



TC01836

Appeal number: TC/2011/04420

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

FIRST-TIER TRIBUNAL

TAX

FYLDE OFFICE SERVICE BUREAU LTD

Appellant

- and -

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

Respondents

TRIBUNAL: MICHAEL S CONNELL (TRIBUNAL JUDGE)

Sitting in public at Alexandra House Manchester on 25 October 2011

For the Appellant Mr David W Parry, Director of the Appellant company

For the Respondents Mr I Birtles Officer of HM Revenue and Customs

DECISION

The Appeal

- 5 1. This is an appeal by Fylde Office Service Bureau Ltd (“the Appellant”) against a default surcharge imposed by the Commissioners for Her Majesty’s Revenue & Customs (“the Commissioners”) under the default surcharge regime in relation to the late payment of VAT for the period 10/2008.
- 10 2. The Appellant is a recruitment service company based in Lancashire. The company received notice from the Commissioners of a VAT default surcharge in the sum of £1,297.76, VAT in the sum of £64,888.31 having been received 43 days late by the Commissioners for the period 10/2008. The surcharge was levied at the applicable rate of 2%, the Appellant having been in the default surcharge regime from December 2007.
- 15 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.
- 20 4. The evidence to the Tribunal consisted of a copy of the exchange of correspondence between the Appellant and the Commissioners relating to the default surcharge and the facts arising relating to the reasons for the late payment; a schedule prepared by the Commissioners showing the Appellant’s default surcharge ‘history’; a schedule prepared by the Appellant showing a copy breakdown of monies received by it for the period 01/06/2008 to 31/08/2008; copy bank statements for the period from 01/08/2008 to 18/09/2008; and the oral evidence of Mr David Parry, Director of the
- 25 Appellant company.
- 30 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
- 35 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.
- 40 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 : -

'(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

5 - 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 ..'

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.

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

'(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.'

15 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.

Relevant facts

20 10. The Appellant's default history shows that surcharge default notices were issued for the period 10/2007, 07/2008 (being the default period under appeal), 01/2010 and 04/2010 as a result of a failure to render a return and/or make full payment of the tax due by the relevant due date. With regard to the 04/2010 default surcharge the Appellant had contacted HMRC ahead of the due date for that period to request a Time to Pay Arrangement, and no default surcharge was therefore payable. The Appellant had successfully completed the default surcharge period to end 07/2008 and therefore the default in 01/2010 resulted in a non-monetary surcharge.

30 11. The Appellant's principle grounds of appeal are twofold. Firstly, as stated in its notice of appeal to the Tribunal, that Mr Parry had telephoned HMRC on 5 September 2008 and had been advised that it may be possible for the existing default notice to be extended rather than a default surcharge being applied. Secondly the reasons for non-payment of VAT of £64,888.31 on the due date of 31 August 2008 was because of cash flow problems arising from what the Appellant described as 'inordinate delays in obtaining payment from its main customers, Blackpool and North Lancashire NHS Primary Care Trusts. In a letter by the Appellant to HMRC's Default Surcharge Appeals Team, Mr Parry states that the Appellant company had hoped to send a cheque for the VAT, having been promised monies from the Primary Care Trusts with whom they place a lot of staff. Mr Parry said that 'unfortunately due to the holiday period within the various departments we did not receive monies as expected by 31 August 2008. We were not therefore able to send a cheque which we knew would be
40 honoured and hope therefore to send a payment within seven days via the banking

system. Unfortunately there were substantial amounts still outstanding owed to us and we were unable to do so, hence the telephone call on 5 September'. In correspondence with HMRC Mr Parry on behalf of the Appellant explained that the company's customer base at the relevant time was a mix of small local businesses, but that the vast majority of work invoiced would be for larger institutions including three of the primary care trusts (PCTs) to whom the Appellant would provide temporary workers. He explained that when the primary care trusts were late in making payments the Appellant's cash flow was affected dramatically and as a consequence of the PCTs not adhering to its thirty day terms the effects of the Appellant's cash flow were quite disastrous.

12. In a further exchange of correspondence with HMRC Mr Parry said that he had written to HMRC on several occasions when the first surcharge had been raised, but had not received a response. He had initially been under the impression that having asked for a review of the default surcharge HMRC had granted an extension of the surcharge liability period and waived the default surcharge. He said that had he been informed otherwise he would have been in touch with the appropriate personnel at the PCT, but that in any event there had been personnel changes at the PCT and the administration of its finance processing centre did not appear to be in order. He said that this resulted in a build up of arrears and whilst he had been able to obtain a £50,000 short term overdraft facility from the Appellant company's bank, this had not been enough to allow the Appellant to extricate itself from its cash flow problems. Mr Parry concedes however that in a letter dated 5 November 2010 to HMRC that, had he known that the default surcharge liability period had not been extended and the default surcharge had not been waived, he would have '.. raised the necessary funds personally and from our bank in an attempt to clear it at a reduced cost'.

13. The schedule and breakdown of monies received by the Appellant company for the period from 01/06/2008 to 31/08/2008 appear to show that income received from the PCTs represented 63.69% of sales for June 2008, 57.97% for sales in July 2008 and 55.48% of total sales for August 2008. Mr Parry said that the delay in the institutions making payment, particularly given the Appellant's reliance upon payments being made within its thirty day term, clearly seriously affected its cash flow position. Mr Parry said that the average payment was over two months at that time. He could not explain the precise reason for those delays, except to say that had he known HMRC had not extended the company's surcharge liability period he perhaps may have been able to speak to personnel at East Lincs Financial Services, the agency which dealt with payment of invoices, to ascertain the reason. Since then he said there had been changes in personnel and it was no longer possible to establish the primary cause for PCTs late payments.

14. HMRC said its call transcript records show that the member of HMRC who spoke to Mr Parry on 5 September 2008 said that the default would either be a surcharge liability extension or a 2% surcharge depending on the amount of VAT liability. The surcharge liability notice for the 07/2008 period was issued on 12 September 2008 and this would have confirmed that a 2% surcharge was in place for that quarter.

15. The Appellant's bank statements for the period from 01/08/2008 to 12/09/2008 show that the Appellant company's overdrawn balance oscillated between approximately £19,000 and £53,000 which appeared to indicate that the company operated within its bank facility for most of the time.

5 16. Mr Birtles on behalf of HMRC said that the company had not provided copy bank statements for June and July 2008. He said that there had been a pattern of default and that to establish a reasonable excuse the Appellant had to demonstrate that the causative event giving rise to the lack of funds for the relevant period was entirely
10 outside the normal hazard of trade, in that there was some element of inescapable or unforeseeable misfortune which resulted in the default. Mr Birtles argued that because there had been a build up of several months arrears in terms of PCTs payment of invoices the cash flow problems would have been an ongoing, and an identified factor and therefore not outside the Appellant company's control. He argued that the Appellant had not entered into any kind of factoring arrangement or negotiated an
15 increase in its bank overdraft facility. He submitted that, because no details had been provided in terms of copy bank statements as to what monies had actually been received by the Appellant during the relevant quarter, it is conceivable that the Appellant may even have received more than its output figures suggested.

20 17. Mr Birtles on behalf of HMRC asserted that the Appellant had acknowledged that the average payment by PCTs was over two months at the time of the default and therefore late payments had virtually become 'the norm' and as such not unforeseeable. The Appellant had not done everything which a prudent and competent business person, mindful of their obligations to VAT, would have done, in the same or similar circumstances to try and pay the tax due. In any event Mr Birtles argued,
25 the copy bank statements which had been provided for August showed that the Appellant had some head room right up to September 2008 to pay at least part of the outstanding VAT and therefore reduce the potential default surcharge.

30 18. 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 not preclude consideration of the underlying cause of insufficiency and that a trader
35 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.

40 19. 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 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.

20. Having considered the Appellant company's circumstances and the background facts and circumstances leading up to the default the Tribunal finds 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 had they put in place appropriate precautionary measures. The company did not operate factoring, had not approached its bankers for an increase in its banking facilities and, as Mr Parry conceded, the Appellant could possibly have paid at least part of the amount due by the due date by raising funds from other sources. The Appellant company had been late in making its VAT payments in respect of periods immediately before and after 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 have been aware of the consequences of failing to make VAT payments on time as this had been adequately explained in the surcharge liability default notice. 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 has not been discharged.

21. For the above reasons the Appellant has not shown that there was a reasonable excuse for its late payment of VAT for the 07/2008 quarter. The Tribunal therefore dismisses the Appellant's appeal.

22. 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.

MICHAEL S CONNELL

TRIBUNAL JUDGE

RELEASE DATE: 17 February 2012