



TC04729

Appeal number: TC/2015/4428

VAT – default surcharge – s 59 VATA 1994 – whether reasonable excuse

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

**Mr DAVID FISH
(FISH & CO, SOLICITORS)**

Appellant

- and -

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

Respondents

**TRIBUNAL: Judge Peter Kempster
Mr John Coles**

Sitting in public at Centre City Tower, Birmingham on 11 November 2015

The Appellant in person

Mr Brian Morgan (HMRC Appeals Unit) for the Respondents

DECISION

1. The Appellant (“Mr Fish”) appeals against a default surcharge in the amount of
5 £1,298.75 (reduced from previously assessed amount of £1,548.75) imposed by the
Respondents (“HMRC”) pursuant to s 59 VAT Act 1994 in respect of his VAT period
02/15.

Legislation

2. Section 59 VAT Act 1994 provides for default surcharges for late submission of
10 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—

- 15 (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,

20 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.

25 (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
30 (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.

35 (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
40 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 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—
- 10 (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;
- (c) in relation to the third such period, the specified percentage is 10 per cent; and
- 20 (d) in relation to each such period after the third, the specified 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 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.
- 25
- (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,
- 40 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 (and, accordingly, any surcharge liability notice the service of which depended upon that default shall be deemed not to have been served).
- 45 (8) For the purposes of subsection (7) above, a default is material to 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.
- 15
- (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.
- 20
- (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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- 35

Appellant’s Case

4. Mr Fish submitted as follows.

5. It was not disputed that most of the VAT payment for the 02/15 period was paid one day late. £15,487.51 was due on 7 April 2015. £2,500 was paid on 5 April and the balance of £13,000 was paid on 8 April.

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6. Mr Fish's solicitors practice in Wolverhampton conducted mainly social welfare law work for clients who were funded by legal aid, being about 95% of total work. This type of work had never been particularly remunerative but had become even less so as a result of funding changes since 2013; these changes had made financial management very difficult. The firm's bank had not been supportive, and had cut the overdraft facility from £20,000 to £10,000. There were now few firms in the Midlands prepared to conduct social welfare law work. The mechanism for payment of fees to the firm by the Legal Aid Agency (the responsible Government agency) was as follows. There were two categories of work. First, Legal Help/Controlled Legal Representation – this comprises initial advice and some tribunal representation work; returns are submitted monthly and normally paid on the first Monday of the following month; a bill for around £8,000 was submitted by the deadline of 20 March 2015 but the first Monday in April was a Bank Holiday, so payment would be expected on Tuesday 7 April (also the VAT due date) but in fact was received on the next day, 8 April 2015. Secondly, Certificated Work – this is longer term work where the firm can bill a matter twice per year (but not within the first three months after a certificate is issued) and only 75% of fees are paid on account, with the remainder paid after completion of the matter; although payment was usually within 2-3 weeks after billing, there were frequently delays because of queries concerning matters such as counsel's fees; this type of work accounted for the remainder of the payment expected from the Legal Aid Agency in April 2015.

7. The part payment of £2,500 on 5 April (and thus before the payment deadline) was all that the firm could afford to pay without breaching its overdraft limit. The balance was paid as soon as the funds were available which was when the payment from the Legal Aid Agency arrived. The payment from the Legal Aid Agency was received and the VAT balance paid both on 8 April, which was within 24 hours after the payment deadline.

8. The firm had incurred several earlier surcharges that had not been appealed. This one was different as it related to a period when the Legal Aid Agency payment was received later than usual. Mr Fish had not been aware at the time that a time-to-pay facility could be agreed in advance. He had discussed with the firm's bookkeeper whether to telephone HMRC about the cashflow problem but had decided that there would be no sympathy for the situation given the previous late payments.

9. In *Stepto v HMRC* [1992] STC 757 the Court of Appeal ruled that a cashflow shortage attributable to "an unforeseeable or inescapable event" could constitute a reasonable excuse for late payment. While the late payment by the Legal Aid Agency may have been foreseeable, it was certainly inescapable.

10. It was unfair that a surcharge should be levied by HMRC for what was, in effect, a payment delay by another government department (the Legal Aid Agency).

11. The surcharge was excessive for a delay, for good reasons, of only one day in payment. On an annualised basis it represented an interest charge of 3,650% pa. Therefore, it could not be supported, as stated in *Energys Holdings UK Ltd v HMRC* [2010] SFTD 387. The Tribunal was also referred to the cases of *Profound Decisions*

Ltd [2015] UKFTT 0300 (TC); *Robert P Slight* [2015] UKFTT 0016 (TC); and *Capital Coin Machine Co Ltd* [2014] UKFTT 003 (TC).

12. Even if the Tribunal found that the surcharge was chargeable, HMRC's calculation was incorrect in that it had been levied on the full amount of VAT although part had been paid on time.

13. Even if the Tribunal found that the surcharge was correct, the twelve month surcharge liability period (which triggered further surcharges for any subsequent defaults) should be curtailed.

Respondents' Case

14. For HMRC Mr Morgan submitted as follows.

15. There was a history of late VAT payments. The payments for periods 02/14, 05/14 & 08/14 were all paid late as to at least some of the amounts due. Mr Fish made periodic payments, as evidenced by a schedule presented to the Tribunal. At March 2015 there had been outstanding arrears of approximately £4,900 and the April payments had been first applied to the earlier arrears, as Mr Fish had not stipulated which periods the payments related to; however, the calculation of the surcharge in respect of 02/15 had been recalculated to give the benefit of the payments entirely against the 02/15 liability, resulting in a reduced surcharge of £1,298.75. Mr Fish had been VAT registered for some time and so would be aware of the appropriate payment dates and, especially given the earlier surcharges, also aware of the risk of surcharges for late payment.

16. HMRC did not consider the reasons given by Mr Fish for late payment to constitute a reasonable excuse within the meaning of the legislation. In particular, there was nothing unforeseen about the Legal Aid Agency payment being received on 8 April, rather than 7 April. That had been notified in advance to Mr Fish's firm some months earlier. Mr Fish was clearly aware that he faced a VAT payment no later than 7 April and expected a Legal Aid Agency receipt on 8 April, yet he took no action to deal with that cashflow situation.

17. The guidance notes supplied with the earlier surcharge liability notices made it clear that a trader anticipating difficulty in paying on time should contact HMRC as soon as possible; similar advice was given on HMRC's website. Mr Fish had not requested a formal time-to-pay arrangement until after the 02/15 payment was overdue. In fact, HMRC had subsequently agreed to a time-to-pay arrangement for monthly instalments.

18. In *Eastwell Manor Limited* [2011] UKFTT 293 (TC) the Tribunal stated:

“30. The Company had cashflow difficulties, and we accepted that it had reached its overdraft limit. Although inability to pay is not a reasonable excuse (s 71(1)(a) VATA), the underlying reason for that inability to pay can constitute a reasonable excuse (*Stepto v R&C Commrs* [1992] STC 527 (“*Stepto*”)).

5 31. The test in *Steptoe* requires the Tribunal to take for comparison a person in a similar situation to that of the actual taxpayer who is relying on the reasonable excuse defence. The Tribunal must then ask itself - with that comparable person in mind - whether, notwithstanding that person's exercise of reasonable foresight and of 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.

10 32. The Tribunal thus needs to be persuaded that that reasonable competent businessman would have defaulted when faced to by the same or similar predicament, despite exercising reasonable foresight.

15 33. In this case the Company's cashflow difficulties were neither new nor sudden. We found that the reasonable competent businessman would have either sought a Time to Pay arrangement with HMRC in advance of the deadline, or ensured that he had secured sufficient funds from other sources in sufficient time to pay the VAT due. We thus found that there was no reasonable excuse.”

20 19. Similar conclusions were reached in *Syigma Security Systems* [2013] UKFTT 329 (TC); *Bancroft v Crutchfield* [2002] STC (SCD) 347; and *The Clean Car Co Ltd* [1991] VATTR 234.

25 20. The method of calculation of the surcharge was provided by statute and neither HMRC nor the Tribunal had discretion to substitute a different amount or mitigate the amount of surcharge. The relevant legislation did not distinguish between lateness of one day or longer periods. In relation to the allegations of unfairness, that was not a matter within the jurisdiction of the Tribunal: *HMRC v Hok Limited* [2013] STC 225.

Consideration and Conclusions

Amount of surcharge

30 21. Mr Fish submits that the original surcharge calculation did not take into account the part payment of £2,500 that was made in time. Mr Morgan submits that the trader was at that point in arrears in relation to earlier periods and, as no stipulation was made concerning to which periods the £2,500 payment related, it was allocated to the outstanding balance. The surcharge has in any event been reduced (during HMRC's internal review) to £1,298.75, which in effect treats the April 2015 payments as relating entirely to the 02/15 period. We find that the £1,298.75 surcharge has been
35 calculated on a basis that is favourable to Mr Fish and, although we do not propose to amend it to a higher figure, we see no justification for any calculation resulting in a lower figure.

Reasonable excuse

40 22. This is Mr Fish's main ground of appeal. Section 71(1)(a) specifically provides that “an insufficiency of funds to pay any VAT due is not a reasonable excuse”. However, it is now well established that the “underlying causes of an insufficiency of funds” (to quote Lord Donaldson in *Steptoe*) may afford a reasonable excuse. In the

present appeal we consider it is important to make a clear finding of fact as to why the April VAT payment was made late. When we first heard Mr Fish's reasons we anticipated that he was expecting payment from the Legal Aid Agency on Tuesday 7 April – the rationale being that normally payment would be on the first Monday of the month but as that was a bank holiday, payment would be made on the first business day after the bank holiday – but the payment had in fact not been received until the following day, by which time the VAT payment was overdue. However, it became clear – and we emphasise that Mr Fish was completely candid about this – that the Legal Aid Agency had communicated to all solicitors firms (including Mr Fish) in advance the payment dates for the whole year and clearly stated that the first payment date in April 2015 was 8 April. Thus, to be clear, it was never the case that the April payment from the Legal Aid Agency was going to arrive in time to fund the timely payment of the 02/15 VAT period liability. Mr Fish urged us to regard the April payment from the Legal Aid Agency as being “late” in the sense that it arrived later than would normally be expected (ie not on the first Monday of the month); however, we do not accept that the payment was at all “late” - the Legal Aid Agency had communicated to all solicitors firms when payment would be made and the April payment was made on time in accordance with that timetable.

23. We sympathise with Mr Fish that his practice, which is performing a socially important and increasingly difficult service, faces severe cashflow difficulties. However, this is not a case where a trader has budgeted to meet a VAT liability on time on the basis of an expected customer payment that has not materialised, and so has paid the VAT late because he was unexpectedly let down by the customer. Rather, the history of defaults by Mr Fish (a schedule was supplied to the Tribunal) make it clear that what he does is to make periodic payments to HMRC as and when he can afford to do so given the firm's overdraft limit. That is what happened in April 2015. As we have already found, it was never the case that the April payment from the Legal Aid Agency was going to arrive in time to fund the timely payment of the 02/15 VAT period liability; instead Mr Fish paid £2,500 before the due date and £13,000 after the due date because that was what could be afforded from the firm's bank account. That cannot, in our view, be considered to give rise to a reasonable excuse for late payment. On the contrary, it is just the type of general insufficiency of funds that is specifically excluded by s 71(1)(a).

Proportionality

24. On the arguments concerning the proportionality of the surcharge, we understand the points made by Mr Fish in relation to the purportedly harsh nature of the penalty given that the payment delay was only one day. However, we consider the Upper Tribunal decision in *Total Technology v HMRC* [2012] UKUT 418 (TCC), [2013] STC 681 (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 trader, 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,

5 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,
10 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).”

15 That position has recently been confirmed by the Upper Tribunal in *HMRC v Trinity
Mirror Plc* [2015] UKUT 0421 (TCC). We cannot rule this surcharge
disproportionate, given that it is a penalty of around £1,300 for a fourth default within
five consecutive VAT periods.

25. We also reject Mr Fish’s comparison of the surcharge amount with an interest
charge for late payment. As has been stated by this Tribunal on many occasions, the
20 purpose of a penalty is to be punitive. Comparison with normal commercial
compensation for late payment is inappropriate.

Fairness

26. In relation to Mr Fish’s other contentions concerning the unfairness of the
surcharge, including that it was a delay by one government department that gave rise
25 to another charging a penalty, the legal position is clear that this Tribunal has no
general jurisdiction to consider matters of “fairness”: see the Upper Tribunal in
HMRC v Hok Ltd [2013] STC 225, at [56-58].

Liability period

27. The way in which the surcharge liability period is “refreshed” for a further
30 twelve months following a default is specifically provided for by the relevant
legislation and there is no jurisdiction for this Tribunal to disapply the extension of
the surcharge liability period. For completeness, even if we had that ability, we
would not exercise it on the facts of the present case.

Conclusion

35 28. For the above reasons we would dismiss the appeal and uphold the surcharge in
the amount of £1,298.75.

Decision

29. The Tribunal decided that the appeal is DISMISSED.

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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**PETER KEMPSTER
TRIBUNAL JUDGE**

RELEASE DATE: 18 NOVEMBER 2015