TC05177

Appeal number: TC/2015/05798

VAT – default surcharge – request for time to pay agreement before due date – initially refused by HMRC – agreed after the due date – surcharge imposed – whether surcharge precluded because of time to pay agreement – if not, whether Appellant had reasonable excuse – whether surcharge disproportionate – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

BW HILLS SOUTHBANK LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE ANNE REDSTON
MR RICHARD LAW

Sitting in public at the Tribunals Service, Friar Street, Reading on 21 April 2016

Mr James Atkinson, Company Secretary of the Appellant, for the Appellant

Ms Karen Powell of HM Revenue and Customs' Appeals and Reviews Unit, for the Respondents

DECISION

1. BW Hills Limited ("the company") had a VAT liability of £162,983.01 for the period ending 30 April 2015. Before the due date for payment, Mr Atkinson, the Company Secretary, asked HM Revenue & Customs ("HMRC") for a time to pay ("TTP") agreement. HMRC initially refused, but agreed after the due date.

2. In the meantime, HMRC had issued the company with a VAT default surcharge. This was calculated at 15% of the VAT payable, so was £24,447.45.

3. There were three issues:

(1) whether the company was chargeable to a surcharge despite the TTP agreement ("Issue 1"); and if not

(2) whether it had a reasonable excuse for the default ("Issue 2"); and if not

(3) whether the surcharge was disproportionate ("Issue 3").

4. The Tribunal decided Issue 1 in the company's favour. As a result, its appeal is allowed.

5. Had we decided Issue 1 against the company, we would have gone on to find that it had no reasonable excuse and that the surcharge was not disproportionate.

The evidence

6. HMRC provided a helpful bundle of documents ("the HMRC Bundle"). This included the correspondence between the parties and between the parties and the Tribunal. It also contained:

(1) a schedule of the company's defaults;

(2) copies of the related VAT returns;

(3) the company's bank statements from 1 May 2015 to 8 June 2015;

(4) a transcript of the telephone conversation between an HMRC Officer and Mr Atkinson on 5 June 2015;

(5) an extract from HMRC's debt management contact database recording communications between HMRC and Mr Atkinson on 5 June 2015; 6 July 2015 and 4 September 2015; and

(6) HMRC's ledger and "accounting interrogation print" for the company.

7. Mr Atkinson provided HMRC and the Tribunal with bank statements for the period from 2 February 2015 to 8 May 2015, although during the hearing both parties referred only to the statements included in the HMRC Bundle.

8. Mr Atkinson gave oral evidence, was cross-examined by Ms Powell and answered questions from the Tribunal. We found him to be an honest witness.

The law

9. The legislation is set out in the Appendix.

10. In summary, surcharges are levied under s 59 Value Added Tax Act 1994 ("VATA"). The company was on a quarterly basis for VAT, so under Reg 25(1) and Reg 40(1) of the Value Added Tax Regulations 1995 its VAT returns and the related payments were due on or before the end of the month following each calendar quarter.

11. However, Reg 25A and Reg 40 allow extra time for filing and paying VAT where both filing and payment are carried out electronically. They also give HMRC power to issue directions setting out the amount of extra time; these directions are published in VAT Notice 700. The version of that Notice current in May and June 2015 provided at paragraph 21.3.1 that:

> "Paying by an approved electronic method will give you up to seven extra calendar days to submit your return and pay your VAT, unless you make annual returns or Payments on Account (and submit quarterly returns). The extended due date will be shown on your online VAT return and you must make sure that cleared funds reach HMRC's bank account by this date."

12. Finance Act 2009 ("FA09"), s 108 provides for the suspension of the default surcharge if a person enters into a TTP agreement with HMRC, and for no surcharge to be payable if the person complies with the TTP. How s 108 works is in dispute, as discussed in Issue 1.

Findings of fact

13. On the basis of the evidence provided, we make the following findings of fact. These were not in dispute, other than where specifically identified. We make further findings of fact about the nature and extent of the company's outgoings later in the decision.

Background

14. The company's main business is the training of racehorses. Its shares are 65% owned by Mr and Mrs Hills, who are also the directors; the balance is held in trust for the eventual benefit of their sons.

15. The economic crisis affected the company's business, although it has now recovered. Until an unspecified date in 2014 the company had an £1.5m overdraft. A new bank manager then required the company to reduce its overdraft to £0.5m and restructure the £1m balance as a loan, repayable at £8,433 per calendar month ("pcm"). The bank also took security over the company's assets.

16. For the period ended 31 October 2012, the company paid its VAT late. HMRC issued it with a Surcharge Liability Notice ("SLN"). Further defaults were recorded for periods 07/13, 10/13 and 7/14. On each occasion, HMRC issued a Surcharge Liability Extension Notice ("SLEN") and a Notice of Assessment. The rate of surcharge increased with each default.

17. For many of the periods leading up to 04/15, the company and HMRC entered into TTP agreements. Commonly, the company paid HMRC a round sum on a weekly basis, with any miscellaneous amounts collected as part of the first and/or last payments. For example, in relation to period 10/13, the company paid £14,291.11 on 9 December 2013, followed by nine payments of £7,500.

18. The VAT due was always paid electronically, using the bank's Faster Payments Service ("FPS").

19. On 2 June 2015, the company paid £50,000 of VAT, being part of the sum due for period 01/15. No surcharge was recorded for that period, so we have inferred that HMRC and the company had made a TTP agreement.

20. When Mr Atkinson made the £50,000 payment, he thought he had settled the amounts due for period 01/15 in full, but HMRC's records showed that £144.98 remained outstanding. It is not necessary for our decision to make a finding as to who is correct.

Period 04/15 and Mr Atkinson's call to HMRC

21. On 5 June 2015, the company filed its VAT return for the 04/15 period. This showed VAT due of £162,983. By the end of the same day, the company's bank balance was overdrawn by £450,427. As already noted, its overdraft limit was £500,000.

22. The normal due date for payment of the 04/15 VAT was 31 May 2015; this became 7 June 2015 with the extra seven days for electronic filing and payment.

23. At 16.29 pm on 5 June 2015, Mr Atkinson called HMRC and asked for a TTP agreement for period 04/15. The HMRC Officer responded by saying "you guys have had several time to pay periods in the past and several payment promises" and that:

> "because you have had so many time to pay periods and such in the past I don't know if I would be able to agree to a formal arrangement with you guys. Basically we would be just expecting payment in full as soon as we possibly could."

24. Mr Atkinson informed the HMRC Officer that the company had been expecting to receive a total of £120,000 from two clients by the due date, but that these sums had unfortunately not yet been received. He hoped the company would be paid this money by 10 July 2015, but on the basis that people often take a bit longer to pay than expected, he asked for a two week extension.

25. The HMRC Officer responded by saying he would note on the company's record that it hoped to pay within the next two weeks, but reiterated "I can't agree to anything, err, any formal arrangements to stop surcharges or anything or to stop the legal action..."

26. HMRC's debt management contact record for the same date, which we have inferred was completed by the same HMRC Officer, states:

> "5/6/15 17.36 TTP Refused – James Atkinson (Cust) Amt Refused £162,983.01. Cust filed 04/15 rtn online for £162,983.01…refused TTP as company has had several in the past, has not kept to arrangements, advised to make payments as and when he can. WTCOG [unexplained] WLAIS [warning of legal action, interest and surcharges]."

27. We note that although this record says that the company "has not kept to arrangements" in the past, there is no reference to this in the verbatim transcript of the conversation. If the company had failed to keep the terms of earlier TTP agreements, we find it surprising that the HMRC Officer did not give this as a reason for refusing the 04/15 request when he was speaking to Mr Atkinson.

28. Ms Powell was not able to assist the Tribunal with any further information from HMRC's perspective. Mr Atkinson's near-contemporaneous letter to HMRC dated 26 June 2015, to which we refer again below, said "as your records will confirm, we have fully complied with the payment plans agreed with your office." Before the Tribunal, Mr Atkinson reiterated that the company had complied with earlier TTP agreements.

29. There is therefore a conflict between the evidence provided by Mr Atkinson and that set out in HMRC's debt management contact record. We prefer that given by Mr Atkinson, because he gave credible oral evidence which was consistent with his letter, and because the debt management contact record does not reflect what was said in the telephone conversation. We find that the company complied with its earlier TTP agreements.

Subsequent communications

30. On 12 June 2015, HMRC issued the company with a surcharge notice for period 04/15 of £24,447.45 on the basis that "your payment of the VAT due for the period 1 February 2015 to 30 April 2015 was not sent in on time."

31. On 26 June 2015, Mr Atkinson appealed the surcharge and said "due to continuing shortage of funds I did ask for a time to pay arrangement for the April 2015 liability but this was declined and the surcharge notice issued." He explained the difficulties the company was facing.

32. By a letter dated 1 July 2015, HMRC Debt Management and Banking ("DMB") Unit wrote to the company, saying:

> "Dear Sir or Madam
>
> **Warning of winding up action**
>
> Please read this letter – it can help the company avoid being wound up.
>
> You have not met the terms of our time to pay agreement, therefore I have cancelled the arrangement.
>
> The company's HMRC debt as detailed in the attached statement, is £187,575.44.

> If you do not take action within **seven working days** of the date of this letter, we will wind up the company for this debt. This will increase the amount it has to pay. The company's bank accounts may also be frozen and its assets put at risk.
>
> There is still time to sort things out, but the company needs to act now by
>
> - **Paying in full now**. Call us for details of how to make the payment
>
> Or
>
> - **Phoning us now** if you cannot pay immediately…"

33. Although this letter says that the company has "not met the terms of our time to pay agreement, therefore I have cancelled the arrangement," the parties agreed that, the HMRC Officer had refused the TTP on 5 June 2015. It follows that on 1 July 2016 no TTP agreement was in place, and so could not be cancelled. Ms Powell was unable to explain the why this sentence had been included in the letter and we assume it was an error.

34. The attachment referred to in the letter stated that the debt of £187,575.44 comprised the VAT due for period 04/15 of £162,983.01; the default surcharge of £24,487.45 and the £144.98 which HMRC said had been omitted from the final 01/15 payment.

35. Mr Atkinson rang HMRC on 6 July 2015, as soon as he received this letter. We do not have a transcript of that call, but it was common ground that he repeated his earlier request for a TTP agreement in relation to period 04/15, and that HMRC agreed.

36. The terms of the agreement were recorded in the HMRC debt management contact record as follows: the company agreed to pay £12,983.01 on that day, together with the first of ten weekly payments of £15,000, both amounts to be paid by BACS. The further payments of £15,000 were to be made by direct debit on 10 July 2017 and weekly thereafter.

37. The sum total of these amounts is £162,983.01. In other words, the TTP agreement related only to the VAT due for period 04/15. Neither the 04/15 default surcharge nor the £144.98 was included.

38. The debt management contact record did not explain why HMRC changed its mind and agreed the TTP for precisely the same amount as had been refused earlier, and Ms Powell did not know either. Possibly a second HMRC Officer reviewed the company's record and found that the reference to the company not having complied with earlier TTP agreements was incorrect, but we make no finding on this.

39. HMRC's payment schedule shows that on 7 July 2015 it received £12,983.01 and £15,000 by FPS. Although Mr Atkinson had agreed to make those payments on 6 July 2015, Ms Powell did not seek to argue that they had been made a day late. It was common ground that banks normally had cut off times for same day faster payments,

and the time of the call between Mr Atkinson and HMRC is not recorded on the debt management contact record.

40. The HMRC payment schedule also shows that each of the further payments of £15,000 was made by direct debit on the due date. The company therefore complied with the terms of the TTP.

41. On 21 August 2015, HMRC carried out a statutory review of the decision to issue the surcharge. The Review Officer said that the appeal had been refused because "in order for a surcharge to be removed, a Time to Pay arrangement must be agreed before the due date of the period to which it relates" and because the company did not have a reasonable excuse. The company appealed to the Tribunal.

Issue 1: The TTP agreement

42. Mr Atkinson had submitted that the company's appeal should be allowed because of the TTP arrangement, but did not refer to any statutory provisions.

43. At the beginning of the hearing, the Tribunal drew the parties' attention to the wording of FA09, s 108, and provided copies of the Explanatory Notes to the relevant clause in Finance Bill 2009. We invited the parties' submissions on whether the facts of this case satisfied the precise wording of the statutory conditions.

44. Ms Powell said she had checked this point internally in advance of the hearing, but asked for time to take further instructions by telephone. The Tribunal agreed an adjournment to allow her to do this, and for Mr Atkinson to consider the legislation.

Mr Atkinson's submissions on behalf of the company

45. Mr Atkinson said that the legislation prevented a surcharge arising if (a) the trader requested the TTP agreement before the due date and (b) HMRC agreed to the TTP. There is no statutory requirement that HMRC agree the TTP before the due date.

46. He said that, on the facts of this case, the company made the same TTP request twice, once before the due date and once afterwards. HMRC accepted the request on the second occasion. The wording of the legislation had been complied with and the surcharge should be cancelled.

Ms Powell's submissions on behalf of HMRC

47. By way of preliminary, Ms Powell said that where, as here, a company was paying electronically, HMRC accepts that the due date is seven days after the end of the calendar month following the end of the quarter. As Notice 700 states, that "extended due date" is shown on the company's online VAT return, and the Notice says "you must make sure that cleared funds reach HMRC's bank account by this date." In particular, Ms Powell did not seek to argue that, where no payment was in fact made, the due date reverted to being the 31st day of the previous month.

48. In relation to s 108, Ms Powell said that HMRC's view was that the TTP had to be agreed before the due date for the section to apply, as the Review Officer had

stated in his letter. In her submission, the key to understanding the legislation was subsection 2(b):

> "P is not liable to a penalty for failing to pay the amount mentioned in subsection (1) if –
>
> (a) the penalty falls within the Table, 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."

49. In her submission, the subsection provided that the penalty was only suspended between the date of the request and "the end of the deferral period." If the TTP was not agreed before the due date, the surcharge was triggered because at that date there was no "deferral period."

50. She went on to say that this can also be seen from the heading to the section, which reads (her emphasis) "Suspension of penalties during currency of agreement for deferred payment." She submitted that suspension could therefore only occur if there was an agreement in place on the due date. In this case the TTP had been refused on 5 June 2015, so there was no TTP agreement on 7 June 2015, the due date, so the surcharge had been triggered. HMRC's subsequent agreement to the TTP did not change the position.

51. She accepted that:

(1) the TTP was for the same amount as Mr Atkinson had requested on 5 June 2015, being the VAT due for period 04/15;

(2) no further information was provided to HMRC on 6 July 2015, in addition to that which it had known about 5 June 2015;

(3) no TTP payment pattern had been discussed with the HMRC Officer on 5 June 2015, but the payments agreed on 6 July 2015 were similar in structure to previous TTP arrangements between the company and HMRC;

(4) although Mr Atkinson referred on 5 June 2015 to his hopes that payment would be possible within two weeks, and the agreement reached on 6 July 2015 extended payments over a longer period, this did not mean that the TTP agreement which was actually agreed was different to that which had been requested earlier; the two week period was simply a suggestion by Mr Atkinson when the HMRC Officer appeared unwilling to agree the TTP; and

(5) HMRC had, for whatever reason, changed its mind and decided to accept the TTP a month after the original request.

52. Ms Powell therefore did not submit that the surcharge had been levied because the TTP agreement made on 6 July 2015 was different from that requested by the company on 5 June 2015. Instead, HMRC's case rested entirely on its submission that FA09, s 108 required that TTP agreements to be concluded before the due date and that had not happened here.

Discussion

53. We first considered the wording of FA09, s 108. Subsection 1 says that the section applies if the following three conditions are satisfied:

(1) the person "fails to pay an amount of tax falling within the Table in subsection (5) when it becomes due and payable." That condition is satisfied because VAT is included in subsection (5), and the company failed to pay the VAT by the due date of 7 June 2015;

(2) the person makes a request to an HMRC officer that the tax payment be deferred. Mr Atkinson first made such a request on 5 June 2015, and he repeated the request on 6 July 2015; and

(3) an HMRC officer "agrees that payment of that amount may be deferred for a period." On 6 July 2015, an HMRC officer agreed the TTP arrangement.

54. Section 108(2) provides that the person is not liable for a penalty if:

(1) it falls within Table 5. Default surcharges are included in Table 5; and

(2) the person "would (apart from this subsection) become liable to [the penalty] between the date on which [the person] makes the request and the end of the deferral period."

55. It follows that, to benefit from s 108, a person must make "the request" before the due date, because the surcharge is triggered on that due date. He would not otherwise become liable to the surcharge between the date of the request and the end of the deferral period.

56. Section 108 continues by providing that if (a) a person breaks the agreement by failing to pay or otherwise meeting the conditions of the TTP agreement, and (b) HMRC serves that person with a Notice specifying the surcharge which had been suspended, the person becomes liable to the surcharge as at the date of the Notice.

57. The statutory wording is clear. In particular it does not say that TTP arrangement must have been agreed by HMRC before the due date, but only that the request must have been made by that date. This cannot have been accidental. It would have been a simple matter to start the suspension period from the date HMRC agreed the TTP. But that would mean, for example, that an administrative delay by HMRC (over which the trader had no control) would prevent the section from applying. HMRC might need to make some internal checks before deciding whether to make the TTP agreement. Or, as here, HMRC could change its mind and come to a different decision on the same facts.

58. It seems to us that in taking this approach, Parliament balanced the powers, rights and responsibilities of the trader and HMRC, because:

(1) the trader has no power to do anything more than make a request. As long as he does this before the due date, he has complied with the statutory requirements. It would have been unfair to bar access to the relief (and cause

the trader to incur a surcharge) because of delays or changes of mind by HMRC; and

(2) HMRC has been given time to carry out whatever checks or reviews it chooses. These may include checking with other HMRC departments, the review of detailed information provided by the trader, and may involve changes of position. Were the relief to be conditional on HMRC making its decision by the due date, this would place it under unreasonable pressure to make that decision quickly.

59. If HMRC's reading of this provision were right, we think it would be without parallel in the tax code. As far as we are aware, no other tax relieving measure is dependent on HMRC making its decision by a fixed point in time. Other statutory provisions which provide access to a tax benefit or relief require that the applicant meet a time limit, but do not oblige HMRC to decide that application by any fixed date. For example, there is a four year deadline for loss claims, but no statutory requirement that HMRC agree the claim within that four year period (or any later period). This is doubtless for the reasons set out in the previous paragraph.

60. We find support for our reading of s 108 in the decision of Judge Connell in *Levi Solicitors LLP v R&C Commrs* [2011] UKFTT 277 (TC) at [34], where he says:

> "There is a requirement that the request for a TTP agreement must be made before the due date for the return payment under s108(2)(b) but no similar provision relating to the period within which the TTP arrangement must be agreed. Otherwise, as the Appellant says, HMRC could protract negotiations and thereby potentially cause the trader to incur additional surcharges which would otherwise be excluded under the time to pay arrangement scheme."

61. Further support comes from the Notes on Clauses. We begin by noting that in *R* (*oao Westminster City Council*) *v National Asylum Support Service* [2002] UKHL 38 at [5], Lord Steyn said:

> "The question is whether in aid of the interpretation of a statute the court may take into account the Explanatory Notes and, if so, to what extent. The starting point is that language in all legal texts conveys meaning according to the circumstances in which it was used. It follows that the context must always be identified and considered before the process of construction or during it. It is therefore wrong to say that the court may only resort to evidence of the contextual scene when an ambiguity has arisen…. Insofar as the Explanatory Notes cast light on the objective setting or contextual scene of the statute, and the mischief at which it is aimed, such materials are therefore always admissible aids to construction. They may be admitted for what logical value they have..."

62. He added, at [6]:

> "If exceptionally there is found in Explanatory Notes a clear assurance by the executive to Parliament about the meaning of a clause, or the circumstances in which a power will or will not be used, that assurance

> may in principle be admitted against the executive in proceedings in which the executive places a contrary contention before a court. This reflects the actual decision in *Pepper v Hart* [1993] AC 593."

63. In relation to Clause 107 of the 2009 Finance Bill, which became FA09 s 108, the relevant Notes say at [10]:

> "In the Pre-Budget Report of November 2008, a new Business Support Package was announced. As part of this package, it was announced that HMRC would not impose penalties or surcharges for late payments of tax in cases where the taxpayer approached them to discuss payment problems before the penalty or surcharge became due and an agreement to defer payment was reached."

64. The two conditions here referred to are (a) the taxpayer must approach HMRC to discuss payment problems before the penalty or surcharge becomes due and (b) an agreement to defer payment must be reached. The paragraph does not say an agreement to defer payment must be reached before the payment or surcharge became due, as one would expect were that a requirement of the new clause. Such a further condition would be a significant restriction to the operation of the relief, and would be very surprising if it were not referred to in the Notes on Clauses.

65. The next following paragraph of the Notes reiterates that there are only two conditions (emphasis added):

> "This clause is intended to remove liability for penalties and surcharges for late payment of taxes when the taxpayer makes representations to HMRC to pay the tax over an extended period. <u>These representations must be made before the penalty or surcharge becomes due and an agreement to pay over time must be reached</u>."

66. The Notes therefore reflect our own reading of s 108, namely that there are two conditions for the relief, first that the request must be made by the trader before the due date, and second, that HMRC must agree to the request. There is no requirement that HMRC's agreement to the request precede the due date.

67. It follows that, where, as here, a request is made before the due date and accepted by HMRC after the due date, a surcharge cannot be levied unless the trader breaks the agreement. That did not happen on the facts of this case: the company complied in full.

68. Ms Powell relied in particular on the heading to s 108, which reads "Suspension of penalties during currency of agreement for deferred payment." She submitted that this meant that the surcharge could only be suspended if there was an agreement which was current, ie in force. Read together with s 103(2)(b), she said that a "deferral period" must exist on the due date to prevent the surcharge being triggered.

69. We accept, of course, that the heading is relevant. In *R v Montila* [2004] UKHL 50 at [34], the Appellate Committee of the House of Lords said:

> "The question then is whether headings and sidenotes, although unamendable, can be considered in construing a provision in an Act of Parliament. Account must, of course, be taken of the fact that these components were included in the Bill not for debate but for ease of reference. This indicates that less weight can be attached to them than to the parts of the Act that are open for consideration and debate in Parliament. But it is another matter to be required by a rule of law to disregard them altogether. One cannot ignore the fact that the headings and sidenotes are included on the face of the Bill throughout its passage through the legislature. They are there for guidance. They provide the context for an examination of those parts of the Bill that are open for debate. Subject, of course, to the fact that they are unamendable, they ought to be open to consideration as part of the enactment when it reaches the statute book.

70. The judgment continued at [36] by saying that headings and sidenotes are "as much part of the contextual scene" as Explanatory Notes and "there is no logical reason why they should be treated differently."

71. We do not, however, agree that the headnote should be read in the way put forward by HMRC. First, that reading conflicts with the express words of the section, which contains only two conditions: the trader's request and HMRC's agreement. Second, it also conflicts with the Explanatory Notes. Third, an alternative reading of the heading is consistent with both the statutory words and the Explanatory Notes, as we explain below.

72. We start with s 108(1)(c), which states that one of the conditions for the relief applying is if "an officer of Revenue and Customs agrees that payment of that amount may be deferred for a period ('the deferral period')." That subsection therefore defines the term "the deferral period" as being the period throughout which the HMRC officer has agreed that payment of the VAT may be deferred.

73. The heading refers to the "agreement for deferred payment" and, following s 108(1)(c), that must be the period for which deferral has been agreed. Since TTP agreements defer a person's obligation to pay a sum which is either about to become due, or has become due, the deferral period begins from the due date for that payment. A TTP agreement is therefore either prospectively effective (if made before the due date), or retrospectively effective (if made after the due date). In either case, the "currency of the agreement" runs from the due date for payment of the VAT, because the agreement to defer payment is effective from that date.

74. As a matter of general law, there is nothing odd or unusual about an agreement being effective from an earlier date. For example, in *Northern & Shell plc v John Laing Construction* [2003] EWCA Civ 1035, Nelson J, giving the leading judgment with which Hale LJJ and Judge LJJ both concurred, said at [51] "Whether or not a clause in a contract is capable of having a retrospective effect, depends upon the express or implied intention of the parties."

75. Properly understood, the heading is therefore consistent with both the statutory wording and the Notes on Clauses.

76. Thus, although the company's TTP agreement was not concluded until after the due date, once agreement was reached, it was effective from that date, because the VAT was deferred from that date.

77. Of course, although all or almost all TTP agreements are effective from the due date, because they defer payment of a liability from that date, many will not benefit from s 108. It is only where the trader has made its request before the due date that he can benefit from the suspension and possible cancellation provided for by that section.

Decision on Issue 1

78. We therefore find that the company's appeal succeeds on Issue 1, because:

(1) it requested the TTP agreement before the due date;

(2) HMRC agreed to the TTP; and

(3) the company did not break the terms of the TTP agreement.

79. As a result, the company satisfied the conditions in FA09, s 108.

80. Issues 2 and 3 are relevant only if the company failed on Issue 1. However, because those Issues were fully argued and in case this appeal goes further, we have considered both below.

Issue 2: reasonable excuse

81. We begin by making further findings of fact, none of which were in dispute.

Findings of fact

82. The company's income is mostly derived from the stabling, training and sale of horses. Smaller sums are received in prize money.

83. In the 04/15 period, the company received income of £1,376,983; an additional £532,072 was received in the seven days between the end of the quarter and the due date.

84. The company had around 70 clients, the largest of which was responsible for around 15% of the company's turnover, and the next largest around 12%. Payment terms were 30 days and Mr Atkinson said that "on the whole we are paid okay" with around two-thirds of debts being settled on or before the end of the 30 day period.

85. As at the due date for paying the 04/15 VAT, the company had four debts which were significantly overdue. These totalled £143,745 and one debt accounted for around half of this sum. Mr Atkinson said that debts were not factored because it did not have much difficulty collecting amounts owed, and also because it was important that the company maintained a personal relationship with its clients.

86. The company's net assets were around £0.5m. It had tried to obtain further funding from its bank, in addition to the restructured loan and the mortgage, but had been refused. The company had also considered changing banks, but decided against this because it had a long-standing relationship with its current bank and because it might be difficult to transfer the restructured debt. No attempt was made to borrow money from other sources.

87. The directors had not injected any funds into the company because they had few liquid assets. However, no attempt was made to raise money on the security of the company shares or any other assets owned personally by the directors.

88. In the period from 1 May 2015 to 7 June 2015 the company made the following regular payments:

(1) Instalments of the bank loan of £8,433 pcm, plus further payments of £10,102 pcm, for the mortgage on part of the company's property.

(2) The weekly wages of the employees, and contributions to their pension fund.

(3) Rent for the accommodation occupied by the stable lads who worked for the company. This was paid to unconnected third party landlords.

(4) The council tax and utilities relating to that accommodation, along with Sky TV subscriptions.

(5) The directors' weekly salary, and contributions of £4,166.66 pcm to their pension fund. Mr Atkinson said that although the directors were trustees, the pension fund also had a corporate trustee, which had advised that contributions be made regularly because the pension fund should "be treated like a third party organisation."

(6) Payments of £9,000 pcm to the vet. The company was around 5-6 months in arrears with its veterinary bills, and the vet had threatened to stop attending the horses if regular payments were not made to meet the accumulated arrears.

(7) Payments of £6,801pcm to the supplier of bedding for the horses. The company had also accumulated debts to this supplier; those debts had been factored to a financial institution which was vigorously enforcing payment.

(8) Payments of £2,000 pcm to the company's auditors, who were owed money for work already carried out.

(9) Hire purchase payments for equipment.

(10) American Express and corporate charge card payments to settle the monthly balances due.

89. The company's outgoings over the month ending 7 June 2015 also included the following:

(1) A payment of £37,800 to Tattersalls, the auctioneer, for the purchase of yearlings. Mr Atkinson said that the company bought 60-70 horses per annum,

with the expectation that most would be on-sold to clients, but some horses remained company assets.

(2) Payments to HMRC of corporation tax (£25,833) and PAYE (£38,698).

(3) Payments to suppliers of hay and feed, around £12,000.

Submissions made by Mr Atkinson on reasonable excuse

90. Mr Atkinson said that the company's income streams were "volatile and unpredictable" but many of its outgoings were fixed, and timing differences between income and expenditure could cause difficulties.

91. He submitted that the company "had explored every avenue to obtain the relevant finance to meet its VAT obligations" but without success. It also had other financial commitments. In particular, the bank would foreclose on the secured loan if the company failed to pay the agreed monthly amounts, and this would mean the end of the business.

92. The company also had to keep within its overdraft. By close of play on 5 June 2015 there was less than £50,000 of headroom in that facility; if the company had paid the VAT due of £162,983 in full and on time, it would have been over £100,000 overdrawn. The bank would then have taken legal action to close down the business.

93. The company also needed to pay its staff, or they would "walk down the road" to another stables, and again the business would cease. Key suppliers had to be paid on a regular basis, particularly the vet and the supplier of horse bedding, as the company had come to agreements with them to pay off the overdue amounts on a regular basis. A refusal by the vet to attend to the horses risked serious damage to the business.

94. In response to questions from Ms Powell and the Tribunal, Mr Atkinson said:

(1) no consideration had been given to deferring the directors' salary or pension payments;

(2) he had not asked Tattersalls if payment for the yearlings could be delayed;

(3) he didn't know what would happen if the company failed to pay the Amex and/or charge cards by their due dates;

(4) he had not asked the auditors, or other suppliers to whom fixed monthly payments were being made, whether these could be further deferred; and

(5) it would have been possible to make a part-payment of the VAT without exceeding the overdraft limit.

Submissions of Ms Powell on reasonable excuse

95. Ms Powell said that VATA s 71(2)(a) provides that an "insufficiency of funds" is not a reasonable excuse for failing to pay VAT by the due date. Although in *C&E Commrs v Steptoe* [1992] STC 757 ("*Steptoe*"), the Court of Appeal had held that the cause of that insufficiency might constitute such an excuse, the facts of this case fell outside that exception. The company had not treated its VAT as a priority and

had instead decided to use the VAT paid to it by its clients to fund its own business requirements, including paying its staff, directors and suppliers.

Discussion and decision on reasonable excuse

96. We agree with Ms Powell that the starting point is VATA s 71(2)(a), so an insufficiency of funds is not a reasonable excuse. However, as she accepts, in *Steptoe* the Court of Appeal (Lord Donaldson MR, Nolan and Scott LJJ) found unanimously that the cause of the insufficiency may provide such an excuse.

97. At page 770 of the judgment, Lord Donaldson MR agreed with Nolan J that the cause of an insufficiency might constitute a reasonable excuse if:

> "… 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…"

98. He went on to say that such an excuse "will be exhausted by the date on which such foresight, diligence and regard would have overcome the insufficiency of funds" and added that "it is more difficult to escape from the unforeseeable than from the foreseeable."

99. On the facts of this case, the company had been facing economic difficulties for at least a year, and almost certainly longer – the first default was for the period ending 31 October 2012, so the shortage of funds on 6 June 2015 was reasonably foreseeable.

100. We do not accept Mr Atkinson's submission that the company "had explored every avenue to obtain the relevant finance to meet its VAT obligations." It had not sought any further loans from financial institutions other than its own bank, even though the company had £0.5m of net assets. It had not asked the directors to borrow money on their own account, and loan that money to the company. No consideration was given to factoring even some of its debts. There was no exploration of what would happen if the Amex and charge card payments were not made on the due date. Payments of salary to the directors continued, as did contributions to their pension fund. No renegotiation of the regular payments to other suppliers was considered. No thought was given to delaying the £37,800 payment to Tattersalls. That sum alone, together with the £50,000 of headroom in the company's bank overdraft, would have met half the VAT liability.

101. The burden is on the company to demonstrate that it had a reasonable excuse, and the points set out in the previous paragraph are sufficient for us to find that it has failed to show that, with reasonable foresight and due diligence and a proper regard for the fact that the VAT would become due on 7 June 2015, it would have been unable to pay its liability.

102. No other reasonable excuse was put forward by Mr Atkinson, and we find that the company would not have succeeded on Issue 2.

Issue 3: proportionality

The parties' submissions

103. Mr Atkinson submitted that the surcharge of £24,447.45 is "disproportionately large and punitive, being 15% of our April 2015 liability." He suggested that 2% or £3,259 would be "more equitable."

104. Ms Powell relied on *HMRC v Trinity Mirror plc* [2015] UKUT 0421 (TCC) ("*Trinity Mirror*"), a decision of Rose J and Judge Berner. That judgment frequently cites *HMRC v Total Technology (Engineering) Ltd* [2012] UKUT 418 (TCC) ("*Total Technology*"), a decision of Warren J and Judge Bishopp.

105. The issue in both *Trinity Mirror* and *Total Technology* was whether a default surcharge was disproportionate. Ms Powell relied in particular on the two following paragraphs from *Trinity Mirror*:

> "65. We agree with the tribunal in *Total Technology* that the default surcharge regime, viewed as a whole, is a rational scheme. The penalties are financial penalties, calculated by reference to the amount of tax unpaid at the due date. Although penalties may vary with the liability of the taxable person for the relevant VAT period, and increase commensurately with an increase in such liability (and, consequently, such default), the penalties are not entirely open-ended. The maximum liability for a fifth or subsequent period of default is 15% of the amount unpaid. In common with the Upper Tribunal in *Total Technology*, we consider that the use of the amount unpaid as the objective factor by which the amount of the surcharge varies is not a flaw in the system; to the contrary, the achievement of the aim of fiscal neutrality depends on the timely payment of the amount due, and that criterion is therefore an appropriate, if not the most appropriate, factor.
>
> 66. However, we accept that, applying the tests we have described, the absence of any financial limit on the level of surcharge may result in an individual case in a penalty that might be considered disproportionate. In our judgment, given the structure of the default surcharge regime, including those features described in *Total Technology*, this is likely to occur only in a wholly exceptional case, dependent upon its own particular circumstances. Although the absence of a maximum penalty means that the possibility of a proper challenge on the basis of proportionality cannot be ruled out, we cannot ourselves readily identify common characteristics of a case where such a challenge to a default surcharge would be likely to succeed."

106. Ms Powell said that Mr Atkinson's submissions were in effect complaints about the structure of the surcharge itself. The default surcharge provisions had been designed by Parliament and found to be proportionate by the Upper Tribunal in both *Total Technology* and *Trinity Mirror,* as was clear from the above cited extract.

107. Although in *Trinity Mirror* the Upper Tribunal had said that there might be a "wholly exceptional case" where the imposition of the surcharge was disproportionate, this was not such a case. Instead the company had been subject to

default surcharges in the past, was familiar with the rules, and had not put forward anything unusual about its facts, so as to bring it within such an exception.

Discussion and decision

108. The proportionality of the default surcharge regime as whole, and its application to particular cases, has been frequently revisited by this Tribunal in the light of *Total Technology* and more recently *Trinity Mirror*. For example, *Blue Ocean Associates v HMRC* [2016] UKFTT 042 (TC) (Judge Beare and Mrs O'Neill) at [25] contains a helpful summary of the principles set out in those two judgments.

109. We agree with Ms Powell that by challenging the imposition of a 15% penalty, and suggesting that 2% would be more "equitable," Mr Atkinson is, in terms, questioning the proportionality of the default surcharge scheme as a whole.

110. As Ms Powell said, the Upper Tribunal in *Trinity Mirror* at [65] "agree[d] with the tribunal in *Total Technology* [that] the default surcharge regime, viewed as a whole, is a rational scheme."

111. In *Total Technology* at [83]-[98] the Upper Tribunal carried out a detailed analysis of the default surcharge regime, and then continued:

> "99. In our judgment, there is nothing in the VAT default surcharge which leads us to the conclusion that its architecture is fatally flawed. There are, however, some aspects of it which may lead to the conclusion that, on the facts of a particular case, the penalty is disproportionate. But in assessing whether the penalty in any particular case is disproportionate, the tribunal must be astute not to substitute its own view of what is fair for the penalty which Parliament has imposed. It is right that the tribunal should show the greatest deference to the will of Parliament when considering a penalty regime just as it does in relation to legislation in the fields of social and economic policy which impact upon an individual's Convention rights. The freedom which Parliament has in establishing the appropriate penalties is not, we think, necessarily exactly the same as the freedom which it has in accordance with its margin of appreciation in relation to Convention rights (and even there, as we have explained, the margin of appreciation will vary depending on the right engaged).
>
> 100. Our conclusion, therefore, is that with the possible omission of an upper limit on the penalty which may be imposed, the regime viewed as a whole does not suffer from any flaw which renders it non-compliant with the principle of proportionality in the sense that it, or some aspect of it, falls to be struck down."

112. The judgments in *Trinity Mirror* and *Total Technology* both found that the structure of the default surcharge regime is proportionate. To the extent, therefore, that Mr Atkinson is challenging the scheme as a whole, he cannot succeed.

113. Ms Powell also said that there is nothing in the "particular circumstances" of this case which would make it "wholly exceptional," and we agree. Mr Atkinson has not identified any such "particular circumstances."

114. We conclude that if the surcharge were to have been due, its quantum would not have been disproportionate.

Decision and appeal rights

115. The company succeeded on Issue 1. We allow its appeal and set aside the surcharge.

116. Had the company's case depended only on Issues 2 and/or 3, we would have dismissed its appeal.

117. 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 REDSTON
TRIBUNAL JUDGE

RELEASE DATE: 16 JUNE 2016

THE LEGISLATION

VATA s 59 Default Surcharge

(1) Subject to subsection (1A) below 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.

(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.

VATA s 71 Construction of sections 59 to 70

(2) For the purposes of any provision of sections 59 to 70 which refers to a reasonable excuse for any conduct—

(a) an insufficiency of funds to pay any VAT due is not reasonable excuse; and

(b) where reliance is place on any other person to perform any task, neither the fact of that reliance nor any dilatoriness or inaccuracy on the part of the person relied upon is a reasonable excuse.

(3) …..

VATA s 83 Appeals

(1) Subject to s83G and 84, an appeal shall lie to the Tribunal with respect to any of the following matters—

…

(n) any liability to a penalty or surcharge by virtue of any of the sections 59 to 69B.

Finance Act 2009 s 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,
(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
(a) the penalty falls within the Table, 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.

(3) But if –
(a) P breaks the agreement (see subsection (4)), and
(b) an officer of Revenue and Customs serves on P a notice specifying any penalty to which P would become liable apart from subsection (2),
P becomes liable, at the date of the notice, to that penalty.

(4) P breaks an agreement if –
(a) P fails to pay the amount of tax in question when the deferral period ends, or
(b) the deferral is subject to P complying with a condition (including a condition that part of the amount be paid during the deferral period) and P fails to comply with it.

(5) The taxes and penalties referred to in subsections (1) and (2) are:

Tax	Penalty
Value Added Tax	Surcharge under s 59(4) …of VATA
…	

VAT Regulations 1995

25 Making of returns

(1) Every person who is registered or was or is required to be registered shall, in respect of every period of a quarter or in the case of a person who is registered, every period of 3 months ending on the dates notified either in the certificate of registration issued to him or otherwise, not later than the last day of the month next following the end of the period to which it relates, make to the Controller a return in the manner prescribed in

regulation 25A showing the amount of VAT payable by or to him and containing full information in respect of the other matters specified in the form and a declaration, signed by that person or by a person authorised to sign on that person's behalf, that the return is correct and complete;…

25A

...

(20) Additional time is allowed to make

(a) a return using an electronic return system or a paper return system for which any related payment is made solely by means of electronic communications (see regulation 25(1)time for making return, and regulations 40(2) to 40(4)payment of VAT), or

(b) a return using an electronic return system for which no payment is required to be made.

That additional time is only as the Commissioners may allow in a specific or general direction, and such a direction may allow different times for different means of payment.

The Commissioners need not give a direction pursuant to this paragraph.

40 VAT to be accounted for on returns and payment of VAT

(1) …

(2) Any person required to make a return shall pay to the Controller such amount of VAT as is payable by him in respect of the period to which the return relates not later than the last day on which he is required to make that return.

(2A) Where a return is made or is required to be made in accordance with regulations 25 and 25A above using an electronic return system, the relevant payment to the Controller required by paragraph (2) above shall be made solely by means of electronic communications that are acceptable to the Commissioners for this purpose.

(3) The requirements of paragraphs (1) or (2) above shall not apply where the Commissioners allow or direct otherwise.

(4) A direction under paragraph (3) may in particular allow additional time for a payment mentioned in paragraph (2) that is made by means of electronic communications.
The direction may allow different times for different means of payment.

(5) Later payment so allowed does not of itself constitute a default for the purposes of section 59 of the Act (default surcharge).