



TC03457

Appeal number: TC/2012/09796

VAT – default surcharge – s 59 VATA 1994 – whether reasonable excuse – whether time-to-pay agreements in place – whether disproportionate penalty – appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

O'BRIEN CONTRACTORS LIMITED

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE PETER KEMPSTER
MR TERENCE BAYLISS**

Sitting in public at Priory Courts, Birmingham on 9 January 2014

Mr Adam Routledge (CTM Limited) for the Appellant

Mrs Pat Checkley (HMRC Appeals Unit) for the Respondents

DECISION

1. The Appellant (“the Company”) appeals against default surcharges imposed pursuant to s 59 VAT Act 1994 in respect of its VAT periods 03/11, 06/11 and 03/12. Following agreement at the hearing between the parties in relation to the effect of earlier VAT periods, the amounts of the surcharges under appeal were agreed to be: 03/11 Nil; 06/11 £5,258.11; and 03/12 £15,973.86.

Legislation

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

“59 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,
- 5 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
- 10 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;
- 15 (b) in relation to the second such period, the specified percentage is 5 per cent;
- © 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
- 20 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
- 25 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—
- 30 (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
- 35 (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
- 40 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
- 45 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.
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- (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,
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- the default shall be left out of account for the purposes of subsections (2) to (5) above.
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- (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.
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- (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:

"71 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.
- 25
- (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."
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Evidence

- 4. The Tribunal had from both parties extensive bundles of bank statements, correspondence and other documents.
 - 5. Mr Peter O'Brien, managing director of the Company, adopted and confirmed a witness statement dated 25 October 2013 and gave oral evidence.
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5 (1) He has been with the Company for over 30 years. He and his brother are the main shareholders. The Company employs 14 office staff and 100 on sites. The business is construction of civil engineering works, as subcontractor to major national contractors. Projects take between one month and two years. Normal practice was to bill monthly for the work done in the previous month, with payment being expected 30-40 days later. The current recession in the construction industry was the worst he could remember since 1995. Although some customers were regular payers (eg universities) most had started to pay later than agreed, starting in 2009. The Company's accountant (Mr Murray) would telephone customers in advance of due payment date to check amounts (usually established by a quantity surveyor) and dates. Much management time was spent chasing payment from customers who had become increasingly evasive. The cash flow problems were close to impossible to manage. Customers had taken to making withholdings from payments, which were above and beyond the legitimate retentions permitted by the contract terms. Solicitors had been instructed with some success, but even the successful cases resulted in delays in collecting funds.

20 (2) Most of the Company's suppliers did offer credit terms because of the Company's long trading history, but they had refused to go beyond 45 days credit. Some suppliers had cancelled contracts.

(3) The Company had had to inform staff that without pay cuts there would be redundancies.

25 (4) A particular problem had been caused by HMRC's threat to withdraw the Company's CIS gross payment status. When the Company protested HMRC acknowledged the appeal but still informed the Company's customers that they should pay net of tax. That had seriously damaged the Company's trading reputation and had taken a lot of management time to resolve satisfactorily.

30 (5) When the Company realised it would be late paying a tax liability, it would always contact HMRC in advance by telephone – usually by Mr Murray but sometimes by Mr O'Brien. There had never been any formal written terms.

35 (6) Mr O'Brien and his brother operated a partnership in parallel to the Company, as a plant hire business which traded with the Company. Both the Company and the partnership had overdraft facilities of £200,000 and £500,000 respectively. The bank had stated it wished to reduce its exposure and the agreement reached was that the partnership facility would be removed entirely but the Company's facility increased to £600,000. That was a reduction in aggregate, and put an extra burden on the Company.

40 (7) In response to questions in cross-examination, Mr O'Brien accepted that the Company had past tax compliance failures and had not kept up-to-date on certain corporation tax payment agreements. He stated that the Company had received letters of apology from HMRC in relation to some periods.

Appellant's Case

6. For the Company Mr Routledge submitted as follows.

7. The Company raised three grounds of appeal:

5 (1) *There was a reasonable excuse for the late payments*, being that customers had paid late unexpectedly and had made underpayments unexpectedly. The Tribunal had extensive evidence of the bank statements and prepared schedules showing the cash flow problems. Although s 71 prevented
10 insufficiency of funds from being a reasonable excuse in itself, the Company's financial shortfall was unexpected and resulted from the actions of its customers. There was also the bank's decision to reduce the overdraft facilities available by £100,000 (taking together the Company and the parallel partnership). Further, the effect on the Company's trading of HMRC mistakenly withdrawing the CIS gross payment status.

15 (2) *Time-to-pay arrangements ("TTPs") were in force for all the periods*. The late payments were made with the agreement of HMRC. HMRC had conceded that a TTP was in place for the 12/10 period, and in correspondence HMRC had stated to the Company that a TTP was in place for the 09/10 period. The Company's contention was that TTPs were also in place for the periods under appeal. There was support for this contention in HMRC's telephone logs.

20 (3) *The amount of the surcharge was disproportionate*. In *HMRC v Total Technology (Engineering) Ltd* [2013] STC 681 the Upper Tribunal had stated (at [72]) that "... an excessive penalty would impose a disproportionate burden on a defaulting trader and distort the VAT system as it applies to him ...". That was the case in this instance; a penalty of over £21,000 in aggregate was disproportionate and put the Company's future in jeopardy.

25 8. In the absence of any statutory power to mitigate the surcharges, they should be removed entirely.

Respondents' Case

9. For HMRC Mrs Checkley submitted as follows.

30 10. The rates and amounts of the surcharges under appeal were to be adjusted as agreed between the parties (as set out in [1] above) but otherwise HMRC resisted the appeal.

35 11. TTPs had been granted by HMRC in respect of earlier periods because of cash flow difficulties faced by the Company. In November 2010 HMRC had allowed the Company a short further extension of time because funds expected had been delayed. HMRC did not agree TTPs for the periods under default. In fact the Company had not even kept to the payment schedule it had itself put forward. The Company had
40 been slow paying its PAYE and corporation tax liabilities, as well as its VAT debts. HMRC did not dispute that the Company had been in contact concerning its inability to pay on time – as shown by HMRC's telephone logs – but there were no TTPs in place for the relevant VAT periods and the Company had been informed of that. The Company's accountants' statement in a letter dated 15 August 2012 that a "deemed TTP agreement is in place" showed that the Company had assumed it had permission

to pay late but there was no TTP agreement. In relation to the Company's tax debts HMRC had been obliged to notify enforcement action and undertake a distraint visit.

12. Section 71 specifically excludes insufficiency of funds and reliance on third parties from being a reasonable excuse. The failures to pay could not be demonstrated to be caused by any particular customer defaults. Scrutiny of the bank statements and schedules showed that most customers were paying in the 30 to 120 day period anticipated; also, that the Company's cash position had actually improved over time. HMRC did not consider the reasons given by the Appellant for late payment to constitute a reasonable excuse within the meaning of the legislation.

13. The surcharges were not disproportionate, and *Total Technology* supports HMRC's case.

Consideration and Conclusions

14. We take in turn the three grounds of appeal.

15. *Reasonable excuse* – We are sympathetic to the severe trading conditions that the Company, in common with most businesses in the construction sector, has faced over the last few years. However, in order for the cash flow problems to amount to a reasonable excuse (within the meaning of ss 59 & 71) the insufficiency of funds is not itself adequate. The Company has helpfully provided extensive analyses of its banking and accounting position at the relevant times. Our conclusion is that the problems were general trading conditions in the business sector at that time. We cannot see that the overdraft reduction (taking the Company and the partnership together) had a demonstrable adverse effect on the Company's ability to pay the three relevant VAT liabilities. Similarly, although HMRC's incorrect withdrawal of the CIS gross payment permission may have caused some embarrassment for the Company with its customers, again we cannot see that it had a demonstrable adverse effect on the Company's ability to pay the relevant VAT liabilities. Accordingly, we find there was not a reasonable excuse (within the meaning of the legislation) for any of the defaults under appeal.

16. *Alleged TTP arrangements* – We have considered carefully the evidence produced, including HMRC's telephone logs and the recollections of the Company's personnel (both Mr O'Brien's testimony, which we accept, and in correspondence between the parties). Our conclusion is that the Company encountered difficulties in meeting many of its tax liabilities (VAT, PAYE and corporation tax) in the relevant period, and it did often telephone HMRC to explain that payment may be late. HMRC have accepted that some of those requests, taken together with HMRC's response, did amount to TTP arrangements (and thus permitted deferred payment of the relevant amounts without penalty or surcharge). However, those occasions accepted by HMRC do not include the late VAT payments for the three VAT periods under appeal. Our conclusion is that we agree with HMRC; the evidence does not show that HMRC agreed to accept deferred payment of any of the relevant VAT liabilities. Indeed, there is some indication that the Company did not even meet its

own deadlines in making late payments; however it is not necessary for our decision for us to make any findings on that point.

17. *Proportionality of the surcharge* – we consider the Upper Tribunal decision in *Total Technology* (which is binding on this Tribunal) is clear that the general system of s 59 surcharges is not disproportionate. On the particular surcharge assessed on the Company, the Upper Tribunal stated (at [99]):

“In our judgment, there is nothing in the VAT default surcharge which leads us to the conclusion that its architecture is fatally flawed. There are, however, some aspects of it which may lead to the conclusion that, on the facts of a particular case, the penalty is disproportionate. But in assessing whether the penalty in any particular case is disproportionate, the tribunal must be astute not to substitute its own view of what is fair for the penalty which Parliament has imposed. It is right that the tribunal should show the greatest deference to the will of Parliament when considering a penalty regime just as it does in relation to legislation in the fields of social and economic policy which impact upon an individual’s convention rights. The freedom which Parliament has in establishing the appropriate penalties is not, we think, necessarily exactly the same as the freedom which it has in accordance with its margin of appreciation in relation to convention rights (and even there, as we have explained, the margin of appreciation will vary depending on the right engaged).”

We cannot rule this surcharge disproportionate, given that it is an aggregate penalty of around £21,000 for a total of three defaults within twelve months, in relation to a taxpayer with monthly turnover in excess of one million pounds.

18. It follows from our above findings that none of the grounds of appeal succeeds and thus the surcharges stand in the amounts assessed.

Decision

19. The Tribunal decided that the appeal is DISMISSED.

20. 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: 3 April 2014