



TC04236

Appeal number: TC/2014/01529

VAT default surcharge - payment six days late - Appellant obliged to pay electronically - payment made by cheque – major customer late in making payment which affected cash flow - insufficiency of funds - no request for time to pay - whether on the facts a reasonable excuse - no - appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

H C M ELECTRICAL LTD

Appellant

- and -

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

**TRIBUNAL: JUDGE MICHAEL S CONNELL
 MR MARYVONNE HANDS**

**Sitting in public at 4th Floor, Byron House, 2a Maid Marian Way, Nottingham
NG1 6HS on 22 October 2014**

**Mr Robert Dickenson, Finance Director of the Appellant Company for the
Appellant**

Mr Philip Osborne, Officer of HM Revenue and Customs, for the Respondents

DECISION

The Appeal

5 1. H C M Electrical Limited (“the Appellant”) appeals against a default surcharge for the period 12/12, for its failure to submit by the due date, in respect of the VAT period, payment of the VAT due.

2. The point at issue is whether the Appellant has a reasonable excuse for making the late payment and whether the surcharge levied is proportionate.

Background

10 3. The Appellant Company is based in Ripley, Derbyshire. It undertakes specialist electrical and mechanical work within the electricity, water and gas utilities industries. It has approximately 50 employees.

4. The Appellant’s payment for the period 12/12 was due and paid as follows:

<u>Tax Period</u>	<u>Amount</u>	<u>Due by</u>	<u>Paid on</u>
12/2012	£173,482.81	31/01/2013	06/02/2013

15 The Appellant made the payment by cheque and was six days late.

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 return for a VAT quarterly period by the due date, 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. 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. The Appellant had been in the default surcharge regime from period 06/10 onwards. Prior to the VAT period subject to this appeal, eight earlier consecutive surcharge liability notices had been issued.

7. The Appellant appealed three default surcharges for periods 03/11, 06/11 and 09/11 on the basis that it had suffered cash flow problems arising from a major customer defaulting on a £300,000 contract in 2009. The Tribunal dismissed the appeal on the basis that the Appellant had failed to show that events in 2009 had any

unforeseeable consequence so far as the timely payment of its VAT was concerned in 2011.

5 8. In October 2012, the Appellant asked HMRC to review the default surcharge that had been imposed in respect of the 06/12 VAT payment which had been paid two months late. The Appellant explained that the late payment:

“was as a consequence of a rapid expansion of a contract, requiring the company to employ additional staff quickly and draining its cash resources. It is difficult to turn away business in this economic climate but it does affect cash flow in the short term.”

10 9. HMRC would not agree to waive the surcharge on the basis that an insufficiency of funds does not represent a reasonable excuse, and the problems described by the Appellant were no more than normal hazards of trade and did not warrant exceptional discretion. Many traders were operating in similar circumstances and in order to maintain the credibility of the surcharge regime the system must be seen to be equitable.

15 10. The Appellant had been mandated in January 2010 to render both returns and payments electronically with effect from period 06/10 onwards, under Regulation 25A(3) VAT Regulations 1995. The online registration screens, which must be used in order to register for online filing, refer to further online information on paying electronically, which details the acceptable electronic payment methods.

20 11. The Appellant having been issued with a mandating letter during January 2010 requiring both returns and payment for period 06/10 and following to be rendered electronically, nevertheless continued to make payment by cheque contrary to VAT Regulations 1995/2518 Reg. 40(2A).

25 12. The due date for receipt of cleared funds by cheque is defined under an amendment to VAT Regulations 1995 Regulation 40, which has an effective date of 1 April 2010. From that date payments of VAT due made by cheque were treated as made on the day the funds clear to HMRC's account.

30 13. The Appellant continued, for each default period, to pay by cheque, whilst rendering returns electronically. No reason was suggested for the payment method chosen.

35 14. The electronic due date for period 12/12 was 7 February 2013, as shown on the electronic return. The return was received on time, electronically, on 6 February 2013. The due date for an electronic payment was 7 February 2013. For those traders eligible to pay by cheque the due date for receipt of cleared funds was 31 January 2013. The tax due was paid by cheque on 6 February 2013.

15. On 15 February 2013 HMRC imposed a penalty of £26,022.42 in respect of the late payment for the period 12/12. The penalty was levied at 15% of £173,482.81 being the total amount of tax paid late.

16. On 23 January 2014, the Appellant wrote to HMRC questioning the surcharges imposed for periods 03/12, 06/12 and 12/12, saying that the late payments had arisen due to circumstances beyond the Appellant's control. HMRC agreed to cancel the surcharge for period 03/12 but upheld the surcharges for 06/12 and 12/12.

5 17. The Appellant gave notice of appeal to the Tribunal with regard to the 12/12 surcharge on 17 March 2014.

“Reasonable excuse” and relevant legislation

10 18. 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).

19. Section 59 (7) VATA 1994 sets out the relevant provisions : -

15 ‘(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 or VAT not having been so despatched then

20 - 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 ..’

It is s 59(7)(b) on which the Appellant seeks to rely.

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

25 ‘(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.’

30 21. Although an insufficiency of funds to pay any VAT due is not a reasonable excuse, the underlying cause of any insufficiency of funds, if entirely unforeseen and outside the control of the taxpayer, may constitute a reasonable excuse – *Customs & Excise Commissioners v Steptoe* 1992 STC 757 (“Steptoe”).

35 22. The onus of proof rests with HMRC to show that the surcharge was correctly imposed. If so established, the onus then rests with the Appellant to demonstrate that there was reasonable excuse for late payment of the tax. The standard of proof is the ordinary civil standard of a balance of probabilities.

Appellant's Case

23. In its Notice of Appeal to the Tribunal the Appellant's stated grounds of appeal were:

5 "We are appealing this decision as a surcharge of £26,022.42 is totally unreasonable on a VAT payment of £173,482.81 particularly as the payment was only just late.

Our financial problems started in 2009 with the non-payment of £300,000 by a major customer Alstom Power. As a result of Alstom's non-payment we have already incurred HMRC surcharges of over £20,000.

10 We would ask you to review this surcharge in relation to the actual VAT payment and the length of time payment was delayed.

We are a small company striving to provide continuous employment for staff and expand our business and the surcharge of £26,000 will seriously hinder that progress

We have always paid our VAT liabilities as quickly as we possibly could.

15 We fully understand the implications of not paying on time & assure you we have always paid our tax as soon as possible and since we have survived the Alstom experience are now back on track.

Perhaps an interest charge for the time the money was delayed would be more appropriate."

20 24. At the hearing, Mr Dickenson reiterated the grounds of appeal as set out in the notice of appeal. He said that the default by Allston Power almost led to the winding up of the company. They had managed to trade through their financial difficulties but it had taken far longer than expected, which resulted in the VAT due for that period (£173,482) being considerably in excess of the company's usual VAT payment.

25 25. In December 2012 the company took on an exceptionally large contract with EDF Energy. EDF operates nuclear, gas and coal fired power stations and the Appellant accepted a contract worth in excess of £4 million in connection with the installation of electrical apparatus in a new power station. The Appellant company was on 30 day terms expecting a £200,000 payment in early February 2013, but the payment was not received early enough to allow payment of VAT due for the December quarter.

30 26. The Appellant therefore says that the delay in payment of its 12/12 VAT payment was entirely due to unforeseen and inescapable circumstances. Payment of the amount due was made by the company as soon as the company's cash position allowed.

35 27. Mr Dickenson said that a few large customers made up the Appellant's main customer base and provided most of its income. Although the company benefited from securing a major new contract which guaranteed a source of revenue, an exceptional amount of working capital had become tied up in materials and taking on 40 electrical contractors with specialised experience to cover the company's additional labour needs. The company normally has approximately 50 employees but

in December 2012 had around 90. There was nothing that could have been done to avoid the cash flow problem if, as happened, EDF paid later than contractual terms stipulated.

5 28. At the time of the default the company had a modest £15,000 overdraft with its bank, which refused to increase the facility.

29. The Appellant had not asked HMRC for time to pay because it expected to be paid by EDF on time. Also, given the company's previous default history, Mr Dickenson did not expect HMRC to be willing to enter into a time to pay arrangement.

10 30. Mr Dickenson said the company was not suffering an insufficiency of funds as a result of poor trading or because of the normal hazards of business, but because of an exceptional event which had caused a temporary but serious interruption in its cash flow.

31. Mr Dickenson said that he was unaware that had the company paid its 12/12 VAT electronically on 6 February 2013, no surcharge would have been levied.

15 HMRC's Case

32. The potential financial consequences attached to the risk of further default would have been known to the Appellant after issue of the Surcharge Liability Notice for the period 11/10, given the information contained in the Notice. Included within the notes on the reverse of the Surcharge Liability Notice, is the following, standard, paragraph:

20 'Please remember: Your VAT returns and any tax due must reach HMRC by the due date. If you expect to have any difficulties contact either your local VAT office, listed under HM Revenue & Customs in the phone book as soon as possible, or the National Advice Service on 0845 010 9000.'

25 33. The requirements for submitting timely electronic payments can also be found -

- In notice 700 "the VAT guide" paragraph 21.3.1 which is issued to every trader upon registration.
- On the actual website www.hmrc.gov.uk
- On the E-VAT return acknowledgement.

30 34. Also, the reverse of each default notice details how surcharges are calculated and the percentages used in determining any financial surcharge in accordance with the VAT Act 1994 s 59(5).

35. Therefore HMRC say that the surcharge has been correctly issued in accordance with the VAT Act 1994 s 59(4).

35 36. HMRC's Notice 700/50 (December 2011) s 6.3 (the notice represents HMRC's policy and understanding of the relevant legislation) states that HMRC consider that

genuine mistakes, honesty and acting in good faith are not acceptable as reasonable excuses for surcharge purposes.

37. It is also specifically stated in s 71(1) VATA 1994 that any insufficiency of funds to pay any VAT is not reasonable excuse.

5 38. The Finance Act 2009 s 108 specifies that there is no liability to a default surcharge for a period where contact is made with HMRC prior to the due date in order to arrange a payment deferment and this is agreed by HMRC. In this case there was no agreement and whether or not a time to pay arrangement should be agreed is entirely within the discretion of HMRC.

10 39. Mr Osborne for HMRC said that the Appellant's arguments regarding financial constraints and the company's cash flow problems along with its efforts to meet its obligations were nothing out of the ordinary. The events that occurred were entirely foreseeable and in essence were in any event normal business risks. The financial challenges facing the Appellant were nothing unusual or out of the ordinary and did
15 not provide a reasonable excuse for the default.

40. On 6 February 2013, when submitting the period 12/12 VAT return, the Appellant would have received an automated on-screen acknowledgement which states:

20 "Any tax due must be paid electronically and received by HM Revenue & Customs by [Payment Due Date]. Payment should be made electronically, by Bankers Automated Clearing Services (BACS), Bank Giro Credit Transfer or by Clearing House Automated Payment System (CHAPS). You must use the VAT Registration number as a reference on your payment. Sort code, Account number and Account Name can be found on the HMRC web site. <http://www.hmrc.00v.uk/payinghmrc/bank-account-checker.htm>

25 Please note: HMRC now accepts Faster Payments. Before making an electronic payment please contact your bank or building society to check the services available to you, any daily value limits and the latest cut off times for making payment. For more information on making electronic payments see the 'How to pay' guide on the HMRC website. <http://www.hmrc.ciov.uk/payinghmrc/vat.htm>"

30 41. In relation to the argument that the default surcharge system is disproportionate, HMRC would draw the Tribunal's attention to the decision in the case of *Total Technology (Engineering) Ltd* in the Upper Tribunal which creates a binding precedent on appeals before the First-tier Tribunal considering issues of proportionality when they are raised.

35 42. The *Total Technology* case centred on a payment being made one day late triggering the imposition of a default surcharge which the company argued was disproportionate. In his judgement Upper Tribunal Judge Mr Justice Warren found that:

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- HMRC's decision to charge Total Technology (Engineering) Ltd a default surcharge for the late payment was correct;

- the default surcharge regime itself does not infringe the principles of proportionality; and
- the surcharge imposed on Total Technology (Engineering) Ltd did not infringe the principle of proportionality

5 43. HMRC contend the above judgement supports HMRC’s position that the default surcharge regime itself is proportionate and that HMRC was correct in charging a default surcharge in respect of the late payment for the accounting period 12/12.

Conclusion

10 44. HMRC argue that the causes of the insufficiency of funds were not exceptional. They argue that they were foreseeable and attributable to the ordinary hazards of trade. As such, they say that they could not be regarded as a reasonable excuse for the Appellant’s late payment of VAT.

15 45. However, that is to regard foreseeability as the sole criteria for determining whether a reasonable excuse has been shown and that, in our view, is not the correct approach. The cash flow interruption in January 2013 could have been foreseen, but was unavoidable. The events which affected the Appellant’s cash flow were outside what the exercise of reasonable foresight would have enabled the Appellant to do in order to avoid the shortage of funds which led to the late payment of VAT. The Appellant’s inability to pay its VAT was caused by an unavoidable interruption to its cash flow rather than insufficiency of funds

20 46. The issue of reasonable excuse and s 71(1)(a) was considered in detail in *Stepto*. The Court of Appeal held that although insufficiency of funds can never of itself constitute a reasonable excuse, the cause of that insufficiency, that is, the underlying cause of the taxpayer’s default, might do so and in considering that, as Lord Donaldson MR explained, the question is whether the late payment was “reasonably avoidable”. The test to apply can be found in his judgment where he said:

30 “... 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.”

35 47. That is the correct test to be applied and is binding upon the Tribunal. In *Stepto* Lord Nolan said that it is necessary to distinguish between the reason for non-payment and excuse for non-payment. The taxpayer here is saying that it should be excused from the surcharge, not because it was short of funds, but because that shortage was brought about by circumstances over which it had no control. Lord Nolan quoting from his own decision in *Customs and Excise Commissioners v Salevon* [1989] STC 907 said:

5 “... It is worth bearing in mind that the penalties imposed for a delay or deficiency in
payment, however slight, are fixed. Neither the commissioners nor the tribunal have
any power to mitigate them by reference to the facts of the particular case. In these
circumstances the wide discretion conferred on the commissioners and the tribunal by
s19(6) should not in my view, be regarded as having been cut down by s33(2) to any
greater extent than the language of the latter subsection strictly requires. The
commissioners and the members of the tribunal are well qualified to distinguish
between the trader who lacks the money to pay this tax by reason of culpable default
and the trader who lacks the money by reason of unreasonable and inescapable
10 misfortune.”

48. However, the management of the Appellant company could have been more
proactive in ensuring that HMRC were aware of its position, and put forward
proposals regarding the date on which realistically, taking into account its payment
terms with EDF Energy, the 12/12 VAT would be paid. HMRC may not have been
15 prepared to agree to a time to pay arrangement, but the Appellant did not even explore
the possibility. Had it done so, and if HMRC refused a time to pay arrangement, it is
possible that the circumstances in this case, that is, a temporary interruption in its cash
flow, rather than an insufficiency of funds could, subject to what is said below, have
been regarded as exceptional and within the principles set down in *Stephoe*.

20 49. The Appellant had a poor compliance history. There was clearly a history of the
management not taking such reasonable steps as they were able, to maintain the
company’s ability to discharge liabilities including VAT when they fell due.

50. The Appellant had been mandated with effect from period 06/10 onwards to
render both returns and payments electronically. As HMRC say, the online
25 registration screens, which must be used in order to register for online filing, refer to
further online information on paying electronically which details the acceptable
electronic payment methods. The Appellant nonetheless continued to make VAT
payments by cheque contrary to VAT Regulations 1995/2518 Reg. 40(2A).

51. The due date for the 12/12 VAT payment by electronic means was 7 February
30 2013. Had the Appellant made its payment electronically it would have been in time.
Because the Appellant paid by cheque, the due date for receipt of cleared funds was
31 January 2013. The tax due was received by cheque on 6 February 2013 and
therefore six days late.

52. Taking these factors into account it cannot be said that the Appellant, having due
35 regard for the fact that it’s VAT was payable on the due date, did everything it could
by the exercise of reasonable foresight and due diligence to ensure payment was made
on time.

53. For the above reasons we find that the Appellant has not shown that it had a
reasonable excuse for the late payment of its VAT in period 12/12 and therefore
40 dismiss the appeal.

54. 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

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TRIBUNAL JUDGE

RELEASE DATE: 19 January 2015

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