TC04088

Appeal number: TC/2013/07559

VAT default surcharges - conjoined appeals relating to three separate VAT quarters - whether reasonable excuse for late payments - insufficiency of funds - whether reasonable excuse - yes for one period - Appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

TRUNKWELL LEISURE LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE MICHAEL S CONNELL
MS ELIZABETH BRIDGE

Sitting in public at 45 Bedford Square London WC1B 3DN on 21 August 2014

Mr Robert Walton, Managing Director of the Appellant Company

Mr Bruce Robinson, Officer of HM Revenue and Customs, for the Respondents

DECISION

The Appeal

1. Trunkwell Leisure Limited ("the Appellant") appeals against default surcharges of £6,581.72 for the period 09/11, £7,018.33 for period 12/11 and £5,739.31 for period 12/12, for its failure to submit by the due date, in respect of the respective VAT periods, payment of the VAT due. The three appeals have been consolidated under appeal number TC/2013/07559.

2. The point at issue is whether the Appellant has a reasonable excuse for making the late payments.

Background.

3. The Appellant had been in the default surcharge regime from period 09/08 onwards. Prior to the periods subject to this appeal twelve earlier Surcharge Liability Notices had been issued.

4. The Appellant was on a quarterly basis for VAT. Section 59 of the VAT Act 1994 requires VAT returns and payment of VAT to be made on or before the end of the month following each calendar quarter. [Reg. 25(1) and Reg. 40(1) VAT Regulations 1995.]

5. 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 electronic filing and payment.

6. In respect of the default in period 09/11, the amount of VAT due was £43,878.18 which was due on 31 October 2011. The return was due on the same date but received on 22 March 2013. Payment was made by four instalments between 5 November 2011 and 23 August 2013. A Surcharge at 15% was imposed on 22 March 2013 at 15% of £3,122.37 (reduced from £6,581.72).

7. In respect of the default in period 12/11, the amount of VAT due was £46,788.87, which was due on 31 January 2012. The return was due on the same date but received on 22 March 2013. Payment was made by five instalments between 5 February 2013 and 22 November 2013. A Surcharge at 15% was imposed on 22 March 2013 at 15% of £7,018.33.

8. In respect of the default in period 12/12, the amount of VAT due was £53,895.51, which was due on 31 January 2013. The return was due on the same date but received on 7 February 2013. A payment of £2,868.44 was made on 22 November 2013. A Surcharge at 15% was imposed on 15 February 2013 at 15% of £5,739.31. The balance of VAT remained outstanding.

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

"Reasonable excuse" and relevant legislation

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).

11. 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 –
>
> (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 ..'

It is s 59(7)(b) on which the Appellant seeks to rely.

12. 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 –
>
> (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, the underlying cause of any insufficiency of funds if entirely unforeseen and outside the control of the taxpayer, may constitute a reasonable excuse – *Customs & Excise Commissioners v Steptoe* 1992 STC 757 ("Steptoe").

14. The onus of proof rests with HMRC to show that the surcharge was 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.

Appellant's Case

15. In a letter to HMRC on 22 May 2013, the Appellant's VAT consultant Mr Ian Marrow, of Constable VAT Consultancy LLP, provided some background to the events which lead to the Appellant's VAT defaults:

1) The Appellant Company provides catering facilities for weddings and other events, mainly of a corporate or conference nature, from premises at Trunkwell House, Beech Hill, Reading, Berkshire.

2) From 1990, the current managing director of the Appellant, Mr Robert Walton, who owned Trunkwell House, was the sole proprietor and operated the business as a hotel.

3) From about 2006, Mr Walton started to work with an events company run by a Mr Trevor Collins, and provided corporate and public events at Trunkwell House, which then became known as Trunkwell Manor. In early 2008 Mr Collins proposed to buy the business from Mr Walton. It was agreed that initially, Mr Collins would acquire 50% of the shares in a new limited company, Trunkwell Leisure Limited, in return for his interest in the events company.

4) As part of this deal Mr Walton would move out of Trunkwell Manor and effectively become a sleeping director of the business. Both Mr Walton and Mr Collins gave personal guarantees of £250,000 in relation to the business.

5) In January 2009 Mr Walton, as a director's loan, invested a further £50,000 on the basis that within three months this sum would be matched by Mr Collins or extra shares in the business would be issued to Mr Walton to reflect his investment. Before that three month period had expired Mr Walton invested another £50,000 on the same understanding.

6) In mid-2009 Mr Walton says that Mr Collins literally "ripped up the contracts" relating to the two £50,000 loans Mr Walton had made.

7) After this incident Mr Walton realised that there were serious issues facing the business and started to investigate. Staff numbers had increased from 12 to 27 (which apparently included a number of Mr Collins' family members). Outstanding insurance claims made against Mr Collins' original events company meant that the insurance premiums paid by the new company were significantly in excess of what would be expected.

8) Mr Walton says that apart from his dispute with Mr Collins his main concern was to recover the company and he made efforts to ascertain and deal with the company's liabilities. On 31 March 2010, he and Mr Collins put forward payment proposals to HMRC for outstanding arrears of £74,506.68.

9) In late 2010, Mr Walton decided to buy Mr Collins out of the business but this was only concluded in early 2012. Throughout this period Mr Walton was not living at Trunkwell Manor and therefore did not see any of the correspondence from HMRC in relation to the debts owed.

10) Without Mr Walton's agreement, in June 2010, the registered office of the company was changed to 44 London Road, Reading. This was an address not known to Mr Walton, and despite several attempts by him to remedy matters, correspondence from HMRC continued to be misaddressed up until late 2011.

11) This led to the situation where Mr Walton was unaware that a winding up petition had been issued by HMRC to Trunkwell Leisure Limited in July 2011. His first knowledge of this was when he received a call from the London Gazette. The amount claimed under the petition was £158,728.01 in respect of outstanding VAT, PAYE and penalties and interest of £38,489.83.

12) Mr Walton was able to pay the petition before the hearing and thus, to his mind, although at that stage not in control of the company, he had cleared the amount due to HMRC as at June 2011.

13) In February 2012, Mr Walton was finally able to buy out Mr Collins. He regained full control of the business and was able to pay on time three consecutive VAT returns, for 03/12, 06/12 and 09/12. He says that he was about to do the same for the fourth period, 12/12 when he was visited by Mr David, who was demanding payment of the outstanding amount due for the VAT periods 09/11 and 12/11 (periods before he resumed control of the business) totalling, with penalties £51,769.60. He paid the demand but then did not have the funds to meet the VAT due for period 12/12, which amounted to £44,001.38. Thus the business incurred another 15% default of £5,739.31.

14) Mr Walton says that although the 09/11 and 12/11 VAT returns were eventually submitted on 22 March 2013, the record keeping in the relevant periods was such that he believes, but currently cannot direct resources to conclusively establish, that VAT has been over declared in those VAT periods.

15) As part of Mr Walton's resumption of control of the company, he wished to establish the extent of the PAYE debts owed by the company. A letter to HMRC was sent in February 2012 enquiring as to the company's position. A response from HMRC stated that according to their records there were no arrears for the years 2008/09, 2009/10 and 2010/11. Any debts to HMRC had been included in the 2011 winding up petition and as such had been settled.

16) It therefore came as a shock to Mr Walton when Mr David arrived at Trunkwell Manor (no previous correspondence had been received by Mr Walton) in June 2012, with a demand for £37,782.91 in relation to PAYE/NIC

for the 2008/09 tax year. Had Mr Walton been aware of this debt, it may well have influenced his decision to buy out Mr Collins.

17) Part of the winding up petition debt was a VAT assessment, issued on 4 August 2011, for £37,654 VAT and interest of £835.83 (total £38,489.83). The assessment was amended in April 2012 and reduced by £7,793. This subsequent reduction should have resulted in a credit for £7,793 but Mr Walton has not received any confirmation of the credit or that it was used to offset any other liabilities outstanding at the time.

18) In June 2013, Mr Walton's VAT consultants wrote to HMRC to say that he intended to appeal the Default Surcharge issued in respect of period 12/12 and that with regard to the then total VAT outstanding of £95,770.98, he intended to pay this amount in twelve monthly instalments of £7,980.92, subject to a refund if any credits were found to be due to him.

19) The proposal was made on the understanding that the Appellant would submit contemporaneous VAT returns on time and also pay any liabilities shown on those VAT returns by the relevant due date.

20) HMRC's Debt Management Unit agreed to a 12 month time to pay period as proposed by the Appellant.

16. At the hearing Mr Walton said that in mid January 2013 when he paid the outstanding VAT for the periods 06/11, 09/11 and 12/11, he did not realise until it was too late that it would have been preferable to pay the 12/12 VAT on time and to discharge the outstanding balances for the earlier periods when the company had the funds to do so. Had he had the opportunity of considering the implications of his actions, he would have acted differently. The 12/12 VAT return would have been submitted and paid in full and on time. This would have resulted in the business not incurring the default surcharge and, as the fourth VAT return would have been submitted and paid in time, the business would have exited the default liability surcharge regime.

17. The difficult financial position of the company, caused by events outside Mr Walton's immediate control, was also exacerbated by the demand for £37,782.91 in relation to PAYE/NIC for the 2008/09 tax year, particularly given that his accountants had been told in 2011, that no amounts were outstanding.

18. In answer to the question put by the Tribunal, as to why he had not conducted appropriate due diligence enquiries of the company, to ascertain whether there were any VAT, PAYE or other liabilities due to HMRC, Mr Walton said 'I just didn't, I was too concerned about rescuing and recovering the business'.

19. Mr Walton said that the Appellant company had been totally VAT compliant since the time to pay arrangement had been agreed, and at the last VAT return, the company was up to date with all monies due to HMRC.

20. He said that the default surcharges relating to the VAT accounting periods 09/11, 12/11 and 2/12 were unfair for a number of reasons which his VAT consultants had set out in correspondence, as follows:

1) He did not receive important correspondence from HMRC, resulting in him being unaware of VAT and PAYE debts and therefore unable to budget for the correct amounts.

2) In 2012 he had been informed that there was no outstanding PAYE due to HMRC, but he was later issued with a demand for £37,782.91 in respect of period 2008/09, which he had not budgeted for.

3) He asks that the Tribunal takes into account the unforeseen shortfall of funds that arose as a result of Mr Collins' maladministration of the business. As a 'sleeping partner' he left all the day-to-day running of the business to Mr Collins and as soon as he became aware of the issues sought to rectify matters. The Court in the case of *Salevon Ltd* held that where an insufficiency of funds arises as the result of totally unforeseeable circumstances this can be a reasonable excuse for late payment. In the case of *Electrical Installation Solutions Ltd*, the Tribunal found that where the taxpayer acted in a proactive manner and did all that could be reasonably expected to make a timely payment of the VAT due this was a reasonable excuse for late payment.

4) The circumstances leading up to the defaults were highly unusual. It is unreasonable that due in part to failures by HMRC, and circumstances outside Mr Walton's control, the company should be financially penalised when it is clear that every attempt was made by Mr Walton to recover a very difficult situation and comply with his obligations.

HMRC's Case

21. The potential financial consequences attached to the risk of further default would have been known to the Appellant after issue of the Surcharge Liability Notice for the period 09/08, given the information contained in the Notice. Included within the notes on the reverse of the Surcharge Liability Notice, is the following, standard, paragraph:

> '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.'

22. 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.

23. 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).

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

25. HMRC's 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.

26. It is also specifically stated in s 71(1) VATA 1994 that any insufficiency of funds to pay any VAT is not reasonable excuse.

27. The Finance Act 2009 Section 108 specifies that there is no liability to a default surcharge for a period where contact is made with HMRC prior to the due date in order to arrange a payment deferment and this is agreed by HMRC. In this case there was no agreement.

28. HMRC contends that, as the Appellant's history of defaults demonstrate, there was a pattern of persistent late payment.

29. It is suggested that Mr Walton did not see any correspondence from HMRC and was unaware of the Appellant's VAT liabilities for periods 09/11 and 12/11. However, the Appellant's letter of 31 March 2010 was signed by both him and Mr Collins and contained payment proposals for outstanding arrears of £74,506.68.

30. There had also been two prior agreements between December 2008 and March 2009.

31. Although in early 2012 Mr Walton regained control of the company, it is unclear what actions he took to contact Debt Management and address any unpaid arrears of VAT.

32. Mr Walton says that correspondence from HMRC was sent to 44 London Rd, an address not known to him. HMRC acknowledge that whilst duplicate letters were sent to that address, being the registered office of the company, these were also sent to Trunkwell Manor, as the principle address, throughout.

33. Companies House records include company accounts for the three years to 31 March 2012, each signed by Mr Walton show the registered address as 44 London Road and an annual increasing turnover.

34. The events which occurred in January 2013 when Mr Walton discharged outstanding VAT for earlier periods does not retrospectively provide a reasonable excuse for the original defaults.

35. Mr Walton says that the implications of not having the funds to pay the tax due for period 12/12 were not fully explained by HMRC. However having been in continuous default from period 09/08 to 12/11 the Appellant had been provided with information on the reverse of each Surcharge Liability Notice issued as to the potential VAT default surcharges payable in the event of a further default.

36. Reference has been made to the cases of QB 1989 STC 907 *Salevon Ltd* and also TC/2012/09627 *Electrical Installation Solutions Ltd*. However, these cases can be distinguished in their facts. In *Salevon* the dishonesty of a former secretary in respect of a debt that had not been disclosed provided a reasonable excuse for default. In the case of *Electrical Installation Solutions Ltd* the Appellant had acted proactively with foresight and had taken all reasonable steps to combat its adverse trading conditions.

37. Mr Robinson for HMRC said that the Finance Act 2009 s 108, specifies that there is no liability to a default surcharge for a period where contact is made with HMRC prior to the due date in order to arrange a payment deferment and this is agreed by HMRC. In this case there was no agreement or any approach by the Appellant to HMRC in respect of the default periods under appeal.

38. Mr Robinson said that the Appellant's arguments regarding the company's management problems and any cash flow difficulties were not exceptional events. There was no evidence that these caused the defaults. The financial challenges facing the Appellant were not unforeseeable or beyond the control of the management.

Conclusion

39. The Appellant company entered the VAT default surcharge regime in period 09/08. Up to and including period 12/11 it defaulted on 13 consecutive occasions. During this three-year period, difficult trading conditions appear to have coincided with significant mismanagement, principally it seems by Mr Collins who was in day-to-day control and perhaps to a lesser extent by Mr Walton, who regarded himself as a sleeping partner, but was nonetheless a shareholder director involved in the company's business.

40. During the two-year period following the first default in 09/08 VAT was paid late sometimes by matter of months, but on other occasions over one and a half years after it fell due.

41. Clearly, between late 2010 and early 2011 when Mr Walton retook control of the company, the financial position of the company began to improve, as evidenced by the fact that Mr Walton was able to discharge accumulated arrears of VAT for periods 12/09, 03/10, 06/10 and 12/10, when settling the winding up petition debt.

42. This left the company short of funds because by February 2012 VAT for periods 06/11, 09/11 and 12/11 remained outstanding. However, in late 2011 and in early 2012, Mr Walton was nonetheless able to pay off a substantial part of the outstanding VAT due for those periods. For period 06/11 the VAT due was approximately £57,000 and Mr Walton had paid approximately £50,000 by April 2012. In respect of period 09/11 the VAT due was approximately £43,000 of which he had paid £23,000

by November 2011. It appears that Mr Walton did not have sufficient financial resources to pay any of the VAT due for period 12/11 and that liability along with the balance owed for periods 06/11 and 09/11 remained outstanding until eventually discharged in January 2013 when HMRC threatened distraint proceedings.

43. Throughout 2012 Mr Walton ensured that the company's VAT was paid on time. In January 2013, had he not been faced with distraint proceedings, the VAT due for 12/12 would have been paid and the Appellant company would have left the VAT default surcharge regime. As it was, the company incurred a further 15% VAT default surcharge.

44. Had Mr Walton had the foresight or opportunity to agree a time to pay arrangement for period 12/12, as part of an agreement to settle the outstanding VAT for periods 06/11, 09/11, and 12/11, the Appellant would not have incurred a surcharge for that period. It is not clear from either evidence given by HMRC or the Appellant whether a time to pay proposal was ever considered.

45. It is however clear from the facts, that after re-taking control of the Appellant Mr Walton did everything he could to exercise reasonable foresight, due diligence and have regard for the fact that the company's VAT was payable on the due dates. Having in November 2011 paid off substantial arrears of VAT (£197,000 or thereabouts) he acted proactively in discharging VAT as it fell due throughout 2012.

46. HMRC argue that an insufficiency of funds is not a reasonable excuse and that in any event the causes of the insufficiency of funds were not exceptional or beyond Mr Walton's control. They argue that the events which led to the company's financial difficulties were foreseeable, unexceptional and did not cause the defaults. They therefore argue that those events cannot be regarded as providing a reasonable excuse for the defaults.

47. The issue of reasonable excuse and s 71(1)(a) was considered in detail in *Steptoe*. The Court of Appeal held that although insufficiency of funds can never of itself constitute a reasonable excuse, the cause of that insufficiency, that is, the underlying cause of the taxpayer's default, might do so and in considering that, as Lord Donaldson MR explained, the question is whether the late payment was "reasonably avoidable". The test to apply can be found in his judgment where he said:

> "… If the exercise of reasonable foresight and of due diligence and a proper regard for the fact that the tax would become due on a particular date would not have avoided the insufficiency of funds which led to the default, then the taxpayer may well have a reasonable excuse for non-payment, but that excuse will be exhausted by the date on which such foresight, diligence and regard would have overcome the insufficiency of funds."

48. That is the correct test to be applied and is binding upon the Tribunal. In *Steptoe* Lord Nolan said that it is necessary to distinguish between the reason for non-payment and excuse for non-payment. The taxpayer here is saying that it should be excused from the surcharge not because it was short of funds but because that

shortage was brought about by circumstances which were inescapable and over which it had no control.

49. Lord Nolan quoting from his own decision in *Customs and Excise Commissioners v Salevon* [1989] STC 907 said:

> "… It is worth bearing in mind that the penalties imposed for a delay or deficiency in payment, however slight, are fixed. Neither the Commissioners nor the Tribunal have any power to mitigate them by reference to the facts of the particular case. In these circumstances the wide discretion conferred on the Commissioners and the Tribunal by s19(6) should not in my view, be regarded as having been cut down by s33(2) to any greater extent than the language of the latter subsection strictly requires. The Commissioners and the members of the Tribunal are well qualified to distinguish between the trader who lacks the money to pay this tax by reason of culpable default and the trader who lacks the money by reason of unreasonable and inescapable misfortune."

49. Unfortunately for Mr Walton, a number of factors combined which caused serious financial problems for the company. However, irrespective of whether Mr Walton was not in actual day-to-day control of the business during periods 09/11 and 12/11, he was or should have been aware of the financial position of the company.

50. Whilst Mr Walton paid VAT on time throughout 2012, he did so having decided to leave VAT outstanding for periods 06/11, 09/11 and 12/11. At no time did he request time to pay under s 108 Finance Act 2009 as he could have done. Accordingly, with regard to those periods, we find that the Appellant company has not shown a reasonable excuse and we dismiss the appeals.

51. In respect of period 12/12, given the totality of financial difficulties which beset the company, the unusual circumstances prevailing at the time of the defaults (as described by the Appellant and set out in paragraph 20 above), and the fact that in our view the default occurred because of circumstances which, even if foreseeable, were nonetheless something over which Mr Walton did not have any control, we find that the Appellant has shown a reasonable excuse for the late payment. The causes of the cash flow shortages were such that the exercise of reasonable diligence and foresight would not have allowed the Appellant avoid the defaults. We therefore allow the appeal in respect of period 12/12 and discharge the VAT default surcharge of £5,739.31.

52. 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: 21 October 2014