[2019] UKFTT 80 (TC)

TC06964

Appeal number: TC/2017/05744

VALUE ADDED TAX – wrong flat rate percentage – assessments upheld in principle but figures subject to adjustment following consideration of overstated turnover due to employee fraud – default surcharges – reduced by taking into account payment made to "wrong" account – one penalty cancelled because payment by cheque treated as received by HMRC in time under VAT Regulations despite being posted to wrong ledger – reasonable excuse for all periods – surcharges cancelled – observations on the legal basis for allowing extension of time to make a return and to pay in certain cases.

FIRST-TIER TRIBUNAL
TAX CHAMBER

JCA SEMINARS LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE RICHARD THOMAS
HELEN MYERSCOUGH ACA

Sitting in public at the Old Bakery, Queens Rd, Norwich on 13 December 2018

Mr Michael Pellizzaro, Accountant, for the Appellant

Ms Esther Hickey, litigator HM Revenue and Customs, for the Respondents

DECISION

1. This was the hearing of appeals by JCA Seminars Ltd ("the appellant") against VAT assessments for periods 08/14, 11/14 and 01/15.

2. It was also a hearing of appeals against default surcharges. The Notice of Appeal to the Tribunal referred to a monetary amount of surcharges, which if taken literally would mean that the relevant periods were 11/15, 02/16, 05/16, 08/16 and 11/16 as these were the ones where the surcharge was other than nil. (A designator of a period such as "08/16" is to be taken as a reference to the three months ending with the last day of the eighth month of the year 2016 and so on: save that the period 08/14 covered the period of some six months from the start of registration).

3. But in the grounds of appeal the appellant referred to payments made which were said not to have been taken into account by HMRC for earlier periods when there was either no liability to a surcharge (because it was the first default) or because HMRC had decided not to assess a surcharge in the light of their policy not so to assess if the result would be less than £400 where the rate was either 2% or 5%. Given this we have treated all periods from 02/15 onwards as under appeal.

4. The appeals were made on 20 July 2017 and were clearly out of time in relation to all assessments and surcharges. HMRC did not object to the appeals being late, and indeed agreed to enter ADR with the appellant. We gave permission for the appeals to be made late.

Facts

5. We had a bundle of documents and we heard evidence from Ms Jane Chandler, the director of the appellant. From this we find the following facts.

VAT assessments

6. Ms Chandler had registered for VAT in 2008 as a sole trader in her own name. At the same time she registered for the flat rate scheme ("FRS") under which she was entitled to account for VAT by applying a percentage chosen by her as the most appropriate from a list in regulations.

7. The rate she chose for her business was that for "business services not listed elsewhere" and was 9%. For the first year of operation a trader is allowed to reduce the rate by 1 percentage point, so it was 8% that was used.

8. Ms Chandler incorporated the appellant to take over the business as a going concern from 16 January 2014. She applied to use her existing VAT registration, but her application was refused (because it seems she had outstanding VAT liabilities). The appellant was accordingly registered for VAT on 30 June 2014 with effect from 16 January 2014. Mrs Chandler's sole trader business was then deregistered with effect from 15 January 2014.

9. On 18 June 2015 an officer of Revenue and Customs visited the appellant and discovered that the appellant had applied a rate of 8% to its turnover. Ms Chandler had not increased the rate on her sole trader business after the first year nor applied statutory increases in the percentage that occurred when the rate of VAT was increased. Following the transfer of the business the appellant had continued to use the 8% rate. The officer told the appellant that the correct rate was 12% and so for the first year of trading it was 11%.

10. On 13 October 2015 HMRC made three assessments covering the three accounting periods in which the first year of operation was comprised in the total sum of £3,359. No assessment action was take to correct the rate for Ms Chandler's personal business, nor were penalties assessed.

Default surcharges

11. The standard schedule produced by HMRC shows that:

(1) The appellant was in default for the first time for the period 02/15 for which they received a surcharge liability notice warning that any default in the next 12 months would trigger a surcharge.

(2) For 05/15 and 08/15 there were defaults in payment and surcharges were due at 2% and 5% respectively, but because the surcharge was less than £400 in both cases no assessments were made.

(3) For 11/15 there was a default in payment and a surcharge of 10% (£179.27) was imposed. This default, like the previous ones, extended the surcharge liability period, in this case to periods ending 11/16 and earlier.

(4) For 02/16, 05/16, 08/16 and 11/16 there were defaults in payment and surcharges of 15% were imposed.

Discussion

VAT assessments

12. The appellant argued that HMRC failed to advise it, and indeed Ms Chandler as sole trader, of the correct percentage and so the VAT assessments should be removed. In the course of the hearing it became clear that the appellant blamed her previous accountant for failing to tell her of the changes.

13. The failings of the accountant may have provided the appellant with grounds for establishing a reasonable excuse as a defence against penalties, but none were assessed. Nor do HMRC have any duty to inform a trader individually that the declared percentage was incorrect.

14. We agree with HMRC that the appellant had used the wrong rate and that they were entitled to assess the appellant at the correct rate for the first year of operation of the appellant.

15. But as we understand it, following matters which emerged in the ADR process HMRC may be making refunds to the appellant on the grounds of overstated turnover due to fraud so we decide this issue in principle only. If HMRC and the appellant are unable to agree that the appeals are to be settled by agreement under s 85 Value Added Tax Act 1994 ("VATA") they should inform the Tribunal with a view to its deciding the figures.

Default surcharges

16. The appellant did not deny that returns were late in some periods. But it says that HMRC did not take all payments made into account. Ms Chandler also explained to us at the hearing about the fraud that had been committed by an employee on the appellant's business and it was this had led to the possibility of refunds because the fraud involved overstating turnover. Ms Chandler told us about the "catastrophic" effect on her finances of the fraud. We understand that the fraud was operative from 2012 to 2015 and that the employee was convicted in about April 2017.

17. HMRC referred in their skeleton to various payments Ms Chandler said she had made. They agreed with Ms Chandler that a payment of £2,000 was made on 25 February 2015, but "into the sole proprietorship account".

18. From the bundle of papers we had we accept that a payment of £2,000 was made to HMRC in February 2015. Ms Chandler told us, and we accept, that the payment was made by her to meet the VAT liabilities of the appellant. This was a time when Ms Chandler had discovered that a member of staff had been defrauding the appellant of significant sums and she was paying her VAT liabilities as and when she could. It seems that the cheque was credited to the previous sole trader account which used a different VAT number and was then held in suspense for a long period

19. We also examined the circumstances behind other payments that Ms Chandler said had been made but we were satisfied they had been taken into account.

20. Ms Hickey argued that for a payment to be effective to avoid a surcharge it had to be credited to the right ledger. We disagree. Regulation 40(2) of the Value Added Tax Regulations 1995 (SI 1995/2518) ("the VAT Regulations") requires only that the VAT be paid to the "Controller": it does not specify that it has to reach a specific account or ledger by that date. By s 6(2) Commissioners for Revenue and Customs Act 2005, "Controller" is to be read as referring to an officer of HMRC.

21. The skeleton argument for the appellant drafted by Mr Pellizzaro suggested that if the "missing" payments were taken into account there was no late payment. We therefore consider the effect on the schedule of default surcharges of treating the payment of £2,000 on 25 February 2015, but no others, as a payment of VAT by the appellant.

22. The effect of that payment is that the amount of VAT paid late for 02/15 was £166, not £2,166 as in the HMRC schedule. This still justifies a surcharge liability notice, but there was an amount of £1,236.30 paid on 18 May 2015 allocated to 02/15

which can be reallocated to 05/15 liabilities, with the effect that there was no late payment for that period and no surcharge. There was a late return and so a surcharge extension is justified. As the liability was £1,110.18 and the payment £1,236.30, £126.12 can be reallocated to 08/15.

23. For 08/15 the liability said to be unpaid at the due date was £1,550.28. By reallocating £126.12 the amount paid late was £1,424.16. Surcharge is due at 2% but the amount is less than £400 so there is no surcharge to be assessed.

24. For 11/15 there is still a late payment even taking the £2,000 into account. But the surcharge is at a rate of 5% and is on £3,343 and so is less than £400 so no surcharge is due.

25. For 02/16 surcharge is due at 10%, not 15% as in HMRC's schedule.

26. For 05/16 the amount said not to be paid by the due date is £2,884.92. But £2,135 was paid by cheque on 2 June 2016 and allocated by HMRC to 02/15 and 05/15 because they thought that there was outstanding liability after the due date. The £2,135 must be regarded as a payment in time of most of the 05/16 amount leaving the surcharge at 15% of £749.

27. There was a payment of VAT for 05/16 on 25 July 2016 of which only £79 falls to be allocated to that period. Thus £2,135 can be regarded as a payment of the 08/16 liability of £1,986 with the result that no surcharge arises for that period, and the £1,986 paid on 12 October 2016 is reallocated to 11/16.

28. For 11/16 the VAT unpaid by the due date is £4,393.28 from which £1,986 falls to be deducted making the unpaid VAT £2,407 which is liable at 15%.

29. Thus the amounts of surcharge we consider are due, having regard to the £2,000 payment, are:

02/16 £238.20 (10% of £2,382)

05/16 £112.35 (15% of £749)

11/16 £361.05 (15% of £2,407)

Default surcharge 11/15: was payment in time?

30. For the 11/15 period (see §24) the schedule of defaults shows the return was received on 29 December 2015 and payment by cheque was recorded as credited on 11 January 2016. The appellant's evidence, which we accept, was that the cheque was sent with the paper return.

31. By regulation 40(2) of the VAT Regulations the due date for payment for any period is the last day on which the trader is required to make the return for that period. By regulation 25(1) of those regulations:

> "Every person who is registered … shall, in respect of every period … 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."

32. Regulation 25A(2) of the VAT Regulations provides:

> "(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."

33. But in this case the appellant did not need additional time to make a return as it was made by 31 December 2015, the due date given by the regulations. It follows from regulation 40(2) that the due date for payment was also 31 December 2015.

34. Where a payment is made by cheque, regulation 40(2B) and (2C) VAT Regulations says:

> "(2B) With effect from 1st April 2010, where a person makes any payment to the Controller required by paragraph (2) above by cheque (whether or not in contravention of paragraph (2A) above)—
>
> (a) the payment shall be treated as made on the day when the cheque clears to the account of the Controller, and
>
> (b) that shall be the day when payment of any VAT shown as due on the return is to be treated as received by the Commissioners for the purposes of section 59 of the Act.
>
> (2C) For the purposes of this regulation, the day on which a cheque clears to the account of the Controller is the second business day following but not including the date of its receipt."

35. If we assume that the cheque was received by HMRC on the same day as the return, then it was received on 29 December 2015. By regulation 40(2B)(a) and (2C) payment is treated as made on the second working day after 29 December 2015. That day was a Tuesday, so the second working day after it is 31 January 2015 and by regulation 40(2B)(b) for the purposes of default surcharge the day of receipt was 31 December 2015, and it was in time.

36. We add that had we needed to decide the matter (ie if the second working day had been after 31 December 2015) we would have held that it was reasonable for the appellant to have expected that the cheque would be received by HMRC by 31 December as she sent it with the return and the return was so received. The relevant question would, in our view, have been whether information was readily available to VAT registered traders to say that where payment is by cheque the "two working days

after receipt" rule applies. As to that question we can see no information about that rule in VAT Notice 700/50 (default surcharge), the website page "Pay your VAT Bill" or the page "VAT Returns" under "Deadlines".

37. The consequences of tour decision here are that the period 02/16, despite the cancellation of the 11/15 surcharge, remains within the surcharge extension period established by the 08/15 default. But our decision in relation to 11/15 means that the surcharge for 02/16 is due at 5%, not 15% as in HMRC's schedule.

38. For 05/16 the surcharge then becomes 10% of £749.

39. For 11/16 the surcharge remains at 15%.

40. Thus the amounts of surcharge we consider are actually due are:

02/16 £119.10 (5% of £2,382) but as it less than £400 it becomes £0.

05/16 £74.90 (10% of £749)

11/16 £361.05 (15% of £2,407)

Default surcharges – all periods: reasonable excuse?

41. But we also have to consider whether the appellant had a reasonable excuse for all (or any) of the periods for which surcharges remain following our findings in relation to the £2,000 payment and to 11/15.

42. We accept of course that inability to pay cannot of itself be a reasonable excuse. But as was held by the Court of Appeal in *Commissioners of Customs and Excise v Steptoe* [1992] STC 757, the underlying cause of the lack of funds can be. We are wholly satisfied that the fraud is such an underlying cause – it is even an unexpected event of the type HMRC for many years erroneously said was the only thing that could make an excuse reasonable. We are also satisfied that the effects of the fraud continued in 2016 and so the surcharges for the three periods we have listed at §40 are cancelled.

43. We have not needed to take into account whether any possible refunds to the appellant on account of the overstatement of turnover said to be part of the fraud are to be taken into account in computing the surcharge.

Observations

44. Ms Hickey suggested to us that even in a case where the due date for payment was extended, the due date for a return remained at the last day of the month following the end of the VAT period. We do not think this is right: if it were it would have the effect that a return and payment made on any day up to the seventh of the following month would trigger a default even if there was no surcharge and so extend the surcharge period.

45. In any event regulation 25A(2) VAT Regulations says:

> "(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."

46. From this it is clear that additional time is allowed to make any return, whether electronic or paper, if the payment is made electronically (whether in time or not), and additional time is also is allowed for the making of an electronic return where no payment is due. It is also clear that in the periods concerned additional time is allowed, though HMRC are somewhat coy about revealing the precise terms of any general direction they have made allowing additional time and saying what that time is. A viewer of the HMRC website will find any number of directions relating to electronic communications, but they all relate to direct taxes, not VAT. HMRC act however as if a direction allowing an additional seven days to make a return has been made, and no taxpayer is going to argue against that to their own detriment.

47. The secrecy about the directions had lead some HMRC officers compiling statements of case or presenting cases to the Tribunal to suggest that the seven day extension is concessionary, so perhaps there are no directions. It would be a sensible and laudable move for HMRC to publish the directions on their website if there are any.

48. The same goes for any directions about payment. Regulation 40(3) and (4) VAT Regulations says:

> "(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."

49. Regulation 40(2) says:

> "(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."

50. Given this there may not be any direction under regulation 40(3) because a direction under regulation 25A(2) extending the time for a return where electronic

payment is made would automatically extend the date of payment for the purposes of regulation 40(2). But HMRC say that there is a different time limit for direct debit payments as contrasted with other types of electronic payment, so there must we would have thought be a direction that conforms with the second sentence of regulation 40(4) to allow this. Since in a direct debit case the date for filing the return is not extended beyond the seventh day of the second month after the end of the VAT period, there is clearly a need for a regulation 40(3) direction as well as a regulation 25A (20) direction. But nothing on HMRC's website gives the text of these directions if they have been made.

51. This discussion leads on to a consideration of the standard schedules produced by HMRC. They are extremely helpful and could and should be copied in other statements of case for other penalties. But they suffer from a fault which is that they show as the default that the due date for returns and payments is the last day of the month following the VAT period. There is then an asterisk which takes one to a passage in a minuscule font saying that the time is extended in certain circumstances. These circumstances cover nearly every VAT return so should be the default.

52. 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: 06 FEBRUARY 2019