[2018] UKFTT 258 (TC)

TC06488

Appeal number: TC/2018/00819

VAT default surcharge – appellant using cash accounting –late payment by clients- reasonable excuse for defaults? – no - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

K D PRODUCTIONS LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE SWAMI RAGHAVAN

Sitting in public at Taylor House, London on 5 April 2018

Mr Kingsley-Dobson, director of the appellant for the Appellant

Mrs Ashworth, HMRC presenting officer, for the Respondents

Both parties participated by video through HMCTS' on-line video facility

DECISION

Introduction

1. This appeal was originally against a default surcharge in the amount of £4131.96 issued by HMRC under section 59 Value Added Tax Act 1994 ("VATA 1994") for the late payment of VAT for period 07/17. As explained below the scope of the appeal was subsequently expanded to take account of a number of material prior periods. There was no dispute that the VAT payments were made late or that the appellant had been duly notified of the surcharges by HMRC. The main question which arose in the appeals was whether the appellant had a reasonable excuse for paying late. While the period originally under appeal was 07/17, further to the relevant legislation the tribunal also considered whether the appellant had a reasonable excuse for its earlier defaults in paying late on the basis those were material to the VAT default surcharge for 07/17. Although the appellant had not filed notices of appeal for those earlier defaults, HMRC confirmed it had no objection to the tribunal giving permission to the appellant to notify those appeals out of time. I gave permission to the appellant to notify the earlier default surcharge appeals late accordingly.

2. The appellant company, K D Productions Ltd was represented by its director and owner, Mr Kingsley-Dobson. He gave oral evidence which HMRC had the opportunity to cross-examine and he helped with tribunal with its further questions. I found Mr Kingsley-Dobson to be an honest and credible witness of fact. The tribunal and parties also had access to a bundle of documents (in Mr Kingsley-Dobson's case this was through viewing a scanned version of the bundle on his screen). The bundle included correspondence between the parties and various bank and cash-flow statements the appellant had sent in.

Law

3. Section 59(7) VATA 1994 provides:

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

4. Section 71 VATA 1994 provides:

'(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.'

Background and Facts

5. K D Productions Ltd builds sets for events and theatres across the country and also supplies technical crew for rock and roll, fashion and other high profile events. Mr Kingley-Dobson is the sole director. There are two other employees. Mr Kingsley-Dobson deals with invoicing but not the accounting. The company has been VAT registered for 5/6 years. The business has a relatively large turnover but only makes a small profit and, when able, Mr Kingsley-Dobson draws a relatively modest salary. Although figures of £2 million plus appeared in the statements in the bundles, Mr Kingsley Dobson's explanation (which was not challenged and which I accept) was that the figures were artificially high because of an error in the use of the firm's QuickBook software whereby a cumulative total from five years of trading was shown.

6. Mr Kingsley-Dobson confirmed in response to HMRC's letter of 5 March 2018 and in response to HMRC's questioning during the hearing that the appellant used Cash Accounting for its VAT (in other words the appellant accounted for VAT on the basis of the monies received and paid during the relevant period).

7. He explained in his letters to HMRC (of 23 January 2018, 5 March 2018 and 23 March 2018) that the appellant has over 100 clients, and that a significant percentage of clients (90% according to his letter of 23 January 2018) paid late. Most clients paid beyond 30 days (the typical invoice term was 14 days).

8. The details of the prescribed accounting periods relevant to this appeal, the relevant due dates, VAT and surcharge amounts are set out in the table below.

Default	**VAT Period**	**Due date** **(date for electronic payments extended to 7 days after date)**	**VAT (and amount paid after due date)**	**Calculation percentage**	**Amount**
1	04/16	31/5/16	£22,733.01 (£2,733.01)	First default	0.00
2	10/16	30/11/16	£34,878.00 (assessed) £51451.16(on	2% 2%	£697.56 £1029.02

			return) (£51,451.16)		
3	01/17	28/2/17	£46,972.00 (£46,972.00)	5%	£2,348.64
(4) original	04/17	31/05/17	£30,775.52 (£30,775.52)	10% (HMRC removed by letter)	£3,077.55
4 (new)	07/17	31/08/17	£41,319.64 (£41,319.64)	15% reduced by HMRC to 10%	£6,197.94 £4131.96

9. I found the following further facts in relation to the periods running up to the various defaults from Mr Kingsley-Dobson's correspondence and oral evidence.

10. *First default (04/16 – VAT due of £22,733.01)* the fact £2733.01 was paid one day late arose because Mr Kingsley-Dobson's bank only allowed him to make a payment of up to £20,000 online or by phone.

11. *Second default (10/16)* – the appellant was working on a project with Camberley Council and another company, Event by Event Ltd which involved setting up an ice rink for event around Christmas 2016. The appellant's role was to provide crew, carpet and build furniture. Event by Event Ltd ran into problems for paying for chilling equipment for the rink. Mr Kingsley-Dobson who had known the director at that the company for the last two to three years was concerned that if Event by Event Ltd could not do it was supposed to then there would be no event with a consequent knock on effect for the appellant. He lent Event by Event Ltd £27k which the appellant had set aside to pay the appellant's VAT. The sum was supposed to be paid back within the week and by 7 December 2016 but was not.

12. *Third default – 01/17* – On the evidence before me I was not able to make any detailed findings of fact as to circumstances surrounding the default, although I infer from the later facts surrounding Event by Event Ltd's insolvency, that the sum that company owed the appellant remained outstanding as at the point the VAT for the period was due.

13. *Original Fourth default 04/17* charged at 10% - In May 2017, Event by Event Ltd went insolvent owing the appellant around £60k made up of sums owing for labour, materials, and the loaned sum of £27k. The appellant took steps to raise more

finance and managed to borrow £48k from the Funding Circle. HMRC removed this surcharge by letter and reissued the 07/17 default as a 10% default rather than 15%. This was in response to the appellant's letter of 26 September 2017 which explained the difficulties with Event by Event Ltd becoming insolvent owing a significant sum and which enclosed an earlier letter the appellant sent to HMRC of 16 July 2017. The 16 July 2017 letter, as well as recounting Event by Event Ltd's insolvency, mentioned difficulties with other clients not paying and a particular payment of £20k which was 120 days late.

14. In June/ July 2017 the appellant carried out work for the Sewell Group fixing the stage for a new theatre in Hull. The VAT invoice of £59k was sent on 18 July 2017. An initial payment of £13k was received initially, but remainder was paid 3 weeks past the due date in the week starting 4 September 2017 and there was in any case a shortfall of £11k which was still outstanding. In the meantime the appellant was still trying to keep other projects it was working on going, paying for supplies and workers. Mr Kingsley-Dobson mentioned another project, where money due in August was not received until the November.

15. From the bank statements and monthly cash flow statements the appellant provided, a number of cash inflows and outflows were apparent. It appears that after the 30 day invoice period expired 17 August 2017 a number of deposits in were received including amounts of £6,810 on 17 August, £14,966, and £10,263 on 18 August, £6,320.40 on 1 September and a payment in of £41,279.40 on 5 September 2017. A number of payments in respect of pay to workers were made that same day and on 6 September with the effect that as at close 6 September the balance stood at £6,905.36. On 7 September 2017 (the due date) there was a payment in of £5,160. The Sewell remittance of £48,040.63 was not credited until 8 September 2017.

16. Mr Kingsley-Dobson explained he had applied to his bank for an overdraft a couple of months ago, but did not do so back in September as he did not think he needed it then.

Parties' arguments

17. For the appellant, Mr Kingsley-Dobson emphasised that while his company had a large turnover it did not make a large profit. It was unfair that his firm which was contributing so much in VAT, rates, PAYE and NICs and providing work for others and contributing to the economy would be charged such a large sum for being only one day late with its payment.

18. HMRC highlighted that the appellant used the cash accounting scheme so only has to account for VAT when the payment was received. The use of VAT which had been paid was within the appellant's control and it had chosen to use funds for other purposes, if had organised matters differently it could meet legal obligation in time. The funds were not available at due date because of the company's cash-flow but that was a risk the business chose to take. Delays in payments became the norm and in these circumstances it was expected the trader should put further measures to make

VAT return on time in particular having received previous surcharge notices. The late payment was not a new or unexpected event.

19. Mr Kingsley-Dobson rejected what he understood followed from HMRC's argument around prioritisation, which was that he should pay VAT in priority to paying his employees and suppliers. He had to pay employees and suppliers first. If he did not no-one would work for him or supply him and there would be no business to run.

Discussion

20. The question of whether a trader has a reasonable excuse will depend on the particular facts and circumstances of the case. Although an insufficiency of funds to pay any VAT due is not a reasonable excuse, the legal principles which emerge from the case-law enable the causes which lie behind a default which is due to insufficiency of funds to potentially form the basis for a reasonable excuse. The test was expressed by Lord Donaldson MR in *CCE v Steptoe* [1992] STC 757 as follows:

> "… [I]f 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."

21. With that test in mind, I consider below whether the various matters the appellant referred me to, gave rise to a reasonable excuse for each of the default surcharges in issue.

22. But before considering the circumstances around each of the payment defaults under appeal there is a general point which it is worth dealing with arising from the fact the appellant accounted for VAT using the cash accounting scheme. A key advantage of accounting on that basis is the cash-flow advantage of not having to account for VAT until payments are actually received thereby alleviating difficulties which arise when a client or customer pays late. While a trader is not prevented from using the VAT included within sums received elsewhere, if it does so, it effectively puts itself back in the situation where (if no other contingency plan is made) late payment by the client or customer may well jeopardise timely payment of the VAT due for the relevant period. A trader using cash accounting, but who uses the amount received in respect of VAT for other purposes would, in exercising reasonable foresight and due diligence and a proper regard to the fact that tax would become due, need to have a firm grip on credit control of overdue invoices and a robust contingency plan in case debts were not paid on time, in order for it to be considered that any insufficiency of funds which then arose was unavoidable.

23. As regards the first default (period 04/16) I do not regard (and Mr Kingsley-Dobson did not suggest otherwise), the fact there was a £20,000 payment limit for phone or on-line payments, to be a reasonable excuse. A trader knowing such a

payment was due would reasonably be expected to check any payment limits and if there were an issue to make alternative arrangements in good time.

24. The appellant did not also in my view have a reasonable excuse for the second default (period 10/16). Mr Kingsley-Dobson accepted, with the benefit of hindsight, both at the hearing and in correspondence that loaning the money (which had been earmarked to pay the upcoming VAT due) to another company involved in the ice rink project was unwise. However, although I can see the thought process behind the loan, namely to preserve the viability of the project, the making of a short-term loan to another company with no readily accessible and liquid security, or comfort that the loan would be repaid in time for the appellant to make its VAT obligation, and no contingency plan if it did not, was not consistent with a trader acting with the requisite exercise of reasonable foresight, due diligence and a proper regard for the fact the VAT would become due on a particular date.

25. As regards the third default (period 01/17), in the appellant's favour it had had an ongoing business services (as opposed to loan provision) relationship with the debtor, Event by Event Ltd. over two to three years without any reported difficulty. However the invoice sum was for atypically high amount (viewing it in the context of the invoice sums apparent in the appellant's later financial records) and therefore presented a higher risk if it was not paid on time. It would, in my view, be reasonably expected that a trader in this situation would take steps to manage their cash-flow by ring-fencing the amounts already paid in respect of VAT from other calls or seeking alternative sources of finance. The appellant did not have a reasonable excuse for this default.

26. Turning lastly to the fourth default, although there was some suggestion initially in correspondence of an error on the part of the bank or that it was due to slow processing on the part of the bank, there was no evidence that this was the case. In relation to 07/17 the appellant argued that it received the remittance from Sewell but that when Mr Kingsley-Dobson went to the bank (HSBC) on 7 September 2017 he was informed the VAT payment may not go through until the 8th depending on when the payment from Sewell would hit the appellant's account. It appeared that the funds the appellant was expecting simply had not cleared in time in order that the payment of VAT could be made on the 7th. The way in which the bank handled the payment does not afford the appellant a reasonable excuse.

27. While HMRC pointed to the fact the appellant did not call the VAT office, even though it was provided with details in letter of 12 January 2017, and submitted that HMRC would have been likely to void surcharge but did not do so, I accept that when Mr Kingsley-Dobson had called HMRC on previous occasions there had never been any talk of cancelling surcharge and that as far he was concerned the surcharge would still be imposed. I do not therefore consider the fact he did not call HMRC to discuss the delayed surcharge as relevant on the facts of this case.

28. Although HMRC highlight the acceptance by the appellant of a prevalence of late payment of invoices in the sector in which the appellant operated, in the appellant's favour, I take into account that Sewell Group appeared to be a new client

and that it would not inevitably follow that just because the majority of customers the appellant had experience of would pay late that Sewell would necessarily also pay late. But the previous experience of other late payers would signal, at the very least, that there was a risk of late payment. Furthermore the relatively large amount of the invoice would mean the impact of any late payment would be that much more significant. It would be incumbent on a trader in the appellant's position, in particular one such as the appellant who had already experienced the consequences of large invoice amounts not being paid on time on its cash flow, to put in place a contingency plan to meet the VAT payment deadline if Sewell paid late. While Mr Kingsley-Dobson says he threatened them with a "fine" of his own if they did not pay up and so was making some attempt to chase the debt the appellant cannot reasonably have assumed those warnings would be successful in bringing about a prompt payment. There was also no back up plan in place in case the remittance from Sewell was delayed despite the warning.

29. Mr Kingsley-Dobson was open in explaining his rationale for paying employees, and suppliers first and indeed it formed the crux of his case. His argument was without maintaining the confidence of employees and suppliers that they would be paid on time there would be no ongoing business. While I accept that this approach reflected his belief and that the cash-flows I saw in the bank statements and monthly statements were consistent with him implementing this way of operating, I do not consider that it gives the appellant a reasonable excuse for the default. Traders will inevitably have competing financial obligations to employees, suppliers and others which must be met keep the business going but equally the trader must also meet its obligations to pay the VAT due on time. In order for those competing priorities to be met, and for any insufficiency of funds leading to non-payment of VAT to be regarded as unavoidable, a trader would need to act with reasonable foresight and due diligence and with proper regard to the fact tax would become due on the relevant date. This would involve putting in place contingency plans such as an overdraft or other backup finance to manage its cash-flow in line with its actual experience of invoice receipts. Even if the appellant was not a trader using cash accounting, the decision to prioritise employee and supplier expenses would not give it a reasonable excuse but would serve to highlight that extra sources of finance would need to be explored and accessed in a timely way so as to be able to make the VAT payment on time. But, where the trader is not liable for VAT until the invoices are paid, as is the case with cash accounting, it makes it all the more difficult to be persuaded the appellant had a reasonable excuse for the default. Even if the appellant had not consciously chosen to manage its cash-flow so that, despite being on cash accounting, the VAT received helped fund other subsequent obligations, having ended up in that situation and exposed to vagaries of late payers, it fell to the appellant to actively mitigate the risks of late payments. While I understand the appellant has recently taken the sensible step of seeking overdraft facilities with its bank which will if obtained help with timely VAT payment in the future this does not help with establishing a reasonable excuse for the late payments under appeal.

30. Taking into account prevalence of late payments generally within the appellant's customer base, the previous adverse experience related to the risks of waiting for a large payments to come through, a trader in the appellant's

circumstances who, despite using cash accounting was relying on other cash inflows rather than retained VAT to pay what was due, would reasonably be expected to have taken on board and addressed the real risk of being late on VAT if the Sewell remittance was late. Such a trader would be expected to have put in place measures in advance to ensure the VAT due could be paid on time even if the Sewell remittance was late. In my judgment the fact that that payment or indeed others were late does not in the circumstances of this appeal afford the appellant a reasonable excuse for failing to pay by the due date.

31. While the appellant's case focused on the issue of reasonable excuse there was a brief discussion on the question of proportionality given the appellant had raised issue around the fairness of the penalty and the fact he was charged a penalty even though he was only a day late. HMRC referred me to the decision of the Upper Tribunal (whose decisions are binding on this tribunal) in *RCC v Trinity Mirror Plc* [2015] UKUT 0421 which in turn considered the UT's decision in *Total Technology* [2012] UKUT 0418. For present purposes is sufficient to note the default surcharge regime as a whole was not held to be disproportionate but that given the absence of maximum penalty limit it was open to a tribunal to rule that an individual penalty was disproportionate. However this was likely to occur only in a wholly exceptional case. Having considered the matter, the particular amounts of the surcharges under appeal, taking account the circumstances of the case, do not appear to me to be so high as to render the surcharges disproportionate. As to a challenge on the basis the surcharges are unfair, it is also clear that the tribunal is only able to deal with the issues the statute says it can. The issue of "reasonable excuse" is one such example which is set out in the law. What the tribunal cannot do is set aside a surcharge on the grounds of general unfairness even if that were demonstrated, or through taking into account the appellant's contribution to the wider economy through keeping the business going.

Conclusion and Decision

32. The appellant's appeals are dismissed and the default surcharges under appeal are upheld.

33. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

SWAMI RAGHAVAN
TRIBUNAL JUDGE

RELEASE DATE: 8 MAY 2018