



TC03331

Appeal number: TC/2013/04668

VAT default surcharge - VAT not paid on time due to cash flow difficulties - whether reasonable excuse - no - whether surcharge disproportionate - no - whether time to pay arrangement in place for earlier default - yes - appeal allowed in part

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

**S E GEORGE & H H SPARROW T/A
ABRAXAS COOKSHOP LLP**

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE MICHAEL S CONNELL
HELEN MYERSCOUGH**

**Sitting in public at Bedford MC 3 St Pauls Square Bedford on 13 November
2013**

Ms Anne Worle for the Appellant

Mr C Jacobs Officer of HM Revenue and Customs, for the Respondents

DECISION

The Appeal

1. Abraxas Cookshop LLP (“the Appellant”) appeals against a default surcharge of £2,445.72, for its failure to submit, in respect of its VAT period ended 01/13, by the due date, payment of the VAT due. The surcharge was calculated at 5% of the amount due of £48,914.56.

2. The points at issue are whether or not the Appellant has a reasonable excuse for making late payment, whether the surcharge is excessive and disproportionate and whether a time to pay arrangement existed in respect of an earlier default period.

3. The surcharge issue date was 13 May 2013 but the Appellant did not lodge its notice of appeal until 15 July 2013. The Appellant therefore applied for permission to make a late appeal. After hearing preliminary submissions by both parties, the Tribunal allowed the Appellant to make the late appeal.

Background

4. The Appellant company was established by Ms. Sparrow and Ms. George in 1996 and trades in kitchen and cookware.

5. The Appellant had previously defaulted on VAT payments in period 07/11, when a VAT surcharge liability notice was issued, and again in periods 01/12, 04/12 and 07/12. The penalties for periods 01/12 and 07/12 were subsequently removed as HMRC agreed that a time to pay arrangement had been agreed with the Appellant. The default under appeal was therefore a third default and subject to a penalty of 5%.

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

7. The Appellant paid VAT on a quarterly basis and usually paid its VAT electronically by the Faster Payment Scheme (“FPS”). HMRC allows additional time for payment when made by electronic means and pursuant to Regulation 40(4) of the VAT Regulations 1995 allows an additional seven days after the end of the calendar month when payment would normally fall due (together with a further three days when the VAT is collected by direct debit). Limitations apply if the due date falls on a weekend or a bank holiday, in which event the due date defaults to the last previous working day.

8. The Appellant submitted its 01/13 VAT return electronically on 26 February 2013 and was therefore on time. Payment was due by 8 March 2013 (10 March was a Sunday) but made on 12 March 2013 by FPS. The VAT payment was therefore late.

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

10. A surcharge liability notice was issued on 15 March 2013 imposing a 10% penalty, later reduced to a 5% penalty on 13 May 2013 (because of the earlier withdrawal of the 07/12 default.)

11. HMRC contend that the Appellant should have been aware of the potential financial consequences of a default, having been in the default surcharge regime from 07/11 and having defaulted on two previous occasions.

12. 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 : -

‘(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 –

(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 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 ..’

13. 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.

14. Section 59(7) must be applied subject to the limitation contained in s71(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 -

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

15. 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
5 insufficiency of funds may constitute a reasonable excuse

Appellant's Case

16. The stated grounds of appeal in the Appellant's notice of appeal were that payment had been "made on 10 March 2013" by FPS and "was only forty-eight hours
10 late". The Appellant said that the business was feeling the pressure of the economic climate but that they made every effort to pay their VAT on time. The Appellant also said that the penalty was disproportionate and excessive.

17. The Appellant queried the default for period 07/11 (the first default) and said that so far as they were aware a time to pay arrangement existed for that period. Ms Worle for the Appellant said that the proprietors of the Appellant company
15 maintained strict control over its finances and although suffering some cash flow difficulties "knew exactly where they were". They said that HMRC had already removed two default surcharges after it had been established that a time to pay arrangement had existed for the periods in question. HMRC screen-print notes in September 2011 appeared to indicate that a time to pay arrangement had earlier been
20 discussed with the Appellant.

HMRC's Case

18. Mr Jacobs said that the potential financial consequences attached to the risk of a default would have been known to the Appellant after issue of the Surcharge Liability Notice and the numerous subsequent surcharge default extension notices. The
25 information contained on the reverse of each Notice states:

30 '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.

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

22. With regard to the Appellant's grounds of appeal, HMRC submit that it is specifically stated in s 71(1) VATA 1994 that any insufficiency of funds to pay any VAT is not reasonable excuse.

23. Mr Jacobs said that HMRC may allow additional time for payment if requested, but any request must be made prior to the date on which the VAT falls due. The Appellant did not make any request for a time to pay arrangement in respect of the default period in question.

10 Conclusion

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

25. The Appellant says that it was suffering cash flow shortages at the time of the default. However, this cannot have amounted to an insufficiency of funds because it appears the necessary funds were in place to discharge the VAT on time. The VAT payment was, in any event, only two days late.

26. The Appellant could have requested a time to pay arrangement with HMRC but did not do so.

27. Under s 71(1) VATA an insufficiency of funds to pay any VAT is not a reasonable excuse.

28. 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.

29. 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 01/13 period.

30. The Tribunal accepted the Appellant's submissions that there was a reasonable basis for their understanding that a time to pay arrangement was in place for the period 07/11 and that consequently the first default was that of period 04/12. This meant that the penalty for the default in period 01/13 should be 2% of the amount of VAT due and not 5%.

31. The appeal is accordingly allowed in part and the surcharge reduced to £978.29.

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

MICHAEL S CONNELL

TRIBUNAL JUDGE

RELEASE DATE: 12 February 2014