[2017] UKFTT 096 (TC)

TC05613

Appeal number: TC/2015/06491

VALUE ADDED TAX – Default surcharges – late payment – Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

J.T.S. PLUMBING & MECHANICAL SERVICES LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE MALCOLM GAMMIE CBE QC
LESLIE BROWN

Sitting in public at Alexandra House, Manchester on 17 November 2016

Mrs Sharon Battle (company secretary) for the Appellant

Mrs Samantha Carr, an Officer of HM Revenue and Customs, for the Respondents

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DECISION

Introduction

1. This is an appeal by J.T.S. Plumbing & Mechanical Services Limited ("the Appellant") against four VAT default surcharges:

    (1) £238.78 (adjusted from £1,723.02) imposed in relation to the late payment of VAT for the period 09/14;

    (2) £1,557.81 – period 12/14;

    (3) £2,374.43 – period 03/15;

    (4) £1,659.70 – period 06/15.

2. They amount to £2,830.72.

3. HMRC's letter of 30 September 2015, which is the decision appealed against, refers only to surcharges imposed in relation to the periods 03/15 and 06/15. In its Statement of Case, however, HMRC treated the appeal as being against each of the four surcharges set out above on the basis that the Appellant's letter of 25 August 2015 referred to appealing surcharges from 30/9/14 to 31/3/15. We have approached the appeal on that basis.

4. The appeal has been subject to a previous decision of this Tribunal (Judge Christopher McNall and Mrs Beverley Tanner), heard on 23 June 2016 and released on 4 July 2016 dismissing the appeal. As that previous decision records, the appeal was heard in the absence of the Appellant pursuant to Rule 33 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (SI 2009/273) ("the Rules").

5. Following the issue of the previous decision the Appellant sought permission to appeal to the Upper Tribunal. The application gave no reasons as to why the previous decision was wrong in law but indicated that the e-mail address that the Tribunal had used was an obsolete one that had not been in use for several months so that the Appellant had received no notification of the hearing date or of the decision. Accordingly on 7 September 2016 Judge McNall exercised his power under Rule 42 of the Rules to treat the application for permission as an application to set aside the previous decision and to direct a new hearing, which he duly did.

6. We had before us a bundle of documents relating to the surcharges under appeal. These comprised the papers before the Tribunal on 23 June 2016 and neither party sought to produce any further documents in the light of the previous decision. However, Mr James Battle, a director of the Appellant, and Mrs Sharon Battle, the company secretary, gave evidence on behalf of the Appellant and answered questions put by Mrs Carr for the Respondents and by the Tribunal.

The Law

7. The VAT default surcharge regime is provided for by section 59 of the Value Added Tax Act 1994 ("VATA"). Section 59(7)(b) VATA provides that a person shall not be liable to a surcharge if there is a reasonable excuse for the VAT not having been despatched.

8. Section 70 VATA provides that the Tribunal may reduce the penalty to such amount (including zero) as it thinks proper. The Tribunal is not, however, allowed to take into account any insufficiency of funds available to pay any VAT due or for paying the amount of any penalty or the fact that a person liable to a penalty has acted in good faith (section 70(4)(a) and (c) VATA).

9. Section 71(1)(a) VATA provides that, for the purposes of section 59, an insufficiency of funds to pay any VAT due is not a reasonable excuse. The difficulty that a taxpayer faces in this regard was expressed by Lord Justice Nolan in *Commissioners of Customs and Excise v Salevon* [1989] STC 907 when he said at 911:

> "… the cases in which a trader with insufficient funds to pay the tax can successfully invoke the defence of "reasonable excuse" must be rare. That is because the scheme of collection which I have outlined involves at the outset the trader receiving (or at least being entitled to receive) from his customers the amount of tax which he must subsequently pay over to the commissioners. There is nothing in law to prevent him from mixing this money with the rest of the funds of his business and using it for normal business expenses (including the payment of input tax), and no doubt he has every commercial incentive to do so. The tax which he has collected represents, in substance, an interest-free loan from the commissioners. But by using it in his business he puts it at risk. If by doing so he loses it, and so cannot hand it over to the commissioners when the date of payment arrives, he will normally be hard put to it … to persuade the commissioners or the tribunal that he had a reasonable excuse for venturing and thus losing money destined for the Exchequer of which he was the temporary custodian."

10. Nevertheless, as this indicates, the taxpayer's task in this respect is not impossible: the underlying reason for the insufficiency of funds may itself provide a reasonable excuse. This appears from the decision of the Court of Appeal in *Customs and Excise Commissioners v Steptoe* [1992] STC 757.

11. The relevant facts of *Steptoe* appear in the decision of Lord Justice Scott. Mr Steptoe was an electrical contractor who did 95 per cent of his work for the London Borough of Redbridge. The Redbridge Council was virtually his only customer and was an extremely slow payer. He was late in paying VAT in several quarters starting with that ending in November 1986 and continuing up to the end of November 1988. The VAT Tribunal concluded that the conduct of the Council was such that Mr Steptoe had a reasonable excuse for three of the four default surcharges that had been imposed but not the fourth because by the time that was incurred the Council had

mended its ways and he could not rely on the excuse that in the fourth period his accountants were responsible for the delay.

12. Scott LJ nevertheless concluded that Mr Steptoe did not have a reasonable excuse because late payment was not an unforeseeable event in the conduct by the taxpayer of his business, such that the taxpayer should have made arrangements to secure his cash flow. If his profit margins were so slim or his financial circumstances such that was unable to secure his cash flow, he was nevertheless caught by what is now section 71(1)(a): "*The reason for the insufficiency of funds is, in such a case, itself an insufficiency of funds.*"

13. Lord Justice Scott was, however, in a minority. The Master of the Rolls, Lord Donaldson, and Lord Justice Nolan upheld the Tribunal's decision, which had concluded in favour of Mr Steptoe. In doing so Lord Donaldson summarised the different approaches of Scott and Nolan LJJ in these terms ([1992] STC 757 at 770):

> "The difficulty which then arises is that Parliament has not specified what underlying causes of an insufficiency of funds which lead to a default are to be regarded as reasonable or as not being reasonable. … Nolan LJ, as I read his judgment explaining and expanding on his judgment in *Customs and Excise Comrs v Salevon Ltd* [1989] STC 907, is saying that if the exercise of reasonable foresight and 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.
>
> Scott LJ on the other hand is of the opinion that the underlying cause of the insufficiency of funds must be an 'unforeseeable or inescapable event'. I have come to the conclusion that this is too narrow in that (a) it gives insufficient weight to the concept of reasonableness and (b) it treats foreseeability as relevant in its own right, whereas I think that 'foreseeability' or as I would say 'reasonable foreseeability' is only relevant in the context of whether the cash flow problem was 'inescapable' or, as I would say, 'reasonably avoidable'. It is more difficult to escape from the unforeseeable than from the foreseeable."

14. It is against that background that we have approached this appeal.

The Facts

15. The Appellant has been in the VAT default surcharge regime since the period 12/12. A series of successive defaults in paying VAT on time through 2013 meant that by 12/13 any further defaults would attract a surcharge at the maximum rate of 15%, until there had been four complete successive periods without default.

16. The Appellant did not dispute that VAT payments for the four periods 09/14, 12/14, 03/15 and 06/15 had either been made late or (in the case of 03/15) not at all.

17. The Appellant's Notice of Appeal was dated 26 October 2015 and stated in the grounds of appeal that the VAT for 09/14, 12/14 and 03/15 had not been paid in time was 'poor cash flow'. The Appellant said that it was operating an overdraft of £60,000 on which £20,000 was added to run a new business. A company for which the Appellant had done a large project in the South of England was said to be in debt to the Appellant for approximately £43,000 including VAT. The Appellant's letter of 25 August 2015 did not attach or enclose any further evidence as to the project in question or of the alleged debt or give any information as to the identity of the debtor company in the South of England.

18. HMRC sought further information on 25 November 2015. Some was provided under cover of an e-mail dated 16 December 2015. This indicated that the job had been at Croydon Town Hall and Victoria Road and had begun before November 2014 (on the basis of the first payment was made on 14 November 2014 pursuant to a certificate). £20,324 (excluding retentions including VAT) was outstanding as at 10 June 2015 against a total contract price of £91,476 including VAT. The contract was with Lambourn Contracts Ltd, which, according to Companies House, went into administration in January 2016.

19. The VAT due for the quarter 09/14 was due on 7 November 2014. The return was submitted on that date but none of the VAT due was paid on time. We did not see the Appellant's bank statements for the whole of that period but its VAT return records sales of £95,329 over purchases of £37,895. The VAT declared due was £11,486.83. The first payment (£279.19) was made on 16 January 2015. Between 16 December 2014 (the earliest date for which we have the details) and 16 January 2015, the Appellant's bank account was never more than £37,651 overdrawn. By the start of 16 January 2015 its overdraft had reduced to £17,837. On this evidence, against an overdraft facility of £60,000, it had at all times from mid-December 2014 sufficient capacity to pay the whole of the VAT due for 09/14.

20. The VAT due for the quarter 12/14 was due on 6 February 2015. The return was submitted on that date but none of the VAT due was paid on time. The Appellant's VAT return records sales of £114,183 over purchases of £62,256. The VAT declared due was £10,385.42. The Appellant received payments totalling £52,860 from Lambourn Contracts between 14 November 2014 (the earliest recorded payment) and 19 January 2015. As at the close of business on 6 February 2015, its bank account was overdrawn by £25,239. Hence against an overdraft facility of £60,000, it had the money to pay the whole of the VAT on time.

21. The VAT due for the quarter 03/15 was due on 07 May 2015. The return was submitted on that date but none of the VAT due was paid on time. The Appellant's VAT return records sales of £142,913 over purchases of £63,766. The VAT declared due was £15,829.58. The Appellant received £27,915 from Lambourn Contracts between 17 February 2015 and 16 April 2015. As at the close of business on 7 May 2015, its bank account was overdrawn by just under £51,000. This reduced to approximately £36,000 on opening of business on 8 May with a receipt of nearly £15,000 but over the course of that day a series of payments (including payments of £1,000 each to Mr and Mrs Battle) returned the overdraft to just over £50,000. By 18 May the overdraft was over £62,000.

22. The VAT for the period 06/15 was due on Friday 7 August 2015. The return was submitted on 5 August but the VAT due was only paid on 10 August. The return was for £11,064.67. In relation to this period the Appellant wrote as follows:

> "… I paid £11,064.67 direct into your bank account via CHAPS payment but for some reason you did not receive it on this date. I had just made a payment of £5,000 for an agreement set up with HM Customs for VAT owed from 2014 to 2015 on the same day I paid the £11,064.67 which took me to my Credit Limit on the Business Account for that day so this was the reason I could not pay the amount direct from our bank to HM Revenue. If I had realised this I would have made the payment of the £11,064.67 first then on Monday made the agreed payment of £5,000."

23. The £11,064.67 was transmitted by CHAPS (incurring a £20 fee) on Monday 10 August 2015 and therefore received three days late. The £5,000 was sent on Friday 7 August 2015 by Faster Payment. This payment was allocated by HMRC between the VAT due on 09/14 (£3,207.64) and 12/14 (£1,792.36) in relation to which surcharges for late payment had already been incurred.

24. The Appellant's bank statements indicate that at close of business on 6 August 2015 the Appellant's overdraft stood at nearly £58,000 but on opening on 7 August 2015 it received two large payments that reduced its overdraft to just over £3,000. There were then a series of payments, including the £5,000 paid to the Respondents, which took the overdraft back to just over £18,000 at the close of business on 7 August. By close of business on 10 August 2015 the overdraft stood at just under £31,000 to which the payment of £11,064.67 had contributed. It seems, therefore, that the Appellant had sufficient capacity to pay the full amount of the VAT due on 7 August 2015 but had failed to take the necessary steps to ensure that payment was received by HMRC on that day. Mrs Battle explained that they had missed the CHAPS payment deadline by 20 to 30 minutes.

The parties' submissions

25. Mrs Battle explained that they were a family business doing their best to keep their business running and at the same time keeping up with payments to HMRC. They had been forced to use the VAT to keep the business afloat and while they recognised that this was not something that they should do, business circumstances sometimes intervened. It had proved impossible over these periods to avoid using the VAT to pay business accounts without the risk of the business going under. They were aiming to trade out of their difficulties but the large bad debt incurred through Lambourn Contracts had made this significantly difficult. The Appellant had other bad debts (although nothing on the Lambourn scale) but wages and overheads still had to be paid.

26. In relation to the final period, although the Appellant had adequate overdraft capacity on 7 August 2015 to pay the VAT due in full, the problem was the daily limit imposed by the bank on the amount that could be overdrawn. As a result it had proved necessary for Mrs Battle to drive to the bank in Kirkham and she had arrived 20 to 30 minutes late for a CHAPS payment to reach HMRC that day.

27. Mrs Carr noted that the Appellant had been in default since 2012 and would have been well aware of the financial consequences of default and also of the advice that HMRC gave to help avoid a default surcharge. She drew our attention to the Appellant's accounts and bank statements, which she said did not demonstrate an inability to deal with their VAT liabilities satisfactorily. She noted that the returns for the periods 09/14 through to 06/15 recorded turnover of £459,748, so that the outstanding debt from Lambourn Contracts was less than 10 per cent of the turnover for those periods. She noted that the Appellant did not appear to have claimed bad debt relief in respect of the debt.

28. As regards the late payment for period 06/15 Mrs Carr said that the Appellant had had sufficient financial capacity to pay in time and should have anticipated the organisational difficulties they had encountered. She drew our attention to Judge Hellier's decision in *Garnmoss Limited v HMRC* [2012] UKFTT 315 (TC) where a clerical error had led to an underpayment of VAT of £39.50. Judge Hellier said this:

> "The Act provides that a person is to be regarded as being in default if he fails to pay the amount of VAT shown on the return as payable by him. The Appellant therefore defaulted in respect of this period. The question for us is whether the appellant has a reasonable excuse. What is clear is that there was a muddle and a bona fide mistake was made. We all make mistakes. This was not a blameworthy one. But the Act does not provide shelter for mistakes, only for reasonable excuses. We cannot say that this confusion was a reasonable excuse. Thus this default cannot be ignored under the provisions of subsection (7)."

29. Ms Carr said that in the present case the Appellant had sufficient funds at the start of the day to pay the VAT in full but what then ensued was a muddle in terms of what was paid and when, culminating in Mrs Battle being just too late at the bank in Kirkham to make a CHAPS payment that would have ensured the VAT was paid on time rather than three days late.

Our Decision

30. We find it difficult to conclude that the scale of the Appellant's problems for the periods of default in respect of the outstanding debt due to it from Lambourn Contracts left it in a comparable position to Mr Steptoe. In *Social Care 4U Ltd v HMRC* [2015] UKFTT 676 the taxpayer effectively had to surrender control of its cashflow to another party who accounted for nearly (but less than) half its business. The Tribunal nevertheless was unable to conclude that the cash flow difficulties that the tax payer faced were sufficient, given its overall cash flow, to provide it with a reasonable excuse for late payment. In the present case, the Appellant's difficulties which it undoubtedly faced were nevertheless on a smaller scale even than that.

31. The taxpayer in *Social Care 4U* had got itself into a situation where it had decided to use its available cash flow to pay its temporary social care workers for the services that they had provided through the third party to local councils while the third party was continuing to delay full payment for those services. To many people it may seem quite reasonable for a business to prefer paying its employees over paying VAT

on time. The Tribunal, however, must deal with matters as the law requires. Although, as *Steptoe* indicates, the underlying cause of cash flow issues is *capable* of providing a reasonable excuse, the *Steptoe* standard is not easy to meet in the case of a failure to collect payment under one contract without that representing a substantial element of the business' turnover.

32. In the Appellant's case it appears that the failure to pay VAT on time for 09/14 and 12/14 was not due to any insufficiency of funds. At the relevant date for payment in each period it appears to have had sufficient funds in hand to pay the whole of the VAT. Nothing that Mr or Mrs Battle were able to tell us about the Lambourn Contracts' default or any other cash flow issues faced by the Appellant leads us to conclude that there was a reasonable excuse for the failure in those periods.

33. The Appellant appears to have been in a less favourable cash position on the due date for the period 03/15. The fact that it may not have had at that date sufficient funds to pay in full is not a reasonable excuse and, as we have just indicated, nothing we have read or heard from Mr and Mrs Battle persuades us that this meets the *Steptoe* standard. Accordingly we conclude that the failure to pay for that period was a simple insufficiency of funds and hence not a reasonable excuse.

34. Finally, in 06/15 the Appellant had sufficient funds but failed to organise its bank transactions in a manner that secured payment on time. That failure did not derive from any factor of which we were told that could itself amount to a reasonable excuse. It was essentially, as Judge Hellier described it in *Garnmoss*, a 'muddle'. Unfortunately for the Appellant this does not provide the basis of a reasonable excuse.

35. We therefore dismiss the Appellant's appeal against all the surcharges set out above (including for the avoidance of doubt the surcharge for 09/14 in the revised sum of £238.78).

36. 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.

MALCOLM GAMMIE CBE QC
TRIBUNAL JUDGE

RELEASE DATE: 23 JANUARY 2017