



TC04037

Appeal number: TC/2014/01340

*VALUE ADDED TAX — default surcharges — prolonged cash flow difficulties
— whether reasonable excuse — no — appeal dismissed*

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

MID WEST SERVICES (UK) LIMITED

Appellant

— and —

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

Respondents

Tribunal: Judge Colin Bishopp

Sitting in public in London on 4 September 2014

Mr Mark Odenore, director, for the Appellant

Mr Philip Rowe, presenting officer, for the Respondents

DECISION

1. This is an appeal by Mid West Services (UK) Limited (“Mid West”) against three default surcharges imposed for the admitted late payment of its VAT liabilities for the periods 07/12, 10/12 and 01/13. The penalties amount to £1,955.39, £3,188.90 and £1,577.31 respectively. The question before me is whether Mid West has a reasonable excuse which, by operation of s 59(7) of the Value Added Tax Act 1994, relieves it from one or more of the penalties.

2. Mid West has been in the default surcharge regime since period 04/11, and has paid its VAT liability late in every period from then until the last of those with which I am concerned. Mr Mark Odenore, the director who represented Mid West before me, accepted that the lateness of the payments which gave rise to the appealed penalties was in every case attributable to nothing other than cash flow problems.

3. Mid West’s business is the supply of cleaners to, in the main, commercial organisations. It has about 25 employees, working as cleaners, and is run by Mr Odenore and an assistant. Mr Odenore explained that the company has half a dozen smaller customers, which require its services on an intermittent basis. Its major customer, accounting for about 80% of its turnover, is the consortium undertaking the Crossrail project.

4. Mid West has a formal, written contract with the Crossrail consortium, providing for the supply by Mid West of cleaners and payment by the consortium by reference to the number of hours worked by the cleaners. It seems that in the earlier part of the period covered by the contract there had been some unforeseen delays in payment by the consortium which led to defaults for periods 10/11 and 01/12, and to surcharges. Mid West appealed to the tribunal against those surcharges and, at the hearing Mr Philip Rowe, who represented HMRC then and before me, accepted that there was a reasonable excuse for those defaults and withdrew the surcharges.

5. Mr Odenore explained that Mid West’s problems had continued. The consortium had required substantially more hours of cleaning work than had been forecast. That had the consequence that his employees were earning more than originally expected, and the threshold at which national insurance contributions became payable had been crossed, thus adding to the cost of employment. There was provision in Mid West’s contract with the consortium for adjustment of the hourly rate payable in various circumstances, including these; but the negotiations had been protracted and even now Mr Odenore had managed to secure only enhanced payments for the future. Nothing had been conceded for the costs he had already incurred. He produced a recent letter written by agents Mid West had instructed to the consortium, in which a substantial claim for the past, it seems considerably in excess of Mid West’s VAT debt, is advanced. To make matters worse, Mid West cannot factor the debt because the consortium refuses to deal with factors. I heard no evidence from the consortium, and had no copy of any response to the letter of claim, so have only Mr Odenore’s version of events; but for present purposes I assume what he told me about Mid West’s contractual relationship with the consortium is correct.

6. Mr Odenore told me that, despite the cash flow problems to which it led, it was not a realistic course to withdraw from the consortium contract, since the business could not survive with its other customers alone. He would have no choice, if he did adopt that course, but to make his staff redundant, and close the business.

7. Mr Odenore also told me (and HMRC accept) that Mid West does not have gross payment status for the purposes of the construction industry scheme, with the consequence that, although it eventually recovers the money deducted from the consortium's payments, it has to wait before it can do so. It does not seem, however, that it is still afflicted by late payments by its customers.

8. Ordinarily, as s 71(1)(a) of the 1994 Act says, "an insufficiency of funds to pay any VAT due is not a reasonable excuse", but it is open to the tribunal to examine the underlying cause of the insufficiency of funds in order to determine whether that cause amounts to a reasonable excuse. The test is that set out by the Court of Appeal in *Customs and Excise Commissioners v Steptoe* [1992] STC 757 at 770:

"... if the exercise of reasonable foresight and of due diligence and a proper regard for the fact that the tax would become due on a particular date would not have avoided the insufficiency of funds which led to the default, then the taxpayer may well have a reasonable excuse for non-payment, but that excuse will be exhausted by the date on which such foresight, diligence and regard would have overcome the insufficiency of funds."

9. There is, uncontroversially, a public interest in ensuring the timely payment of taxes, and there can be no objection in principle to the imposition of penalties on those who do not comply with their obligations. However, as I have said on several occasions in the past, the default surcharge system is a blunt and unforgiving instrument, and I can only agree with Mr Odenore that the imposition on a small trader, as Mid West is, of repeated surcharges necessarily has the effect of making it increasingly difficult to meet its obligations. As he said, if Mid West did not pay its employees they would cease to work; and if it did not pay its suppliers they would cease to supply. It is understandable that payments to those on whose goodwill the continuing existence of the business depend take priority.

10. However, Parliament has decreed that those who do not pay their VAT liabilities on time without reasonable excuse are liable to surcharges, and the authorities make it clear that, although unforeseen events or other circumstances against which he cannot reasonably guard which frustrate the responsible trader's efforts to pay on time may amount to a reasonable excuse, the excuse will not subsist indefinitely. I accept that Mid West is mindful of the need to pay its VAT liabilities on time (and it is to its credit in this respect that its recent returns have been submitted on or before the due date even if the tax has not been paid), and that it does suffer financial pressures which impede its ability to meet its obligations as they arise; but it is not enough to do as Mid West has done, that is carry on without taking steps to address the problem, for example by seeking additional finance. While it is, as is commonly known, difficult in the current economic climate to secure additional funding, I had no evidence that Mr Odenore had attempted to do so, or had taken any other action. Although, as I have recorded above, some renegotiation of Mid West's contract with the Crossrail

consortium has taken place, and it may in time improve Mid West's financial situation, it was not a step taken with a view to improving its VAT compliance, but is merely one of the factors demonstrating the difficulties which face it.

5 11. In my judgment the excuse which Mid West had for the late payment of its VAT for periods 10/11 and 01/12 was not one which could extend to defaults in periods six months and more later, and I can find no other factor which amounts to a reasonable excuse as that phrase has been interpreted by the courts and tribunals. For those reasons the appeal must be dismissed.

10 12. 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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**Colin Bishopp
Tribunal Judge**

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Release date: 29 SEPTEMBER 2014