



TC03231

Appeal number: TC/2012/09362

VAT default surcharge – insufficiency of funds - CIS refund due from HMRC to Appellant - whether reasonable excuse - no - whether penalty disproportionate - no - Appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

FRENCH POLISH LIMITED

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE MICHAEL S CONNELL
NICHOLAS DEE**

Sitting in public at Bedford Square London on 11 October 2013

The Appellant Company did not attend and was not represented

Mr Ojo, Officer of HM Revenue and Customs, for the Respondents

DECISION

The Appeal

5 1. French Polish Limited (“the Appellant”) appeals against a default surcharge of £1,043.46, 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 10% of the VAT due of £10,434.62.

10 2. The Appellant did not attend the hearing. The Tribunal was satisfied that the Appellant had been given notice of the time, date and venue of the appeal hearing and that it was in the interests of justice to proceed.

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

Background

15 4. The Appellant had previously defaulted on VAT payments in period 12/10, when a VAT surcharge liability notice was issued, and again in periods 03/11 and 09/11.

20 5. 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 Appellant’s return was received by HMRC on time. The VAT was due to be paid by 31 July 2012.

25 6. 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 06/12 period, if payment was made electronically, was 7 August 2012. Payment was made late by two Faster Payment System instalments on 28 August 2012 and 17 September 2012.

30 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
35 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 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. It is s 59(7)(b) on which the Appellant seeks to rely. The burden falls on the Appellant to establish that it has a reasonable excuse for the late payment in question.

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

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

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

11. 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 12. 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.

13. The Appellant’s appeal against the surcharge for period 06/12 was submitted to the Tribunal on 8 October 2012.

35 Appellant’s Case

40 14. The Appellant does not dispute that its VAT payment for the period 06/12 was due on 31 July 2012 or that it was late making payment. It is also agreed that the payment, if made electronically, was due on 7 August 2012 but that the VAT was paid late in part on 28 August 2012 and the final balance due did not reach HMRC until 17 September 2012.

15. The Appellant's stated grounds of appeal in its Notice of Appeal to the Tribunal is that an insufficiency of funds was created by circumstances outside its control. The Appellant says that the shortage of funds significantly impacted upon its ability to discharge VAT on time and that HMRC owed the Appellant £6,265.80 in overpaid tax and had this been repaid to the Appellant, it would have been able to discharge its VAT on time. The principle of 'set off' should apply. The Appellant received its overdue tax in September 2012 and then paid its VAT liability in full immediately.

16. The Appellant is a small struggling company. The surcharge is excessive and disproportionate to the amount involved particularly given the reasons for the late payment and the fact that the VAT payment was only 'a few weeks late'.

HMRC's Case

17. At the hearing, Mr Ojo for HMRC said that period 06/12 had a due date of 7 August 2012 for an electronic VAT Payment. The VAT Return was received electronically by HMRC on 6 July 2012. The amount due on the tax return was £10,434.62. The company paid the VAT by way of two FPS instalments, one made on 28 August 2012, which was seventeen days after the due date and the balance made on 17 September 2012 which was forty-one days after the due date.

18. 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 for period 12/10, and a Surcharge Liability Extension Notice in period 03/11, particularly given the information contained in the Notice which on the reverse states:

'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.'

19. 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.

20. 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).

21. Mr Ojo said that HMRC understood the £6,265.80 which the Appellant refers to related to Construction industry Scheme (CIS) deductions and that to reclaim these the Appellant should offset the deductions during the tax year against the company's

monthly or quarterly liabilities. Where a payment is due at the end of the tax year the company should make a request for a repayment in writing to HMRC. The Appellant has not demonstrated that a request in writing had been made.

22. Mr Ojo said that whilst it is appreciated that suffering deductions under the CIS will inevitably have an effect on the company's cash flow, it is not something which the Appellant would have been unaware of and that it should therefore have been in a position to prepare accordingly. The Appellant has produced no evidence to substantiate its assertion that it was suffering an insufficiency of funds due to unforeseen circumstances beyond its control, or evidence that it had requested a set off in respect of repayable CIS payments.

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.

25. 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:

(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

(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. The penalty was therefore not excessive or disproportionate. The penalty is tax geared and levied on the amount of VAT paid late at a percentage applicable to the number of defaults.

Conclusion

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

27. The Appellant's main ground of appeal is that it suffered a cash flow shortage caused by constraints on its cash flow as result of both trading conditions and the fact that a CIS refund due to the company had not been made by HMRC..

5 28. 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
10 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.

15 29. 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,
20 those factors would not have avoided the insufficiency of funds which led to the failures.

25 30. Having considered the Appellant company's circumstances and the background facts and circumstances leading up to the default, the Tribunal finds that the underlying and primary cause of the default was a cash flow shortage caused by trading conditions and the fact that a CIS refund was due to the Appellant. The refund was not paid until September 2012, being after the due date for payment by the Appellant of VAT for period 06/12. However, as HMRC argued, no evidence of a written request for set off had been provided. Set off cannot be applied unilaterally by a tax-payer in such circumstances. A request for repayment may have been made by
30 the Appellant or its accountants but a prudent tax person in similar circumstances would have written to HMRC in advance to explain the position and ask for time to pay or a request to set off the amount due from HMRC in respect of the CIS refund.

35 31. 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 06/12 period.

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

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33. 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.

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MICHAEL S CONNELL

TRIBUNAL JUDGE

RELEASE DATE: 13 January 2014

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