



TC03033

Appeal number: TC/2012/02449

*VAT default surcharge – insufficiency of funds – whether reasonable
excuse – no – whether penalty disproportionate – no – Appeal dismissed*

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

ESTATES AND LAW LIMITED

Appellant

- and -

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

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

**Sitting in public at Alexandra House, The Parsonage, Manchester on 22 May
2013**

Mr Steven Cunningham for the Appellant

Mr Ian Birtles, Officer of HM Revenue and Customs, for the Respondents

DECISION

The Appeal

1. This an appeal by Estates and Law Limited ('the Appellant') against a VAT
5 default surcharge of £2,443.28 imposed for its failure to submit, in respect of its VAT
period ended 31 July 2012, by the due date, payment of the VAT due. The surcharge
was calculated at 10% of the VAT due of £24, 432.89.

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

10 Background

3. The Appellant company was formed in 1987. It's main business activity is the
production of bespoke marketing and advertising brochures for the legal profession.

4. Prior to the default for 07/12 the Appellant had previously defaulted on VAT
15 payments in period 04/11 when a VAT surcharge liability notice was issued and again
for periods 10/11and 01/12.

5. Section 59 Value Added Tax Act 1994 ("VATA") sets out the provisions in
relation to the default surcharge regime. Section 59 of VATA 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].

20 6. 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
25 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
30 the specified percentage is 2%. The percentage ascends to 5%, 10% and 15% for the
second, third and fourth default.

7. HMRC have discretion to allow extra time for both filing and payment when
these are carried out by electronic means. [VAT Regulations 1995 SI 1995/2518 regs
25A (20), 40(2)]. Under that discretion, HMRC allow a further seven days for filing
and payment. The due date for the 07/12 period was 7 September 2012.

35 8. The Appellant paid VAT on a quarterly basis, usually by cheque. The
Appellant's return was received by HMRC on 29 August 2012 and was therefore on
time. Payment was made late by five instalments. Four payments were made
electronically by the 'faster payments scheme' between 13 September 2012 and 6
November 2012 and the final balance by cheque on 4 February 2013.

9. The onus of proof rests with HMRC to show that the surcharges were correctly imposed. If so established, the onus then rests with the Appellant to demonstrate that there was reasonable excuse for late payment of the tax. The standard of proof is the ordinary civil standard of a balance of probabilities.

5 10. 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 sets out the relevant provisions : -

10 ‘(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 –

15 (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

20 (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 ..’

11. The burden falls on the Appellant to establish that it has a reasonable excuse for the late payment in question. It is s 59(7)(b) VATA on which the Appellant seeks to rely on the basis that for reasons set out below the VAT was paid late because it was suffering severe cash flow shortages.

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

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

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

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

35 14. The Appellant’s appeal against the surcharge was received out of time by the Tribunal on 2 April 2013. Its request to bring a late appeal was allowed on the basis that it had not received the Respondents review decision dated 26 October 2012 until a copy was sent on 25 March 2013.

Appellant’s Case

40 15. The Appellant does not dispute that its VAT payment for the period 07/12 was due on 31 August 2012 or that it was late making payment. It is agreed that the

payment if made electronically was due on 7 August 2012 but that payment was made by instalments, all of which were late, the final balance not reaching HMRC until 4 February 2013.

5 16. In its notice of appeal to the Tribunal, the Appellant's stated grounds of appeal were:

"1) We have moved banks and increased our overdraft in an effort to enable us to make our payments on time.

2) We have made one member of staff redundant in order to reduce our fixed costs and ease cash flow as per HMRC advice.

10 3) We have reduced some of our production costs

4) We have met our current commitments to pay VAT on time

5) A levy of 10% being £2443.28 will only make it more difficult for us to meet future payments to our suppliers."

15 17. Mr Cunningham for the Appellant said the company's main ground of appeal is that an insufficiency of funds had been created by a combination of circumstances outside its control. He said that the company was formed twenty-six years ago and had been a successful business. Prior to 2008 the company had an impeccable tax compliance record. However, at the time of the onset of the recession in 2008 his business partner had become ill and left the business. The cost of Mr Cunningham taking over the business and retaining all its staff was approximately £200,000. This imposed enormous constraints on the company's business capital. It caused acute cash flow problems, which were then exacerbated by the onset of the recession.

25 18. There had been a significant reduction in the Appellant's customer base, many law firms having gone out of business or having significantly reduced their marketing and advertising budgets. Many of the law firms which were surviving the recession were unusually late in settling their accounts. At one stage the business was owed more than £120,000 when typically the businesses aged debts prior to the recession would have only been approximately £25,000.

30 19. The company had made one person redundant and changed banks. Following the introduction of new systems and better credit control VAT was now being paid on time.

20. A 10% surcharge was excessive and disproportionate taking into account the Appellant's obvious financial difficulties. It would only add to the businesses problems.

35 HMRC's Case

21. The period 07/12 had a due date of 31 August 2012 for electronic VAT payments and the return. The VAT return was received electronically by HMRC on

29 August 2012 and was therefore on time. The amount due on the tax return was £24,432.89. The payment was made by 'Faster Payment' instalments, each made after the due date late and the final balance was not received by HMRC until 4 February 2013.

- 5 22. The potential financial consequences attached to the risk of a default would have been known to the Appellant after the issue of a Surcharge Liability Notice in June 2011, given the information contained in the Notice. Included within the notes on the reverse of the Surcharge Liability Notice, is the following, standard, paragraph:

10 '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.'

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

- 15
- 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.

20 24. 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).

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

25 26. With regard to the Appellant's grounds of appeal, it is specifically stated in s71(1) VATA that an insufficiency of funds to pay any VAT is not a reasonable excuse.

27. Insofar as the Appellant argues that the surcharge is entirely excessive or disproportionate to the modest delay which occurred, the case of *Total Technology (Engineering) Limited v HMRC* heard in the Upper Tribunal held that:

- 30 (1) There is nothing in the architecture of the Default Surcharge system which makes it fatally flawed.
- (2) In order to determine whether or not a penalty is disproportionate, the Upper Tier Tribunal addressed the following factors:
- (a) The number of days of the default
- 35 (b) The absolute amount of the penalty
- (c) The 'inexact correlation of turnover and penalty'

(d) The ‘absence of any power to mitigate’

and decided that none of these leads to the conclusion that the Default Surcharge regime infringes the principle of proportionality.

28. Mr Birtles for HMRC said that the Appellant’s stated grounds of appeal in the
5 Notice of Appeal to the Tribunal were clearly not grounds of appeal. The company
had been given time to pay in respect of earlier VAT payments and there was no
reason why it could not have requested time to pay in respect of the July 2012 VAT,
providing of course that the arrangement was requested and agreed with HMRC
before the due date for payment. The VAT did not belong to the company; the monies
10 represented public funds which should not have been used by the Appellant for
ordinary everyday trading purposes.

Conclusion

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

15 30. The Appellant’s main ground of appeal is that it was still suffering cash flow
shortages caused by the onset of the recession in 2008 and also because of a
significant capital outlay following the loss of Mr Cunningham's business partner. In
essence, the reason for the late payment of VAT was insufficiency of funds.

20 31. 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
25 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.

30 32. 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
35 dates, those factors would not have avoided the insufficiency of funds which led to
the failures.

33. Having considered the Appellant company’s circumstances and the background
facts and circumstances leading up to the default, the Tribunal accepts that the
underlying cause of the default was an acute shortage of funds. However a prudent
40 tax-payer in circumstances similar to that of the Appellant would have put in place
appropriate precautionary measures. There was no evidence that the company had

applied to HMRC for time to pay prior to the date of default and it does not appear to have approached its bankers for an increase in its banking facilities or attempted to raise funds from other sources.

5 34. It appears that following the default in August 2012 the Appellant put in place more robust credit control mechanisms and its VAT compliance record improved. It had been late in making its VAT payments in three other periods before the default period under appeal. There had therefore been a pattern of the Appellant failing to adhere to its VAT payment obligations. Had it improved its systems earlier than it did, the VAT default for period 07/12 could have been avoided.

10 35. The burden of proof is on the Appellant to show that the underlying cause of its failure to meet its VAT payment obligations was due to 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 07/12 period.

15 36. The appeal is accordingly dismissed and the surcharge upheld.

20 37. 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.

25

MICHAEL S CONNELL

TRIBUNAL JUDGE

RELEASE DATE: 8 November 2013