[2016] UKFTT 757 (TC)

TC05484

Appeal number: TC/2014/04009

VALUE ADDED TAX – default surcharge – late payment and late return – whether potential winding-up of subsidiary was a reasonable excuse – no – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

CATPLANT LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE ASHLEY GREENBANK
SHAMEEM AKHTAR

Sitting in public at Birmingham on 17 June 2016

Glyn Edwards of Croner Tax for the Appellant

Mary Donnelly, officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal by the Appellant, Catplant Limited ("Catplant") against the imposition of default surcharges for the periods ended 31 October 2013 (the "10/13 period") and 31 January 2014 (the "01/14 period") in the amounts of £58,633.06 and £73,727.95 respectively.

The hearing

2. We were provided with a bundle of documents by HMRC. The bundle of documents included a witness statement of Mr Ian Berry, a self-employed accountant, who has acted as accountant and auditor for Catplant and its associated companies. Mr Berry gave evidence and was cross-examined on his statement.

3. At the hearing, the evidence included references to a trust account established by the order of the High Court. We directed that HMRC should provide details of the terms of the trust account and make submissions on the relevance of the trust and its terms to the Tribunal following the hearing. We also directed that Catplant should be given the opportunity to comment on HMRC's submissions. We have received submissions from HMRC and Catplant in response to that direction.

The facts

4. We find the facts as follows.

The companies

5. Catplant is the representative member of a VAT group that comprises Catplant and two other companies, Catplant Quarry Limited ("CQL") and HS(37) Limited.

6. CQL is, and at all material times has been, a wholly-owned subsidiary of Catplant.

7. HS(37) Limited is controlled by the same shareholders as Catplant.

8. Catplant and CQL operate a quarry on land near Doncaster. CQL also operates a landfill site on the same land.

9. CQL's activities result in significant landfill tax liabilities. The landfill tax is calculated by tonnage and can be several times the net turnover (i.e. after landfill tax and VAT).

10. CQL's business is significantly the larger of the two companies. For example, for the two periods in question, the 10/13 period and the 01/14 period, the aggregate VAT liability for the group was approximately £882,000 and, of this amount, £820,000 was attributable to the activities of CQL.

The winding-up petition

11. We have described in paragraphs [12] to [29] below the circumstances surrounding the issue of the petition for the winding-up of CQL in November 2013 and the subsequent negotiation of a company voluntary arrangement ("CVA"), which was finally approved in May 2014. During that period, Catplant was required to submit returns and to account for VAT for the VAT group for the 10/13 period and the 01/14 period. We have dealt separately with the obligations of Catplant to make returns and account for VAT and the payments made on account of VAT in paragraphs [30] to [49] below.

12. CQL fell into arrears in its payments of landfill tax. By early 2013, these arrears were substantial (in excess of £1 million). CQL received a letter from HMRC dated 3 May 2013, in which HMRC warned that, if no action were taken to meet the liabilities within seven working days, HMRC would take steps to wind-up the company. The outstanding liabilities referred to in that letter were £1,413,387.53,

13. CQL and its agents received further letters from HMRC in a similar form dated 5 August 2013 and 23 September 2013. The outstanding liabilities on each of those dates were £1,714,166.33 and £2,523,736.80 respectively.

14. Mr Berry said in his evidence that CQL was in contact with HMRC regarding the payment of its landfill tax liabilities and was seeking to put forward a repayment plan to HMRC. For this purpose, CQL sought to negotiate additional funding from its usual bankers, Barclays. Possible funding arrangements were under discussion with Barclays when, on 6 November 2013, HMRC wrote to CQL once again to advise that, if the outstanding arrears of landfill tax, which by that time amounted to £2,088,536.88, were not paid within seven days, HMRC would take steps to wind up the company.

15. CQL and its agents contacted HMRC by telephone on 14 November 2013 in an attempt to persuade HMRC to defer the issue of the winding-up petition. No assurances were given. The winding-up petition was issued on 18 November 2013.

16. Following the issue of the petition, Barclays froze the company's bank accounts. It refused to permit any payments and did not accept any credits. From this point onwards, CQL did not have full control of its bank accounts. It did not regain full control of its bank accounts until a company voluntary arrangement ("CVA") was agreed and approved by the High Court on 9 May 2014.

17. The evidence before the Tribunal included a significant amount of correspondence between the various parties, CQL, HMRC, Barclays, Deloitte (acting as adviser to CQL) and various other advisers in the period following the issue of the winding up petition to the agreement of the CVA. That evidence is important in that it demonstrates that the company and its directors were throughout this period seeking to negotiate a CVA to allow CQL to continue trading and were expending significant time and energy in seeking to do so. However, much of the detail of the correspondence is not relevant to the issues before the Tribunal. We have recorded only the material aspects below.

18. At an early stage, it was recognized that CQL should continue trading while the negotiations continued. This was considered essential for health and safety reasons as methane gas was produced at the landfill site.

19. CQL made an application to the court for a validation order on 27 November 2013 to permit certain payments to be made into and out of the company's bank accounts. The draft order which accompanied the application included provisions for the operation of a separate bank account (referred to as the "Second Account") into which amounts in respect of landfill tax and VAT would be paid and held on trust for HMRC.

20. The application for the validation order was made on behalf of CQL. The proposals for the use of the Second Account set out in the draft order were included at the instigation of the company and its advisers in order to address any concerns that the court may have that the position of HMRC might be prejudiced if the court were to approve the validation order.

21. The application was neither supported nor opposed by HMRC. In a letter dated 28 November 2013 and sent by fax, Mrs Sallie Swarsbrick of HMRC acknowledged receipt of the papers concerning the application for the validation order and stated:

> "HM Revenue and Customs do not get involved with validation orders as they are a matter between a company and their bank. HMRC will neither support nor oppose a validation order."

22. The hearing of the application was originally scheduled for 28 November 2013, but it was adjourned. Various validation orders were made to approve specific payments into and out of the company's accounts before, on 11 December 2013, the High Court made a validation order under which CQL was permitted to make payments into and from its accounts to enable it to continue to trade. The order included the following provisions in relation to the operation of the separate bank account:

> "Provided always that all monies received by Catplant Quarry Limited ("the Company") are paid into the Company's bank account number [*details omitted*] ("the First Account") held at Barclays Bank Plc ("the Bank") [*details omitted*] and that within two business days of receipt of cleared funds into the First Account by way of VAT and Landfill Tax the Company shall instruct its bankers to transfer a sum equivalent to the Landfill Tax and VAT received into the First Account to account number [*details omitted*] ("the Second Account") held at the Bank.
>
> For the avoidance of doubt, the Order set out below is conditional upon the proviso set out above and in the event that the Company does not comply with the proviso set out above the following Order shall be of no effect.
>
> It is recorded that the monies held in the Second Account are held on trust for HMRC to the extent that such monies are due and payable by way of Landfill Tax and VAT.
>
> IT IS ORDERED THAT

1.1 …

1.2 All payments into the Company's Second Account in respect of Landfill Tax and VAT liabilities incurred after the date of presentation of the Petition until the date of judgement on the Petition or further Order in the meantime and all payments out of the Second Account to HMRC in respect of such liabilities shall not be void pursuant to section 127 of the [Insolvency Act 1986] in the event of an Order for the winding up of the Company being made on the Petition; …"

23. Further validation orders were made after the order made on 11 December 2013. In the period from the issue of the petition on 18 November 2013 to the date of the order approving the CVA on 9 May 2014, CQL's bank accounts were operated under these arrangements. All payments into and out of CQL's bank accounts were monitored and approved by Barclays and Deloitte.

24. In his evidence, Mr Berry suggested that, as a practical matter, the effect of these arrangements was that the funds in CQL's accounts could not be easily released to HMRC. That is not apparent from the wording of the court order. Indeed, as we have described below, several payments were made from the Second Account to HMRC during this period. While we accept that there were constraints on the operation of the Second Account in order to ensure compliance with the court order, we do not accept that these constraints as a practical matter prevented the release of funds to HMRC.

25. The company submitted a proposal for a CVA to Deloitte on 16 December 2013. On 8 January 2014, CQL wrote to HMRC requesting its support for a CVA and its approval to the termination of the winding up proceedings. On 14 January 2014, HMRC advised Deloitte that it was unable to provide a response to an informal proposal.

26. On 16 January 2014, Barclays demanded the repayment of loans made to CQL in the amount of £2,594, 841. A demand was also made to Catplant and HS(37) Limited as guarantors of those loans. No steps were taken to enforce those demands.

27. On 30 January 2014, the company made a request for payments to be made out of the Second Account in respect of landfill tax and VAT. A payment was made from the Second Account on 31 January 2014. Further payments were made from the Second Account in the period between 31 January 2014 and 6 May 2014. A final payment was made on 9 May 2014. Details of these payments to the extent that they relate to the group's VAT liabilities are set out at paragraphs [40] and [47] below.

28. A formal proposal for a CVA was submitted to HMRC on 6 March 2014. The initial proposal was rejected by HMRC. However, HMRC agreed that it would not oppose an application to adjourn the petition to wind-up CQL on the basis that further monies held in the Second Account were paid to HMRC on account of landfill tax and VAT liabilities.

29. The CVA was approved on 9 May 2014. On that date, the balance of the funds on the Second Account was paid to HMRC.

VAT issues

30. Catplant had been in the default surcharge regime since 16 December 2011, when it was issued a liability notice in respect of the 10/11 period following a late payment of VAT.

31. Catplant also made late payments of VAT in respect of the 10/12 period, the 01/13 period, and the 04/13 period. Surcharge notices were issued for each of these periods and default surcharges were imposed at rates of 2%, 5% and 10% of the outstanding VAT respectively.

32. On 7 December 2013, Catplant was due to file the VAT return for the VAT group for the 10/13 period and to account for the group's VAT liability of £390,887.13. It did not file the return and it did not pay any amount of, or on account of, the VAT liability at that time.

33. On 7 December 2013, Catplant's bank accounts showed a credit balance of £96,250.59. However, after taking into account payments and receipts that had not fully cleared, it is estimated that Catplant had available cash resources of £79,213.81. It also had overdraft facilities of £70,000. HS(37) Limited had no available funds at this time.

34. On 7 December 2013, CQL's bank accounts showed a credit balance of £38,637.35. It also had overdraft facilities of £400,000. However, these funds were not available following the freezing of CQL's accounts by Barclays.

35. On 13 December 2013, HMRC issued a surcharge liability notice in respect of the 10/13 period. The default surcharge shown in this notice was calculated on estimated figures and the surcharge was recalculated following the submission of the return (see paragraph [39] below).

36. Catplant did not contact HMRC about the late submission of its return and the late payment of the VAT until 9 January 2014, when, in response to a telephone call from HMRC, Ron Harrod, a director of Catplant telephoned HMRC. He informed HMRC that the return was late because the company's accountant had "personal issues", but that the return would be submitted by close of business on 10 January 2014. He mentioned that he was unsure whether a payment could be made on account of the VAT at the same time and was advised to speak to the staff at HMRC who deal with time to pay arrangements.

37. There is no evidence that, at any stage, Catplant sought to contact HMRC about the availability of a time to pay arrangement. Mr Berry explained in his evidence that the company did not pursue a time to pay arrangement because it was not in a position to do so. It was his understanding that HMRC would require the company to commit to a schedule of payments and, at the time, the company was not able to predict with any certainty when funds might be available.

38. Catplant filed the VAT return for the 10/13 period on 15 January 2014.

39. A notice of a supplementary assessment of surcharge was issued by HMRC on 16 January 2014. This notice recalculated the surcharge to take into account the actual figures in the return. The recalculated default surcharge was £58,633.06 being 15% of the outstanding VAT of £390,887.13.

40. Payments were made to discharge the VAT liability for the 10/13 period on various dates between 31 January 2014 and 14 March 2013. Details of the payments are set out in the table below. There are some minor discrepancies between the dates of the payments in the companies' records and those of HMRC. The table shows the dates in HMRC's records but nothing turns on this point. The table also sets out cases in which the funds were derived from the Second Account.

Date	**Amount**	**Source of funds**
31 January 2014	£50,902	
31 January 2014	£232,394	Second Account
17 February 2014	£15,465	Second Account
11 March 2014	£8,980	Second Account
14 March 2014	£83,146.13	Second Account

41. On 7 March 2014, Catplant was due to file the VAT return for the VAT group for the 01/14 period and to account for the group's VAT liability of £491,519.67. It did not file the return and it did not pay any amount of, or on account of, the VAT liability at that time.

42. On 7 March 2014, Catplant's bank accounts showed a credit balance of £126,986.59. However, after taking into account payments and receipts that had not fully cleared, it is estimated that Catplant had available cash resources of just £3,561.11. It also had overdraft facilities of £70,000. HS(37) Limited had available funds of £5,212.80.

43. On 7 March 2014, CQL's bank accounts (other than the Second Account) showed a credit balance of £385,132.43, although this amount includes receipts of £41,316.56 which had not fully cleared. There was a balance of £1,125,545.05 on the Second Account.

44. On 14 March 2014, HMRC issued a surcharge liability notice in respect of the 01/14 period. The default surcharge shown in this notice was again calculated on estimated figures and the surcharge was recalculated following the submission of the return (see paragraph [46] below).

45. Catplant filed the VAT return for the 01/14 period on 21 March 2014.

46. A notice of a supplementary assessment of surcharge was issued by HMRC on 21 March 2014. This notice recalculated the surcharge to take into account the actual figures in the return. The recalculated default surcharge was £73,727.95 being 15% of the outstanding VAT of £491,519.67.

47. Payments were made to discharge the VAT liability for the 01/14 period on various dates between 14 March 2014 and 6 August 2014. Details of the payments are set out in the table below. (The information in this table is shown on the same basis as that in the table at paragraph [40] above.)

Date	Amount	Source of funds
14 March 2014	£126,512.87	Second Account
20 March 2014	£9,396.79	
14 April 2014	£139,285	Second Account
25 April 2014	£58,082	Second Account
6 May 2014	£72,614.08	Second Account
9 May 2014	£59,253	Second Account
6 August 2014	£26,375.93	

48. The decisions to impose the default surcharges were upheld following a review.

49. Catplant appealed to the Tribunal.

The applicable legislation

50. Under regulations 25(1) and 40(2) Value Added Tax Regulations 1995 (SI 1995/2518), where a taxpayer makes quarterly returns, the return must be made and the tax payment is due on or before the end of the month following the end of the relevant quarter. Where, however, the taxable person files returns and pays tax electronically, HMRC allow a further seven days from the end of the month next following for filing and payment.

51. The legislation governing the operation of the default surcharge is set out in section 59 of the Value Added Tax Act 1994 ("VATA 1994"). Under section 59(1), a taxable person is regarded as in default for any period for which HMRC have not received the return or payment by the last day on which the return and payment was required.

52. Section 59(2) provides for HMRC to issue a surcharge liability notice specifying a period of one year from the last day of the period in which the default occurred (the "surcharge liability period") during which any further default will be subject to a surcharge. If the taxable person then defaults within the surcharge liability period, under section 59(4) VATA 1994, the taxable person is liable to a surcharge at a specified rate of the outstanding VAT for the prescribed accounting period or, if greater, £30. On each subsequent default, the surcharge liability period is extended to run for 12 months from the end of the latest period of default.

53. The specified rates are 2% for the first default in the surcharge liability notice period, 5% for the second default, 10% for the third default and 15% for all subsequent defaults (section 59(5)).

54. Section 59(6) describes the circumstances in which a person will be regarded as having "outstanding VAT" for these purposes. It provides as follows:

"(6) For the purposes of subsections (4) and (5) above a person has outstanding VAT for a prescribed accounting period if some or all of the VAT for which he is liable in respect of that period has not been paid by the last day on which he is required (as mentioned in subsection (1) above) to make a return for that period; and the reference in subsection (4) above to a person's outstanding VAT for a prescribed accounting period is to so much of the VAT for which he is so liable as has not been paid by that day."

55. Section 59(7) sets out certain circumstances in which a taxable person will not be liable to a surcharge. In particular, it provides that a taxable person will not be liable to a surcharge if there is a reasonable excuse for that person's failure to submit the return or pay the outstanding VAT:

"(7) If a person who, apart from this subsection, would be liable to a surcharge under subsection (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,

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 (and, accordingly, any surcharge liability notice the service of which depended upon that default shall be deemed not to have been served)."

56. For the purpose of determining whether a taxpayer has a reasonable excuse, section 71(1) VATA 1994 provides:

"**71 Construction of sections 59 to 70**

(1) For the purpose of any provision of sections 59 to 70 which refers to a reasonable excuse for any conduct –

(a) an insufficiency of funds to pay any VAT due is not a reasonable excuse; and

(b) where reliance is placed on any other person to perform any task, neither the fact of that reliance nor any dilatoriness or inaccuracy on the part of the person relied upon is a reasonable excuse."

The issues before the Tribunal

57. As we have explained above, we asked the parties for submissions following the hearing regarding the operation of the Second Account.

58. HMRC in its submissions emphasised that HMRC was not involved in the creation of the Second Account and had no control over its operation. It was set up by CQL in connection with its application for a validation order in order to address

questions that the court may raise regarding the protection of the interests of HMRC as a creditor. We accept that submission and it is reflected in our description of the facts above.

59. Catplant, in its submissions, noted that the court order provided that monies in the trust account were held "on trust for HMRC to the extent that such monies are due and payable to HMRC".

60. Catplant submitted that once the funds in the Second Account became due and payable to HMRC, they were therefore beneficially owned by HMRC even if the funds had not been released to HMRC. However, Catplant acknowledged that the Second Account was only created on 11 December 2013 and so funds in the account could not be regarded as paid in respect of the VAT liability for the 10/13 period. Furthermore, Catplant noted that, on 7 March 2014, the amount standing credit to the Second Account, being £1,125,545, was less than the landfill tax liability for the quarter ending 31 January 2014 of £1,408,653.21, which became due and payable on 28 February 2014.

61. For these reasons, Catplant did not seek to argue that there was any amount in the Second Account that could be regarded as having been paid as VAT for the 01/14 period on 7 March 2014, the due date for payment in respect of that period. It is not clear that the Second Account in fact operated in this way, but we have taken this submission to mean that Catplant accepts that no amount of VAT could be treated as paid on that date and so the "outstanding VAT" for the purposes of the calculation of the default surcharge for the 01/14 period was the amount shown on the return.

62. Catplant has not raised any other arguments to suggest that the default surcharges were not correctly calculated. Furthermore, Catplant has not disputed that the returns were late and has not disputed that the VAT payments were not made by the due dates.

63. The only issue between the parties therefore is whether Catplant had a reasonable excuse for the late payments for the 10/13 period and the 01/14 period.

64. The burden of proof is on Catplant to prove that it had a reasonable excuse.

The parties' arguments

Arguments for Catplant

65. Mr Edwards makes the following points on behalf of Catplant.

(1) Catplant is the representative member of the group but it is not the most substantial trading company within the group.

(2) The most substantial trading company within the group is CQL. The main part of its monthly tax liabilities was landfill tax.

(3) CQL was in regular contact with HMRC concerning its landfill tax liabilities before November 2013. The issue of the winding-up petition was unexpected.

(4) Following the issue of the winding-up petition, Catplant had no access to funds in CQL's bank accounts. All of the payments made by CQL were subject to validation orders issued by the High Court. CQL could only make business critical payments which were approved by the court orders. Amounts in respect of VAT and landfill tax were credited to the Second Account over which Catplant had limited control. None of the companies had access to their overdraft facilities. This was an unexpected cash crisis over which Catplant had no control. These circumstances amount to a reasonable excuse for Catplant's failure to account for VAT on the due dates.

(5) Throughout this period, the executives of Catplant acted as responsible businessmen seeking to ensure the survival of both companies by pursuing the negotiation of a CVA. It was entirely reasonable for the directors to focus their attention on the negotiations of the CVA. It enabled them to save the businesses and repay all of the indebtedness to HMRC.

(6) HMRC's argument relies on showing that the events which led to Catplant's insufficiency of funds were neither unforeseeable nor inescapable. This argument relies on the judgment of Scott LJ in *Customs and Excise v Steptoe* [1992] STC 757. However, Scott LJ was in the minority in that case. The other judges did not place a similar emphasis on the underlying cause of an insufficiency of funds being either unforeseeable or inescapable in order to constitute a reasonable excuse. In any event, the events in this case were both unforeseeable and inescapable.

(7) The group might be criticised for not making a part payment and for not seeking a time to pay arrangement. However, neither of these two options were realistic at the time. A time to pay arrangement was not possible because the group did not have any clear indication of when funds might become available. If the group had used all its available funds to meet their immediate VAT liability, the group would have endangered its own future and so its ability to meet the liabilities in the future.

Arguments for HMRC

66. Mrs Donnelly makes the following points for HMRC.

(1) The winding up of CQL and the inability of Catplant to access its funds cannot be a reasonable excuse for the failure of Catplant to account for VAT for the group. The only reason why CQL was under threat of winding up was because it had failed to pay its landfill tax liabilities. A failure to meet one tax liability (landfill tax) should not be regarded as a reasonable excuse for a failure to meet another (VAT).

(2) The winding up of CQL was not unexpected. HMRC had been in correspondence with CQL about its arrears of landfill tax for some considerable time. The liability had been outstanding for some considerable time.

(3) A lack of funds on the parts of Catplant is not in itself a reasonable excuse (Section 71(1)(a) VATA 1994).

(4) Catplant did not take any of the steps which would be expected of a reasonable tax payer that was intending to meet its tax liabilities. It did not file its returns on time. It did not seek to enter into any arrangements with HMRC to pay its liabilities over a longer period. It did not seek to make any payment on account of its liabilities.

Discussion

67. As we have mentioned above, section 71(1) VATA 1994 provides that an insufficiency of funds to pay any VAT due is not a reasonable excuse.

68. The leading case on the construction of section 71(1) VATA 1994 is the decision of the Court of Appeal in *Customs and Excise v Steptoe* [1992] STC 757. In that case, the Court of Appeal held unanimously that although insufficiency of funds can never of itself constitute a reasonable excuse, the underlying cause of that insufficiency could do so.

69. Lord Donaldson MR said (at p769-p770):

> "There is agreement between [Nolan and Scott LJJ] that section 33(2)(a) of the Finance Act 1985 [now section 71(1)(a) VATA 1994] is not to be construed in the way in which the Commissioners of Customs and Excise (the Commissioners) would wish to construe it, namely, that an insufficiency of funds can in no circumstances amount to a reasonable excuse for failing to dispatch the tax due, however short the duration of that failure and whatever the reason for the insufficiency of funds. In practice this would mean that the taxpayer had always to demonstrate that he could have paid the tax, but failed to do so for some reason constituting a reasonable excuse. Not only is this an improbable construction, but it really cannot survive in the context of section 33(2)(b) [now section 71(1)(b) VATA 1994]. There the words "neither the fact of that reliance nor any dilatoriness or inaccuracy on the part of the person relied upon is a reasonable excuse" show clearly that although reliance on another person is not of itself capable of constituting a reasonable excuse, the Commissioners and the Tribunal are expected to look behind that reliance and to ask themselves whether in such a case the underlying cause was dilatoriness or inaccuracy on the part of that person or whether, for example, he was run over by a bus. If the same approach is applied to section 33(2)(a) [now section 71(1)(a) VATA 1994], as clearly it should be, the legislative intention is that insufficiency of funds can never of itself constitute a reasonable excuse, but that the cause of that insufficiency, i.e. the underlying cause of the default, might do so."

70. There were some differences in the views of the members of the Court of Appeal in *Steptoe* about the nature of an underlying cause that can constitute a reasonable excuse in cases where the default occurred because of an insufficiency of funds. Scott LJ expressed the view that the underlying cause of the insufficiency of funds must be an "unforeseeable or inescapable misfortune" (see p762). The majority view (that of Lord Donaldson MR and Nolan LJ) was that it was not necessary to show that the underlying cause was unforeseeable or inescapable.

71. Lord Donaldson MR summarized the position as follows (at p770):

> "The difficulty which then arises is that Parliament has not specified what underlying causes of an insufficiency of funds which lead to a default are to be regarded as reasonable or as not being reasonable. Prima facie the legislative intention is the same as in the context of section 33(2)(b) [section 71(1)(b) VATA 1994]. This is that, save in so far as Parliament has given guidance, it is initially for the Commissioners to decide whether the underlying cause constitutes a reasonable excuse and for the tribunal to decide this on an appeal. That said, there must be limits to what could be regarded as a reasonable cause. Nolan LJ, as I read his judgment explaining and expanding on his judgment in *Customs and Excise Commissioners v Salevon Ltd* [1989] STC 907, is saying that 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.
>
> Scott LJ on the other hand is of the opinion that the underlying cause of the insufficiency of funds must be an "unforeseeable or inescapable event". I have come to the conclusion that this is too narrow in that (a) it gives insufficient weight to the concept of reasonableness and (b) it treats foreseeability as relevant in its own right, whereas I think that "foreseeability" or as I would say "reasonable foreseeability" is only relevant in the context of whether the cash flow problem was "inescapable" or, as I would say, "reasonably avoidable". It is more difficult to escape from the unforeseeable than from the foreseeable.
>
> It follows that if I have correctly interpreted the two judgments, I am in agreement with Nolan LJ rather than Scott LJ."

72. It follows that we agree with Mr Edwards's submission that it was not necessary for him to show that the events which led to Catplant's insufficiency of funds were unforeseeable or inescapable. The correct question to ask is whether or not, given the underlying cause of the insufficiency of funds, "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" (to use the words of Lord Donaldson MR in *Steptoe*) or whether or not the insufficiency of funds "was reasonably avoidable" (see the decision of the Upper Tribunal (Judge Sinfield and Judge Clark) in *ETB (2014) Limited v HMRC* [2016] UKUT 424, to which we were not referred by the parties, at [15]).

73. It remains necessary, however, for Catplant to identify an underlying cause of the insufficiency of funds which can be regarded as a reasonable excuse. Catplant's argument is that it had a reasonable excuse for failing to pay the VAT on the due dates for the 10/13 period and the 01/14 period because it suffered from a cash crisis. That cash crisis was caused by the petition to wind-up its major subsidiary (CQL), the freezing of CQL's bank accounts and the arrangements put in place by the court which denied Catplant access to funds which it would have expected to have been available to discharge the VAT liabilities.

74. As a starting point, in the context of a VAT group, where the representative member is obliged to account for VAT in respect of supplies made by all of the

members, it seems to us that the potential winding up of a member of the group and the resulting constraints imposed on its financing arrangements cannot of themselves be regarded as the underlying cause for an insufficiency of funds which constitutes a reasonable excuse for the non-payment of the group's VAT by the representative member. In that context, the potential winding-up of a member of the VAT group and the related constraints imposed upon it are simply symptoms of the insufficiency of funds in the group. An insufficiency of funds in itself cannot be a reasonable excuse.

75. Catplant must therefore go further than simply relying up on the winding-up petition in relation to CQL and its consequences (i.e. the freezing of CQL's accounts and the constraints imposed by the court order). It must either show: that the underlying cause of CQL's lack of funds which led to the winding-up petition and its consequences was itself a reasonable excuse; or, if the freezing of CQL's accounts and the constraints of the court order are themselves to be regarded as a reasonable excuse, that those events deprived Catplant of access to funds that it might otherwise reasonably have expected to be available to it to discharge the group's VAT.

76. On the first point, the only reason that Catplant has advanced for the lack of funds in CQL is the level of its accruing landfill tax liabilities. In our view, the level of CQL's landfill tax liabilities cannot amount to a reasonable excuse for the failure to discharge the group's VAT liabilities. It is the statutory duty of any business to pay the tax associated with its activities on time. If cash flow problems arise as a result of business conditions, it remains its duty to make financial arrangements that will enable the tax to be paid.

77. For this reason, Catplant must be able to point to some other factor in addition to CQL's tax liabilities which might constitute a reasonable excuse. Catplant has not provided us with any material evidence of the underlying reasons for the lack of funds in CQL which put it in a position where it could not meet its landfill tax liabilities.

78. On the second point, Catplant argues that the freezing of CQL's accounts and the constraints imposed by the court order denied Catplant access to the funds in CQL's accounts that could have been used to meet the group's VAT liabilities. However, even if the winding-up petition had not been issued, and even if CQL's bank accounts had not been frozen, and even if the court had not required the creation of the Second Account, there would not have been sufficient funds available to CQL on the due dates to enable it to meet its landfill tax liabilities. If it had paid its landfill tax liabilities, CQL would not have had any funds that it could make available to Catplant to discharge the group's VAT liabilities. The only way in which the group could reasonably expect to be able to meet its VAT liabilities on the due dates was by continuing to ignore CQL's landfill tax liabilities.

79. Was it reasonable for Catplant and CQL to assume that HMRC would continue not to enforce the payment of CQL's landfill tax liabilities so that the funds in its accounts would be available to meet the group's VAT liabilities? In our view, it was not. CQL had received several letters from HMRC warning of possible action to wind-up the company before the letter of 6 November 2013. While we accept that the steps taken by HMRC to initiate the issue of a winding-up petition in November 2013

may have taken the directors of Catplant and CQL by surprise, it was not reasonable for Catplant or CQL to draw any inference from the failure of HMRC to take action following the issue of the previous letters that HMRC would continue to defer winding-up action indefinitely. Furthermore, although Mr Berry, in his evidence, stated that the CQL was in discussions with HMRC concerning the payment of its liabilities, we have seen no evidence of any representation made by HMRC to the effect that payment could be deferred.

80. Catplant also says that the attention of the group's executives was diverted to dealing with the winding-up petition and seeking to negotiate the CVA on behalf of CQL. We acknowledge that the companies must have devoted significant resources to seeking the CVA. However, in our view, that is not a reasonable excuse for the failure of Catplant to meet its liabilities. The reason that Catplant was unable to meet its liabilities was that it suffered from a cash flow crisis. The insufficiency of funds in itself is not a reasonable excuse and Catplant has not demonstrated to us an underlying cause for that insufficiency which could amount to a reasonable excuse.

81. The burden proof is on Catplant to show that there was a reasonable excuse for the non-payment of its VAT liabilities. In our view, it has failed to discharge that burden.

Decision

82. We dismiss these appeals.

Rights to appeal

83. 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.

ASHLEY GREENBANK
TRIBUNAL JUDGE

RELEASE DATE: 11 NOVEMBER 2016