[2017] UKFTT 878 (TC)

TC06273

Appeal number: TC/2017/05965

VALUE ADDED TAX – default surcharge – interaction with repayment due under regulation 56 Income Tax (Construction Industry) Regulations – whether inability to pay VAT due because of effect on business cash flow of repayment sufficient to meet VAT liabilities even after other liabilities discharged only becoming due after end of tax year a reasonable excuse – held yes – surcharge quashed and notice of default for preceding period deemed not served – s 59(7)(8) VATA 1994

FIRST-TIER TRIBUNAL
TAX CHAMBER

DESIGN RATIONALE LTD **Appellants**

- and -

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

TRIBUNAL: JUDGE RICHARD THOMAS

The Tribunal determined the appeal on 6 December 2017 without a hearing under the provisions of Rule 26 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (default paper cases) having first read the Notice of Appeal dated 2 August 2017 (with enclosures), HMRC's Statement of Case (with enclosures) acknowledged by the Tribunal on 21 September 2017 and the Appellant's Reply dated 4 October 2017 (with enclosures).

DECISION

1. This was an appeal by Design Rationale Ltd ("the appellant) against a decision of the Commissioners for Her Majesty's Revenue and Customs ("HMRC") that the appellant was liable to a surcharge for late payment of Value Added Tax ("VAT") and against an assessment of that surcharge for the appellant's prescribed accounting period of the three months ending 28 February 2017 ("02/17"). The amount assessed is £1,345.08

Facts

2. From the papers I have I find the following facts, being ones not in dispute.

Background

3. The appellant was registered for VAT in 1992 and carries on a business of design and manufacture of interior fittings.

4. The appellant is also a sub-contractor so as to fall within the Construction Industry Scheme ("CIS"). During the tax year 2016-17 it did not have "gross payment" status, and so payments to it for labour were made by main contractors who deducted amounts from the payments in accordance with the rules of the CIS.

VAT returns and payments

5. The appellant entered the default surcharge regime for its 11/16 period (the three months ended 30 November 2016).

6. The appellant was issued with a Surcharge Liability Notice informing the recipient that they are in default, but that no liability to a surcharge has been incurred. It warns that a further default within 12 months may lead to a surcharge liability.

7. For the 11/16 period the return was well in time. VAT of £1,000 was paid by E-payment on 7 March 2017 but the remaining £123,821.20 of the amount shown on the return was unpaid until it was credited by HMRC to the appellant's VAT account with them on 24 May 2017 by way of offset of a repayment of amounts due to the appellant under the rules of the CIS. Accordingly the appellant was in default.

8. For 02/17 the return was in time. The VAT due of £67,254.40 shown on the return was unpaid until it was also credited by HMRC to the appellant's VAT account with them on 24 May 2017 by way of offset of a repayment of amounts due to the appellant under the rules of the CIS. Accordingly the appellant was also in default for this period.

9. HMRC records show that a notice of assessment and V162 (Surcharge Liability Extension Notice) was issued on 13 April 2017 imposing a surcharge of £1,345.08 being 2% of the VAT paid late.

CIS details

10. On 20 December 2016 Mrs Lesley Heap, an employee of the appellant, wrote to HMRC CIS Deductions (NIC & EO) to inform them that she had completed the VAT return for 11/17 to show that there was a large bill to pay, and that they do not have the money in then bank to pay it because there was an amount of £384,186.12 overpaid "via CIS deductions" which was rising each month but which could not be paid to them.

11. She said she had completed an online form asking for an offset of some of the overpaid amount against the VAT due. The VAT office had told her they had no authority to deal with her (unlike the CIS office) and that she should take it up with CIS.

12. She asked for £124,821.20 to be credited to the VAT account, pointing out that the corporation tax due on 1 November 2016 (£37,668) had already been offset and that the monthly PAYE/NIC bill was around £21,000 so there was an ample cushion.

13. On 31 January 2017 Mrs Heap wrote to the Debt Management & Banking Office of HMRC ("DMB") in response to a letter from them of 24 January which is not in the file (but is presumably a demand for the outstanding VAT due on 7 January). She said that she had had some telephone dialogue with CIS and VAT and that a Mrs Davies of CIS had suggested some agreement might be reached but that her systems were down.

14. She gave revised figures for the overpayment as being £391,850.37 as of 31 January with PAYE/NI of roughly £25,000 per month. She asked for postponement of aggressive debt collection, but she recognised "that legislation does not allow you to utilise this year's money overpaid to offset money owed but common sense says that there is only so much money that a company can afford and we are way over that right now." She asked DMB to let her know her options.

15. On 7 March Mrs Heap emailed DMB to update the figures to show CIS deductions to date £695,670.61 which would continue to rise, PAYE to date £241,987.63 with a further £25,000 in the rest of the tax year and £4,966.24 CIS deductions made. This made the overpayment £448,716.74 and rising.

16. She also mentioned that she would be paying £1,000 VAT that day.

17. On 25 April 2017 Lesley Heap wrote to DMB in response to a letter of 13 April which is not in the bundle, but seems to have been a demand for VAT. Lesley Heap referred again to the overpayment for 2016-17 and said she had sent a letter to the address supplied asking for overpayments to be repaid by using part to pay the outstanding VAT. She added "I would not expect any interest or surcharges to be made against any items due for payment as you have a huge amount of our money in your account that we don't owe you".

18. She also enclosed a copy of the letter to HMRC CIS dated 10 April 2017 formally applying for repayment "as per the instructions on your CIS Helpcard". She

said that the overpayment by them of £422,149.22 was crippling their small business which does not make much profit. They had had to use a large overdraft facility while HMRC was sitting on their money. She added that even though HMRC were vastly overpaid the company had continued to make its VAT payments until November 2016 when it became impossible.

19. She asked that no interest should be charged on the VAT due, and asked if they paid interest on the overpayment.

20. From the VAT Payments schedule it seems that the overpayment was offset against the VAT outstanding on 24 May 2017.

Correspondence on VAT

21. On 25 April 2017 it seems that the appellant wrote to HMRC VAT asking for a review of their decision to issue a default surcharge. The letter is not in the bundle.

22. On 30 May 2017 HMRC wrote to the appellant with the conclusions of the review which were to uphold the default surcharge. The reasons given were that a default surcharge can only be cancelled if one of three conditions was met, being:

(1) HMRC being satisfied that a business had a reasonable expectation that they would receive the payment by the due date

(2) That there is a reasonable excuse for the payment and/or return being late

(3) A time to pay request had been agreed before the due date for payment.

23. The appellant was told that a reasonable excuse is something that "stopped you from meeting a tax obligation on time that you took reasonable care to meet".

24. The author, Miss Carter, was aware that the VAT debt had not been paid as "you were awaiting a refund of CIS payment". But, the appellant was told, "you should not withhold a payment of a return even if you are anticipating a refund from HMRC".

25. On 2 June Mrs Heap phoned Miss Carter to ask her to look again, and she records that Mrs Heap was adamant that they should not be receiving a VAT surcharge.

26. On 13 June 2017 Miss Carter write to the appellant telling Mrs Heap that only one review was allowed, and as there was no additional information they could not change their view.

27. On 23 June 2017 Mrs Heap replied. She referred to a phone call they had had on 5 June when she records that Miss Carter said "I must admit I do not know how CIS works".

28. Mrs Heap repeated the facts of the case and the effect on the business.

29. On 14 July 2017 Miss Carter advised the appellant to go to he Tribunal.

30. On 2 August 2017 the appellant appealed to the Tribunal.

Law

VAT Default surcharge

31. There is no point in setting out the lengthy text of s 59 Value Added Tax Act 1994 ("VATA") which sets out the default surcharge rules for those businesses which do not make payments on account, as there is no dispute that the surcharge for 02/17 was imposed in accordance with the provisions of 59 and that the assessment of the surcharge was correct in amount, was assessed in time and notice of it was served on the appellant.

32. But it is worth setting out the provisions of s 59(7) and 71(1) VATA:

> "(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)."

and

> "(1) For the purpose 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 a reasonable excuse; and
>
> (b) where reliance is placed 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."

33. And, given what Miss Carter said in her review letter, s 108(1) and (2) FA 2009:

> "(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."

34. Section 59 VATA appears in that Table.

35. From this it can be seen that while Miss Carter referred in her three bullet points to s 59(7)(a) and (b) VATA and to s 108 Finance Act ("FA") 2009 she did not refer to s 71(1) VATA.

CIS deductions

36. Section 61 FA 2004 provides:

"(1) On making a contract payment the contractor (see section 57(3)) must deduct from it a sum equal to the relevant percentage of so much of the payment as is not shown to represent the direct cost to any other person of materials used or to be used in carrying out the construction operations to which the contract under which the payment is to be made relates.

(2) In subsection (1) "the relevant percentage" means such percentage as the Treasury may by order determine.

(3) That percentage must not exceed—

(a) if the person for whose labour (or for whose employees' or officers' labour) the payment in question is made is registered for payment under deduction, the percentage which is the basic rate for the year of assessment in which the payment is made, or

(b) if that person is not so registered, the percentage which is the higher rate for that year of assessment."

37. This is the basis for the appellant receiving payments from which the contractor has deducted sums at a rate equal to the basic or higher rate of income tax.

38. Section 62 deals with the recipient:

"(1) A sum deducted under section 61 from a payment made by a contractor—

(a) must be paid to the Board of Inland Revenue, and

(b) is to be treated for the purposes of income tax or, as the case may be, corporation tax as not diminishing the amount of the payment.

(2) If the sub-contractor is not a company a sum deducted under section 61 and paid to the Board is to be treated as being income tax paid in respect of the sub-contractor's relevant profits.

If the sum is more than sufficient to discharge his liability to income tax in respect of those profits, so much of the excess as is required to discharge any liability of his for Class 4 contributions is to be treated as being Class 4 contributions paid in respect of those profits.

(3) If the sub-contractor is a company—

(a) a sum deducted under section 61 and paid to the Board is to be treated, in accordance with regulations, as paid on account of any relevant liabilities of the sub-contractor;

(b) regulations must provide for the sum to be applied in discharging relevant liabilities of the year of assessment in which the deduction is made;

(c) if the amount is more than sufficient to discharge the sub-contractor's relevant liabilities, the excess may be treated, in accordance with the regulations, as being corporation tax paid in respect of the sub-contractor's relevant profits; and

(d) regulations must provide for the repayment to the sub-contractor of any amount not required for the purposes mentioned in paragraphs (b) and (c).

(4) For the purposes of subsection (3) the "relevant liabilities" of a sub-contractor are any liabilities of the sub-contractor, whether arising before or after the deduction is made, to make a payment to the Inland Revenue in pursuance of an obligation as an employer or contractor.

(5) In this section—

(a) "the sub-contractor" means the person for whose labour (or for whose employees' or officers' labour) the payment is made;

(b) references to the sub-contractor's "relevant profits" are to the profits from the trade, profession or vocation carried on by him in the course of which the payment was received;

(c) "Class 4 contributions" means Class 4 contributions within the meaning of the Social Security Contributions and Benefits Act 1992 (c 4) or the Social Security Contributions and Benefits (Northern Ireland) Act 1992 (c 7).

(6) References in this section to regulations are to regulations made by the Board of Inland Revenue.

(7) Regulations under this section may contain such supplementary, incidental or consequential provision as appears to the Board to be appropriate."

39. The relevant regulations referred to in s 62(3) consist solely of regulation 56 of SI 2005/2045, the Income Tax (Construction Industry Scheme) Regulations 2005 ("CIS Regulations"), the relevant parts of which are:

"(1) This regulation applies to sums deducted from contract payments made to a sub-contractor which is a company ("the qualifying sub-contractor").

(2) So much of any sum deducted under section 61 of the Act by a contractor in a tax year and paid to the Commissioners for Her Majesty's Revenue and Customs as is required shall be applied—

(a) first, in discharge of any liability of the qualifying sub-contractor to account for primary Class 1 contributions in respect of earnings paid to its employees in that year;

(b) second, in discharge of any liability of the qualifying sub-contractor for secondary Class 1 contributions in respect of earnings paid to its employees in that year;

(c) third, in discharge of any liability of the qualifying sub-contractor to account for tax deducted from the emoluments of its employees in accordance with Regulations made under section 684 of ITEPA (pay as you earn) in respect of that year;

…

(f) last, in discharge of any liability of the qualifying sub-contractor to account for sums deducted by it (in its capacity as a contractor) under section 61 of the Act from payments made to other sub-contractors.

…

(3) So much of any sum deducted under section 61 of the Act as is not required to discharge the sub-contractor's liabilities specified in paragraph (2) shall be repaid to the qualifying sub-contractor.

This is subject to the qualifications in paragraphs (5) and (6).

(5) The Commissioners for Her Majesty's Revenue and Customs shall not repay any sum deducted under section 61 of the Act to the qualifying sub-contractor unless—

(a) the tax year in which the deduction was made, has ended; and

(b) the qualifying sub-contractor has paid to the Commissioners for Her Majesty's Revenue and Customs—

(i) any amounts the qualifying sub-contractor deducted from contract payments in their capacity as a contractor during that tax year, and

(ii) any amounts due under the PAYE Regulations in respect of that tax year,

but this paragraph does not apply to a qualifying sub-contractor within paragraph (5A).

(5A) A qualifying sub-contractor is within this paragraph if—

(a) that sub-contractor is subject to a winding-up under Part 4 of the Insolvency Act 1986, and

(b) that sub-contractor has—

(i) ceased trading,

(ii) permanently ceased making payments to which section 61 of the Act(a) applies in its capacity as a contractor, or

(iii) ceased trading and permanently ceased to make any payments within subparagraph (b)(ii).

(5B) Where a qualifying sub-contractor is within paragraph (5A), the Commissioners for Her Majesty's Revenue and Customs may repay any sum deducted under section 61 of the Act to that sub-contractor during the tax year in which the deduction was made.

(6) If it appears to an officer of Revenue and Customs that there is an outstanding liability of the qualifying sub-contractor in respect of corporation tax due for an accounting period ending before the relevant payment is made under section 61 of the Act, the amount required to discharge that liability shall be retained by the Commissioners for Her Majesty's Revenue and Customs and applied in discharge of that liability.

…"

40. The rules relating to set off by HMRC are in s 130 FA 2008 (but note subsection (8):

"(1) This section applies where there is both a credit and a debit in relation to a person.

(2) The Commissioners may set the credit against the debit (subject to section 131 and any obligation of the Commissioners to set the credit against another sum).

(3) The obligations of the Commissioners and the person concerned are discharged to the extent of any set-off under subsection (2).

(4) "Credit", in relation to a person, means—

(a) a sum that is payable by the Commissioners to the person under or by virtue of an enactment, or

(b) a relevant sum that may be repaid to the person by the Commissioners.

(5) For the purposes of subsection (4), in relation to a person, "relevant sum" means a sum that was paid in connection with any liability (including any purported or anticipated liability) of that person to make a payment to the Commissioners under or by virtue of an enactment or under a contract settlement.

(6) "Debit", in relation to a person, means a sum that is payable by the person to the Commissioners under or by virtue of an enactment or under a contract settlement.

(7) In this section references to sums paid, repaid or payable by or to a person (however expressed) include sums that have been or are to be credited by or to a person.

(8) This section has effect without prejudice to any other power of the Commissioners to set off amounts."

Submissions

41. For HMRC it is submitted (among a huge list of things which are not really submissions) that:

(1) The appellant was liable to the surcharge because they did not pay the VAT by the due date, which was 7 April 2017.

(2) The period concerned fell within the surcharge period established by the default for 11/17.

(3) No Time to Pay agreement was in place before the due date.

(4) The appellant is entitled to be paid any excess of CIS deductions over relevant liabilities, but not until after the relevant liabilities have been met and that cannot be before the end of the tax year.

(5) The appellant should not withhold a VAT payment even if they anticipate a refund from HMRC

(6) Any set-off by HMRC under s 130 FA 2008 to set "the credit against the debit" is a discretionary action and not an obligation on HMRC.

42. And in the 42nd paragraph of HMRC's "Contentions" they say that the appellant has not provided any grounds that can be considered a reasonable excuse for the late payment.

43. In a number of documents, including the Notice of Appeal, the appellant has said:

(1) They could not pay the VAT due on the due date because the huge overpayment held by HMRC had had a crippling effect on their finances.

(2) They had paid VAT on time for as long as they could, borrowing heavily through overdrafts to do so until they could afford no more.

This they said is a (very) reasonable excuse.

44. In response to HMRC's statement of case they make several points:

(1) They were not asking for a repayment before the time permitted, just for HMRC to recognise the money they already had

(2) They were not "withholding" payment of VAT: they could not pay it.

(3) They say that discretionary action under s 130 FA 2008 would "make sense here"

45. They say again that the huge overpayment sitting with HMRC is a reasonable excuse not to be penalised for not paying any more money.

Discussion

46. Although HMRC have spent a considerable part of their lengthy contentions dealing with the treatment of CIS deductions suffered by companies and the rules for

set-off they are not really that relevant to the main point at issue here, whether the appellant had a reasonable excuse for non-payment by the due date.

47. The appellant accepted at an early stage that the law does not permit the overpayment to be repaid or set off until at the very earliest the end of the tax year in which the deductions were made, which for 2016-17 meant 5 April 2017, and given what HMRC say about PAYE liabilities needing to be established before repayment can be made, realistically no repayment would be made before the due date for VAT, 7 April 2017.

48. If however HMRC are wrong then that would in my view strengthen any arguments the appellant had that there was a reasonable excuse, so I propose to expend some effort in examining the provisions.

49. The crucial provision is s 62 FA 2004. It refers to amounts deducted under s 61, and the point to note there is that, unlike say the withholding taxes found in Part 15 Income Tax Act 2007, the sum deducted is not income tax. The mechanisms for its collection are *sui generis* and are found in Part 3 of the CIS Regulations which do not mention income tax.

50. Section 62 then has a lot of deeming and treating to do. For sub-contractors within the charge to income tax the position is relatively simple. By s 62(2) section 61 deductions are treated as income tax paid on the sub-contractor's profits and enter the sections 9 and 59B Taxes Management Act 1970 calculations of tax payable or repayable. This is subject to the caveat that any excess of the s 61 deductions over the income tax charged on the profits is to be treated as being Class 4 NICs up to the amount required to discharge the liability to make those contributions.

51. For companies and others within the charge to corporation tax the situation is different. Section 62(3)(a) specifies that s 61 deductions are to be (must be) treated as having been paid (by the contractor to HMRC) on account of "relevant liabilities" of the tax year (6 April to 5 April) in which the deductions are made. "Relevant liabilities" are defined in s 62(4) as those liabilities to make a payment to HMRC as employer or contractor.

52. Section 62(3)(b) is somewhat obscurely worded. It says that regulations must provide that a sum to be applied in discharging relevant liabilities can only be used to discharge liabilities of the tax year in which the deduction is made. It is not clear to me why paragraph (b) is worded in a different way from paragraph (a) (or why that proposition could not simply be stated in s 63(2)(b) as an enactment in statute). Paragraph (a) makes it clear that the contractor deducting the sum and paying it to HMRC is, unwittingly, paying it on account of the sub-contractor's own relevant liabilities. That wording "treated as paid on account" would be equally apt in paragraph (b) but instead that paragraph refers to discharging liabilities. But it seems to be the same thing.

53. Section 62(3)(c) deals with any excess not needed to discharge relevant liabilities, saying that the excess *may* be treated, in accordance with any regulations,

as being corporation tax ("CT") paid in respect of the relevant profits of the sub-contractor. These profits are the profits of the trade in respect of which the net payments are received, not, it is to be noted, the total profits of the company. Section 63(3)(d) makes it mandatory for the regulations to provide that any excess, the amount not required for the discharge of relevant liabilities or treated as CT, is to be repaid to the sub-contractor.

54. Turning to the CIS Regulations it can be seen that regulation 56(2) lays down a pecking order for the discharge of different types of relevant liabilities such as Class 1 NIC and PAYE and makes the necessary allocation to a tax year required by s 62(3)(b). Regulation 56(3) says that any excess not required to discharge those liabilities must be repaid, but repayment shall not (ie must not) be made unless that tax year of deduction has ended (ie until 6 April) and unless any amounts due under PAYE regulations have been paid for that year, which may not be until later than 6 April (22 April being the due date for payment of any liabilities arising in the month ending 5 April).

55. HMRC may also retain the amount needed to discharge any outstanding CT liability – regulation 56(6). This is not quite what s 63(3)(c) seems to require the regulations to do, as that paragraph says that the amounts may be treated as CT paid in respect of the profits. Discharging liabilities is the language of regulation 56(2) and in that regulation there is no equation of the sums with the tax liability.

56. Finally it is not clear to me what is the precise nature of the sums to be repaid under regulation 56(3). It does not appear to be transmuted into CT by regulation 56 and that is consistent with s 62(3). What is repaid is then simply an amount equal to the sum deducted by the contractor and paid to HMRC under the CIS regulations[1].

57. Despite what appear to be infelicities or inconsistences in the wording, on the face of it then no repayment can be made to the company of amounts equal to the sums deducted under s 61 until at the earliest the end of the tax year. This is reinforced, if reinforcement is needed, by regulation 56(5A) and (5B) which does allow early repayment to a sub-contractor subject to a winding-up.

58. But as to section 130 FA 2008 (set-off) it seems to me to be arguable that the wording of regulation 56(3) makes the excess of sums not required in the future to discharge relevant liabilities or CT at least "payable" within the meaning of s 130(4)(a) *before* 5 April. Regulation 56(5)(a) simply delays the date of repayment of that payable amount. That seems to me to be a factor that strengthens any claim that there is a reasonable excuse, but not to any great extent.

59. After that diversion I return to the main point in issue: is there a reasonable excuse?

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[1] This and indeed the rest of the CIS Regulations make one wonder why they are called the "*Income Tax* ….. Regulations".

60. Miss Carter, the reviewing officer, in her conclusions letter said that none of the three things that would lead to the cancellation of a surcharge apply in the appellant's case. Clearly two of them do not. The other is that the appellant has a reasonable excuse. She did not say why the appellant did not have a reasonable excuse. Instead she informed the appellant what in her view a reasonable excuse was, namely something that stopped them from meeting a tax obligation on time that they took reasonable care to meet, but she did not say why she thought that the appellant did not take such reasonable care.

61. The Statement of Case is no better. It simply said that the appellant had not provided any grounds that can be considered a reasonable excuse. There is nothing said about why the extensive statements made by the appellant do not amount to a reasonable excuse, unless it is the laughable statement that the appellant was deliberately withholding paying the VAT it owed.

62. HMRC did not address the appellant's repeated statements that it could not afford to pay the VAT. It is as if s 70(1)(a) VATA did not exist. Why did they not even mention that impecuniosity is not a reasonable excuse? A suspicious mind might think it is because of the S words – S for Salevon and Steptoe.

63. In *Commissioners of Customs and Excise v Salevon Ltd* [1989] STC 907 ("*Salevon*"), Nolan J upheld the decision of the VAT Tribunal (Judge Patrick Medd QC) who had rejected the arguments for the Commissioners that inability to pay was the be all and end all and the cause of it was irrelevant and did so on the grounds that it failed to distinguish between the reason for non-payment and the excuse for non-payment.

64. In the Court of Appeal in *Commissioners of Customs and Excise v Steptoe* [1992] STC 757 ("*Steptoe*"), Nolan LJ, as he had become, said:

> "… the argument for the commissioners on the basic question of the construction of s 33(2)(a) *is* still, as it was in *Salevon,* that if the direct cause of the trader's failure to pay the tax is insufficiency of funds then he can never have a reasonable excuse for non-payment, whatever the circumstances. Having reconsidered the matter as best I can, I have arrived once again at the conclusion which I expressed in *Salevon,* and do not think that I can usefully add to the reasons which I then gave".

65. *Steptoe* and *Salevon* are binding on me. I must therefore consider what was the reason was for the undoubted fact that the appellant was unable to pay. Quite obviously it was the fact that HMRC were in possession of an amount well in excess on any possible estimate of the appellant's relevant liabilities which they would not or could not pay to the appellant or set off against its VAT liabilities, and that was causing severe difficulties for the appellant which paid its VAT until it could pay no more and paid a token amount well after the due date for 11/16 .

66. I have not found it at all difficult to come to the conclusion that that circumstance amounts to a reasonable excuse notwithstanding s 70(1)(a) VATA. The circumstances are undoubtedly "something that stopped you from meeting a tax

obligation on time that you took reasonable care to meet" to quote Miss Carter's definition of a reasonable excuse.

67. Section 59(7) VATA says (with a bit of comminution and modernisation) that if a person satisfies a tribunal that, in the case of *a default which is material to the surcharge*, [my emphasis] there is a reasonable excuse for the VAT not having been paid by the due date, they shall not be liable to the surcharge or be regarded as in default.

68. The words in italics are defined in s 59(8):

> "…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."

69. The period 02/17 is within paragraph (a). The period 11/16 is within paragraph (b) because the liability in 02/17 depends on there being a default in 11/17 which established the surcharge period in which 02/17 falls, and there is no intervening period where there is a default (in fact there is no intervening period at all).

70. The circumstances of the failure to pay on time for 11/16 are the same as those for 02/17. There was therefore also a reasonable excuse for 11/16. The practical effect of this decision is that should there have been any defaults for 05/17 or, if not then, for 08/17 or, if for neither, if there is one for 11/17, it will not cause a surcharge to arise because there will be no surcharge period in existence.

Decision

71. The surcharge liability notices for 11/16 and 02/17 are deemed not to have been served.

72. There is no default for those periods because the appellant has a reasonable excuse.

73. The appeal against the assessment of the surcharge for 02/17 is allowed and the assessment reduced to nil.

74. 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.

RICHARD THOMAS
TRIBUNAL JUDGE

RELEASE DATE: 18 December 2017