



TC03595

Appeal number: TC/2013/03473

VAT default surcharge - five late payments appealed - insufficiency of funds and illness of proprietor - whether reasonable excuse - no - whether surcharges disproportionate - no - Appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

PHILIP THOMAS JONES & PARTNERS

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE MICHAEL S CONNELL
MEMBER BEVERLY TANNER**

**Sitting in public at Alexandra House, The Parsonage Manchester on 5 February
2014**

The Appellant did not attend and was not represented

Lisa Fletcher, Officer of HM Revenue and Customs, for the Respondents

DECISION

The Appeal

- 5 1. Philip T Jones & Partners (“the Appellant”), appeals against five default surcharges totalling £5,174.95, for its failure to submit, in respect of its VAT periods ended 11/11, 02/12, 05/12, 08/12, and 11/12, by the due date, payment of the VAT due.
2. The point at issue is whether or not the Appellant has a reasonable excuse for making late payment.
- 10 3. The Appellant did not attend the hearing and was not represented. However, Mr Philip Jones had previously indicated that he would not be attending the hearing on his doctor’s advice and put forward reasons which he asked to be taken into account by the Tribunal in coming to a decision. The Tribunal was therefore satisfied that the Appellant had no objection to the appeal being heard in the absence of the Appellant
- 15 and that it was in the interests of justice to proceed.

Background

4. The Appellant is a firm of accountants and tax consultants
5. The Appellant had previously defaulted on VAT payments in period 02/11 when a VAT Surcharge Liability Notice was issued and again in respect of periods 05/11 and
- 20 08/11. There were then five further defaults, which are the subject of this appeal.
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].
- 25 7. 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
- 30 the due date defaults to the last previous working day.
8. The due date for the filing of a return and payment of VAT due for the five periods under appeal are set out in the schedule below. The schedule includes the amount due, the date of payment, the amount paid late, the date the return was received and the surcharge.

Period	Date due	VAT Due	Paid/ late	Date paid	Return rec'd	% rate	Surcharge
11/11	31.12.11	£10,385.34	All late	18.05.12	15.03.12	10	£1,088.40
02/12	31.03.12	£6,354.12	All late	20.08.12	05.04.12	15	£953.11
05/12	30.06.12	£6,873.66	£3230.19 paid	18.03.13	06.07.12	15	£1,031.04
08/12	30.09.12	£6,445.20	outstanding	-	08.10.12	15	£966.78
11/12	31.12.12	£7,902.97	outstanding	-	07.01.12	15	£1,185.44

9. Period 11/11 had a due date of 7 January 2012 for electronic payments and returns. The VAT Return was received electronically by HMRC on 15 March 2012. The Appellant paid their VAT by two Faster Payment Service (FPS) transactions. The payments reached HMRC's bank account on 18 May 2012 and 13 June 2012.

10. Period 02/12 had a due date of 7 April 2012 for electronic payments and returns. The VAT Return was received electronically by HMRC on 5 April 2012. The Appellant paid their VAT by two Faster Payment Service FPS transactions. The payments reached HMRC's bank account on 13 June 2012 and 20 August 2012.

10 11. Period 05/12 had a due date of 7 July 2012 for electronic payments and returns. The VAT Return was received electronically by HMRC on 6 July 2012. The Appellant paid part of their VAT by Faster Payment Service (FPS) transactions. The part payment of £3,230.19 reached HMRC's bank account on 18 March 2013. The balance of £3,643.47 remained outstanding at the date of appeal.

15 12. Period 08/12 had a due date of 7 October 2012 for electronic payments and returns. The VAT Return was received electronically by HMRC on 8 October 2012. The full VAT liability of £6,445.20 remained outstanding at the date of appeal.

20 13. Period 11/12 had a due date of 7 January 2013 for electronic payments and returns. The VAT Return was received electronically by HMRC on 7 January 2013. The full VAT liability of £7,902.97 remained outstanding at the date of appeal.

25 14. 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.

15. 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 VAT Surcharge Liability Notice, the specified percentage is 2% and the percentage ascends to 5%, 10% and 15% for the second, third and fourth default.

16. 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 ..’

17. 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

18. The Appellant does not dispute that its VAT payment for the periods under appeal were paid late. In fact, at the date of the appeal only part of the VAT for period 05/12 had been paid, and VAT for periods 08/12 and 11/12 had not been paid at all. Subject to this, the basis of the Appellant’s grounds of appeal are that

- i. The Appellant’s bank had halved its overdraft facility and its debtor’s book doubled. This was entirely unexpected and unforeseeable.
- ii. Mr Jones, the proprietor of the business, has been ill.
- iii. Penalties totalling £5,174.90 are disproportionate to the total VAT due of £21,764.

19. Mr Jones, one of the partners of the Appellant firm, submitted five letters, each identical and dated 22 February 2013, requesting a review of the default surcharge for the periods under appeal. Each letter states the same reason for the late payment of VAT. In his letter Mr Jones says:

“We have struggled as a practice to collect debtor’s monies and our bankers have reduced our facilities leaving us unable to borrow funds to settle the VAT debt liability.

These are unforeseen circumstances which could not have been envisaged i.e. debtors taking over nine months to pay, banks ceasing to lend to practices such as ours.

5 *The imposition of such surcharges would result in this practice having to reduce our staffing requirements. In the present economic climate it is totally unproductive to implement surcharges on a business which cannot pay initially as it merely compounds the problem. I must stress I have no wish whatsoever to avoid the debt.*

We would ask you to consider an appeal on the following grounds

10 *1. Unforeseeable and unavoidable misfortune (unexpected cash crisis). The lack of support from banks. Indeed, no one could have foreseen that the banks would reduce our overdraft facility and debtors taking twice as long to pay.*

15 *2. The proprietor of the business has been absent for long periods from business due to high blood pressure and this had resulted in the business being run less efficiently. Indeed, since the vast reduction in property prices and other factors the proprietor has been under extreme financial pressure whilst attempting to keep the business afloat. The proprietor’s long-term health problems were not envisaged and were totally unforeseen.*

20 *3. The total penalties of £5,174.90 would appear to be disproportionate to the debt due of £21,764. Please note that after 44 years in business our track record up to 31 May 2009 was excellent, i.e. until unforeseen circumstances due to the recession. We are determined to remain in business and your kind consideration accepting our appeal would be of much assistance. As you will be aware surcharges are not tax relievable making the impact on the practice substantially higher.”*

25 20. The Appellant sent a copy of a letter from his doctors dated 26 February 2013 which said "This is to certify that the above patient is registered on my panel. Mr Jones has suffered from hypertension since 2008."

HMRC’s case

30 21. Ms Fletcher said that HMRC's notes of conversations with the Appellant included one on 5 May 2011 (prior to the first default under appeal) when the Appellant reported *“massively increased debtor book, coupled with creditors continually pressing for payment and bank is cutting overdraft by 50%, this has given to extreme cash flow.”*

35 22. HMRC contend that the first Default Surcharge under appeal which was for Period 11/1 had a due date of 7 January 2012. As the bank had by then already withdrawn part of the overdraft facility (i.e. by May 2011), the Appellant failed to take appropriate or sufficient steps to ensure that the company met its VAT payment obligations. The Appellant failed to prioritise the submission of its VAT payment in order to prevent the default.

23. VAT Act 1994 s 71(1)(a) excludes an insufficiency of funds as a reasonable excuse for late payment of VAT.

24. Mr Jones' periods of illness had been ongoing since 2008, and therefore should have been foreseeable. HMRC also say that the Appellant has not provided any date specific evidence relating to his health problems covering the period defaults. As such
5 HMRC are unable to agree a reasonable excuse existed for health reasons.

25. In relation to the argument that the default surcharge system is disproportionate, the decision in the case of *Total Technology (Engineering) Ltd* [2012] UKUT 418 in the Upper Tribunal, considered issues of proportionality.

10 26. The *Total Technology* case centred on a payment which was made one day late, triggering the imposition of a default surcharge which the company argued was disproportionate. In his judgement Upper Tribunal, Judge Mr Justice Warren found that:

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- i. HMRC's decision to charge Total Technology (Engineering) Ltd a default surcharge for the late payment was correct;
 - ii. the default surcharge regime itself does not infringe the principles of proportionality; and
 - iii. the surcharge imposed on Total Technology (Engineering) Ltd did not infringe the principle of proportionality.

20 HMRC submit that the above judgement supports HMRC's position that the default surcharge regime itself is proportionate and that HMRC was correct in charging default surcharges in respect of the late payments for the relevant periods. The *Total* case established the VAT default surcharge penalty regime was not "flawed legislation" and did not "amount to a breach of convention rights", as had been argued
25 in that case. The penalty had been arrived at by applying a scheme of calculation which did not involve a breach of the principle of proportionality.

27. 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 02/11 and the further surcharge default notices for periods 05/11 and 08/11,
30 and indeed each of the five defaults under appeal. The information contained on the reverse of each Notice states:

35 '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.'

28. 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.

29. 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).
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30. Therefore the surcharge has been correctly issued in accordance with the VAT Act 1994 s 59(4).

31. HMRC may allow additional time for payment if requested. Any request must be made prior to the date on which the VAT falls due. No request for a time to pay arrangement was received by HMRC from the Appellant prior to the default.
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Conclusion

32. The Appellant's main ground of appeal is that it was still suffering cash flow shortages caused by its bank halving its overdraft facilities and an unexpected increase in debtors. In essence, the reason for the late payments of VAT was insufficiency of funds.
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33. In *Customs & Excise Commissioners –v- Steptoe* [1992] STC 757 the taxpayer 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.
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34. 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 taxpayer 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, those factors would not have avoided the insufficiency of funds which led to the failures.
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35. Having considered the Appellant company's circumstances and the background facts and circumstances leading up to the default, the Tribunal recognizes that the underlying cause of the default was a shortage of funds brought about by various factors. However a prudent tax person in circumstances similar to that of the Appellant would have put in place appropriate precautionary measures. There was no evidence that the company applied to HMRC for time to pay prior to the date of default and it does not appear to have attempted to raise funds from a source other
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than its bank. The VAT does not belong to the taxpayer and should not be relied on as part of its working capital or cash flow. The insufficiency of funds suffered by the Appellant is therefore not a reasonable excuse.

5 36. With regard to proportionality, as the Upper Tribunal said in *Total Technology*, there is nothing in the VAT default surcharge regime which leads to the conclusion that its architecture is fatally flawed or that it infringes the principle of proportionality. The Tribunal recognised that the VAT default surcharge legislation imposes a highly prescriptive regime with an inflexible table of surcharges laid down with no, or virtually no, discretion for HMRC to relieve a surcharge once imposed. It
10 recognized that there must be some upper limit on the penalty for a default which was proportionate, although it did not suggest what that might be, given that all the circumstances of the default must be taken into account.

15 37. In assessing whether a penalty in any particular case is disproportionate, the Tribunal must be astute not to substitute its own view of what is fair for the penalty which Parliament has imposed. The Tribunal should show the greatest deference to the will of Parliament when considering the application of the VAT default surcharge scheme.

20 38. By way of further background to the Tribunal's reasoning in *Total*, the Tribunal referred to what Simon Brown LJ had said in *International Transport Roth GmbH v Home Secretary* [2003] QB 728 at [26], setting out the test for assessing proportionality -

25 ".... it seems to me that ultimately one single question arises for determination by the court: is the scheme not merely harsh but plainly unfair so that, however effectively that unfairness may assist in achieving the social goal, it simply cannot be permitted? In addressing this question I for my part would recognise a wide discretion in the Secretary of State in his task of devising a suitable scheme, and a high degree of deference due by the court to Parliament when it comes to determining its legality. Our law is now replete with dicta at the very
30 highest level commending the courts to show such deference."

35 The Tribunal observed that the "not merely harsh but plainly unfair" test set a high threshold which must be surmounted before a Tribunal could find that a penalty, correctly levied on the taxpayer by statutory provisions set by Parliament, should be struck down as disproportionate.

40 39. Although the Appellant regards the penalties as disproportionate the taxpayer was sent surcharge liability notices, warning it that it would be liable to surcharge if it defaulted again within a year. The taxpayer therefore knew its position. The penalty is not a fixed sum but is geared to the amount of outstanding VAT. The percentage applicable to the calculation of the penalty increases with successive defaults if they occur within twelve months of each other. In this case there have been no less than seven defaults following the initial default. In our view, in such circumstances the surcharges

cannot either on their own, or collectively be said to be outside a range which would sensibly regarded as entirely proportionate.

5 40. Whilst we accept that illness can sometimes be a reasonable excuse, Mr Jones had clearly been under the care of his GP for several years and it is not unreasonable to have expected him or his partners to have put in place measures to accommodate whatever problems Mr Jones' illness caused the business. Furthermore, as HMRC say, any difficulties brought about by Mr Jones' illness were not unforeseeable.

10 41. 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 periods under appeal.

42. The appeal is accordingly dismissed and the surcharges upheld.

15 43. 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

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RELEASE DATE: 15 May 2014