



Neutral Citation: [2023] UKFTT 00013 (TC)

Case Number: TC08675

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

By remote video hearing

Appeal reference: TC/2022/00594

VAT – default surcharge – reasonable excuse – COVID-19 causing cashflow problems – appeal allowed

Heard on: 7 November 2022

Judgment date: 21 December 2022

Before

**TRIBUNAL JUDGE MALCOLM FROST
JOHN AGBOOLA**

Between

BICESTER PROPERTY INTERIORS LIMITED

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY’S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Jake Holdsworth, Director of the Appellant

For the Respondents: Pembe Ramadan litigator of HM Revenue and Customs’ Solicitor’s Office

DECISION

INTRODUCTION

1. The Appellant, Bicester Property Interiors Limited (“BPIL”) appeals against HMRC’s decision to issue default surcharges for the VAT periods 04/20, 01/21 and 04/21.

FORM OF THE HEARING AND EVIDENCE PROVIDED

2. With the consent of the parties, the form of the hearing was V (video), using the Tribunal’s video hearing system.

3. Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

4. The Tribunal was provided with an agreed bundle of documents comprising 190 pages. Mr Holdsworth, director of BPIL, gave evidence and was cross-examined.

BACKGROUND FACTS

5. BPIL is an interior renovation company that fits kitchens and bathrooms, and carries out other interior renovation work. The company began trading in August 2019 and has been registered for VAT from 25 February 2020.

6. BPIL submits VAT Returns on a quarterly basis.

7. It was not disputed that BPIL fell into default in a number of VAT accounting periods. As a result of the defaults, HMRC issued a surcharge liability notice (“SLN”), several surcharge liability notice extensions (“SLNE”s) and default surcharge assessments. These are summarised in the table below.

Period	Due date	Default	Percentage	Penalty	Notice
07/20 (1 August 20- 31 October 20)	7 September 2020	VAT Return-19 November 2020 VAT paid in 2 parts: Part 1- 27 April 2021 Part 2- 29 April 2021	(No penalty, HMRC issued a ‘Help Letter’)	£0	SLN – the surcharge period of 6 November 2020 - 31 July 2021 notified
10/20 (1 August- 31 October 20)	7 December 2020	VAT Return – 17 January 2021 Payment in 3 parts: First - 5 July 2021 (WorldPay internet payment)	(No penalty as this was considered the first default)	£0	SLNE surcharge period extended until 31 October 2021

		Last - 15 December 2021 (direct debit)			
01/21	7 March 2021 (1 November 2020- 31 January 2021)	VAT Return- 7 April 2021 VAT Paid in 4 parts- First- 15 December 2021 Last- 15 March 2021 (direct debit)	2%	£0	SLNE surcharge period extended until 31 January 2022
04/21	7 June 2021	VAT return- 2 June 2021 VAT Paid- 21 June 2021 (WorldPay internet payment)	5%	£620.22	SLNE surcharge period extended until 30 April 2022
07/21 (1 May 2021- 31 July 2021)	7 September 2021	VAT return- 7 September 2021 VAT paid- 10 September 2021 (Faster payment service)	10%	£864.80	SLNE surcharge period extended until 31 July 2022
10/21 (1 August 2021- 31 October 2021)	7 December 2021	VAT return- 12 November 2021 VAT paid- 24 December 2021 (Worldpay Internet payment)	15%	£1,183.56	SLNE surcharge period extended until 31 October 2022

8. On 13 September 2021, accountants acting for BPIL requested a review of the decision to issue the surcharges for the periods 04/20, 01/21 and 04/21.

9. On 10 January 2022, HMRC issued a review conclusion letter. The outcome of that review was to uphold the surcharges.

10. On 14 January 2022, the BPIL submitted a notice of appeal against the surcharges imposed.

EVIDENCE AND FINDINGS OF FACT

11. Mr Holdsworth had provided a witness statement dated 19 August 2022. The witness statement was accompanied by 38 exhibits. Four of the exhibits were extracts from HMRC's published statements relating to COVID-19, the remainder were extracts from email correspondence between BPIL and its clients setting out instances of difficulties as a result of COVID-19.

12. We found Mr Holdsworth to be a careful and reliable witness. He was willing to provide information which he would have been aware may not have supported his case, as well as information in support of his case.

13. Some of what Mr Holdsworth said, such as references to HMRC's published statements and how this related to the question of what constitutes a reasonable excuse, are more properly understood as submissions on the law and as such we have not given such statements any evidential weight.

14. Mr Holdsworth's witness statement did not provide a great deal of explanation of the significance of the various emails exhibited alongside his witness statement. The Tribunal questioned Mr Holdsworth at some length in order to ascertain the circumstances said to be evidenced by the emails.

15. In his witness statement Mr Holdsworth said:

(1) HMRC's decision had been based on solely one issue – a lack of funds. He did not accept that this was the reason he had given. He said that the defaults were the consequential result of a string of factors linked to COVID-19.

(2) BPIL had never tried to avoid its VAT obligations nor unreasonably withheld payment. As soon as the funds were available, he made sure that VAT was paid as soon as possible in order to remedy the issue.

(3) Loss of revenue was only part of the issue at hand. Waiting for revenue for far longer periods than normal as projects took far longer was the major issue.

(4) For example, BPIL may date an invoice in June 2021 as the bulk of the work has been carried out that months. Through COVID-19 isolation, product availability or product delays, the job may not be completed until the middle of July or August 2021. This causes severe cash flow problems and in cases creates a VAT liability for an invoice that has not in fact been paid

(5) Where a VAT payment is due around the same time as payroll, and BPIL are awaiting projects to finish, BPIL simply cannot meet its VAT liability.

(6) The exhibited documents showed email communications between customers and the business which demonstrated that COVID-19 had impacted scheduling. These were the only examples where they have a paper trail. However, there had also been many telephone conversations with customers and suppliers too.

(7) He had made several attempts to call HMRC during the relevant period but had been placed on hold for very long periods of time before cancelling the calls.

(8) HMRC had published a statement in which “due to the impact of COVID-19 on individuals and businesses around the country” HMRC had provided all taxpayers with a 28-day extension to the self-assessment deadline (from 31 January 2021 to 28 February 2021). Furthermore, HMRC had stated “HMRC recognise that due to the ongoing pandemic some customers and agents will still have difficulty meeting their filing obligations”

(9) During the height of the COVID-19 months, no degree of business foresight or due diligence could prepare a business owner for sometimes weekly changes in government guidance; a daily or even hourly disruption to staffing and scheduling due to the immediate halting of work through isolation or limitations to imports or availability of goods.

(10) Due to being a new business, BPIL did not receive government grants related to COVID-19, nor were loans or overdrafts available until 2022.

(11) Any mixing of VAT funds with business funds was not done with the intention of venturing, it was done purely for Mr Holdsworth's business, employees and livelihood. Had this not happened, BPIL would have been forced to dissolve.

16. In oral evidence, Mr Holdsworth expanded on his witness statement as follows:

(1) The business was founded in August 2019 with 3 employees. Mr Holdsworth had borrowed money from his parents to fund the business.

(2) By the time the COVID-19 pandemic hit in February 2020, the business had around £4,500 in the bank. Due to the early stages of the business, no overdraft facility was available to him.

(3) The conditions of the pandemic were not normal, this changes in the law being made to compel people to stay in their homes. It would be an understatement to say that times had been tough.

(4) The 'pingdemic' in which people could be obliged to self-isolate as a result of a notification from NHS tracing services, or a mobile phone app, caused potentially even greater difficulties for the business than initial periods of lockdown.

(5) By way of example, the business might be six days into a bathroom project only to be told that they could not return to the property for ten days due to self-isolation. Staff would need to be moved to another project and may not be able to return to the first project for some time. This delay could then be further compounded if staff need to isolate again.

(6) The result was that jobs went on for 2 to 3 times longer, and the business therefore had to wait 2 to 3 times longer to be paid.

(7) He had at times made conscious choices to pay staff or suppliers in preference to HMRC. He considered that it was the right thing to do in the situation he found himself in. Mr Holdsworth was particularly forceful on this point, stating that his view was that paying HMRC late has far less consequence than a staff member missing a mortgage payment or not being able to buy food.

(8) He explained that HMRC had extended the self-assessment filing deadline by a month, whereas the longest HMRC had had to wait for the company to make its VAT payments had been 17 days.

17. When asked in cross examination why he had not contacted HMRC sooner to explain the difficulties in the business, Mr Holdsworth stated that when defaults first began in the period ending 7/20 he had not considered that he needed to have communication with HMRC about late VAT payments. At that stage the business had shrunk but cashflow seemed ok. It was only as he got closer to the end of the pandemic that things got harder and that the 'pingdemic' was the worst part.

18. Mr Holdsworth said that he was not able to forecast when a customer was going to isolate and delay. He did not contact HMRC sooner because at the time he didn't think he had to. His focus was on getting the job done and paying in time.

VAT invoicing arrangements

19. Prompted by questioning from the Tribunal, Mr Holdsworth explained that the VAT invoicing arrangements in place in the business were tied in with the management accounting arrangements. VAT invoices would be produced by the firm's accounting software when the

bulk of the work had been done. However, the invoice would not be sent to clients until the job was fully complete.

20. The impact of these arrangements was that jobs would be included on a VAT return some time prior to the invoice being sent to a client, and therefore some time prior to payment being received.

21. There is a question as to whether such invoicing arrangements are in compliance with the law. An invoice issued only for internal purposes and not sent to a client is arguably not ‘issued’ for the purposes of s. 6(4) VATA. As a result, it may be that the tax point used for the purposes of the relevant VAT returns was earlier than that provided for in the legislation. However, nothing turns on the point in the present proceedings.

22. For present purposes we note that the VAT invoicing arrangements seem to make matters harder for BPIL than they need to be. The inclusion of a sum on a VAT return some time in advance of the time at which the corresponding invoice is sent to the client is likely to exacerbate cash flow difficulties and has some bearing on the reasonableness of BPIL’s excuse. This is considered further in the discussion section.

Specific examples of COVID-19-related delays

23. A number of emails were exhibited to Mr Holdsworth’s witness statement. These were said to be examples of COVID-19–related impacts on the business.

24. It is informative to set out the complete list of examples. The descriptions in the table below are those provided by Mr Holdsworth.

9 June 2020	Email explaining project delays due to minimal staff.
7 September 2020	Customer isolating.
14 September 2020	Delayed project.
14 September 2020	Customer isolating and delayed project.
21 October 2020	Delayed project.
2 November 2020	Email explaining project delays due to minimal staff.
9 November 2020	Staff isolating.
9 November 2020	Email stating limiting numbers of projects.
20 November 2020	1 x employee isolating
22 November 2020	Customer isolating.
24 November 2020	2 x employees isolating
25 November 2020	Customer isolation and invoice dating.
21 December 2020	Delayed project.
21 December 2020	Delayed project.
21 December 2020	Delayed project.
4 Jan 2021	Staff isolating.
2 February 2021	1 x employee isolating.
22 February 2021	Contractor isolating delaying a project.
31 March 2021	Project delay.
7 May 2021	Staff isolating.
7 May 2021	Staff isolating.
10 May 2021	Staff isolating.
18 June 2021	Subcontractor cancelled with Covid delayed
28 June 2021	Mum in hospital project delay (non covid linked)

28 June 2021	Product delays driver shortage linked to Covid.
15 July 2021	Product delays driver shortage linked to Covid.
6 August 2021	Staff shortage isolating.
31 August 2021	Staff isolating.
14 September 2021	Delivery delay due to Covid.
30 September 2021	Driver shortage skip collection delay.
9 November 2021	Staff isolating.
9 December 2021	3 x staff members isolating.
17 December 2021	Three staff members isolating.

25. At the prompting of the Tribunal, Mr Holdsworth expanded upon the circumstances and significance of a number of the examples given.

2 February 2021

26. One email to a customer was dated 2 February 2021 and contained the line “One of my lads has had to take the rest of the week off unfortunately so we need to postpone your bathroom until Monday and not tomorrow as originally planned”. Mr Holdsworth explained that this was an example of a tiler being required to isolate due to a positive COVID test.

27. When asked about the cashflow impact of such a delay, Mr Holdsworth explained that the job would have been worth in the region of £1,000-£2,000. He was not able to provide precise details on the impact of that particular delay, he speculated that the job was likely to have been invoiced in February (which we take to mean an invoice having been issued on BPIL’s system, but not issued to the client) but the delay in the job may have resulted in the cash coming in later.

7 June 2021

28. Mr Holdsworth explained that he had been on holiday 7-11 June 2021 but his return to work had been delayed because his mother had contracted sepsis and was hospitalised.

29. In the period 14-18 June 2021 Mr Holdsworth was away from home, in Taunton, where his mother was in hospital. He was in hospital nearly every day visiting his mother. In that period, he explained, he was not “on the tools”, meaning he was not able to attend client sites or organise his staff. He explained that this would have resulted in the business losing money.

6 August 2021

30. Another email to a customer, dated 6 August 2021 stated “Unfortunately, I have been a man down most of this week and likely two days next week too so this means we are hugely behind on the decorating schedule. We will not be able to decorate until the 23rd now”.

31. Mr Holdsworth explained that this was a delay caused in part by COVID-19 (the first week) but that the “likely two days next week” were due to a staff member being on annual leave. Mr Holdsworth stated that the cashflow impact of the delay would have been around £1,400-£1,500 plus VAT – up to £1,800 in cash terms.

31 August 2021

32. Another email to a customer, dated 31 August 2021 stated “Christian is having to isolate today, which I was not expecting! This means we will be delayed on completing your en-suite until tomorrow. I understand he will be back tomorrow the they [sic] boys will do all they can to make up for the one day delay and keep the bathroom on track”.

33. Mr Holdsworth stated that this job was invoiced (which we take to mean an invoice being issued on the accounting system and included on the VAT return, but not sent to the client) on 31 August but was not paid until 24 September. The invoice value was £3,924.

34. We note that this would mean that the VAT amount would have been included on the VAT return due to be paid on 7 September, but the cash would not have been received until 24 September.

14 September 2021

35. In an email to a customer dated 14 September 2021 Mr Holdsworth stated “One of our projects due to start on 4 October needs to be postponed [sic] due to the tiles being delayed so I was wondering if you would like to swap your start date for their October one?”

36. Mr Holdsworth explained that this was an example of another common cause of COVID-19 related delay. Driver shortages as a result of the pandemic were resulting in deliveries of tiles (that were normally imported from Spain) being delayed.

37. When asked how often jobs would be moved around in normal trading, Mr Holdsworth stated that it did not happen very often and that he had not had to move a job or customer since February of the current year (a period of around 8 months).

9 December 2021

38. In an email to a customer dated 9 December 2021, Mr Holdsworth stated “Both myself, Christian and Pedro are isolating currently and Pedro had had a positive test for COVID so I quite literally have no one available on our bathrooms team”

39. Mr Holdsworth explained that this was an example of three employees being unable to work, on a project worth £3,700.

40. Mr Holdsworth explained that the bulk of the work on that particular job was finished on 26 November (and so would have been included on a VAT return at that point but without the invoice being issued to the client) but that the invoice was not sent out until 16 December and the cash was not received until 23 December 2021.

41. The relevant VAT payment due date in relation to the final default was 7 December 2021.

42. Mr Holdsworth noted that the VAT payment for the final default period was paid on 24 December 2021 – one day after payment for this job was received from the customer. Mr Holdsworth suggested that if the job had not been delayed, the invoice would have been sent out sooner and the VAT paid in time.

17 December 2021

43. Another email to a customer, dated 17 December 2021 states “We have been hit with COVID in the past few weeks so have been very short staffed with three of us isolating at times”.

44. Mr Holdsworth explained that this was an instance of his son having to go for a COVID-19 test, and that the rules in place at that time were such that, if any member of a household was symptomatic the entire household was required to isolate. At the time two other members of staff were isolating, meaning that 3 of the five people working in the business were isolating.

45. Mr Holdsworth stated that at the time of the delay the job would have been invoiced (in the sense of being invoiced on the accounting system and included on a VAT return) but not paid, resulting in a cash flow hit of £2,776.

Overall findings related to the impact of COVID-19 on BPIL

46. Having heard all of the above, we are satisfied that there was ongoing and significant interference with BPIL's business as a result of COVID-19. Each time a job was delayed, we find that this resulted in receipts of cash of between £1,000 to around £4,000 being delayed. The cumulative impact of such delays in a business with limited working capital was substantial.

47. We find that there was very little that BPIL could have done in order to prevent COVID-19-related delays. The nature of the work carried on by the business was such that staff had to regularly visit private homes to carry out work. This made staff vulnerable to either contracting COVID-19 or being required to isolate due to potential exposure to COVID-19 (the so-called 'pingdemic'). The need for customers to isolate also caused unavoidable delays.

48. When asked about how business during the pandemic compared to normal operation, Mr Holdsworth explained that the last calendar year was what he considered a normal economic situation because near the end of 2021 the business got over the 'pingdemic'. He explained that when the business can schedule a job, put staff in and get paid, the business can fulfil its VAT obligations. He noted that the business had not filed or paid late since then.

49. Mr Holdsworth said that COVID-19 had been the biggest single difference between the default periods and normal operation. Where nothing out of the ordinary happened, there might be difficulties such as bad payers but this would be mitigated by the ongoing income generation of the business.

50. We accept Mr Holdsworth's evidence on this point and find accordingly.

The default periods

51. There are three VAT return periods in which default surcharges were imposed and which are under appeal. We asked Mr Holdsworth to confirm the cash position of the company on each VAT return date. We make the following findings in relation to the default periods.

52. For the period ending 30 April 2021:

(1) The VAT return was filed on time. The sum due to HMRC on the VAT return was £12,404.54.

(2) Payment was due on 7 June 2021 but not paid until 21 June 2021. Payment was therefore 14 days late. On 7 June 2021 the company had around £11,000 in its bank account.

(3) Mr Holdsworth has provided evidence of 3 specific examples of delay to jobs due to COVID-19 in that period. There are numerous delays prior to that period which we find would have had an ongoing effect on the cash position of the company.

53. For the period ending 31 July 2021:

(1) The VAT return was filed on time. The sum due to HMRC on the VAT return was £8,648.

(2) Payment was due on 7 September 2021 but not paid until 10 September 2021. Payment was therefore 3 days late. On 7 September 2021 the company had £10,962 in its bank account.

(3) Mr Holdsworth has provided evidence of at least 4 specific examples of delay to jobs due to COVID-19 in that period, as well as Mr Holdsworth being absent from the business due to his mother's illness.

54. For the period ending 31 October 2021:

(1) The VAT return was filed on time. The sum due to HMRC on the VAT return was £7,890.37.

(2) Payment was due on 7 December 2021 but not paid until 24 December 2021. Payment was therefore 17 days late. On 7 December 2021 the company had around £7,000 in its bank account.

(3) Mr Holdsworth has provided evidence of at least 5 specific examples of delay to jobs due to COVID-19 in that period. There are numerous delays prior to that period which we find would have had an ongoing effect on the cash position of the company.

55. Overall, we find that, on the balance of probabilities, in relation to each default the cash position of the company was substantially reduced as a result of COVID-19-related business interruption. We find that Mr Holdsworth had chosen not to pay (or part pay) the VAT liability on the due date due to the limited funds available (in two cases the VAT liability exceeded the funds available and in one case payment of the full liability would have resulted in the company having just over £2,300 to meet its other liabilities). We find that COVID-19-related delays were both the causative reason for cash flow difficulties on a ‘but for’ basis and additionally were the dominant cause of the defaults.

THE LAW

56. The law on the default surcharge is primarily set out in s. 59 Value Added Tax Act 1994 (“VATA”).

57. Section 59(1) provides for the basic concept of a default:

(1) ...if, by the last day on which a taxable person is required in accordance with regulations under this Act to furnish a return for a prescribed accounting period –

(a) The commissioners have not received that return, or

(b) The commissioners have received that return but have not received the amount of VAT shown on the return as payable by him in respect of that period,

then that person shall be regarded for the purposes of this section as being in default in respect of that period.”

58. The existence of a default gives rise to power for HMRC to issue a surcharge liability notice to a taxpayer. The effect of the notice is to give rise to a surcharge period. The surcharge period can be extended as a result of further defaults and the issue of extension notices by HMRC. This is provided for in ss s 59(2) and (3) VATA, as follows:

(2) Subject to subsections (9) and (10) below, subsection (4) below applies in any case where-

(a) a taxable person is in default in respect of a prescribed accounting period; and

(b) the Commissioners serve notice on the taxable person (a “surcharge liability notice”) specifying as a surcharge period for the purposes of this section a period ending on the first anniversary of the last day of the period referred to in paragraph (a) above and beginning, subject to subsection (3) below, on the date of the notice.

(3) If a surcharge liability notice is served by reason of a default in respect of a prescribed accounting period and that period ends at or before the expiry of an existing surcharge period already notified to the taxable person concerned,

the surcharge period specified in that notice shall be expressed as a continuation of the existing surcharge period and, accordingly, for the purposes of this section, that existing period and its extension shall be regarded as a single surcharge period.

59. Any defaults within the surcharge period result in the taxpayer being liable to surcharges of a percentage of the outstanding VAT for the prescribed accounting period. The surcharge and percentages are provided for in ss 59(4) - (6) VATA:

(4) Subject to subsections (7) to (10) below, if a taxable person on whom a surcharge liability notice has been served—

(a) is in default in respect of a prescribed accounting period ending within the surcharge period specified in (or extended by) that notice, and

(b) has outstanding VAT for that prescribed accounting period,

he shall be liable to a surcharge equal to whichever is the greater of the following, namely, the specified percentage of his outstanding VAT for that prescribed accounting period and £30.

(5) Subject to subsections (7) to (10) below, the specified percentage referred to in subsection (4) above shall be determined in relation to a prescribed accounting period by reference to the number of such periods in respect of which the taxable person is in default during the surcharge period and for which he has outstanding VAT, so that—

(a) in relation to the first such prescribed accounting period, the specified percentage is 2 per cent;

(b) in relation to the second such period, the specified percentage is 5 per cent;

(c) in relation to the third such period, the specified percentage is 10 per cent; and

(d) in relation to each such period after the third, the specified percentage is 15 per cent.

(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.

60. Section 59(7) VATA provides for the reasonable excuse defence that is at the heart of this case:

(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).

61. Section 71 VATA 1994 specifies two situations that are not capable of constituting a reasonable excuse, as set out below.

Construction of section 59 to 70

(1) For the purpose of any provision of section 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.

Test to be applied

62. HMRC submitted, and we accept, that the proper approach to the question of reasonable excuse is that set out in *Perrin v Revenue and Customs Commissioners* [2018] UKUT 0156 (TCC) (“*Perrin*”), at [81]:

81. When considering a "reasonable excuse" defence, therefore, in our view the FTT can usefully approach matters in the following way:

(1) First, establish what facts the taxpayer asserts give rise to a reasonable excuse (this may include the belief, acts or omissions of the taxpayer or any other person, the taxpayer's own experience or relevant attributes, the situation of the taxpayer at any relevant time and any other relevant external facts).

(2) Second, decide which of those facts are proven.

(3) Third, decide whether, viewed objectively, those proven facts do indeed amount to an objectively reasonable excuse for the default and the time when that objectively reasonable excuse ceased. In doing so, it should take into account the experience and other relevant attributes of the taxpayer and the situation in which the taxpayer found himself at the relevant time or times. It might assist the FTT, in this context, to ask itself the question "was what the taxpayer did (or omitted to do or believed) objectively reasonable for this taxpayer in those circumstances?"

(4) Fourth, having decided when any reasonable excuse ceased, decide whether the taxpayer remedied the failure without unreasonable delay after that time (unless, exceptionally, the failure was remedied before the reasonable excuse ceased). In doing so, the FTT should again decide the

matter objectively, but taking into account the experience and other relevant attributes of the taxpayer and the situation in which the taxpayer found himself at the relevant time or times.

63. The objective element of the test was emphasised by HMRC, who drew our attention to two further cases on the point.

64. Firstly, *Rowland v Revenue and Customs Commissioners* [2006] STC (SCD) 536 in which the special commissioner noted (at [19]) that the question of reasonable excuse “is a matter to be considered in the light of all the circumstances of the particular case”

65. Secondly, *Clean Car Company v C&E Commissioners* [1991] VATTR 234 in which the Tribunal chair (Judge Medd) stated:

“It has been said before in cases arising from default surcharges that the test of whether or not there is a reasonable excuse is an objective one. In my judgement it is an objective test in this sense. One must ask oneself: was what the taxpayer did a reasonable thing for a reasonable taxpayer conscious of and intending to comply with his obligations regarding tax, but having the experience and other relevant attributes of the taxpayer and placed in the situation that the taxpayer found himself at the relevant time, a reasonable thing to do?”

66. Judge Medd went on to say

“It seems to me that Parliament in passing this legislation must have intended that the question of whether a particular trader had a reasonable excuse should be judged by the standards of reasonableness which one would expect to be exhibited by a taxpayer who had a responsible attitude to his duties as a taxpayer, but who in other respects shared such attributes of the particular Appellant as the tribunal considered relevant to the situation being considered. Thus though such a taxpayer would give a reasonable priority to complying with his duties in regard to tax and would conscientiously seek to ensure that his returns were accurate and made timeously, his age and experience, his health or the incidence of some particular difficulty or misfortune and, doubtless, many other facts, may all have a bearing on whether, in acting as he did, he acted reasonably and so had a reasonable excuse”

67. HMRC also drew our attention to two cases in which it was established that, although inability to pay is precluded by the statute from being a reasonable excuse, the underlying reason for the inability to pay may constitute a reasonable excuse.

68. The first such case was *Customs and Excise Commissioners v Salevon Ltd* [1989] STC 907 QBD (Nolan J) (“*Salevon*”). In *Salevon*, the former secretary of the taxpayer company had drawn cheques for the amounts of VAT due from the company and shown them in the company's records as having been paid. However, he had not in fact posted the cheques.

69. The company was purchased by a Mr Antony who, upon discovering the VAT debt made arrangements with the commissioners to make payment. However, the cash flow problems caused by the debts were then exacerbated by a number of bad debts. The cumulative result was that the company fell into arrears in respect of three subsequent accounting periods and became liable to default surcharges. At first instance the VAT tribunal had held that that the real cause of the default was the conduct of the former company secretary which led to the cash flow problem.

70. On appeal, Nolan J noted (at p911) noted:

“The commissioners and the members of the tribunal are well qualified to distinguish between the trader who lacks the money to pay his tax by reason of culpable default and the trader who lacks the money by reason of unforeseeable and inescapable misfortune.”

71. Nolan J expressed some reservations about the first instance Judge’s conclusion that the bad debts could provide a reasonable excuse, as “The risk of bad debts is an incident of most, if not all, types of business activity”. However, Nolan J took some comfort in the fact that “It is clear from his judgment that he would not have decided the case as he did if he had thought that the deficiency of cash was due to the normal hazards of trade”.

72. HMRC drew our attention to the following passage:

“...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 amount of tax which he must subsequently pay over to the commissioners. There is nothing in law to prevent him from mixing his 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 of payment arrives, he will normally be hard put to invoke s 19 (6) (b). in other words he will be hard put to it to persuade the commissioners or the tribunal that he had a reasonable excuse for venturing and thus losing money destined for the Exchequer of which he was the temporary custodian’.”

73. The second case concerning insufficiency of funds to which we were referred was *Stepto v Revenue and Customs Commissioners* [1992] STC 757 CA (“*Stepto*”).

74. In that case, Scott LJ, giving a dissenting decision, considered the question of the significance of the ‘normal hazards of trade’, as follows (at p765):

“The relevant question is not what the normal hazards of are commercial in general, but what are the normal hazards of the taxpayer’s particular business. If the normal hazards of a taxpayer’s particular business include the late payment of bills, then that taxpayer should make arrangements to finance his cash flow on that footing. If he cannot afford to do so, then as it seems to me, he is relying on nothing other than an insufficiency of funds. If he can afford to do so but does not do so, the reason for insufficiency of funds can hardly be a reasonable excuse. It is only if the events giving rise to the insufficiency of funds are outside the normal course of the taxpayers’ business that a possibility of a reasonable excuse can arise’.”

75. However, Nolan LJ, giving one of the majority judgments, indicated that the words “unforeseeable and inescapable misfortune” used in *Salevon* set the bar for a reasonable excuse too high (at p768):

“My references in *Salevon* to ‘the wrongful act of another’ and to the distinction between ‘the trader who lacks the money to pay his tax by reason of culpable default and the trader who lacks the money by reason of unforeseeable and inescapable misfortune’ were directed to the facts of that case. They cannot be regarded as an all-purpose test of what constitutes a reasonable excuse.”

76. Thus, the underlying cause of the insufficiency need not be restricted to unforeseeable or inescapable events. Lord Donaldson MR noted (at p770) that:

“If the exercise of reasonable foresight and 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 taxpayer's default, then the taxpayer might well have reasonable excuse for non-payment, but that excuse would be exhausted by the date on which such foresight, diligence and regard would have overcome the insufficiency of funds.”

77. We would also note an *obiter* comment made by Nolan LJ in *Steptoe* (at p769), which may have some relevance to the VAT accounting arrangements in place in the present case:

“I would repeat that as a general rule a small trader dealing with larger organisations and having difficulty in securing the prompt payment of his bills should elect to account for his value added tax on the cash basis and would have no reasonable excuse for failing to do so.”

78. Scott LJ made the following additional comment on VAT accounting arrangements (at p758):

“In general, traders must account for output tax and input tax on the basis of invoices issued in respect of the supply of the goods or services in question (see ss 4, 5 and 14). It is an inevitable consequence of this scheme that a trader may become liable to account to the commissioners for output tax at a time before he has been paid by his customer the price of the goods or services supplied or the tax thereon. It may seem a hardship that traders should be placed under this liability but the hardship is the consequence of a tax collection scheme under which the trader is responsible for collecting the tax from the customer and is accountable to the commissioners not on the basis of receipts but on the basis of invoices. The hardship to which I have referred is mitigated to some extent by the 'Cash Accounting Scheme' introduced by the Value Added Tax (Cash Accounting) Regulations 1987.”

79. Overall, we conclude that the proper approach to be applied is that set out in *Perrin*. When considering the question to be considered at the third stage of that approach (i.e. “was what the taxpayer did (or omitted to do or believed) objectively reasonable for this taxpayer in those circumstances?”) we consider that we must take into account that:

- (1) a taxpayer who has collected funds representing VAT on behalf of HMRC in advance of the date for payment to HMRC will only rarely be able to establish that he has a reasonable excuse for using those funds for a purpose other than making payment to HMRC
- (2) an event outside the normal course of the taxpayer's business (but potentially falling short of an unforeseeable or inescapable event) may give rise to such a reasonable excuse
- (3) such an event can only be considered to provide a reasonable excuse for so long as the exercise of reasonable foresight and due diligence and a proper regard for the fact that the tax would become due would not have avoided the insufficiency of funds
- (4) where a taxpayer does not routinely collect funds representing VAT from customers prior to the date for payment to HMRC, the fact that the taxpayer has not adopted the cash accounting scheme is a factor to be given some weight in determining whether the taxpayer has exercised such reasonable foresight, due diligence and proper regard.

ISSUES

80. No issue was raised by BPIL as to whether the surcharge notices and assessments were correctly issued. Accordingly, we find that they were correctly issued.

81. The sole issue between the parties is whether BPIL had a reasonable excuse for the late payments.

SUBMISSIONS ON BEHALF OF BPIL

82. Mr Holdsworth, for BPIL, submitted that the cashflow impact of COVID-19 provided a reasonable excuse for the defaults and that the defaults were remedied within a reasonable timescale.

83. Mr Holsworth submitted that:

(1) The lack of available funds was directly linked to the effect COVID-19 had on the business and was the overriding reason for the defaults.

(2) BPIL had never tried to avoid its VAT obligations. VAT was paid to HMRC as soon as funds were available. BPIL has remained up to date with its VAT account.

(3) HMRC had seen fit to extend the filing date for self-assessment returns by 30 days, whereas the longest HMRC had had to wait for the company to make its VAT payments had been 17 days.

(4) COVID-19 was a rare event and outside of the control of the business. It could not be predicted when a customer or staff member would need to isolate.

(5) In some circumstances he had chosen to pay staff rather than HMRC but this was a choice forced upon him. He had paid VAT as quickly as he possibly could, and in full.

SUBMISSIONS ON BEHALF OF HMRC

84. Ms Ramadan, for HMRC, submitted that the facts asserted by BPIL did not objectively constitute a reasonable excuse.

85. Ms Ramadan submitted that:

(1) HMRC accepted that COVID-19 could provide a reasonable excuse but that the burden of proof lay on BPIL to provide evidence as to how COVID-19 prevented the submission of the VAT return or payment of the VAT liability. HMRC did not accept that BPIL had demonstrated a causal link between the delays caused by COVID-19 and the failure to make payments on time.

(2) Section 71 VATA specifically excludes an insufficiency of funds as a reasonable excuse, although the underlying reason for the inability to pay may constitute a reasonable excuse. The reason must be rare and outside the taxpayer's control.

(3) BPIL had admitted that it had made a positive choice to pay HMRC late and to pay staff and suppliers first. As set out in *Savelon*, if a business chooses to use VAT received to pay staff and suppliers they would be hard put to persuade the Tribunal that they had a reasonable excuse for using the money which was destined for the exchequer.

(4) Even if the risk of late payment had been exacerbated by delays to work schedules, the risk was not outside the usual course of the taxpayer's business, or BPIL's foresight at the time. The pandemic lasted for some time, BPIL would have been aware of the challenges it posed such that the difficulties caused would have been within BPIL's reasonable foresight.

(5) BPIL had the option to apply for the cash accounting system in order to mitigate the risk but chose not to.

(6) BPIL had received multiple surcharge notices so would have been aware of the defaults. Mr Holdsworth could have contacted HMRC and notified them of the challenges at the time but failed to do so.

(7) Although some of the delays were short, it had been established by the Tribunal in *Energys Holdings UK Ltd v Revenue and Customs Commissioners* [2010] UKFTT 20 (TC) that even a single day of delay due to a minor slip is not (without more) sufficient to constitute a reasonable excuse. The legislation draws a line at the end of the calendar month and there is no judicial discretion to draw the line elsewhere.

DISCUSSION AND DECISION

86. As noted above, we consider that the correct approach to the question of reasonable excuse is to apply the four-step test set out in *Perrin*. We therefore apply that approach.

Step one – establish the facts asserted

87. The facts asserted are as set out at length above. In essence, COVID-19 resulted in various delays to work carried on by the business, resulting in a cashflow impact that in turn necessitated delayed payment.

Step two – decide which facts are proven

88. The COVID-19 pandemic undoubtedly caused significant disruption to life in this country and businesses operating within it. However, generalised statements of difficulties caused will not normally be sufficient to found a defence of reasonable excuse. The Tribunal will need to be presented with evidence of specific interruptions and the specific difficulties caused as a result.

89. In this case, as a result of the specific examples put forward, supported by documentary evidence and amplified in oral evidence, we find that, on the balance of probabilities, COVID-19 did indeed impact the business as asserted on behalf of BPIL.

90. However, we also find that, at the time payment was due, BPIL had some funds in its bank account and was therefore not entirely prevented from making at least part payment of its VAT liabilities. Accordingly, we find that BPIL made a positive choice to retain cash in order to pay staff members or suppliers in preference to HMRC.

91. We further find that the VAT accounting measures in place would have served to increase the risk of cash payments being received after the date upon which BPIL was required to account to HMRC for the associated output VAT.

Step three – do the facts amount to an objectively reasonable excuse?

92. We apply the test set out in *Perrin*, taking into account the additional factors we have identified from case law.

93. We take into account all the relevant attributes of BPIL and the situation in which it found itself. The key attributes being a business with only around 5 staff, with very limited cash resources and no overdraft or other reserve funding.

94. We consider that the COVID-19 pandemic was an unprecedented and unforeseeable event. The difficulties encountered as a result of the COVID-19 pandemic were particularly pronounced for a business such as that carried on by BPIL, which relied on staff being present in private homes for extended periods to carry out their work.

95. There may come a time at which modern medicine renders COVID-19 more of a minor annoyance than an existential threat, but that was certainly not the case during the periods of default. We accept Mr Holdsworth's submission that at the material time the almost daily changes in law and guidance in response to the pandemic created a climate in which it was not possible to predict how matters would develop or to make effective plans for the business.

96. We consider that the business was carried on with the level of foresight, diligence and proper regard that might be expected in the circumstances. We consider that the insufficiency of funds was unavoidable in the circumstances.

97. We give some weight to HMRC's submission that BPIL made positive choices to pay staff and suppliers in preference to HMRC. It is a distinctly unattractive argument for a taxpayer to assert that it is better for it to pay staff and customers first as this will keep the business going longer and provide an overall better result for the exchequer. The statutory regime does not permit a taxpayer to take matters into its own hands and speculate with funds otherwise due to the exchequer. Indeed, it may fairly be said that one of the underlying reasons for the surcharge regime is to provide a disincentive to choose to pay HMRC last.

98. In the normal course of events, if a business chooses not to pay its VAT liabilities then it must accept the consequences of that choice and pay the surcharge that results. However, that principle must be tempered by the circumstances in which that choice is made. The evidence in this case indicates that the cash flow pressures were considerable, and brought about by factors outside BPIL's control. In the case of two of the defaults there were insufficient funds in the company bank account to pay the VAT liability in full and in the case of the third default the company bank balance only exceeded the VAT due by around £2,000.

99. Overall, we consider that the course of action pursued by BPIL was a reasonable one for it to take in the circumstances in which it found itself.

100. We have considered the VAT invoicing arrangements in place and how they impact the question of reasonable excuse.

101. In our view, the VAT invoicing arrangements utilised by BPIL clearly made life harder for BPIL than it needed to be. If BPIL had altered its VAT accounting arrangements so that VAT invoices were only produced at the point work was complete and the client was to be billed, this would have been likely to have had a positive impact on cash flow.

102. We can also see some force in Ms Ramadan's submission that BPIL could have chosen to make use of the cash accounting scheme (and note Nolan J's obiter comment that it would be unreasonable not to opt for such an arrangement in applicable circumstances). However, access to the cash accounting scheme is normally not available where a business is not already up to date with VAT returns or payments. Therefore, once BPIL began its first surcharge liability period it was already too late to adopt the cash basis.

103. The test to be applied is whether or not BPIL has a reasonable excuse for the default. We do not consider that an otherwise reasonable course of action necessarily becomes unreasonable as a result of another, arguably more reasonable, course of action being available. The question is a matter of fact and degree to be judged in all the circumstances of the case. The test is not that no other option was available, or that the course of action was the best course in the circumstances.

104. In this regard, we note our finding that during normal operation, in times where COVID-19 has not been a factor, the business has kept fully up to date with its VAT obligations. The invoicing system in operation has therefore not caused defaults when exposed to the normal hazards of the business.

105. As a result, notwithstanding the possibility that BPIL might have improved its situation by modifying its VAT accounting arrangements, we answer the question posed in *Perrin* - was what the taxpayer did (or omitted to do or believed) objectively reasonable for this taxpayer in those circumstances? - in the affirmative. BPIL had a reasonable excuse. The issue with VAT accounting arrangements pushes the position towards the margins of reasonableness but overall

we are satisfied that the significant interruptions due to COVID-19 render BPIL's actions in seeking to keep the business going and make payments were objectively reasonable.

106. For completeness, we note that we have also considered the question of whether Mr Holdsworth's absence in order to care for his mother during June 2021 might constitute a reasonable excuse in its own right. We would expect that some unanticipated staff absence would form a part of the normal course of events of such a business and accordingly do not consider that it can found a reasonable excuse in of itself.

Step four – was the failure remedied without unreasonable delay

107. Following on from our findings, we accept that VAT payments were made as soon as cashflow allowed. As such the failures were remedied without unreasonable delay.

DISPOSAL

108. For the reasons set out above, we conclude that BPIL did have a reasonable excuse for its defaults and accordingly the appeal is allowed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

109. 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.

**MALCOLM FROST
TRIBUNAL JUDGE**

Release date: 21st DECEMBER 2022