



TC01437

Appeal number: TC/2011/04088

VAT – reasonable excuse – cash accounting – time to pay arrangement

FIRST-TIER TRIBUNAL

TAX

DNA DEFENCE LTD

Appellant

- and -

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

Respondents

**TRIBUNAL: RACHEL SHORT (TRIBUNAL JUDGE)
WILLIAM HAARER (MEMBER)**

Sitting in public at Vintry House, Wine Street, Bristol BS1 2BP on 26 July 2011

Mr James Clery for the Appellant

Mr David Lewis for the Respondents

DECISION

1. The Tribunal decided that the appeal should be DISMISSED.

2. This case was an appeal against a VAT default surcharge under s 59 Value Added
5 Tax Act 1994 in an amount of £1,408.64 relating to VAT periods August – October
2010 and November 2010 – January 2011.

Preliminary matter:

3. The Tribunal had been served with a large bundle of documents three days before
the hearing date. The Appellant had received the bundle but stated that he did not
10 want HMRC to rely on them since he had not had time to consider them. HMRC
therefore requested an adjournment of the hearing to give the parties time to consider
the documents. The Tribunal decided that it was in the interest of justice for the case
to proceed without reference to the additional bundle of documents, which in the
Tribunal's view were not critical to the fair hearing of a case which had been listed as
15 a basic case.

The facts

4. Although it was not made clear in the Taxpayer's notice of appeal it was agreed
at the Tribunal that the £1,408.64 of VAT surcharge penalty related to the VAT
periods ending October 2010 and January 2011 representing 15% of the VAT due for
20 both periods. It was agreed that the VAT in respect of these periods had not been paid
at the due date.

5. The Taxpayer was in the business of providing expert witnesses for court cases
and all of his income came indirectly from the Legal Services Commission (LSC) via
the solicitors who were his clients. The LSC were notoriously late in settling fees and
25 as a result the Taxpayers' clients were often very late to pay him. The Taxpayer has
been running this business for four years and has dealt with the LSC for the whole of
this period.

6. The Taxpayer was not aware until a recent conversation with HMRC that it was
possible to pay VAT on a cash basis.

30 7. The Taxpayer had attempted to manage his cash flow by entering into factoring
arrangements with his bank and has since May 2011 employed a credit control clerk.

8. The Taxpayer has an accountant who deals with his VAT affairs and notifies him
of when, and how much VAT is due.

The arguments

35 9. Mr Clery, on behalf of the Taxpayer explained that late payment became a
particular issue in the May – July 2010 VAT period because a large number of
invoices were sent out by the Taxpayer to clients during that period.

10. Mr Clery argued that he believed that he had made a “time to pay” arrangement with HMRC in respect of the VAT which was payable in respect of the May – July 2010 period and that this “time to pay” arrangement was valid for all subsequent VAT periods, including the October 2010 and January 2011 periods to which this appeal relates.

11. The Taxpayer realised that he would struggle to pay VAT for these later periods and so he spoke to HMRC, sometime during August, to ask to be able to pay in instalments. The Taxpayer could not provide a specific date or any written record of this conversation.

12. However, VAT payments for these periods were paid in three instalments. The Taxpayer spoke to HMRC on later dates to confirm this payment method and wrote to HMRC on 21 September 2010 and 4 January 2011 in respect of this arrangement. HMRC did not respond to these letters which the Taxpayer considered to indicate that they accepted the arrangement.

13. The Taxpayer also referred to the *Stepto* decision [1991] STC 302 and argued that this situation was analogous to the taxpayer in that case; he had an insufficiency of funds to pay VAT due to the failure of his clients to pay him. He had used reasonable efforts to force them to pay on time, but they were all at the mercy of the LSC, which was outside the control of the Taxpayer.

14. The Taxpayer agreed that paying VAT on a cash basis would solve his cash flow problems going forward, and would have avoided these issues for earlier periods had he been aware of it.

15. HMRC disputed the Taxpayer’s evidence in respect of the time to pay arrangement. Their records demonstrated that no time to pay arrangement had been agreed until 21 September 2010 and it had been made clear that this was only effective for the May – July 2010 period as clearly stated in their letter of 29 September.

16. No other time to pay arrangement had been agreed, although they did have records of various other conversations with the Taxpayer, none of those amounted to a time to pay arrangement. Merely accepting the Taxpayer’s instalment payments could not be treated as confirming the existence of an agreement to pay in instalment other than for the period to which the 29 September letter related.

17. HMRC referred to the *Stepto* decision and the 1990 decision of *Alexis Modes* VTD 4780 arguing that the latter was the more relevant. It was intrinsic to the nature of the Taxpayer’s business, a “hazard of his trade” that payments of invoices would be likely to be late.

18. Late payment was not a sudden and unexpected event. It was incumbent on the Taxpayer to arrange his affairs to ensure that VAT could nevertheless be paid on time.

19. Ignorance of the law was no excuse. The Taxpayer could have found out about the cash accounting scheme had he searched HMRC’s on line guidance.

Decision

20. In order to successfully appeal against this surcharge the Taxpayer needs to demonstrate that he has a “reasonable excuse” in accordance with s 59(7) Value Added Tax Act 1994 as construed in accordance with s 71 of that Act.

5 21. The Tribunal considered the detailed arguments provided by both parties. It was undoubtedly the case the Taxpayer thought that he had an agreement with HMRC to pay VAT for the relevant periods by deferred instalments. However the Taxpayer had not been able to produce clear evidence that such an agreement had been made with HMRC in the terms required under s108 Finance Act 2009 for the two periods in
10 question.

22. The Tribunal considered that more was required for these purposes than HMRC merely cashing the instalment cheques and not responding to the Taxpayer’s letters confirming the payment which were to be made. In particular it was made very clear in HMRC’s letter of 29 September 2010 that any existing time to pay arrangement did
15 not apply for future periods.

23. Therefore the Tribunal has concluded that the Taxpayer did not do everything which a reasonable businessman would have done to ensure that a valid time to pay arrangement was in place and that his incorrect belief that a time to pay arrangement was in place does not constitute a reasonable excuse for these purpose.

20 24. The Taxpayer’s second argument is that despite the specific reference in s 71(1) (a) Value Added Tax Act to an insufficiency of funds not constituting a reasonable excuse for non payment, this case falls within the exception to that rule established in the *Steptoe* decision because the reason for the insufficiency of funds is beyond the Taxpayer’s control.

25 25. In respect of the *Steptoe* arguments the Tribunal agreed that, like the taxpayer in that case, this Taxpayer was suffering cash flow problems as a result of a government department failing to pay on time, however, there were a number of important distinguishing factors.

30 26. Unlike in *Steptoe*, the Taxpayer did not have a direct relationship with the government department, his invoices were sent to his solicitor clients, not to the LSC and to that extent his business was one step removed from the late paying government department. Unlike in *Steptoe*, The LSC was not his only client; in fact it was not his client at all.

35 27. Second, it was clear in this case that late payment by the Taxpayer’s clients as a result of late payment to them by LSC was eminently predictable. The LSC had been late payers for all of the four years for which the Appellant had been running his business.

40 28. The issue which had created a cash flow problem for this Taxpayer for the VAT periods in question was not a sudden and unexpected failure to pay by LSC, but the fact that the Taxpayer had submitted a large number of invoices in the immediately

preceding period. Therefore it cannot be said that the cash flow problems arose as a result of the actions of LSC or his clients, which were outside the Taxpayer's control.

29. Third, and significantly, this Taxpayer has accepted that utilising the VAT cash accounting scheme would have alleviated his cash flow issues. This failure of the taxpayer to take advantage of the cash accounting scheme was not raised by HMRC before the Tribunal in the first instance *Stepto* decision and so did not form part of that decision. The judges in the higher courts do however mention that fact that failure to take advantage of the cash accounting scheme would usually be a relevant consideration in determining whether a taxpayer has acted reasonably in cases such as this.

30. We do not think that this Taxpayer's ignorance of the availability of the cash accounting scheme helps his arguments. As HMRC point out, either the Taxpayer or his accountant would have had access to information from HMRC which provided details of the scheme.

31. There were a number of other actions which the Taxpayer could have taken to manage his cash flow problems, including the appointing of a credit control clerk, as has now been done.

32. Finally, at the time when the *Stepto* case was decided, taxpayers did not have the option of entering into time to pay arrangements with HMRC. This option was open to the Taxpayer, although he failed to properly comply with the requirements to establish an agreement for the relevant periods.

33. The Tribunal considers that the availability of time to pay arrangements makes it more difficult to taxpayers such as the Appellant to rely on *Stepto* type arguments unless there is a very good reason why a time to pay arrangement has not been entered into.

34. The Tribunal has concluded that for the VAT periods in question the Appellant was not suffering from a shortage of funds as a result of "unforeseen and inescapable circumstances" and that there were a number of actions which he could, and which a reasonable business man would, have taken in order to alleviate his cash flow issues and pay his VAT on time.

35. For these reasons this appeal is dismissed.

36. 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.

RACHEL SHORT

5

**TRIBUNAL JUDGE
RELEASE DATE: 12 SEPTEMBER 2011**

10