[2019] UKFTT 347 (TC)

TC07175

VAT – default surcharge – s 59 VATA 1994 – whether reasonable excuse for late payments

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2018/01479

BETWEEN

SDI-UNISTRIDE (SOUTHERN) LIMITED **Appellant**

-and-

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

TRIBUNAL: JUDGE PETER KEMPSTER
MS JANET WILKINS

Sitting in public at Taylor House, London on 5 February 2019

Mr Sam Howell (Director) for the Appellant

Ms Nickeshia Davis, HMRC Solicitor's Office and Legal Services, for the Respondents

DECISION

INTRODUCTION

1. The Appellant appeals against two default surcharges imposed by the Respondents ("**HMRC**") pursuant to s 59 VAT Act 1994 in respect of its VAT periods 05/17 (£6,892.10) and 08/17 (£7,953.82).

Legislation

2. Section 59 VAT Act 1994 provides for default surcharges for late submission of VAT returns and/or late payment of VAT.

> "**The default surcharge**
>
> (1) Subject to subsection (1A) below, 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.
>
> (1A) A person shall not be regarded for the purposes of this section as being in default in respect of any prescribed accounting period if that period is one in respect of which he is required by virtue of any order under section 28 to make any payment on account of VAT.
>
> (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.
>
> (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.

(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).

(8) For the purposes of subsection (7) above, a default is material to a surcharge if—

(a) it is the default which, by virtue of subsection (4) above, gives rise to the surcharge; or

(b) it is a default which was taken into account in the service of the surcharge liability notice upon which the surcharge depends and the person concerned has not previously been liable to a surcharge in respect of a prescribed accounting period ending within the surcharge period specified in or extended by that notice.

(9) In any case where—

(a) the conduct by virtue of which a person is in default in respect of a prescribed accounting period is also conduct falling within section 69(1), and

(b) by reason of that conduct, the person concerned is assessed to a penalty under that section,

the default shall be left out of account for the purposes of subsections (2) to (5) above.

(10) If the Commissioners, after consultation with the Treasury, so direct, a default in respect of a prescribed accounting period specified in the direction shall be left out of account for the purposes of subsections (2) to (5) above.

(11) For the purposes of this section references to a thing's being done by any day include references to its being done on that day."

3. Section 71 VAT Act 1994 construes "reasonable excuse" for the purposes of s 59:

"**Construction of sections 59 to 70**

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

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

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

(2) In relation to a prescribed accounting period, any reference in sections 59 to 69 to credit for input tax includes a reference to any sum which, in a return for that period, is claimed as a deduction from VAT due."

Findings of Fact

4. The Appellant has been registered for VAT since 2009 and its business is drainage inspection, maintenance and repair.

5. The Appellant attracted default surcharges for late payment for VAT periods 08/16 (0% surcharge), 11/16 (2% surcharge), and 02/17 (5% surcharge).

6. The due date for electronic filing and payment for the 05/17 VAT period was 19 June 2017. The return was filed on time but the liability was paid late: £8,850.15 on 30 June 2017 and £60,070.85 on 11 July 2017. HMRC levied a 10% surcharge.

7. The due date for electronic filing and payment for the 08/17 VAT period was 19 September 2017. The return was filed on time, and £25,000 of the liability was paid on time; but the remainder of the liability was paid late: £50,625.49 between February and April 2018. HMRC levied a 15% surcharge on the late amounts.

Appellant's Case

8. Mr Howell submitted as follows for the Appellant.

9. The company had a long and troubled relationship with HMRC – particularly over PAYE and CIS matters. HMRC had mishandled CIS overpayments; in one year an alleged £340,000 liability turned into a refund of £85,000, after a complaint to an MP. HMRC continued to deny that the company had serious cash flow problems, and that this had resulted in the company being unable to obtain credit. HMRC had been arrogant, complacent and unhelpful. Much of the company's costs were labour, so it had high net VAT liabilities to meet each quarter.

10. Many of the company's debtors are effectively part of the Government – eg Transport for London – and if they paid on normal commercial terms then the company's cashflow would be much improved; instead many customers insisted on 85 days credit and permitted only monthly billing, resulting in no cash receipts until 115 days after the work was performed; by contrast, the company was paying its staff wages weekly.

11. In relation to the 05/17 period, the company had previously had a time-to-pay agreement (relating to very old problems) but when it became apparent in February 2017 that payments could not be made, HMRC refused to extend time or reschedule the agreement, and even took steps to start winding-up the company. The company then had to use its funds to pay the outstanding amounts under the agreement, rather than pay the VAT due for the 05/17 period, as intended.

12. In relation to the 08/17 period, a substantial customer ("**CBUL**") had been due to make a payment on 19 September, which would be used (together with other funds) to pay the VAT liability due on that same date. The customer had previously paid on time, and so the company did not anticipate having to request a further time-to-pay agreement. The customer had, as usual, pre-cleared the invoice for payment, and the credit controller had reminded CBUL of the amount (£31,000) and date due. It was only after payment did not arrive on the expected date that the customer's contract manager (who had left CBUL by this point) confirmed that the routine had changed and payment would follow later. This was entirely outside the Appellant's control; there was concern that the customer may be going the same way as Carillion. After threats of legal action, the invoice was paid on 24 October 2017. The Appellant did pay £25,000 of the VAT liability on time; it was accepted that there was outstanding VAT even if the £31,000 had been received on time; a small shortfall could be met out of funds, but not a large one. Everything had been paid to HMRC by 4 April 2018.

Respondents' Case

13. Ms Davis submitted as follows for HMRC.

14. Using the test set by the High Court in *CCE v Salevon Ltd* [1989] STC 907 the Appellant did not have a reasonable excuse for the late payments. The Appellant had not exercised reasonable foresight; nor had it exercised due diligence; nor had it had proper regard to the fact that VAT would become due on a particular date.

15. The Appellant has been subject to the Construction Industry Scheme since it commenced trading; therefore the fact that it received monies from customers after 20% deductions was a feature of its normal cash flow. Any refunds for surplus deductions could only be made by HMRC after the end of the year and after verification of the annual returns. For the VAT periods under appeal, there was no allegation that there had been any delay in agreeing CIS refunds.

16. Prior to February 2017 the Appellant did have a time-to-pay agreement with HMRC (covering substantial amounts of VAT, PAYE & NIC), but it defaulted on the agreement. For that reason, a further time-to-pay agreement had been refused by HMRC.

17. In an earlier appeal to the Tribunal ([2016] UKFTT 0226 (TC)) the Appellant had claimed its late VAT payment was due to non-payment by a normally reliable customer. It could not rely on the same excuse a second time.

18. The Appellant was well aware of the payment terms of its major customers, and those formed part of the normal cash flow of its business.

19. The Appellant claimed it expected around £31,000 from the customer who paid late, but that accounts for only a part of the total VAT liability. Therefore, even if that customer had paid on time, there would still have been a late payment of VAT (albeit in a smaller amount).

20. The Appellant had produced no evidence of attempts to raise funds to pay the VAT liabilities – eg from bank funding.

21. If the Appellant was arguing that the surcharge was in some way disproportionate, then that matter was settled by the Upper Tribunal decision in *HMRC v Trinity Mirror PLC* [2015] UKUT 421 (TCC).

Consideration and Conclusions

22. There is no dispute that the VAT liabilities for the two VAT periods were paid wholly or mainly late. The Appellant claims that it has a reasonable excuse (within the meaning of s 71 VATA 1994) for the late payments for both periods.

23. Section 71(1)(a) is clear that an insufficiency of funds to pay any VAT due is not a reasonable excuse. However, it is well established (see for example *CCE v Steptoe* [1992] STC 757) that although an insufficiency of funds is not, by itself, a reasonable excuse for late payment, the reason for the insufficiency may be in very limited circumstances. An insufficiency of funds does not give rise to a reasonable excuse if it results from normal hazards of trade, or because the trader applies the funds elsewhere in its business – per *Salevon* (at 911):

> "… 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 of payment arrives, he will normally 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."

24. The position may be different where the trader has been deprived of the means to pay VAT by the wrongful act of another. In *Steptoe* The Master of the Rolls stated (at 711):

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

25. We apply that test to the Appellant's circumstances in the two VAT periods 05/17 and 08/17. We appreciate that a trader who is paid under deduction through the Construction Industry Scheme will suffer a cash flow disadvantage; also that a trader whose inputs are mainly labour will have large net output VAT payments to make each quarter; further that large contractors in the construction and civil engineering sectors are reputed to impose lengthy payment terms on their subcontractors. However, for a company in the line of business of the Appellant those are all part of the normal hazards of trade accepted (perhaps reluctantly) by any trader in the same business.

26. In terms of particular reasons for the late payments, the Appellant puts forward the following:

> (1) For the 05/17 period - HMRC had cancelled an earlier time-to-pay agreement, and refused to make a new agreement when so requested by the Appellant.
>
> (2) For the 05/17 period - Due to the cancellation of the earlier time-to-pay agreement and a threat of a winding-up order from HMRC, the Appellant had to use funds earmarked for the VAT payment instead to meet the outstanding amounts due under the agreement.
>
> (3) For the 08/17 period - CBUL had been due to pay £31,000 on 19 September; the Appellant had no reason to suspect the funds would not arrive as promised; the funds were earmarked to pay part of the VAT liability due on the same date; CBUL did not pay until (after threats of legal action) 24 October.

27. Taking each of those in turn, the reason HMRC cancelled the earlier time-to-pay agreement was because the Appellant defaulted on payment of one or more instalments. In those circumstances it was not reasonable of the Appellant to expect that a new agreement (or an extension of the earlier agreement) would be granted by HMRC to a trader who had already dishonoured the earlier agreement. We conclude that HMRC's refusal to grant a time-to-pay agreement is not a reasonable excuse for the late payment.

28. The consequence of the Appellant dishonouring the earlier time-to-pay agreement was that the outstanding tax balances became due, and HMRC commenced (or so threatened) winding-up proceedings. In that position the Appellant chose to use its funds to pay the past liabilities rather than settle on time the 05/17 VAT liability. While that is understandable and (to quote from *Salevon*) "no doubt he has every commercial incentive to do so", it is really no more than a trader with insufficient funds choosing to settle one liability rather than another, and we conclude that making that choice is not a reasonable excuse for the late VAT payment.

29. We accept that the Appellant fully expected to receive approximately £31,000 from CBUL on 19 September but this did not arrive until 24 October. Had the Appellant then promptly used the purportedly earmarked funds of £31,000 to settle (part of) the outstanding 08/17 VAT liability then we might be persuaded that the circumstances described in *Steptoe* and *Salevon* were satisfied. However, in fact no further instalment of the 08/17 VAT liability was paid until February 2018. In reality the Appellant banked the late receipt and used it as part of its general working capital, and this is a further instance of a trader with insufficient funds choosing to settle one liability rather than another. Again, we conclude that making that choice is not a reasonable excuse for the late VAT payment.

30. For the above reasons, we do not find that any of the explanations put forward by the Appellant constitute a reasonable excuse (within the meaning of s 71 VATA 1994) for the late payments, and thus we must dismiss the appeals against both default surcharges.

31. For completeness:

> (1) HMRC point out that even if the £31,000 had been paid on time, there would still have been late payment of VAT of around £19,000 and thus a default would still be chargeable for 08/17. We agree, but that goes to the calculation of the amount of the surcharge, not the issue of reasonable excuse for late payment.
>
> (2) We understood HMRC to suggest that as the Appellant had put forward in a previous appeal the explanation that VAT was paid late because of late receipts of

monies from a customer, the company could not offer the same excuse again. We disagree; while a trader would be expected to learn from previous experience, it is not the case that a subsequent similar incident could not in itself constitute a reasonable excuse using the test outlined above.

Decision

32. The Tribunal decided that the appeal is DISMISSED.

Right to apply for permission to appeal

2. 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.

PETER KEMPSTER
TRIBUNAL JUDGE

RELEASE DATE: 31 MAY 2019