



**TC03982**

**Appeal number: TC/2014/01059**

*VAT – Default Surcharge; reasonable excuse; insufficiency of funds, whether economic climate, trading conditions relevant; Value Added Tax 1994, s 71 (1)(a); yes; appeal allowed*

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**SCRIMSIGN (MICRO-ELECTRONICS) LTD**

**Appellant**

**- and -**

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

**Respondents**

**TRIBUNAL: JUDGE J GORDON REID QC FCI Arb**

**Sitting in public at George House, Edinburgh on 23 June 2014**

**Keith Scrimshire (managing director) for the Appellant**

**Elizabeth McIntyre, Officer of HMRC, for the Respondents**

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## DECISION

### Introduction

5 1. This is a default surcharge appeal under the VAT regime on the ground that the *recession* and related circumstances have been the causes of failure to pay VAT on time and therefore constitute a *reasonable excuse* for late payment of VAT.

2. A hearing took place at Edinburgh on 23 June 2014. Keith Scrimshire, the managing director of the Appellant company, appeared on its behalf.  
10 Mrs Elizabeth McIntyre, an HMRC officer appeared on behalf of the respondents. A bundle of documents was produced, the authenticity of which was not in dispute.

3. The Notice of Appeal, lodged on 20 February 2014 was *late*, but HMRC did not resist Mr Scrimshire's application to allow it to proceed. In the circumstances, the appeal was allowed to proceed.

### 15 Grounds of Appeal

4. There are no specific grounds in the Notice of Appeal. Attached to the Notice is a series of letters, from which I deduce that the basis of the appeal is insufficiency of funds caused by the recession, and in particular, trading difficulties, lack of working capital, the attitude of the banks, existing customers dictating unfair terms and  
20 conditions and failing to pay the Appellant timeously.

### Statutory Background

5. S59 of VATA 1994 sets out the default surcharge regime. S59(7)(b) provides, in effect, that if *there is a reasonable excuse for the return or VAT not having been so despatched* (ie submitted or paid on time) *he* (ie the taxpayer) *shall not be liable to the*  
25 *surcharge..... and shall be treated as not having been in default in respect of the prescribed accounting period in question.*

6. S71 provides that for the purpose of any provision of sections 59 to 70 which refers to a reasonable excuse or any conduct, that *an insufficiency of funds to pay any VAT due is not a reasonable excuse.*

30 7. The default surcharge regime is summarised in *HMRC v Total Technology (Engineering) Ltd.*<sup>1</sup>

### Factual Background

8. The Appellant is a family business. It was established in 1986. It designs and manufactures, supplies and installs electronic display systems and customised control  
35 software. Their systems are used in the transport industry, the health service,

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<sup>1</sup> [2012] UKUT 418 (TCC) paragraphs 7-9

financial services and other commercial sectors. It currently employs two full-time and three part-time staff. For the year ended 31 December 2011, the Appellant had a turnover of £290,283 with a pre-tax loss of £10,371 and £267,248 for the previous year, with a pre-tax loss of £9,988.

5 9. Hitherto, the Appellant has fulfilled its statutory tax obligations on time. In recent years, the Appellant has been badly hit by the effects of the recession but has nevertheless managed to continue to trade. It has had a good relationship with the majority of their long term suppliers and have managed to arrange credit facilities with the suppliers from time to time.

10 10. However, their own customers have not been so understanding. Many of them are in the position to dictate their own terms of business and frequently provide for payment after 60 days or more. In the past, the Appellant had sufficient working capital to meet VAT shortfalls from time to time. More recently, working capital has been depleted and the Appellant's bank has been unwilling to extend existing  
15 overdraft facilities. In order to remain in business, the Appellant has had to cut overheads to the minimum. Although trading conditions have improved somewhat, banks are still not lending freely and working capital is difficult to obtain.

11. Eight surcharge liability notices were issued to the Appellant in relation to VAT periods between 09/10 (ie the three-month period ending on 30/09/10) and 12/12.

20 12. On 28 February 2012, the Appellant contacted HMRC by phone and explained their inability to pay the VAT due on 7 February 2012. HMRC records lack of work, debtors not paying on time, overdraft facilities being at their maximum and could not be extended, and personal credit cards used to bolster the business being at their maximum limit. The surcharge liability notice in respect of that period was  
25 subsequently cancelled by HMRC letter dated 27 March 2012.

13. On 23 May 2012, Mr Scrimshire wrote to HMRC in relation to a surcharge liability notice for the period 03/12. He attributed the Appellant's inability to pay in full and on time to the recession. However, that notice was also subsequently  
30 withdrawn because it fell to be calculated at a lower rate and the resulting sum fell below the threshold of £400 which, I was informed, HMRC apply in the exercise of their discretion.

14. On 14 September 2012, the Appellant's accountants wrote to HMRC Default Surcharge Review Team intimating that the Appellant was experiencing severe financial difficulties although the long term outlook for the business was said to be a  
35 little more encouraging. They sought a review of the surcharges levied in respect of 03/12 and 06/12. There is also correspondence around that time and subsequently with his MP who appears to have written on his behalf to HM Treasury. A letter from HM Treasury dated 8 April 2013 acknowledged *this difficult economic period*.

40 15. By letter dated 22 October 2012, HMRC, following an internal review, refused to accept that the Appellant had a reasonable excuse in relation to the periods 03/12 and 06/12. They took the view that an appeal on the grounds of insufficiency of funds

could only be considered when the taxpayer is able to demonstrate that the circumstances that led to the loss of income and subsequent default were unforeseen and outside their influence and control; the normal hazards of trade did not warrant exceptional discretion. They did, however, offer a Time To Pay arrangement. That offer was not taken up. There was no discussion at the hearing of what those arrangements would or might have been.

16. On 26 March 2013, Mr Scrimshire wrote a long letter to HMRC. This letter was attached to the Notice of Appeal and is summarised above.

17. HMRC have produced a schedule of defaults. There are eight between the VAT period 09/10 (ie the three-month period ending on 30/09/10) and 12/12. There are three defaults in respect of which a surcharge is outstanding, the others having been cancelled or withdrawn.

18. The first is for the period 06/12. A Surcharge Liability Notice (or more accurately, a Notice of Assessment of Surcharge) was issued on 17 August 2012 in the sum of £1097.78. As earlier surcharge notices have been cancelled or withdrawn, the rate of charge has been reduced from 15% to 10%. The amount payable is therefore £731.18. The bulk of the VAT due for that period was paid about three months late.

19. The second is for the period 09/12. A Surcharge Liability Notice was issued on 16 November 2012 in the sum of £405.32. The rate of charge was 15%. The VAT due for that period was paid about one month and seven days late.

20. The third is for the period 12/12. A Surcharge Liability Notice was issued on 15 February 2013 in the sum of £1,885.67. The rate of charge was 15%. About two thirds of the VAT due for that period was paid less than one month late.

21. The total sum due under these notices is £3022.17.

22. Mr Scrimshire informed the Tribunal that in 2010 the Appellant's turnover was reduced by 50% following the takeover of the Alliance and Leicester by Santander. However, the Appellant managed to continue in business. Cash flow was tight, the working week was reduced; he gave up his company car. *Big customers* were throwing their weight about by delaying payment beyond even the 60 days for which they began to stipulate. Mr Scrimshire said that much of his high value goods were supplied to such customers so they had simply to accept the position. He produced an undated letter from the Appellant's bank still refusing to extend overdraft facilities. It appears from the correspondence available that the letter must have been written between about October 2012 and March 2013.

23. In relation to the three outstanding surcharges, Mr Scrimshire's position was that the Appellant would have had to cease trading if the VAT had been paid on time. The business was operating from day to day and there was no way of predicting whether his customers would pay timeously. He pointed out that the VAT was always paid in full and was frequently only a few days late. She said that economic conditions were still difficult but that his business had survived. The Appellant has

only one major creditor supplier. There is no PAYE or income tax arrears. If he had given up, five people would have become unemployed.

24. Mrs McIntyre, for HMRC, explained how the schedule of eight surcharge notices had been reduced to three. She referred to *Stepto*<sup>2</sup> and submitted that a prudent taxpayer would, in the circumstances described by Mr Scrimshire, have contacted HMRC and made suitable time to pay arrangements. Alternatively, the Appellant could have operated the cash accounting system of payment. In these circumstances, she submitted that the appeal should be refused, although she indicated that HMRC understood the difficulties the Appellant faced.

## 10 Decision

25. I have no reason to doubt the factual background narrated by Mr Scrimshire and set forth, in particular, in paragraphs 22 and 23 above. It was not disputed by HMRC. While what he said was fairly general, the substance was that the underlying cause of the Appellant's inability on occasion to pay the VAT due from time to time was the long term effects of the recession which has endured for much longer than many businesses predicted. The shortage of working capital was attributable to the lending attitude of banks (again linked to the recession), the ability of customers to dictate unfair terms of business which resulted in a small business such as the Appellant giving long-term credit to larger companies was done on an unpredictable basis. Although the Appellant was always able to pay the sums specified in its VAT returns eventually, there were occasions when the lack of working capital, and the inability to obtain extended overdraft facilities, simply prevented the Appellant from making payment on the due date, as for these various reasons it had insufficient funds to enable it to do so. While the extent of delay in payment is not a mitigating or aggravating factor in relation to the amount of surcharge payable,<sup>3</sup> the mainly short periods involved in the three outstanding surcharge notices at least give general support for the assertion that every effort was being made to pay on time.

26. The question whether an economic recession can constitute a *reasonable excuse* for the purposes of s71(1)(a) VATA 1994 was considered in *Dollar Land (Feltham) Ltd & Anr v CEC*<sup>4</sup>. I drew parties' attention to that case in the course of the hearing. In *Dollar*, the tribunal, after considering *Stepto*, took the view that there was no reason in principle why the length and depth of a recession should be incapable of giving rise to a reasonable excuse provided that it was clearly shown that the recession was the real cause of the shortage of funds and that the resultant lack of funds was not reasonably avoidable. The tribunal considered that an excuse need not necessarily arise from a single event, although normally it did so. The appeal in that case, in which detailed evidence was heard, failed because the evidence disclosed that the appellant or the group of which it formed part had committed funds to capital investment at a time when it was already in difficulty with its VAT payments. That

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<sup>2</sup> [1992] STC 757 (CA)

<sup>3</sup> *Total Technology* at paragraph 9

<sup>4</sup> [1993] VATTR 30; [1995] STC 414 (CA)

was a commercial decision but it was not established that such expenditure was essential to the continued survival of the group. The tribunal therefore concluded that it had not been established that the defaults arose unavoidably from the recession. In the Court of Appeal, the question of *reasonable excuse* was not discussed; the appeal related to the tribunal's general supervisory jurisdiction.

27. I agree with the views expressed by the tribunal in *Dollar* on *reasonable excuse*. Applying these observations to the present appeal leads me to conclude that the Appellant's temporary lack of funds which prevented it from meeting its VAT obligations timeously was caused not through any imprudence on the part of Mr Scrimshire, who controlled the company, but by the underlying economic recession the effects of which so far as the Appellant was concerned were difficult to predict but could not reasonably be avoided. It is to the Appellant's credit that it has managed to remain in business and meet (eventually) all its fiscal obligations.

28. The effects of the recession have travelled far afield and have affected many businesses in many different ways at different times. In the present appeal, these effects seem to me to be somewhat different from the normal hazards of trade. I accept that the Appellant was placed in difficult financial circumstances which arose because of a combination of factors flowing from the general effects of the recession. Unlike *Dollar*, the Appellant did not commit funds to capital investment. Rather, it cut back in order to remain in business and preserve jobs. Mr Scrimshire invested funds in the Appellant by using his personal credit card facilities on behalf of the company. He did so to enable the Appellant to continue in business and meet its various financial obligations including those to HMRC. In my view, HMRC were correct to be sympathetic to the Appellant's position. It is unfortunate that they did not have the observations of the tribunal in *Dollar* in mind when considering how to exercise their discretion. Although the information provided by Mr Scrimshire is not as detailed as it might have been, I consider that it is just sufficient to enable me to conclude that the Appellant has a reasonable excuse for the failure to make payment timeously on the three occasions which are still in issue. All outstanding sums were paid as soon as it was reasonably possible to do so.

## **Result**

29. In the foregoing circumstances, the appeal is allowed.

30 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.

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**J GORDON REID  
TRIBUNAL JUDGE**

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**RELEASE DATE: 3 September 2014**