



TC01848

Appeal number:TC/2011/06559

*Value Added Tax – late payment – default surcharge – s 59(7)(b) VATA 1994 –
insufficiency of funds – whether reasonable excuse – no – appeal dismissed*

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

WARRENS DISPLAY LTD

Appellant

- and -

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

TRIBUNAL: JUDGE MICHAEL S CONNELL

**Sitting in public at 4TH floor City Exchange 11 Albion Street Leeds LS1 5ES
on 21 October 2011**

For the Appellant : Mr Stewart Pennells Director of the Appellant Company

For the Respondents : Ms W Newham Officer of HM Revenue and Customs

DECISION

The appeal

1. This is an appeal by Warrens Display Ltd ('the Appellant') against a default surcharge imposed by the Commissioners for Her Majesty's Revenue & Customs ('HMRC') under the default surcharge regime in relation to the late payment of VAT for the period 01/2011.

2. The Appellant provides exhibition and display services and is based in Leeds, West Yorkshire and Chessington, Surrey. The tax assessed on the Appellant's VAT return for the period 03/2011 was £42,338.07. The sum of £21,169.04 was received by HMRC on 9 May. The Appellant maintained that payment had been made by 9 May 2011. By concession HMRC agreed that the payment had not been made late, but a surcharge was levied at the rate of 15% being the applicable rate in respect of the payment of the balance of £21,169.03 paid on 25 May. The surcharge was subsequently reduced to 5% because of the withdrawal and reduction of previous surcharges. The surcharge penalty was therefore £1,058.45.

3. The Appellant does not dispute that payment of its VAT was late for the period in question. The Appellant's argument is that it is not liable to the surcharge because it has a reasonable excuse for the late payment of the VAT.

4. Evidence to the Tribunal consisted of a copy of the Appellant's default surcharge history, a copy of the exchange of correspondence between the Appellant and HMRC relating to the default surcharge and the facts arising relating to the reasons for the late payment. The Tribunal also heard oral evidence from Mr Stewart Pennells, Director of the Appellant company.

Relevant legislation

5. Section 59 Value Added Tax Act 1994 (VATA) sets out the provisions in relation to the default surcharge regime. Under s 59(1) a taxable person is regarded as being in default if he fails to make his VAT return for a VAT quarterly period by the due date for that quarter, or if he makes his return by that due date but does not pay by that due date the amount of VAT shown on the return as payable in respect of that period. The Commissioners may then serve a surcharge liability notice on the defaulting taxable person, which brings him within the default surcharge regime so that any subsequent defaults within a specified period result in assessment to default surcharges at the prescribed percentage rates. The specified percentage rates are determined by reference to the number of periods in respect of which the taxable person is in default during the surcharge liability period. In relation to the first default the specified percentage is 2%. The percentage ascends to 5%, 10% and 15% for the second, third and fourth default.

6. A taxable person who is otherwise liable to a default surcharge may nevertheless escape that liability if he can establish that he has a reasonable excuse for

the late payment which gave rise to the default surcharge(s). Section 59 (7) VATA 1994 sets out the relevant provisions : -

5 ‘(7) If a person who apart from this sub-section would be liable to a surcharge under sub-section (4) above satisfies the Commissioners or, on appeal, a Tribunal that in the case of a default which is material to the surcharge –

(b) there is a reasonable excuse for the return of VAT not having been so despatched then

- he shall not be liable to the surcharge and for the purposes of the preceding provisions of this section he shall be treated as not having been in default in respect of the prescribed accounting period in question ..’

10 7. It is s 59(7)(b) on which the Appellant seeks to rely. The burden falls on the Appellant to establish that it has a reasonable excuse for the late payment in question.

8. Section 59(7) must be applied subject to the limitation contained in s 71(1) VATA 1994 which provides as follows : -

15 ‘(1) For the purposes of any provision of section 59 which refers to a reasonable excuse for any conduct –

(a) any insufficiency of funds to pay any VAT is not reasonable excuse.’

9. Although an insufficiency of funds to pay any VAT due is not a reasonable excuse, precedent case law has established the principle that the underlying cause of any insufficiency of funds may constitute a reasonable excuse.

20 Relevant facts

10. The Appellant’s grounds of appeal are that one its major clients Etetra Limited had gone into administration in April 2011 owing the Appellant the sum of £48,040.79 which Mr Pennells on behalf of the Appellant company said had been monies budgeted for receipt by the end of April. Mr Pennells explained that Etetra’s default had had a serious impact on the Appellant company’s short term cash flow and consequently it was only able to pay 50% of the VAT due which it paid electronically, he says, by the due date of 7 May 2011. Mr Pennells said that the balance of £21,169.03 was paid electronically on 20 May 2011. He argued that the late payment of VAT was unavoidable and entirely due to the exceptional circumstances in which the Appellant company found itself.

11. Mr Pennells explained that the Appellant obtains its finance from Lloyds TSB Invoice Finance which allows the company to draw down 80% of the value of its invoices when raised, followed by 20% once they are paid. Although the Appellant company had had the benefit of the 80% draw down of the Etetra debt, the monies had, following the default by Etetra, been set aside in the Appellant company’s cash flow projections to cover the repayment due to Lloyds TSB Invoice Finance the following month. Mr Pennells explained that the months leading up towards summer are normally the company’s quietest months in the trade exhibition display market and consequently it was the worst time for the company to be confronted with a £48,000 bad debt. This was reflected in the Appellant’s reducing turnover in the

- months to April 2011 which were respectively £303,000 in January, £200,000 in February, £210,000 in March and £133,000 in April (which would have been £181,000 had Etetra Limited honoured the debt). Mr Pennells said that Etetra Limited was a major customer of the Appellant and that sales to Etetra in the quarter ending 31
- 5 March 2011 equated to 13% of turnover. The Appellant company had not been able to agree a Time To Pay arrangement (because of its VAT default history) with HMRC, nor a temporary overdraft facility with its bankers. The Etetra bad debt had not been remotely foreseeable and previously bad debts had represented no more than an average of £5,000 per annum.
- 10 12. Ms Newham on behalf of HMRC argued that a shortfall in income of £48,000 represented less than 12% of the Appellant company's turnover of £591,363 for the quarter in question. She said that, as Mr Pennells acknowledged, the early summer months were always difficult trading months and the Appellant company should have made provision for any potential drop in income. A reduction in the company's
- 15 income during early summer had become 'the norm' and as such not unforeseeable. Ms Newham argued that the Appellant company had not done everything which a prudent and competent business person, mindful of their obligations in respect of payment of VAT, would have done in the same or similar circumstances to avoid a late payment of tax. Ms Newham further contended that the company's other
- 20 customers, assuming they honoured the Appellant company's thirty day terms, would have provided sufficient funds to allow the VAT to be paid on time. In the circumstances she submitted that the shortfall in funds caused by the Etetra bad debt was not an exceptional situation and under s 59(7)(a) an insufficiency of funds to pay VAT is not a reasonable excuse.
- 25 13. In *Customs & Excise Commissioners –v- Steptoe [1992] STC 757* the tax-payer argued that although the proximate cause of his default was insufficiency of funds, the underlying cause of that insufficiency, namely the unexpected failure by a major customer to pay him on time, amounted to a reasonable excuse. The Court determined on a majority that the statutory exclusion of insufficiency of funds as an excuse did
- 30 not preclude consideration of the underlying cause of insufficiency and that a trader might have a reasonable excuse if it were caused by an unforeseeable or inescapable event or when, despite the exercise of reasonable forethought and due diligence, it could not have been avoided. The Court nevertheless made it clear that the test had to be applied strictly.
- 35 14. To decide whether a reasonable excuse exists where insufficiency of funds causes the failure the Tribunal must take for comparison a person in a similar situation to that of the actual tax-payer who is relying on the reasonable excuse defence. The Tribunal should then ask itself, with that comparable person in mind, whether notwithstanding that person's exercise of reasonable foresight, due diligence and a
- 40 proper regard for the fact that the tax would become payable on the particular dates, those factors would not have avoided the insufficiency of funds which led to the failures. That has been the approach taken by the Courts in a VAT context where the tax-payer on account of insufficiency of funds has failed to make payment of tax on time.

15. Having considered the Appellant company's circumstances and the background facts and circumstances leading up to the default the Tribunal concurred with HMRC that the underlying and primary cause of the default was not the late payment by one of the company's major customers. The Tribunal takes the view that a prudent tax person in circumstances similar to that of the Appellant company could have avoided the insufficiency of funds. The Appellant company had been late in making its VAT payments in respect of periods immediately before the default period under appeal and therefore there was a pattern of the Appellant failing to adhere to its VAT payment obligations. The Appellant would therefore have been aware of the consequences of failing to make VAT payments on time. The burden of proof is on the Appellant to show that the underlying cause of its failure to meet its VAT payment obligations was due to unforeseen circumstances or events beyond its control and in the Tribunal's view that burden had not been discharged.

16. For the above reasons the Appellant has not shown that there was a reasonable excuse for its late payment of VAT for the 01/2011 quarter. The Tribunal therefore dismisses the Appellant's appeal and confirms the default surcharge of £1,058.45.

17. 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.

25

MICHAEL S CONNELL

TRIBUNAL JUDGE

RELEASE DATE: 22 February 2012

30