[2017] UKFTT 413 (TC)

TC05877

Appeal number: TC/2016/03451

VAT – default surcharge – whether HMRC at fault for inhibiting the appellant's VAT account – whether request to offset CIS credit against VAT liability relevant – whether sudden change of payment terms by main customer amounts to a reasonable excuse – whether shortage of funds foreseeable and reasonably unavoidable* – Steptoe and Clean Car *applied* – *appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

DM SPECIALIST JOINERY LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE HEIDI POON
MR IAN SHEARER

Sitting in public at Tribunal Centre, Eagle Building, 215 Bothwell Street, Glasgow on 16 January 2017

Mr Ryan Maguire of R.A.M. Tax Practitioners, for the Appellant

Mr Mark Boyle, Presenting Officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. The appellant, DM Specialist Joinery Ltd, appealed against two default surcharge notices, in the sum of £8,898.72 at 10% surcharge rate for VAT period 02/15, and in the sum of £8,257.88 at 15% surcharge rate for period 05/15. The surcharges under appeal total £17,156.60.

2. Mr Daniel Miller, Managing Director of the appellant, gave evidence and was cross-examined by Mr Boyle. Mr Maguire, agent of the appellant, made representations on behalf of the appellant. We accept Mr Miller's evidence without qualification.

3. The principal issue for the Tribunal to determine is whether the appellant had a reasonable excuse under s 59 of the Value Added Tax Act 1994 ('VATA') for making the VAT payments late for either or both of the said periods.

The Law

4. The Tribunal is provided with a bundle of legislation and authorities in relation to the default surcharge regime. The legislation includes sections 59 (on default surcharge), 70-71 (on mitigation of penalties and on interpretation of reasonable excuse), 83 (on appeal), of the VATA 1994 ('VATA'), and regulations 25, 25A and 40 of VAT Regulations 1995 on accounting, payment and returns, and s 108 of the Finance Act 2009 ('FA 2009') on suspension of penalties during currency of agreement for deferred payment.

5. The provisions for the default surcharge regime are under s 59 of VATA. Of direct relevance to this appeal is sub-s 59(1)(b) VATA, which states that a taxable person shall be regarded as being in default in respect of a prescribed accounting period if, by the statutory due date, the Commissioners 'have not received the amount of VAT shown on the return as payable by him in respect of that period'.

6. By virtue of s 59(7), a taxable person is not liable to the surcharge if he '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, …'.

7. Section 108 FA 2009, provides for the suspension of penalties during the currency of an agreement for deferred payment. The section applies if 'P makes a request to an officer of Revenue and Customs that payment of the amount of tax be deferred', and an officer 'agrees that payment of that amount may be deferred for a

period'. In practice, this is commonly referred to as a 'Time-to-Pay' agreement ('TTP').

8. The authorities referred to in this decision are: *Rowland v HMRC* [2006] STC (SCD) 536 ('Rowland'); *The Clean Car Company Ltd v C&E Comrs* [1991] VATTR 234 ('*Clean Car*'); *C G Steel Structures v HMRC* [2014] UKFTT 504 (TC) ('*C G Steel*'); *C&E Comrs v Steptoe* [1992] STC 757 ('*Steptoe*'); *C&E Comrs v Salevon Ltd* [1989] STC 907 ('*Salevon*'); *C&E Comrs v Salevon Ltd* [1989] DTC 907 ('*Salevon*'); *Barrett v HMRC* [2015] UKFTT 329 (TC) ('*Barrett*'); *Electrical Installation Solutions Limited v HMRC* [2013] UKFTT 419 (TC); UKUT 418 (TCC) ('*Electrical Installation'*).

The Facts

Background

9. The appellant is a limited company and registered for VAT on 1 April 2012. The appellant submits VAT returns and makes VAT payments electronically. The appellant accounted for VAT on a cash accounting basis at the relevant periods.

10. The business of the appellant is in joinery installation, and the company operates as a major sub-contractor in construction projects. The mode of operation of the appellant's business renders it heavily reliant on its main contractors.

11. In these construction projects, a project management company is often involved as the 'agent' of the main contractor. The appellant therefore does not contract directly with the end contractor, but with the project management company engaged in the particular construction project. At the material times, the appellant was contracted in two construction projects via a project management company known as Tusk Plant and Civil Engineering Ltd ('Tusk').

12. The end contractor of these two construction projects, of which Tusk functioned as the project manager, was the Scottish and Southern Energy Plc ('SSE'). SSE is a British energy company headquartered in Perth, Scotland, and is listed on the London Stock Exchange as a constituent company of the FTSE 100 Index.

13. The two projects of SSE, project-managed by Tusk, of which the appellant was a contractor involved the installation of External Wall Insulation ('EWI'). One project ('Fallin and Plean') consisted of EWI installation for 120 houses, and another project known as 'Perth Friarton' was for 150 houses in Perth.

14. The appellant, in turn, is the contractor of some 130 sub-contractors under the Construction Industry Scheme ('CIS), whereby the appellant is under a statutory obligation to account for income tax at basic rate on the payments made to the CIS sub-contractors, unless the sub-contractors are entitled to receive the payments gross.

History of defaults and payment settlements

15. The appellant met its VAT payments by a variety of methods, which included Faster Payment System (FPS), Bill Pay, National Direct Debit System (NDDS) and Telephone Payment System (TPS), and Direct Debit arrangement ('DD').

16. The history of defaults and surcharges imposed are as follows:

(1) First default period 11/12, Surcharge Liability Notice (SLN) issued.

(2) Second default period 11/13 at 2%, surcharge of £292 within the *de minimis* limit of £400 and waived.

(3) Third default for 05/14 at 5%, surcharge of £1,251.18 paid.

(4) Fourth default for 02/15 at 10%, surcharge of £8,898.72 under appeal.

(5) Fifth default for 05/15 at 15%, surcharge of £8,257.88 under appeal.

17. For the first default for 11/12, the appellant requested a Time-to-Pay agreement ('TTP') on 11 February 2013 to settle the VAT liability of £9,443.14 by nine direct-debit instalment payments of £1,049 each. The last instalment was paid on 14 October 2013, almost a year after the period end to which it related.

18. For the periods 02/13, 05/13, and 08/13, the appellant did not go into default, but did so again for period 11/13, with the result that the surcharge rolling period was extended by another 12 months.

19. For the second default in relation to 11/13, the VAT liability was £14,711.94 and the appellant requested a TTP on 18 March 2014. The outstanding VAT was settled by a TPS of £2,500 on 18 March 2014, followed by 9 instalments of £1,250 and a balancing payment of £2,211.94 on 17 December 2014 by direct-debit method.

20. For the third default for 05/14, the VAT payment was due on 7 July 2014, and the liability for the period was £25,023.63. No TTP arrangement was entered into for this default and the outstanding VAT was fully met by a FPS payment on 7 August 2014, a month after the due date of payment.

21. The periods 11/12, 11/13 and 02/15 were the three defaults settled with a TTP arrangement. The request for each of these TTP agreements was made after the due date of the related VAT liability, so s 108 FA 2009, on relief for the suspension of penalties during currency of agreement for deferred payment was not in point for any of the defaults, including the period 02/15 under appeal.

22. The five defaults are all in consequence of the VAT payments being late. All VAT returns have been consistently filed on time.

The default in relation to period 02/15

23. For the fourth default in relation to 02/15, the VAT liability was £153,734.65. The payment details for this period are as follows:

(1) On 16 April 2015, £50,000 by FPS;

(2) On 11 May 2015, £60,000 by FPS;

(3) On 29 May 2015, £20,000 by FPS; hence a total of £130,000 was paid towards the liability for 02/15, leaving a balance due of £23,734.65.

(4) At some point, a VAT reconciliation was carried out between the parties. A TTP was agreed on 24 May 2016 (over a year after the liability was due) to settle the residual balance of VAT liability for 02/15.

(5) In May 2016, 4 payments totalling £13,500 by FPS and Bill Pay were made: (i) £3,500 on 13/5; (ii) £5,500 on 23/5; (iii) £2,500 on 23/5; and (iv) £2,000 on 26/5.

(6) On 9 June 2016, a balancing payment of £7,500 by FPS was made.

24. We note the overall payments allocated to period 02/15 total £151,000, which is short of the £153,734.65 stated as the full liability. The details of the VAT reconciliation do not form part of the evidence, and the parties seem to be in agreement of the figures involved and of that the liability for this period as having been fully settled after the reconciliation.

25. The factual matrix surrounding the VAT return for period 02/15 depart to various extents from the norm. To start with, the period 02/15 did not cover a normal quarter but covered the six months from 1 September 2014 to 28 February 2015. The extension of the return period to six months was in consequence of a chain of events triggered by the appellant's change of business address.

26. In August 2014, the appellant notified HMRC on form VAT 484 of its change of VAT registered address to Fitzroy Grove, from its former address at Langlands Road, both addresses being in East Kilbride.

27. By letter dated 3 September 2014, HMRC wrote to the appellant at the agent's business address at Main Street Village, advising that HMRC were 'unable to accept the new information' because 'the advice was not signed'. The letter enclosed another form VAT 484 for completion, and advised the appellant:

> '**The VAT register will remain unchanged until this information is received'** (emphasis in bold original).

28. For some reasons, no immediate action was taken to submit a signed VAT 484 to update the appellant's registration address. Meanwhile, a letter sent by HMRC to the appellant's Langlands Road address was returned to HMRC. It signalled that the appellant was no longer at the registered address, and as a result of the returned post, HMRC placed the appellant's VAT file on 'inhibition'.

29. In consequence of the 'inhibition', the appellant was removed from the agent portal, and when Mr Maguire tried to submit 11/14 VAT return online, he was unable to do so. Mr Maguire contacted VAT Helpline on 7 January 2015 to investigate the matter, and was advised of the inhibition placed on the appellant's file which was instigated by the post returned to HMRC.

30. In respect of making VAT payment for period 11/14, according to Mr Maguire, the appellant's VAT account was also frozen. No VAT payment could be made despite an attempt to pay £64,747.44 due on account at the time.

31. The form VAT 484, when it was eventually furnished to HMRC and duly signed, was dated 7 January 2015, and received by HMRC on 13 January 2015, over 4 months after the September 2014 letter.

32. On 19 January 2015, HMRC updated the appellant's registration details and removed the inhibit signal, which allowed the appellant to submit returns online.

33. The next return due was for the period 02/15, and the return was made to cover also the period from 1 September 2014 to 30 November 2014, making the return period six months long. The total VAT payable for the six-month period was £153,734.65 per the return submitted, which was due for payment by 7 April 2015.

34. The total liability was eventually settled by several payments as detailed at §23, with the first payment of £50,000 being made on 16 April 2015 after the due date and surcharge at 10% of £15,373.46 was imposed.

The default in relation to period 05/15

35. For the fifth default in relation to 05/15, the VAT liability was £55,052.57, which was due on 7 July 2015. The outstanding sum was paid in full within two weeks after the due date on 20 July 2015 by a FPS Payment.

36. On 14 May 2015, Mr Miller wrote to HMRC to appeal against the surcharge for 02/15 and with the view of requesting a TTP agreement 'in advance' for the 05/15 payment which he knew by then could be late. (The intention of such a request was borne out in his oral evidence though not clearly stated in writing.) The letter reads in full as follows:

> 'I am writing to explain my current position regarding the Company's overdue VAT bill, and to assure you that this will be paid in full as soon as the funds become available to me.
>
> I would also like to appeal against the surcharge [for period 02/12] as this extra payment will be detrimental to the business at this time.
>
> The situation arose when two major clients namely SSE and Tusk Civil Plant Engineering withheld payments and then restructured their terms, without notice, resulting in temporary but serious disruption to my company's cash flow.
>
> This was done without any consultation or forewarning and has resulted in this worrying delay in settling my account.
>
> I do not have any other business concerns, and feel that I have a genuine and unavoidable reason for this late payment.
>
> I am therefor [sic] in a position to make this promise to pay.

> I hope that this information will enable you to allow me some grace to rectify the situation.'

37. By letter dated 2 June 2015, Mr Maguire wrote to HMRC PAYE Employers Office at Longbenton under the appellant's PAYE and CIS references. The letter stated that after the submitted P35, Employer Payment Summary ('EPS') and CIS 300 monthly returns, the appellant had overpaid by £34,488.63 for the year ended 5 April 2015. The letter gave instructions as how the overpayment should be allocated:

> 'After discussions with the client the entity has indicated the desire for the credit to be offset against the following liability, at your earliest convenience, with the remaining balance being offset against our client's VAT account:
>
> **Corporation Tax: £17,143.20 UTR Ref: [of the appellant]**
>
> **Vat [sic] Liability: £17,345.43 Ref Nos: [of the appellant]**' (emphasis original)

HMRC did not formally respond to this request until 8 September, when part of the CIS credit was offset against the Corporation Tax liability, and the balance was repaid to the appellant instead of being used against any outstanding VAT liability.

38. Included in the documents bundle was a copy extract from the appellant's bank statement showing a 'Returned DD' on 10 July 2015. The sum of direct debit applied for to meet the VAT liability for 05/15 was £55,052.57, which reduced the bank balance to a deficit of £32,091.06. The funds held in the account would have been £22,961.51 in credit before the direct debit payment.

39. On 10 July 2015 at 10.16am, a sum of £27,868.33 from Tusk was credited to the appellant's account by Faster Payment, which reduced the deficit to £4,222.73. With the direct debit payment being 'returned' on the same day, the balance then increased to £50,829.84 in credit.

40. On 20 July 2015, the full liability of £55,052.57 was settled by a Bill Payment (ie online payment made by debit or credit card via external website). The page of bank statement shows funds as high as £104,857.15 on 17 July 2015, which indicates a net inflow of funds in the order of £54,027 between 10 July and 17 July after the direct debit was returned.

Appellant's request for review

41. On 30 July 2015, Mr Maguire sent a letter to HMRC Debt Management at Elgin House, Edinburgh. The contents of the letter included: (1) reference to Mr Miller's letter of 14 May 2015, and highlighted the cash flow difficulties faced by the appellant due to the shortfall in remittance from Tusk which 'resulted in the failure of the direct debit payment'; (2) the CIS credit 'for which we have since requested that the balance be offset against the existing Vat liability … [leaving] a balance owed to HMRC of £6,408.99 for VAT before any Vat penalties are applied'; (3) that the appellant was 'placed in a difficult but ... increasingly common situation where they find themselves unable to extract the revenue promised from a bigger more powerful

contractor'. This letter requested a review of 'the extremely large penalties from HMRC for non-compliance'. The request was not actioned because it was sent to Debt Management instead of the Appeals and Review department in Newcastle.

42. Before the appellant's request for review could reach the right department, it made another detour to HMRC's Euston office in London. The Euston office address as the correct destination for the review request was given by Debt Management. So, on 11 November 2015, Mr Maguire wrote to HMRC's 'Surcharge Appeals' at 286 Euston North, London, referring to the original appeal correspondence dated 30 July 2015. The letter stated the following reasons in support of the review:

> (1) That 'despite the relevant Vat 484 being submitted by our practise [sic] to update the record', the client was unable to pay the £64,747.44 due on account; that HMRC had advised that 'the client had no alternative other than to pay the full balance via a six month return and send in another updated Vat 484'.
>
> (2) That at the time of 02/15 and 05/15 return, the client was having difficulty obtaining payment form Tusk and SSE, and highlighting that 'the May return was settled 13 days after it was due'.
>
> (3) That the client was in credit with its PAYE account of £34,488.63, and 'had asked for the balance of £17,343.68 after settling all outstanding corporation tax liability due to be offset against the outstanding VAT liability of the 28/2/2015. This should [be] there for been [sic] credited to the clients [sic] VAT account reducing the liability to £6,408.99.' (Mr Maguire was referring to the residual balance still outstanding for 02/15 of £23,734.65, which was eventually settled in May and June of 2016.)

43. Further delay was caused by having sent the review request in November 2015 to HMRC's Euston office. Finally, by letter dated 5 May 2016 to the 'Default Surcharge Appeals Team' at VAT Department 200, SO483, Newcastle (NE98 1ZZ) the request reached the correct department.

44. Two separate letters were sent on 5 May 2016. The first one (p67 of bundle) requested a review for a surcharge of £878.01 for 02/16, and the second one (p74 of bundle) was in relation to the periods 02/15 and 05/15.

HMRC's review

45. By letter dated 27 May 2016, HMRC's review decision cancelled the surcharge for 02/16, which is therefore not a subject of this appeal.

46. The review decision upheld the surcharges for 02/15 and 05/15. The review officer stated as reasons for upholding the surcharges the following:

> 'Your representative states the business were [sic] in difficulty obtaining payment from clients which is often the case. However, we do not appear to have been advised there would be any problems meeting your tax liability at the time for these VAT periods. Time to pay should be requested prior to the due date of each VAT period.'

The appellant's hardship application

47. On 22 June 2016, Mr Maguire wrote on behalf of the appellant to the Default Surcharge Appeals Team in reply to the review letter of 27 May 2016. The purpose of the letter is to make a hardship application:

> 'This letter is a direct application for hardship to allow the company above to proceed with the tribunal request. The company at present is not in a position to pay of [sic] in full the £23,631.34 in surcharges which falls [sic] under the indirect tax appeal section the principle [sic] reason for this is it has recently paid the following paymens to HMRC for the capital vat arrears … [listing payments at §23(5) and (6) above].

The Appellant's Grounds of Appeal

48. By notice dated 21 June 2016, the appellant appealed to the Tribunal. The grounds of appeal are as follows, and would seem to be drafted by Mr Maguire:

> '(1) Initial liability caused by HMRC's refusal to take payment because a letter had been returned from clients [sic] address. This had been updated via VAT 484 form but had not been captured by HMRC. The client expressed desire to pay liability at the time. However HMRC refused payment and insisted on 6 month return. This conversation would have been taped at the time.
>
> (2) Included in our schedule of paperwork is a returned D/D on 10/07/2015 on the same day Tusk make a short payment of £27,868.33. Should have been £43,000 this caused further penalty. The full balance was paid on the 20/07/2015 at our earliest opportunity. We did not get any notice from Tusk regarding short payment so therefor [sic] could not alert VAT that payment would not be forthcoming.
>
> (3) There was correspondence sent to HMRC 02/06/2015 requesting CIS overpayment was offset against C/Tax then to VAT for a payment of £17,345.43. HMRC have never actioned our request, for VAT payment despite settling corp'n tax liability.
>
> (4) We were advised by ... Debt Mgt to send our appeals to … Euston Road, London which we dually [*sic* duly] complied with. We have never to date received any correspondence back from that address. We were then given a correct address at Newcastle and Plymouth some time later all adding to the long time frame for seeking appeals against both penalty surcharges.'

HMRC's Revision Letter

49. In HMRC's Statement of Case dated 19 August 2016, Mr Boyle stated at [19] that the inhibit signal placed on the appellant's file, 'whilst preventing the submission of a return, does not prevent any payment being made to the Respondents'.

50. By letter dated 13 September 2016, Mr Boyle wrote to the appellant to reduce the total 10% surcharge imposed for period 02/15 to £8,898.72. The amendment followed after Mr Boyle had listened to the recorded telephone conversation, which confirmed that that the appellant had attempted to make a payment of £64,747.44 'prior to the due date'. (The letter does not state the actual date of the telephone conversation.) The surcharge was consequently reduced by £6,474.74, being 10% of the amount of attempted payment, leaving £8,898.72 standing.

Appellant's Oral Evidence

51. In evidence, Mr Miller informed the Tribunal that from 14 March 2015, 'without any warning', Tusk changed the payment terms. Prior to the change, the arrangement was that the appellant was to submit fortnightly valuation to Tusk, to be paid in 28 days. Mr Miller testified that 'for a full year [prior to the change], every payment was fine'.

52. The new payment terms doubled the valuation period from 14 days to 28 days, but the settlement period remained as 28 days. In evidence, Mr Miller stated that the change in payment terms was 'without notice', and the company's cash flow was 'thrown out of alignment', with income taking longer to reach the appellant's account while the CIS sub-contractors continued to be paid at fortnightly intervals. Mr Miller spoke of the CIS sub-contractors as having mortgages and bills to pay, and that there would be 'social knock-on effects' if the appellant were to discontinue the fortnightly payment terms with the CIS sub-contractors.

53. The Tribunal tried to ascertain the contractual arrangements between SSE, Tusk and the appellant. In evidence, Mr Miller gave more details about the 'EWI' projects, in which SSE would give operational directions, and supplied all materials. The two EWI projects were both for existing dwellings of 'solid wall houses'; the appellant supplied labour of all trades for the purpose of installing external wall insulation on to these existing houses.

54. Mr Miller also confirmed that the two projects represented 100% of the appellant's business for most of the time during the currency of the contracts.

55. By March 2015, the projects had been running for about 15 months and nearing their ends. Mr Miller described the payment arrangements for the 15 months as 'back-to-back' whereby the appellant would submit valuations to Tusk fortnightly for Tusk to invoice SSE, and the appellant would then be paid on a valuation in 28 days after its submission. The valuation interval had therefore been fortnightly from the start of the contracts, with settlement in 28 days.

56. According to Mr Miller, such 'back-to-back' arrangements had been the mode of operation for 15 months until a new senior decision-maker joined the SEE operations team, 'when things completely changed' and the changes 'came without warning'. The change came in 'the middle of March', which Mr Miller stated as 14 March 2015 when the Tribunal asked if he could be more exact with the timing. The fundamental change was that SSE changed its payment terms with Tusk, from 14 days

to 28 days. This change of payment terms by SSE to Tusk in turn caused Tusk to change the 'back-to-back' arrangements with the appellant. Instead of submitting valuations at 14-day intervals for invoicing, the appellant was to submit valuations at 28-day intervals.

57. Referring to the March 2015 valuation, Mr Miller informed the Tribunal that in the early part of that year, rough-casting was being undertaken at a rate of 6,000 metres per month, and the valuation was sent in to Tusk on or around 1 March for approximately £250,000. In consequence of the changes in payment terms, the appellant was therefore not able to submit a further valuation to Tusk until the end of March, which was for a smaller sum, as the work was by then beginning to tail off. After the early March invoice was submitted, the £250,000 was not in fact settled within 28 days. The payment was made by instalments over a period of time. The appellant was only paid 'what Tusk could afford', according to Mr Miller. He explained that Tusk eventually went into administration in the autumn of 2016.

58. Mr Miller stated that it was 'the first time Tusk paid in instalments', and that around 92% of the appellant's business was with Tusk at that time, with other small jobs going on in parallel. He further mentioned that a payment by instalment of £46,000 was expected from Tusk around the time when 05/15 payment was due to HMRC (although we note that in the grounds for appeal this expected figure was stated to be £43,000), but it was short; that the appellant did not receive one isolated payment but several payments; that Tusk had been making short payments 'without due warning'; that the management had 'no idea how much [the payment] would have been short by'; that it all depended on what SSE was paying Tusk, for Tusk to pay the appellant; that it happened a lot with these big companies, taking 28 days to 90 days to pay its suppliers; and that no formal structure was in place for enforcing payment against SSE. Mr Miller added that if his company had attempted to withdraw from the contract, SSE would not have continued to pay Tusk, and then Tusk would not have paid the appellant the outstanding sums which were due.

59. By May 2015, the appellant was experiencing serious pressure on its cash flow. By mid-May, Mr Miller realised that the appellant might not be able to meet its VAT payment for 05/15, and tried to arrange a TTP agreement with HMRC. He did not know when Tusk would pay the appellant. Mr Maguire was on holiday, and was not available to be asked as regards the appropriate action to take to deal with the cash flow difficulties. With the help of his father-in-law, Mr Miller told the Tribunal that he 'wrote a letter [to HMRC] in advance to cover the event', and the letter was sent by special delivery for receipt. Mr Miller said he was trying to 'pre-empt the situation', and he thought a TTP was 'agreed' with the officer with whom he usually dealt, a Mr Redmond.

60. Mr Maguire added that this was also at a time when the existing VAT reconciliation with HMRC 'was not clear'. Questioned by the Tribunal on why he had not secured a TTP more robustly, he said that he never negotiated TTP arrangements for clients, that it was always the clients who did this, and that Mr Miller would usually speak to Mr Redmond directly.

HMRC's Submissions

61. The onus is on HMRC to demonstrate that the surcharges are imposable due to the VAT payments being late. The appellant does not dispute the payments were made after their respective due dates. HMRC submit that the onus has been discharged in this respect. The onus is then on the appellant to establish it had a reasonable excuse for the late payments.

62. HMRC further submit that the form V484 was received and acknowledged, but because 'it was unsigned, the information contained therein was unacceptable', and by letter dated 3 September 2014, the appellant was advised to re-submit a signed V484 for HMRC to action the change of address.

63. HMRC contend that the refusal in payment that was referred to in the appellant's grounds of appeal was in respect of a request for TTP made on 20 November 2014, for the period 08/14. HMRC refused the TTP request for 08/14 because the appellant was already in a TTP arrangement to clear their debt for period 11/13.

64. As for the request to pay £64,747.44, HMRC have conceded that such a request was made on checking the telephone conversation recorded, and the surcharge has been accordingly reduced.

65. It is HMRC's position that no TTP agreement was requested for the period 05/15, although the appellant was clearly aware of the provisions for, and importance of, TTP agreements. A clearly-framed TTP request could have been properly notified, and possibly agreed, but was not. Furthermore, a TTP agreement is given as a 'short term solution' to financial or cash flow difficulties; that it 'not reasonable to expect the public purse to support company finances on a long term basis'. It was a 'business decision' by the appellant 'to use the VAT to pay its own sub-contractors'.

66. As regards the shortfall between the expected and actual payment received from Tusk, the shortfall equated to 'only 4.6% of the total output tax' for period 05/15.

67. Section 71(1)(a) of VATA specifically excludes the insufficiency of funds as providing a reasonable excuse for late payment. HMRC contend that the cash flow issues have been ongoing for some time as evidenced by the various TTP requests.

68. In respect of the CIS credit offset, even if this request were accepted to offset the balance of CIS credit against VAT for the period 02/15, it was after the due date and a surcharge would still have been imposable. It would have been imprudent of the taxpayer to rely on any CIS credit to offset VAT liability, given the necessary checks HMRC had to carry out before a CIS credit offset can be approved. The appellant's agent should have been well aware of the time required to process CIS repayments.

69. HMRC can only apologise for the incorrect address given by their Debt Management Unit, to which the original appeal request was made.

70. Finally, HMRC submit that the potential effect that the payment of the surcharges may have on the appellant's finances does not amount to a reasonable excuse for the cancellation of the surcharge for the periods 02/15 and 05/15.

Appellant's Submissions

71. Mr Maguire made representations similar to those stated as the grounds of appeal in the Notice of Appeal. In particular, he reiterated the contents of his letter to Debt Management on 30 July 2015, of the request to offset CIS credit against outstanding VAT liability, and of the shortfall in the remittance from Tusk that caused the failure to collect the 05/15 payment by direct debit. He also referred to the serious and widespread problems of late payments by large main contractors in the construction industry, which he commented had been a recent concern for both Parliament and the UK Government.

Discussion

General observations

72. The course of communications between the parties had been chequered and frustrated, and that of itself has occasioned extra efforts on our part to collate the facts in this appeal. We do not consider all the facts noted in our findings as relevant for the determination of this appeal, but for completeness, we have noted these facts as referred to by the appellant in its grounds of appeal and representations.

73. In terms of approach, the parties have tended to treat the two periods 02/15 and 05/15 as a continuum, and the appellant's grounds of the appeal were presented in a manner that drew little distinction between the facts concerning the two periods. Three letters were sent by the appellant to different departments and addresses of HMRC to request a review, and Mr Maguire had presented the reasons for the request with different emphasis. We have noted these reasons in conjunction with those stated as grounds of appeal in the Notice of Appeal.

74. We should clarify, for the benefit of the appellant, that the application for hardship by letter dated 22 June 2016 to HMRC, and again in the Notice of Appeal, is not relevant in this appeal. Mr Maguire has confused the surcharge with 'the tax in dispute'. In an appeal against indirect tax such as VAT, the tax in dispute has to be deposited before the appeal can proceed, unless hardship is granted. Here, it is the surcharge, and not the VAT liability, that is in dispute. An appeal against a penalty does not require the disputed penalty to be deposited before its progress. There is no need for the Tribunal to address the hardship application.

75. The principal issue for determination in this appeal is whether the appellant had a reasonable excuse for making the VAT payment late for either, or both, of the periods 02/15 and 05/15. The term 'reasonable excuse' is not defined by statute; it is 'a matter to be considered in the light of all the circumstances of the particular case' (*Rowland* at [18]). Whether there was a reasonable excuse is determined by an objective test as set out by Judge Medd in *Clean Car*:

> 'In my judgment it is an objective test in this sense. One must ask oneself: was what the taxpayer did a reasonable thing for a responsible trader conscious of and intending to comply with his obligations regarding tax, but having the experience and other relevant attributes of the taxpayer and placed in the situation that the taxpayer found himself at the relevant time, a reasonable thing to do?'

76. Each period turns on its own facts concerning the existence of a reasonable excuse for the late payment. It is necessary therefore to examine the facts for each period separately, and to draw distinctions between them. While the period 02/15 continued into 05/15, the facts relevant to each period are not the same.

Whether reasonable excuse for the period 02/15

77. The background to the change of business address had resulted in this return period being six months long. Mr Maguire seemed to be making much of the fact that the VAT 484 submitted in August 2014 by his office was not actioned by HMRC as a ground for the late payment of VAT for 02/15. We have considered the implications of this fact, and concluded none of which can amount to a reasonable excuse for the late payment of the liability of £153,734.65.

(1) The submitted form in August 2014 was unsigned and Mr Maguire should have known as a tax practitioner that an unsigned form in this regard does not meet the formality requirements for HMRC to update the registered address on their records.

(2) HMRC's letter of 3 September 2014 stated clearly in bold that '*the VAT register will remain unchanged*' until a signed form of VAT 484 is returned. HMRC acted properly in accordance with their protocol in placing the appellant's VAT records on inhibition when mail to the appellant's address was returned.

(3) The fact that the appellant had not acted timeously to return a signed VAT 484, and only did so on 7 January 2015, was the underlying cause of the chain of events that resulted in the failure to submit the 11/14 return.

(4) The appellant was in no way prejudiced or disadvantaged by having to submit the 02/15 return to cover a longer period. On the contrary, the appellant had gained an unintended cash flow advantage of being able to withhold the VAT liability for 11/14 without any adverse consequences.

(5) The sum of £64,747.44 that Mr Maguire reiterated several times as being refused payment by HMRC has been *deemed* as paid on time for the purpose of calculating the surcharge. The appellant had been given the credit for attempting to pay such sum at the time, notwithstanding the fact that the sum was not actually paid over.

(6) The fact pattern of the eventual settlement of the VAT liability for 02/15 as detailed at §23 suggests some inordinate delay in settling the full liability. The appellant seemed to have allowed the VAT withheld for 11/14 to become part of the working capital. The last payment in settlement of the full liability was in June 2016, over a year after the due

date of 7 April 2015. A prudent taxpayer would have made the requisite arrangement to set aside the VAT liability withheld for 11/14, (and indeed the 3 months subsequent) to enable a timeous payment to be made.

(7) The appellant accounted for its VAT liability on a cash accounting basis, which means that the output VAT had been credited to the appellant's account before it was required to be returned to HMRC. In other words, the appellant only paid as its VAT liability from *a whole month up to four months later* after it had received the output VAT from its customers.

78. The second ground of appeal in relation to this appeal concerns the CIS credit offset against the VAT liability. This ground was given much prominence in Mr Maguire's submissions, and was a ground rehearsed in several of his letters to HMRC with different emphasis.

79. The Tribunal, however, sees no relevance of this fact whatsoever in this appeal. The comments by Judge Connell in *C G Steel* apply equally to this case:

> '… no evidence of a written request for set off prior to the Vat falling due has been provided. Set off cannot be applied unilaterally by a taxpayer in such circumstances. A request for repayment was made by the Appellant's accountants in June 2013 but this was after the first default. A prudent tax person in similar circumstances would have written to HRMC in advance to explain the position and ask for time to pay.'

80. The following facts peculiar to the instant case highlights why this ground of appeal must fail:

(1) The first time the request to offset CIS credit was raised was in the letter dated 2 June 2015.

(2) This was nearly two month after the due date of the VAT liability for 02/15. If the request had indeed extended to VAT liability in June 2015, the VAT payment that was due on 7 April 2015 would still have been late.

(3) The letter of 30 July 2015 was a request for review, and the CIS credit offset was stated as having since been made against the 'existing' VAT liability, leaving a balance due of £6,408.99.

(4) The 'existing' VAT liability was clearly a reference to the residual balance for 02/15 of £23,734.65. The CIS credit was for £34,488.64, and after corporation tax offset of £17,143.20, would leave £17,345.44 against VAT. The difference of £23,734.65 and £17,345.44 is the £6,408.99 referred to by Mr Maguire.

(5) That the offset against VAT did not happen makes no difference to the calculation of the surcharge, which is calculated on *any* of the payment being late, even if it is late by one day only. Whether the VAT offset of £17,345.44 should have happened in June 2015, or was met by the

instalment payments in May 2016, would have no bearing on quantifying the surcharge due for the period.

(6) The offset of £17,345.44 would have represented only around 11% of the full VAT liability for the period of £153,734.65. The 89% of VAT liability would still have been paid late.

(7) Finally, even if there had been a properly notified and timely request for such an offset to be processed by the due date of 7 April 2015, HMRC would have been quite entitled to allocate the £17,345.44 against the *deemed* payment of £64,747.44, leaving the balance of surcharge now sought of £8,898.72 completely intact.

81. The third ground of appeal for the period 02/15 was the generic argument about the cash flow difficulties experienced by the appellant due to the change of payment terms by Tusk. The change took place in March and April of 2015, and the first payment that was affected was the valuation invoice rendered on 1 March 2015. This was after the end of the return period for the six months to 28 February 2015. Since the appellant accounted for VAT on a cash accounting basis, the change of the payment terms could, in no way, be of a relevant factor amounting to a reasonable excuse for this period.

82. The appeal against the surcharge for 02/15 therefore fails on all grounds.

Whether reasonable excuse for period 05/15

83. Section 71(1)(a) specifically precludes an insufficiency of funds from being a reasonable excuse. This statutory exclusion is qualified, to a limited extent, by the authority in *Steptoe*, which establishes the principle that there is a distinction between the direct or proximate cause from the underlying cause for the shortage of funds.

84. In *Steptoe*, the taxpayer was an electrical contractor with 95% of his work being done for a Local Council, which was 'virtually his only customer', and 'an extremely slow payer'. The tribunal of first instance described the council as having 'never paid the amount owing on an invoice less than six weeks after it was delivered and usually it was paid upwards of two months late.'

85. The taxpayer in *Steptoe* was not on cash accounting, and was late in paying his VAT for two periods in a year (11/86 and 08/87) and then continued to be in default for the four successive periods of 11/87, 02/88, 05/88 and 11/88. The payments were late by about two months, and the taxpayer pleaded cash flow difficulties as his reasonable excuse. The Commissioners rejected the grounds for reasonable excuse, but the tribunal allowed the taxpayer's appeal on the grounds of the Council's pattern of paying late. The Commissioners appealed to the High Court, and Kennedy J confirmed the tribunal's decision. The Commissioners' appeal to the Court of Appeal was dismissed by a majority (Lord Donaldson MR and Nolan LJ, Scott LJ dissenting).

86. It is worth highlighting that HMRC's published view that a 'reasonable excuse' is 'an unexpected or unusual event that is either unforeseeable or beyond the

taxpayer's control' would seem to accord more closely with Scott LJ's dissenting judgment in *Steptoe*. The inappropriateness of this formulation has been highlighted in *Barrett* by Judge Berner at [153]:

> '… the view of HMRC that a reasonable excuse must be some circumstance which is both "unforeseen and beyond the control of the taxpayer". That reflects HRMC's own published guidance which is, as this tribunal has pointed out in a number of cases, notably in *Electrical Installation Solutions Ltd v Revenue and Customs Commissioners* [2013] UKFTT 419 (TC), wrongly places reliance on the dissenting judgment of Scott LJ in *Steptoe* … It is inappropriate for HMRC to seek to rely on that formulation as representing the state of the law on reasonable excuse.'

87. The doctrine of precedent means that the dissenting judgment has no precedent value other than as a potentially persuasive authority. It is the reasoning of the majority in *Steptoe* that constitutes the *ratio decidendi* and is binding on this tribunal.

88. The reasoning of the majority in *Steptoe*, according to Lord Donaldson, as regards the legislative intention of the predecessor provision of s 71(1)(a), 'is that insufficiency of funds can never *of itself* constitute a reasonable excuse, but that the cause of that insufficiency, ie the underlying cause of the default, might do so'.

89. That said, Lord Donaldson states that 'there must be limits to what *could* be regarded as a reasonable excuse'. As to what those limits could be, Lord Donaldson agrees with Nolan LJ's reasoning in this respect:

> 'Nolan LJ, as I read his judgment in *Customs and Excise Comrs v Salevon Ltd* [1989] STC 907, is saying that 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, then the taxpayer may well have a reasonable excuse for non-payment, but that excuse will be exhausted by the date on which such foresight, diligence and regard would have overcome the insufficiency of funds.'

90. In contrast, Scott LJ's opinion that the underlying cause of the insufficiency of funds must be an 'unforeseeable or inescapable event' is considered as 'too narrow' by Lord Donaldson for the following reasons:

> '(a) it gives insufficient weight to the concept of reasonableness and (b) it treats foreseeability as relevant in its own right, whereas I think that "foreseeability" or as I would say "reasonable foreseeability" is only relevant in the context of whether the cash flow problem was "inescapable", or as I would say, "reasonably avoidable". It is more difficult to escape from the unforeseeable than from the foreseeable.'

91. According to Lord Donaldson therefore, the appropriate test concerning whether an insufficiency of funds amounts to a reasonable excuse is to examine if the underlying cause of the insufficiency is 'reasonably avoidable'. It is important to distinguish between what is foreseeable from what is avoidable. The foreseeability of the insufficiency has no relevance in its own right, and foreseeability is only relevant

in assessing whether the shortage of funds could have been avoided. Shortly stated, what is unforeseen cannot be avoided; only the foreseeable is avoidable.

92. Following Lord Donaldson's reasoning in setting the limits for an insufficiency of funds as giving rise to a reasonable excuse, we apply a two-stage test by asking: (a) whether the shortage of funds was foreseeable; and (b) if foreseeable, whether the shortage of funds was *reasonably* avoidable, with the test of reasonableness as formulated by Judge Medd in *Clean Car*.

93. Turning to the facts in relation to 05/15, it is common ground that the shortage of funds was foreseeable. The change in payment terms started on 14 Mach 2015, and by the end of period 05/15, cash flow would have been an ongoing issue for two and a half months. Mr Miller's letter dated 14 May 2015 was evidence that the management foresaw the cash flow difficulties ahead. Having foreseen the insufficiency of funds, was the insufficiency reasonably avoidable?

94. For 05/15, the appellant had a direct debit arrangement to pay the VAT liability. The existence of a direct debit arrangement means that the taxpayer was allowed an extra three working days to meet the payment, since HMRC would only apply for the sum of VAT payable on the return on the due date for electronic filing, namely on the seventh of the relevant month. A direct-debit payment normally takes three working days to process, effectively extending the due date for payment to 10 July 2015.

95. The direct debit application of £55,052.57 failed as the bank balance on 10 July 2015 was only £22,961.51 before the payment from Tusk was credited. If the credit of £27,868.33 from Tusk was taken into account, the balance of shortage of funds to meet the VAT payment was £4,222.73.

96. Viewed in the round, the particular facts surrounding the direct debit payment for 05/15 lead us to conclude that the shortage of funds at that particular juncture was not reasonably avoidable, so far as the inflow of cash was concerned. We so conclude for three reasons:

(1) Mr Miller's evidence stated that Tusk represented 92% of the appellant's business at that time, and that the quarter 05/15 represented 'the first time Tusk paid in instalments'. The payment by Tusk of £27,868 was an instalment payment towards the expected sum of £46,000 (or £43,000 as stated in the Grounds of Appeal).

(2) We note also that the appellant had no forewarning if a payment was to fall short of the expected amount. It would appear that had the sum of £46,000 been paid instead of the short payment, the direct debit payment would not have failed.

(3) The appellant did not seem to have an overdraft facility to cover the shortage of funds on the day, which would have been £4,222.73 after the short payment of £27,868.33 from Tusk.

(4) In common with the facts in *Steptoe*, the appellant's supplies were made to one main customer: a London Borough Council in *Steptoe* and

SSE for the appellant. During the currency of the EWI projects, the supplies to SSE accounted for 100% of the appellant's turnover for most of the time and only tapered to 92% towards the end of those projects around March and April of 2015.

(5) In common with the facts in *Steptoe*, the parties in the EWI contracts are of hugely differing bargaining powers. SSE is a predominant energy supplier in Scotland with a considerable market share and can command its terms and conditions on both its suppliers and its customers. The appellant is a contractor, in competition with other contractors for the business of SSE, and is relatively weak in being able to object to the terms and conditions set by SSE, as related in Mr Miller's evidence at §58.

97. Unlike the taxpayer in *Steptoe*, the appellant accounted for its VAT liability on a cash accounting basis. The fact that the appellant is on cash accounting is a factor that weighs against the application of *Steptoe*. However, we view the facts of the present case in the round. We have special regard to the particular circumstances that caused the failure of the direct debit application at that juncture, as detailed above. We consider the immediate shortage of funds as occasioned by the expected payment from Tusk being short from the £46,000 as not reasonably avoidable by the appellant.

98. Furthermore, in our judgment, the lengthening of the invoicing cycle from 14 to 28 days, the waiting time for payment by a further 28 days, coupled with invoice settlements falling short of the invoiced totals, created an invidious situation for a trader who was almost entirely reliant on a main customer at that point in time. The labour costs in these EWI projects were essentially the CIS payments to the sub-contractors, which the appellant paid up within a fortnight of them being incurred. In turn, these labour costs were to be converted into the appellant's turnover to be invoiced via Tusk to SSE. At its worst estimation, the appellant would require working capital for at least a full quarter to keep afloat, on the basis that any CIS payments made could take up to, or more than 3 months to be 're-paid' as turnover.

99. Apart from the inflow of cash, we consider whether the appellant could have exercised due diligence to avoid the foreseeable shortage of funds, and have regard to the following:

(1) Despite the sudden change in payment terms from its customers, the appellant continued to pay its sub-contractors fortnightly.

(2) In anticipation of the likely cash flow problems, Mr Miller did write to HMRC to alert the impending possibility of not being able to make payments on time.

(3) The letter of May 2015 to 'pre-empt the situation' (presumably of a default arising), fell short of stating the request for a TTP. The letter was drafted when the appellant's agent was on holiday leave, and was not followed up for a reply in any manner or form.

100. Overall, we find Mr Miller an honest and responsible witness. Whilst the order of the facts as related by Mr Miller had at times confused the chronology of events,

his candour and sense of responsibility towards his obligations, both as a contractor for his sub-contractors, and as a taxpayer towards the state, did impress us.

101. Notwithstanding the ineffectualness of Mr Miller's letter of 14 May 2015, we consider him a conscientious businessman who has exercised reasonable foresight, due diligence and has a proper regard for the fact that the tax would become due by trying to take appropriate action to forestall a late payment penalty. The VAT liability was settled in full 10 days later by a bill payment on 20 July.

102. We conclude that the reasoning of *Steptoe* applies in relation to period 05/15; that while the insufficiency of funds was foreseeable, the facts surrounding the shortfall which caused the direct debit payment to fail was not reasonably avoidable. We further apply the objective test of reasonableness as set out in *Clean Car*, to the subjective circumstances of Mr Miller. Having regard to his experience and other relevant attributes, which to us explained why the May 2015 letter failed to be specific enough for its intended purpose, we consider that what Mr Miller did was a reasonable thing for a responsible trader, conscious of and intending to comply with his obligations regarding tax, to have done. We allow the appeal for period 05/15.

Decision

103. The appeal against the surcharge in relation to period 02/15 is dismissed. The surcharge of £8,898.72 is confirmed in full.

104. The appeal against the surcharge in relation to period 05/15 is allowed. The surcharge of £8,257.88 is accordingly cancelled.

105. 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.

DR HEIDI POON
TRIBUNAL JUDGE

RELEASE DATE: 15 May 2017