The default surcharge regime itself does not infringe the principles of proportionality.

The appellant

19. It is argued that the 15% penalty is unfair and disproportionate.

20. In his letter to HMRC dated 27 October 2014, Mr Jesner argued that the reasons for insufficiency of funds were:

> (a) trading levels collapsed because of the recession, hence the losses in 2010-2012,
>
> (b) customers were taking more time to pay,
>
> (c) large suppliers were demanding quicker payment,
>
> (d) the bank had transferred the appellant into its Specialised Business Support Department and then reduced the level of overdraft.

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[3] 2010 UK FTT 78 at 14

[4] 1991 VATTR 234

21. The appellant relied on *Scrimsign* on the basis that the similarity between the circumstances in *Scrimsign* and in this appeal are numerous. In particular both companies fell victim to the economic recession, a factor that was both unforeseen and outwith their control, both parties had to make adjustments to their businesses in order to continue while trying to preserve as many jobs as possible, both directors borrowed money on credit cards and used it for business purposes, both appellants had to rely on the goodwill of their main suppliers, and both companies did manage to trade their way out of their working capital problem and HMRC arrears.

Discussion and findings-in-fact

22. The appellant is a double glazing company providing double glazed units and conservatories to both retail and trade customers as well as contract customers and has been registered for VAT since February 2003. On 19 November 2014 the appellant's agents wrote to HMRC indicating that the customer base is split between retail, trade and contracts on a ratio of approximately 40:30:30. The terms vary between cash on delivery (COD) and 60 days. It was also advised that the company had been unable to factor its invoices during the period in question "as the bank regarded their sales ledgers unsuitable, due to some of their customers being retail sales where people paid on delivery". Accordingly it seems quite clear from that that 40% of their customers paid cash on delivery. However, at the hearing it was argued that that was not always the case. Nevertheless an unquantified percentage was paid on delivery.

23. It is admitted by the appellant that their problem for at least the last four years is that it has not had sufficient working capital. HMRC requested sight of the appellant's bank accounts for each of the VAT quarter payment dates and took the view that the appellant could have paid VAT on the due dates.

24. The appellant argues that HMRC had not taken into account the uncleared cheques position.

25. HMRC had calculated the percentage that VAT bore to turnover after deduction of costs other than wages. With the exception of one quarter it amounted to an average of 7%. However, the payroll, which fluctuated as some payment was by commission and the work was seasonal, was, even after the redundancies in 2012, a material cost at around £90,000 net per month. In correspondence Mr Jesner had indicated that the decision to make redundancies was taken in the year to February 2012, however, Mr Sandland was very clear that the decision was probably taken in or about August and implemented by November 2012 since he wished to reduce the wage bill by approximately £200,000 p.a.

26. We had no precise figures. We do know that prior to the redundancies, the appellant incurred a loss of £66,000 in 2010-11 and £76,000 or £77,000 in 2011-12. The turnover in the year to 28 February 2011 fell from £5.76 million to £5.55 million. We have no figures other than HMRC's record of turnover and inputs per the VAT returns for any period after that.

27. We explored the management of funds in considerable detail. We found Mr Sandland to be a patently honest and frank witness. It is evident that, as he said, he was constantly "juggling" the available funds, paying everything by cheque since it provided a breathing space, but ultimately honouring all obligations. Initially he had cut costs to the bare minimum whilst awaiting "steadiness in the sector".

28. In early 2011, one major housebuilder who had previously accounted for 35% of that part of the business simply stopped building so the focus for the appellant had been on increasing turnover and looking to maximise sales. In doing so the appellant had extended credit to customers in order to achieve sales. On reflection, it was conceded that the pursuit of turnover had not been successful. Further the bank had not supported that strategic decision. Indeed, Mr Jesner asserted in his letter of 17 May 2015 that the bank had accused the appellant of overtrading by trying to increase its turnover and had insisted that that be corrected.

29. The bank had made it clear that it would not continue to offer significant overdraft support. In 2011 the appellant's bankers refused the request for additional financial support and therefore in 2012 the company had to downsize its work force. It was then that the bank moved the appellant's account into its Specialised Business Support Department.

30. As at 5 April 2013 the overdraft stood at £425,000. Previously, that level had been on an "uncleared basis" but by late 2013 the bank was insisting on cleared funds being lodged by 2.30 pm each day. On 3 January 2014, with minimal notice, the overdraft was reduced to £400,000 and on 23 May 2014 again on minimal notice it was reduced to £175,000. There was a further reduction to £125,000 on 3 October 2014 and at the end of October 2014 the appellant successfully changed its banking facilities to a different bank. In the interim period the bank had required detailed management accounts with supporting documentation such as cash projections and analysis of creditors and profit projections etc. There had been extremely regular contact with the bank who monitored the appellant's business closely.

31. In March 2014 HMRC's Debt Management and Banking Unit issued a seven day notice demanding payment of £88,000 to clear arrears of VAT and PAYE. The bank was not prepared to support the company and insisted that the debt be cleared. The appellant's main suppliers supported them through that crisis.

32. It is HMRC's argument that no appropriate priority was given to payment of tax debt. It was noted that the appellant had requested a time to pay arrangement on 1 September 2011 (which was refused) on the basis that they were unable to pay as they had to pay a supplier and wages.

33. The appellant argued that it gave all creditors equal priority. Whilst that may well have been the intention it does not seem to have been the reality. We were told that on a couple of occasions wages were paid a day or perhaps two late. The tax payments were always very much more than a day or two late. That is one of the many differences between the facts in this case and *Scrimsign* where at paragraph 25 Judge Reid noted that the delay in payment was "mainly short periods". In that case it was accepted that "every effort was being made to pay on time". In this case as is evident from the timing of the payments, although all the tax was eventually paid it is very clear that there were some very long delays indeed in payment. For example, the tax due by 31 May 2013 was only finally paid on 7 April 2014.

34. If the appellant indeed had to pay large suppliers more quickly then that certainly does not sit well with the argument that all creditors were given equal priority. The reduction in the overdraft facility was only after the appellant had been in the default surcharge regime for many periods.

35. We do not accept that trading levels collapsed. The fall in turnover between 2011 and 2012 (which included the period when the housebuilder ceased to build) is less than 4%. It may well be that the resultant margins were lower but it is not a collapse. In the *Scrimsign* case the appellants turnover was reduced by 50%. That is a collapse.

36. No doubt customers were taking longer to pay, as indeed was the appellant, but that was a common factor for almost every business in the country.

37. Every case turns on its own individual facts and this Tribunal is not bound by the decision of the Tribunal in *Scrimsign.* The facts are entirely different. In addition to those noted above there were not just three defaults in issue and the defaults are over a very much longer period. This was not the "temporary lack of funds" described by Judge Reid at paragraph 27 which reads:

> "27 … applying these observations to the present appeal leaves me to conclude that the appellant's temporary lack of funds which prevented it from meeting its VAT obligations timeously was caused not through any imprudence … but by the underlying economic recession, the effects of which so far as the appellant was concerned were difficult to predict but could not reasonably be avoided."

38. Judge Reid goes on to say at paragraph 28:-

> "28 … in the present appeal, these effects seem to me to be somewhat different from the normal hazards of trade… Although the information provided … is not as detailed as it might have been, I consider that it is just sufficient to enable me to conclude that the appellant has a reasonable excuse for the failure to make payment timeously on the three occasions which are still at issue. All outstanding funds were paid as soon as it was reasonably possible to do so."

As we indicate above that is not the case in this appeal. Further in *Scrimsign*, unlike in this case, there were no PAYE arrears.

39. It is argued for the appellant that the 15% penalty is unfair and disproportionate. The decisions in both *HMRC* v *Total*[5] and *HMRC v Hok Ltd* [6] make it very clear that whether or not the penalty regime might be perceived as harsh or unfair, the Tribunal has absolutely no jurisdiction to vary or adjust the level of penalty. Specifically the Upper Tribunal in *Hok* re-affirmed the First-tier Tribunal's limited jurisdiction in respect of penalty appeals, and in particular emphasised that it had no statutory power to adjust a penalty on the grounds of fairness. The default surcharges fall to be either confirmed or not.

40. Undoubtedly the appellant found itself in difficulties but it and only it had to make the decisions in regard to how incoming funds were allocated. The appellant knew that the cost of not paying VAT on time would incur a 15% penalty. The appellant chose to pursue turnover in the face of unequivocal advice from its bank. In doing so it undoubtedly struggled but that was its own commercial and strategic decision. The failure to pay VAT on time on a very regular basis over numerous years although triggered by the recession was caused by the trading decisions.

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[5] 2012 UKUT 418 (TCC)

[6] [2012] UKUT 363 (TCC)

Decision

41. We had sympathy with Mr Sandland and understood how the appellant found itself in the dilemma it did but having regard to all of the circumstances we do not accept that there was a *reasonable excuse* since there was a straightforward insufficiency of funds. We therefore confirm the default surcharges and the appeal is dismissed.

42. 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.

ANNE SCOTT
TRIBUNAL JUDGE

RELEASE DATE: 25 AUGUST 2015

APPENDIX

Value Added Tax Act 1994, Part IV Administration, collection and enforcement [OTH]

59 The default surcharge

(1) [Subject to subsection (1A) below][1] If, by the last day on which a taxable person is required in accordance with regulations under this Act to furnish a return for a prescribed accounting period—
(*a*) the Commissioners have not received that return, or
(*b*) the Commissioners have received that return but have not received the amount of VAT shown on the return as payable by him in respect of that period,
then that person shall be regarded for the purposes of this section as being in default in respect of that period.
[(1A) A person shall not be regarded for the purposes of this section as being in default in respect of any prescribed accounting period if that period is one in respect of which he is required by virtue of any order under section 28 to make any payment on account of VAT.][1]

(2) Subject to subsections (9) and (10) below, subsection (4) below applies in any case where—
(*a*) a taxable person is in default in respect of a prescribed accounting period; and
(*b*) the Commissioners serve notice on the taxable person (a "surcharge liability notice") specifying as a surcharge period for the purposes of this section a period ending on the first anniversary of the last day of the period referred to in paragraph (*a*) above and beginning, subject to subsection (3) below, on the date of the notice.

(3) If a surcharge liability notice is served by reason of a default in respect of a prescribed accounting period and that period ends at or before the expiry of an existing surcharge period already notified to the taxable person concerned, the surcharge period specified in that notice shall be expressed as a continuation of the existing surcharge period and, accordingly, for the purposes of this section, that existing period and its extension shall be regarded as a single surcharge period.

(4) Subject to subsections (7) to (10) below, if a taxable person on whom a surcharge liability notice has been served—
(*a*) is in default in respect of a prescribed accounting period ending within the surcharge period specified in (or extended by) that notice, and
(*b*) has outstanding VAT for that prescribed accounting period,
he shall be liable to a surcharge equal to whichever is the greater of the following, namely, the specified percentage of his outstanding VAT for that prescribed accounting period and £30.

(5) Subject to subsections (7) to (10) below, the specified percentage referred to in subsection (4) above shall be determined in relation to a prescribed accounting period by reference to the number of such periods in respect of which the taxable person is in default during the surcharge period and for which he has outstanding VAT, so that—
(*a*) in relation to the first such prescribed accounting period, the specified percentage is 2 per cent;
(*b*) in relation to the second such period, the specified percentage is 5 per cent;
(*c*) in relation to the third such period, the specified percentage is 10 per cent; and
(*d*) in relation to each such period after the third, the specified percentage is 15 per cent.

(6) For the purposes of subsections (4) and (5) above a person has outstanding VAT for a prescribed accounting period if some or all of the VAT for which he is liable in respect of that period has not been paid by the last day on which he is required (as mentioned in subsection (1) above) to make a return for that period; and the reference in subsection (4) above to a person's outstanding VAT for a prescribed accounting period is to so much of the VAT for which he is so liable as has not been paid by that day.

(7) If a person who, apart from this subsection, would be liable to a surcharge under subsection (4) above satisfies the Commissioners or, on appeal, a tribunal that, in the case of a default which is material to the surcharge—
(*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
(*b*) there is a reasonable excuse for the return or VAT not having been so despatched,

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 upon that default shall be deemed not to have been served).

(8) For the purposes of subsection (7) above, a default is material to a surcharge if—
(*a*) it is the default which, by virtue of subsection (4) above, gives rise to the surcharge; or
(*b*) it is a default which was taken into account in the service of the surcharge liability notice upon which the surcharge depends and the person concerned has not previously been liable to a surcharge in respect of a prescribed accounting period ending within the surcharge period specified in or extended by that notice.

(9) In any case where—
(*a*) the conduct by virtue of which a person is in default in respect of a prescribed accounting period is also conduct falling within section 69(1), and
(*b*) by reason of that conduct, the person concerned is assessed to a penalty under that section, the default shall be left out of account for the purposes of subsections (2) to (5) above.

(10) If the Commissioners, after consultation with the Treasury, so direct, a default in respect of a prescribed accounting period specified in the direction shall be left out of account for the purposes of subsections (2) to (5) above.
[(11) For the purposes of this section references to a thing's being done by any day include references to its being done on that day.][1]

Commentary—
De Voil Indirect Tax Service **V5.371–V5.376.**

Press releases etc—
C&E Press Notice 23/95 10-4-95 (Customs error in imposing penalties).

Simon's Tax Cases—
s 59(7), *T E Davey Photo Service Ltd v C&E Comrs [1997] STC 889*; CMS Peripherals Ltd v R&C Comrs [2008] STC 985.*

Definitions—
"The Commissioners", s 96(1); "prescribed accounting period", s 25(1); "reasonable excuse", s 71(1); "regulations", s 96(1); "taxable person", s 3; "tribunal", s 82; "VAT", ss 1, 96(1).

Cross references—
See VATA 1994 s 59B(1)(*b*), (3) (application of this section where a prescribed accounting period in respect of which a person is not liable to make a payment on account ends within a surcharge period under s 59A).
VATA 1994 s 66(7) (failure to submit EC sales statement within time limit: circumstances in which person is not to be treated as in default);
VATA 1994 s 69(4)(*a*), (9) (avoidance of double penalty for same conduct);
VATA 1994 s 71(1) (reasonable excuse for conduct within this section);
VATA 1994 s 71(2) (meaning of "credit for input tax");
VATA 1994 ss 76, 77 (assessment of surcharges under this section);
VATA 1994 ss 83, 84 (appeal to a tribunal in respect of a surcharge under this section);
VATA 1994 Sch 13 para 14 (modification of this section in its application to certain periods before the commencement of VATA 1994).
FA 2009 s 108 (suspension of penalties during currency of agreement for deferred payment).

Amendments—
[1] Words in sub-s (1), and sub-ss (1A), (11), inserted by FA 1996 s 35(3), (4), with effect in relation to any prescribed accounting period ending on or after 1 June 1996, but a liability to make a payment on account of VAT shall be disregarded for the purposes of the amendments made by FA 1996 s 35 if the payment is one becoming due before that date.