



TC03016

Appeal number: TC/2012/09625

VAT default surcharge - insufficiency of funds - appellant erroneously thought a time to pay arrangement was in place - whether reasonable excuse - no - appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

CHARLES EVANS GROUP LIMITED

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE MICHAEL S CONNELL
PETER WHITEHEAD**

**Sitting in public at the Civil and Family Court, 35 Vernon Street, Liverpool on 2
August 2013**

Mr. G Thompson director of the Appellant Company

Mr. P Jones Officer of HM Revenue and Customs, for the Respondents

DECISION

The Appeal

1. Charles Evans Group Limited (“the Appellant”) appeals against a default surcharge of £3,385.43, for its failure to submit in respect of its VAT period ended 30 June 2012, by the due date, payment of the VAT due. The surcharge was calculated at 2% of the VAT due of £169,271.67.

2. The point at issue is whether or not the Appellant has a reasonable excuse for making late payment.

10 Background

3. The Appellant’s principle business activity is the provision of specialist joinery, manufacturing and shop fitting services. Customers include national supermarkets, retail stores and smaller organisations such as hotels and restaurants.

4. The Appellant had previously defaulted on VAT payments in period 06/11 when a VAT surcharge liability notice was issued.

5. A time to pay arrangement was in place in respect of earlier outstanding tax and VAT, under which the sum of £225,000 was due to be paid by instalments between October 2012 and July 2013.

6. The Appellant paid VAT on a quarterly basis. Section 59 of the VAT Act 1994 requires a VAT return and payment of VAT due, on or before the end of the month following the relevant calendar quarter. [Reg 25(1) and Reg 40(1) VAT Regulations 1995]. The due date for the 06/12 period was 31 July 2012. The Appellant’s return was received by HMRC on time. The amount due was £169,271.67. Payment was made in part only (£41,000) by cheques on 12 September 2012, 11 October 2012 and 14 November 2012.

7. Section 59 Value Added Tax Act 1994 (“VATA”) sets out the provisions in relation to the default surcharge regime. Under s 59(1) a taxable person is regarded as being in default if he fails to make his return for a VAT quarterly period by the due date or if he makes his return by that due date but does not pay by that due date the amount of VAT shown on the return. The Commissioners may then serve a surcharge liability notice on the defaulting taxable person, which brings him within the default surcharge regime, so that any subsequent defaults within a specified period result in assessment to default surcharges at the prescribed percentage rates. The specified percentage rates are determined by reference to the number of periods in respect of which the taxable person is in default during the surcharge liability period. In relation to the first default after the issue of a surcharge liability notice the specified percentage is 2%. The percentage ascends to 5%, 10% and 15% for the second, third and fourth default.

8. A taxable person who is otherwise liable to a default surcharge may nevertheless escape that liability if he can establish that he has a reasonable excuse for the late payment which gave rise to the default surcharge(s). Section 59 (7) VATA 1994 sets out the relevant provisions : -

5 ‘(7) If a person who apart from this sub-section would be liable to a surcharge under sub-section (4) above satisfies the Commissioners or, on appeal, a Tribunal that in the case of a default which is material to the surcharge –

10 (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

15 (b) there is a reasonable excuse for the return or VAT not having been so despatched then 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 ..’

9. Section 59(7) must be applied subject to the limitation contained in s 71(1) VATA 1994 which provides as follows : -

20 ‘(1) For the purposes of any provision of section 59 which refers to a reasonable excuse for any conduct -

any insufficiency of funds to pay any VAT due is not a reasonable excuse.’

25 10. Although an insufficiency of funds to pay any VAT due is not a reasonable excuse, case law has established the principle that the underlying cause of any insufficiency of funds may constitute a reasonable excuse.

30 11. The initial onus of proof rests with HMRC to show that a surcharge has been correctly imposed. If so established, the onus then rests with the Appellant to demonstrate that there was a reasonable excuse for late payment of the tax. The standard of proof is the ordinary civil standard on a balance of probabilities.

Appellant’s Case

35 12. The Appellant does not dispute that its VAT payment for the period 06/12 was due on 30 July 2012 or that it was late making payment. It is also agreed that the payment, if made by cheque, was due on 31 July 2012. The Appellant also acknowledges that the VAT was paid late and in part only.

13. The Appellant’s main ground of appeal is that an insufficiency of funds was created by circumstances outside its control which in turn impacted upon its ability to discharge VAT on time. Its problems have been caused by adverse trading conditions brought about by the economic recession and a number of other factors.

40 14. Mr Thompson for the company said that only a year ago the company was close to going into administration. The Appellant employed Duff and Phelps who

negotiated with HMRC and agreed an instalment arrangement with regard to the company's PAYE/NI and Corporation tax arrears whereby the sum of £225,000 was to be repaid between 15 October 2012 and 15 July 2013.

5 15. The business had been family-owned until June 2002 when it was acquired through a management buyout, and then in 2005 was acquired by the current owner. The two buyouts resulted in the introduction of debt from both the Appellant's bank and venture capital funds. The business is highly geared as a result of the two buyouts with high levels of amortisation interest and capital commitments which undermined trading performance and absorbed cash resources.

10 16. Additionally large contracts had created significant losses (£179,000). There were also numerous doubtful debts adding to the company's cash flow problem.

17. The company implemented a number of cost-cutting and efficiency measures including redundancies and pay cuts of between 5% and 15% for all staff members.

15 18. The Appellant mistakenly thought that the VAT due for the default period under appeal was included in the time to pay arrangement.

HMRC's Case

19. The Period 06/12 had a due date of 31 July 2012 for a non-electronic VAT payment. The VAT payment was received in part by HMRC in three instalments. £41,000 was paid. The amount due on the tax return was £169,271.67.

20 20. HMRC say that the potential financial consequences attached to the risk of further defaults would have been known to the Appellant after issue of the Surcharge Liability Notice in July 2011 and a Surcharge Liability Extension Notice in January 2012, particularly given the information contained in the Notice which on the reverse states:

25 'Please remember your VAT returns and any tax due must reach HMRC by the due date. If you expect to have any difficulties contact either your local VAT office, listed under HM Revenue & Customs in the phone book as soon as possible, or the National Advice Service on 0845 010 9000.'

30 21. The requirements for submitting timely electronic payments can also be found -

- In notice 700 "the VAT guide" paragraph 21.3.1 which is issued to every trader upon registration.
- On the actual website www.hmrc.gov.uk
- On the E-VAT return acknowledgement.

35 22. Also the reverse of each default notice details how surcharges are calculated and the percentages used in determining any financial surcharge in accordance with the VAT Act 1994 s 59(5).

23. Therefore HMRC say that the surcharge has been correctly issued in accordance with the VAT Act 1994 s 59(4).

24. With regard to the Appellant's grounds of appeal, Notice 700/50 (December 2011) s 6.3 (the notice represents HMRC's policy and understanding of the relevant legislation), states that HMRC consider that genuine mistakes, honesty and acting in good faith are not acceptable as reasonable excuses for surcharge purposes, and it is specifically stated in s 71(1) VATA 1994 that any insufficiency of funds to pay any VAT is not reasonable excuse.

Conclusion

25. The Appellant was clearly aware of the due date for payments of its VAT and the potential consequences of late payment.

26. The Appellant's main ground of appeal is that it suffered cash flow shortages caused by a number of factors as set out above and because it erroneously thought that the VAT due in the default period formed part of the time to pay arrangement.

27. In *Customs & Excise Commissioners –v- Steptoe [1992] STC 757* the tax-payer argued that although the proximate cause of his default was insufficiency of funds, the underlying cause of that insufficiency, namely the unexpected failure by a major customer to pay him on time, amounted to a reasonable excuse. The Court determined on a majority that the statutory exclusion of insufficiency of funds as an excuse did not preclude consideration of the underlying cause of insufficiency and that a trader might have a reasonable excuse if it were caused by an unforeseeable or inescapable event or when, despite the exercise of reasonable forethought and due diligence, it could not have been avoided. The Court nevertheless made it clear that the test had to be applied strictly.

28. To decide whether a reasonable excuse exists where insufficiency of funds causes the failure, the Tribunal must take for comparison a person in a similar situation to that of the actual tax-payer who is relying on the reasonable excuse defence. The Tribunal should then ask itself, with that comparable person in mind, whether notwithstanding that person's exercise of reasonable foresight, due diligence and a proper regard for the fact that the tax would become payable on the particular dates, the tax-payer would not have avoided the insufficiency of funds which led to the failures.

29. Having considered the Appellant Company's circumstances and the background facts and circumstances leading up to the default, the Tribunal finds that an underlying cause of the default was cash flow shortages caused by a combination of events. However, the main cause appeared to be the Appellant's erroneous belief that the VAT due in the default period was subject to a time to pay arrangement. Mr Thompson for the company accepted that the mistake was because of a misunderstanding with Duff and Phelps. Unfortunately mistakes of this nature do not amount to a reasonable excuse for late payment, and with greater diligence the

management would have been aware that the VAT for the default period was not part of the time to pay arrangement.

5 30. The burden of proof is on the Appellant to show that the primary cause of its failure to meet its VAT payment obligations was unforeseen circumstances or events beyond its control. In the Tribunal's view, for the reasons given above, that burden has not been discharged and there was no reasonable excuse for the Appellant's late payment of VAT for the 06/12 period.

31. The appeal is accordingly dismissed and the surcharge upheld.

10 32. 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)" 15 which accompanies and forms part of this decision notice.

MICHAEL S CONNELL

TRIBUNAL JUDGE

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RELEASE DATE: 22 October 2013