TC06552
Appeal number: TC/2017/01027

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INCOME TAX –Whether cash flow difficulties provided reasonable excuse for late payment of VAT returns - No. Whether surcharge liability notice and subsequent surcharges correctly addressed and received by the appellant –No. Appeal allowed.

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FIRST-TIER TRIBUNAL
TAX CHAMBER

EXCEL COMMERCIAL CLEANING SERVICES LIMITED **Appellant**

- and -

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

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TRIBUNAL: PRESIDING MEMBER: PETER R. SHEPPARD FCIS FCIB CTA AIIT
MEMBER: SUSAN STOTT FCA CTA

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Sitting in public at Alexandra House, 14-22 The Parsonage, Manchester on 20 April 2018.

25 **Sarah L. Davies, Director for the appellant**

Anthony J. O'Grady, Inspector of Taxes for HMRC

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DECISION

1. **Introduction**

This considers an appeal against VAT Default Surcharges levied by HMRC over the period 1 August 2015 to 31 March 2016 during which time the appellant submitted monthly VAT returns. The Notice of Appeal dated 14 December 2016 appealed against surcharges totalling £12,605.19. Since then there have been a number of amendments and corrections to the amounts of the surcharges as originally levied. At the hearing Mr O'Grady helpfully explained these and parties were agreed that the amount being appealed now totalled £9,947.41.The surcharges were for the late filing and/or late payment by the appellant of its VAT returns. Details of the amounts are given at paragraph 13 below.

2. **Statutory Framework**

The VAT Regulations 1995 Regulation 25 (1) contains provisions for the making of returns and requiring them to be made not later than the last day of the month following the end of the period to which it relates. It also permits HMRC to vary that period, which they do in certain circumstances e.g. by allowing a further 7 days for those paying electronically.

3. Regulation 25A (3) requires the provision of returns using an electronic system.

4. Section 59 of the VAT Act 1994 sets out the provisions whereby a Default Surcharge may be levied where HMRC have not received a VAT return for a prescribed accounting period by the due date, or have received the return but have not received by the due date the amount of VAT shown on the return as payable.

A succinct description of the scheme is given by Judge Bishopp in paragraphs 20 and 21 of his decision in Enersys Holdings UK Ltd. [2010] UKFTT 20 (TC) TC 0335 which are set out below.

> 20" ……….The first default gives rise to no penalty, but brings the trader within the regime; he is sent a surcharge liability notice which informs him that he has defaulted and warns him that a further default will lead to the imposition of a penalty. A second default within a year of the first leads to the imposition of a penalty of 2% of the net tax due. A further default within the following year results in a 5% penalty; the next, again if it occurs within the following year, to a 10% penalty, and any further default within a year of the last to a 15% penalty. A trader who does not default for a full year escapes the regime; if he defaults again after a year has gone by the process starts again. The fact that he has defaulted before is of no consequence.
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> 21. There is no fixed maximum penalty; the amount levied is simply the prescribed percentage of the net tax due. The Commissioners do not collect some small penalties; this concession has no statutory basis but is the product of a (published) exercise of the Commissioners' discretion, conferred on them by the permissive nature of s 76(1) of the 1994 Act, providing that they "may"

impose a penalty, and their general care and management powers. Even though the penalty is not collected, the default counts for the purpose of the regime (unless, exceptionally, the Commissioners exercise the power conferred on them by s 59(10) of the Act to direct otherwise). Similarly, where the monetary penalty is nil, because no tax is due or the trader is entitled to a repayment (…..) the default nevertheless counts for the purposes of the regime, subject again to a s 59(10) direction to the contrary."

5. Section 59 (7) VAT ACT 1994 covers the concept of a person having reasonable excuse for failing to submit a VAT return or payment therefor on time.

6. Section 71 VAT Act 1994 covers what is not to be considered a reasonable excuse.

7. Section 98 VAT Act 1994 covers the serving of notices.

8. Finance Act 2009 Section 108 provides that there is no liability to a surcharge for a period where contact with HMRC is made before the due date in order to arrange a payment deferment.

9. VAT Regulations 1995, in particular Regulations 40 which creates an obligation on a person who makes a VAT return to pay the VAT due.

10. Interpretation Act 1978 Section 7.

11. **Case law**

Enersys Holdings UK Ltd. [2010] UKFTT 20 (TC) TC 0335
C & E Commissioners v Medway Draughting & Technical Services Ltd QB [1989] STC 346
C & E Commissioners v Salevon Limited QB (1989) STC907
C & E Commissioners v Steptoe [1992] STC 757

12. **Facts**

The appellant was incorporated on 1 November 2013. Their registered address was St. John's Chambers, Love Street, Chester CH1 1QN

On 9 January 2015 Companies House received by recorded delivery a form AD01 notification of a change of registered office. This advised a change of registered address to Unit 7, Evans Easyspace, Minerva Avenue, Chester CH1 4QL.

The appellant's corporation tax record was updated to reflect this change on 21 January 2015.

A copy of the appellant's VAT returns for each of the periods 04/14, 10/14, 05/15, 07/15, 08/15, 09/15, 10/15, 11/15, 12/15, 01/16, 02/16, and 03/16 was included in the bundle of papers before the Tribunal. All of these returns showed the name of the appellant and the address as Unit 25 Evans Business Park, Minerva Avenue, Chester CH1 4QL.

13. A schedule of Defaults produced by HMRC shows that the appellant first defaulted in period 04/14 by sending payment 6 days late. A Surcharge liability Notice was issued.

The next default was in period 10/14 and a surcharge issued on 12 December 2014. This default was removed on 9 March 2017 as it was realised a Time to pay agreement had been agreed before the due date. The effect of the removal of the surcharge for period 10/14 was that by April 2015 the appellant had not defaulted for twelve months so escaped the default surcharge regime.

The next default was in respect of period 05/15 and a surcharge notice was issued for this on 17 July 2015. As this technically put the appellant back into the default surcharge regime this was a first default and it was necessary to issue a surcharge liability notice which was not done until 9 March 2017.

After the 05/15 default further surcharges were levied by HMRC and after various adjustments the amounts ultimately levied by HMRC which make up the total of £9,947.41. These are shown in the following table:

VAT Period	Surcharge applied to tax due	Amount of Surcharge
08/15	2%	De minimus no surcharge levied
09/15	5%	£531.87
10/15	10%	£1,108.05
11/15	15%	£1,661.08
12/15	15%	£1,548.72
01/16	15%	£1,657.45
02/16	15%	£1,789.68
03/16	15%	£1,650.06

14. **Appellant's Submissions**

In a letter to HMRC dated 26 May 2016 the appellant wrote:

> "I am writing to you to formally lodge an appeal against penalty charges we have just been verbally notified of yesterday, 25/5/16.
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> We discovered from a telephone call from the local tax office yesterday that we have been charged around £12,000 in penalty charges for late payment of our VAT, we have apparently been sent numerous letters about this, but these have all been sent to an address we no longer operate from and have not for over 2 years. We are aware that we have made late payments on our VAT recently, but appeal the penalty charges on the following grounds:
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> 1) We amended our VAT payments to monthly from quarterly to try to ensure we were not allowing our payments to grow to a level we could not pay each quarter, therefore even though we have been up to 30 days late on our monthly payments, this is still paid earlier than if we were paying quarterly, and we have not allowed payments to be more than 30 days late.

2) The letters regarding the penalty charges have all been sent to the wrong address, the previous home address of our director, this is despite us receiving letters from HMRC regarding both PAYE and Corporation Tax to our current and correct address.

3) Meetings have been held with representatives of the local tax office regarding VAT at the new office premises, therefore we obviously were of the belief and understanding that this was the registered address they had on the system.

4) With every online payment we have made towards our VAT, which is generally 2 -3 payments per month, we have to confirm our address and have always confirmed the new office address.

5) We feel it is totally irresponsible for us to only receive a telephone call after the penalties have reached a huge amount, I believe around £12,000. Why, when we did not respond to any of the letters sent to the wrong address did someone from the tax office not call us earlier in the process, before the penalties were allowed to build to such a large figure, despite our address changing, our telephone number has always remained the same, and if we were aware of the penalties, we would have made more effort to pay on time, but as we did not hear anything, we thought that making our payments gradually over the month, albeit a little wait, was acceptable.

6) We are aware that as responsible business operators, we should not pay our VAT late, but we are trying our best to keep up to date. Over the past 12 months, we have had more than one customer go bankrupt on us, owing us significant sums of money, we have attempted to regain these funds through the small claims court system and the insolvency service., but with no success on some occasions, whereas on another case which we won successfully through the small claims court system a customer owing us £3,000 has been allowed to pay us back at £50 per month, all these individual cases add up and cause strain on our cash flow situation. People owing us money through official channels are given authority to pay back in small sums over a long period of time. years in some cases, yet we are penalised heavily for being around a month late with our payments.

Please can someone advise us to the next step in this process, but we want to make it very clear at this point that we will do everything in our power to appeal against these charges as we do not feel it is fair that they have been allowed to reach this level before alternative means of communication were made, and despite the fact that the HMRC already had our correct address for other departments."

15. HMRC took this letter as a request for a review and on 22 July 2016 wrote to the appellant to confirm the result of the review which was that the decision had been made not to cancel the default assessments.

16. The appellant responded to this in an undated communication and made comments which were very similar to those in the Grounds of Appeal in their Notice of appeal dated 14 December 2016. This stated:

> "Due to circumstances outside our control we experienced significant and unexpected cash flow issues due to several customers becoming insolvent. This left us with outstanding payments from these customers amounting to £23,996.76 As a result we were unable to make all our VAT payments in the periods 08/15, 09/15, 10/15, 11/15, 12/15, 01/16, 02/16, and 03/16.
>
> On 25 May 2016 we were notified verbally that we had incurred substantial surcharges in relation to our underpaid VAT. However, we had not received any correspondence in relation to this as the surcharges were sent to an old address. HMRC maintain that there is no record of our address being changed, however correspondence from HMRC was sent to our correct address on 18 December 2014 – prior to surcharges being issued. Additionally, we have received correspondence from HMRC in relation to PAYE and Corporation Tax at the address we advised HMRC to change our address to. There must be a reasonable expectation that when an address change is notified that all systems and records are updated by HMRC.
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> Section 98 (VATA 1994) states that "any notice, notification, requirement or demand to be served on, given to or made of any person for the purposes of this act may be served, given or made by sending it by post in a letter addressed to that person or his VAT representative at the last or usual residence or place of business of that person or representative." The case of Medway Draughting and Technical Services Ltd (STC 346) stated that it was Parliament's intention that a warning in the form of a surcharge liability notice should be given before a surcharge could be levied. It held that the whole scheme of default surcharges was dependent upon service of the surcharge liability notice and lack of receipt of the notice deemed them invalid. Had we been in receipt of the surcharge liability notices we would've acted immediately to agree a formal payment plan rather than paying by instalments informally.
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> In addition to not being in receipt of the surcharge liability notices, we feel that we have a reasonable excuse for not being able to pay our VAT on time. HMRC state that an example of a reasonable excuse is:
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> "an unexpected cash crisis; where funds are unavailable to pay your tax due following the sudden reduction or withdrawal of overdraft facilities, sudden non-payment by a normally reliable customer, insolvency of a large customer, fraud, burglary or act of God such as fire."
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> As highlighted above, we have lost several clients to insolvency and have unpaid bills amounting to £23,996.76. Additionally one of our clients who paid us £2,318.40 each month lost their site in a fire and as a result our services were not required. This has had a significant impact on our cash position and as a result we were unable to meet our tax payments."

17. At the hearing Mrs. Davies submitted that she had not received any of the surcharge liability notices which she asserted had been sent to out of date addresses. Mrs Davies confirmed that she lived in rented accommodation and had changed address a number of times during the period 2009 to date.

She gave the following addresses:

5, The Poplars, Hawarden, Deeside 2009 to Nov 2013

3, The Poplars, Hawarden, Deeside CH5 3QD Nov 2013 to March 2014

Birch Heath Farm, Christleton, Chester, March 2014 to Jan 2016 (also known as Birch Heath Farm, Stamford Lane, Cotton Edmunds, Chester. CH3 7QD)

Broughton House Farm, Broughton Jan 2016 to Jan 2017.

Mrs Davies said she did not consider it reasonable of HMRC to send the notices to an old personal address of a director rather than to the usual business address of the appellant which had been Unit 25 Evans Business Park, Minerva Avenue, Chester for the whole of the period covered by the surcharges appealed against. It was also the address which HMRC officer Julie Fuge had visited.

Mrs Davies explained that at various times the appellant had occupied units 3, 7 and 25 of the Evans Business Park. The Tribunal notes that previously Evans Business Park had been known as Evans Easyspace. Mrs.Davies explained that correspondence was often sent to the wrong Unit number in Evans Business Park but the appellant had no experience of not receiving post as a result.

18. Mrs Davies said that the appellant had suffered cash flow difficulties in the accounting periods 08/15 to 03/16 inclusive. She said that several customers went into liquidation owing the appellant £23,996.76 including VAT. Another client who paid the appellant £2,318.40 per month for cleaning services suffered a major fire and as a result no longer required the appellant's services. She accepted that full payment of the amounts due had not been made by the due date in the periods for which the surcharges had been made.

19. **HMRC's submissions**

Some of HMRC's submissions are included in paragraphs 12 and 13 above.

Mr.O'Grady had prepared speaking notes which he used to address the Tribunal. He handed a copy to the Tribunal and the appellant. These notes were helpful to the Tribunal and included the following comments:

HMRC accept that the appellant's corporation tax record was updated to show the new address of Unit 7 Evans Easyspace on 21 January 2015.

However, they say the Appellants PAYE address history shows that from 18 March 2015 the appellant's correspondence address was Unit 3 Evans Business Centre until 29 June 2015 when this was changed to Unit 7.

They say that the first Surcharge liability notice was issued on 13 June 2014 to the principal place of business address held on HMRC's VAT record which at that time they submitted was also Mrs Davies's personal address at 5 The Poplars.

They say that there therefore appears to be no reason why the Appellant should not have received the initial surcharge liability notice. HMRC also say that therefore the potential financial consequences attached to the risk of further default would have been known to the Appellant from this point onward, having regard for thee information printed on the surcharge liability notice that was issued.

HMRC argue that whatsoever subsequent confusion there was concerning the address of the principal place of business, the fact remains that the surcharge liability notice was sent to Ms Davies at her correct private address at that time (which was also the principal place of business on the VAT record) and therefore HMRC had met its legal obligation to notify the Appellants that they had entered the surcharge regime, in accordance with Section 59(4) of the VAT Act 1994.

HMRC say that the fact that the initial surcharge liability notice did not contain a financial element may be relevant in that the appellant may not have realised that it was a default surcharge notice.

With regard to the initial surcharge liability notice, and the subsequent surcharge liability notices and notices of surcharge HMRC point out that undelivered correspondence is recorded by HMRC and there are no records held that show any mail was returned undelivered.

They say it follows that all notices served for the periods 04/14 through to 03/16 are deemed to have been served in the ordinary course of post, and it is for the Appellant to prove otherwise, as provided for in by Section 7 of the Interpretation Act 1978.

20. In respect of the cash flow difficulties HMRC say that in order to accommodate the varying needs of traders they provide different schemes for the accounting of VAT. The cash accounting scheme allows a trader to account for VAT on the basis of payments received and made, rather than tax invoices issued and received. It is particularly beneficial if a trader gives their customers lengthy periods of credit or if a trader has a high level of bad debts. HMRC say that it may have been prudent for the appellant to consider accounting for VAT using this scheme, given the cash flow issues they describe.

HMRC say that the appellant did not take appropriate or sufficient steps to ensure that they met their VAT payment obligations during the period affected by any bad debts.

HMRC say that these defaults did not occur as something which was completely out of the appellant's control. The appellants could have contacted HMRC prior to the due date, and requested a time to pay agreement, but they did not do so.

21. HMRC point out that the legislation at Section 71 (1) (a) of the VAT Act 1994 specifically excludes insufficiency of funds from providing a reasonable excuse for the late payment of VAT.

HMRC say that an appeal on the grounds of insufficiency of funds, can only be considered when the appellant is able to demonstrate that the circumstances which led to the loss of income were unforeseen and out of their influence and control; something that came completely out of the blue. HMRC say that the difficulties described by the appellant do not fall outside the parameters of the ordinary hazards of trade.

22. HMRC refer to the decision in the case of Steptoe where Lord Nolan quoted himself from the earlier Salevon case. He said:

"the cases in which a trader with insufficient funds to pay the tax can successfully invoke the defence of reasonable excuse must be rare. That is because the scheme of collection which I have outlined involves at the outset the trader receiving (or at least being entitled to receive) from his customers the amount of tax which he must subsequently pay over to the commissioners. There is nothing in law to prevent him from mixing this money with the rest of the funds of his business and using it for normal business expenses (including the payment of input tax) and no doubt he has every commercial incentive to do so. The tax which he has collected represents, in substance, an interest free loan from the commissioners. But by using it in his business, he puts it at risk, if by doing so he loses it, and so cannot hand it over to the commissioners when the date for payment arrives, he will be hard put to it ……….to persuade the commissioners or the tribunal that he had reasonable excuse for venturing and thus losing money destined for the exchequer of which he was the temporary custodian."

23. HMRC say that most cash flow difficulties will fall within the usual hazards of trade, and in this instance the type of difficulties experienced by the appellant are no different to those experienced by many other businesses.

24. HMRC say that on 7 November 2016 the appellant telephoned to advise that their largest client had gone into administration owing them £17,000. During the appeal process documentation dated 16 September 2016 confirmed that the client concerned, The New Moon Pub Company Ltd. had commenced liquidation proceedings. HMRC consider that this was all subsequent to the due dates for the VAT quarters under appeal and is not therefore relevant.

25. HMRC say there is a procedure in place which allows traders to claim relief from VAT on bad debts incurred. However there is no evidence to to show the bad debts relief procedure was implemented by the appellant.

26. Tribunal's Observations

The Tribunal considers that it is the Appellant's responsibility to submit its VAT returns and relevant payments on time. The Appellant has accepted that full payment was not made in time in respect of the returns for which surcharges were levied. The Appellant has not challenged the calculation of the surcharges. The Tribunal accepts them as accurate.

27. The appellant has put forward two arguments that it considers provides them with reasonable excuse for the failure to pay on time.

Firstly it had suffered unexpected cash flow difficulties in the periods concerned due to bad debts and the loss of a customer who cancelled the cleaning contract as a result of a major fire.

Secondly the appellant argues that it was unaware that it was on the default surcharge scheme as it had not received a surcharge liability notice and subsequent surcharge notices.

28. The Tribunal has also considered carefully the grounds of appeal set out in the Notice of appeal.

29. In respect of the appellant's submissions on cash flow difficulties the legislation at Section 71 (1) (a) of the VAT Act 1994 specifically excludes insufficiency of funds from providing a reasonable excuse for the late payment. However the reason for the insufficiency of funds might provide a reasonable excuse. The Tribunal considers that bad debts are a normal hazard of trade as is the loss of customers. If significant these could provide a reasonable excuse for the appellant. In the case of Steptoe v HMRC the amounts of the delayed payments were a very large proportion of the appellant's turnover for the period and therefore provided a reasonable excuse for late payment. However the amounts involved in this case are nowhere near as significant.

The Tribunal accepts Mr.O'Grady's submission that most cash flow difficulties fall within the usual hazards of trade and the type of difficulties described by the appellant are no different to those experienced by many other businesses. HMRC do operate a bad debt relief scheme but it seems that the appellant's did not avail themselves of it. In addition the appellant chose to do monthly returns and not to use the cash accounting scheme which was available to it.

The Tribunal was not convinced that the cash flow difficulties were sufficient to establish that the appellant had reasonable excuse for the late payments of VAT due on their returns.

30. In respect of the issue of the surcharge liability notice and subsequent surcharges the Tribunal is not convinced that the first surcharge liability notice was received by the appellant. Although it was sent to the address on the VAT record Mrs. Davies advised the Tribunal that she had left that address well before the notice was issued and had not received it.

Even if the appellant did receive the Surcharge liability notice in respect of the period 04/14 no surcharges became due as a result of it because by period 04/15 there had been no further defaults liable to a surcharge (the 10/14 default being subsequently removed). The result was that the appellant was no longer in the default surcharge system. The next default was period 05/15 which meant that the surcharge system started again and it was necessary to issue a fresh surcharge liability notice but HMRC did not send this to the appellant until 9 March 2017.

The surcharge notices from 05/15 onwards appear to also have been forwarded to former addresses of the appellant's director. It is not clear why HMRC did not forward the notices to the appellant's business address which was the one visited by their officer Julie Fuge It is also not clear why after receipt of notification of the change of the business address for corporation tax purposes they did not also change the address for PAYE and VAT purposes. It is clear that they used an old address when sending out the VAT surcharge notices from 05/15 onwards. The Tribunal noted that all the VAT returns in the bundle did show the new Evans business park address. In the light of this Mr O'Grady could not explain why the surcharge liability notices had been sent to a different address.

31. There is a facility whereby a company can, using one form AD01, notify both Companies House and HMRC of a change of registered office address. The Government web-site "Running a limited Company" under the heading "Changing your limited company's registered address" states

"You must tell Companies House if you want to change your company's registered office address. If the change is approved they will tell HMRC."

It appears to the Tribunal that the phrase "they will tell HMRC" is misleading in that on investigation it was discovered that the notification to HMRC is sent to HMRC Corporation tax division. It appears there is no internal mechanism for the notification to be passed to HMRC VAT division.

The Tribunal has found that if one looks elsewhere on the government website it can be found that a separate notification of change of address to cover VAT is necessary. However where one reads that Companies House will tell HMRC of the change there is no indication that a separate notification for VAT is necessary so why would one look elsewhere. In the absence of any accompanying advice to the contrary it is reasonable to assume that that statement applies to the whole of HMRC and that is what the appellant did. The Tribunal considers that that was a reasonable assumption to make.

32. In the circumstances the Tribunal finds that surcharges notices covering periods from 05/15 to 03/16 were sent to an old address and not received by the appellant, and the 05/15 surcharge liability notice was not sent to the appellant until 9 March 2017.

HMRC did issue a surcharge notice to the appellant on 17 July 2015 but it appears that they used an address which the director had vacated in March 2014. The director believed that the appellant had notified HMRC of the Company's change of address in January 2015.

33. The Tribunal is satisfied that the Appellant has established that it did not receive surcharge liability notices or the subsequent surcharge notices therefore the appeal against the surcharges is allowed.

34. 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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PETER R. SHEPPARD
TRIBUNAL JUDGE

10 RELEASE DATE: 22 JUNE 2018