TC03116

Appeal number: TC/2013/03521

VAT default surcharge - insufficiency of funds – whether reasonable excuse - no - whether penalty disproportionate - no - whether tax payer given opportunity to discuss time to pay arrangement - no - whether reasonable excuse - yes - Appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

WE R YOUR IT LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE MICHAEL S CONNELL
ANN CHRISTIAN

Sitting in public at City Exchange Leeds on 22 July 2013

Mr Jonathan Granville Fall for the Appellant

Ms Rosalind Oliver, Officer of HM Revenue and Customs, for the Respondents

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DECISION

The Appeal

1. We R Your IT Limited ("the Appellant") appeals against default surcharges of £496.46 and £1,111.79, for its failure to submit, in respect of its VAT periods ended 30 June 2012 and 30 September 2012, by the due dates, payment of the VAT due. The surcharges were calculated at 5% and 10% of the VAT due of £9,929.27 and £11,117.91 respectively.

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

Background

3. The Appellant had previously defaulted on VAT payments in period 09/11 when a VAT surcharge liability notice was issued and again on 12/11.

4. The Appellant paid VAT on a quarterly basis. Section 59 of the VAT Act 1994 requires a VAT return and payment of VAT due, on or before the end of the month following the relevant calendar quarter. [Reg. 25(1) and Reg. 40(1) VAT Regulations 1995].

5. In respect of the first default, the Appellant's return was received late by HMRC on 30 August 2012 and the payment was made by BACS in three instalments between 31 August 2012 and 24 September 2012. In respect of the second default, the Appellant's return was received late by HMRC on 5 November 2012 and the payment was made by BACS in three instalments between 12 November 2012 and 4 December 2012.

6. HMRC have discretion to allow extra time for both filing and payment when these are carried out by electronic means. [VAT Regulations 1995 SI 1995/2518 regs 25A (20), 40(2)]. Under that discretion, HMRC allow a further seven days for filing and payment. The due date for the 06/12 period was 7 August 2012. The due date for the 09/12 period was 7 November 2012.

7. 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.

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

> '(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 of VAT not having been so despatched then
>
> - 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 ..'

9. It is s 59(7)(b) on which the Appellant seeks to rely. The burden falls on the Appellant to establish that it has a reasonable excuse for the late payment in question.

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

> '(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.'

11. Although an insufficiency of funds to pay any VAT due is not a reasonable excuse, precedent case law has established the principle that the underlying cause of any insufficiency of funds may constitute a reasonable excuse.

12. The onus of proof rests with HMRC to show that the surcharges were 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.

13. The Appellant's appeal against the surcharges was received by the Tribunal Service on 17 May 2013.

Appellant's Case

14. The Appellant does not dispute that its VAT payment for the periods under appeal were late. It is agreed that the payment, if made electronically, was due and paid on the dates referred to in paragraph 5 above.

15. The Appellant puts forward three grounds of appeal -

i. insufficiency of funds

ii. that the surcharges are unfair and disproportionate

iii. the Appellant was not afforded the opportunity of agreeing a time to pay arrangement with HMRC's debt management division as he had done in the past.

16. Mr Jonathan Fall, proprietor of the Appellant company, said that the business had been formed in 1998 and was relatively successful until the onset of the recession. He started as a sole proprietor, and by 2000 had ten employees. In 2008 business started to fall away and he had to reduce the company's employees to three. The company supplies IT hardware mainly to long-standing customers. It is very capital intensive and late payers put an enormous strain on the business. Mr Fall said that he was unable to inject any further capital into the company. His bank had been particularly unhelpful and his house was already mortgaged. Sometimes he had to resort to the use of credit cards to make purchases.

17. The company's business ran in half yearly cycles. One half of the year tended to be busy and the other not so busy. If corporation tax and VAT fell due for payment in the less busy period it was often very difficult to survive.

18. Mr Fall said that his main ground of appeal was the fact that he had not been given the opportunity of agreeing or even discussing a time to pay arrangement with HMRC. The company had previously been afforded a time to pay arrangement some years earlier which had been particularly helpful, but when he telephoned HMRC in June 2012 to request a time to pay arrangement, he was refused and simply lectured on his obligation to pay the company's VAT on time.

19. He telephoned HMRC again in September 2012 and was again met with the same response. It was not until later that he discovered the telephone number he had been given was the VAT helpline and not the HMRC Debt Management Service, who he had found to be far more responsive and had on a previous occasion readily agreed a time to pay arrangement.

20. He had a debt payment plan that he knew he would be able to adhere to but feels he had not been given the opportunity of discussing it with HMRC's debt management division. Prior to each default he had telephoned HMRC before the VAT fell due for payment. He accepted that HMRC had a discretion whether or not to agree a time to pay arrangement, but felt aggrieved that he had not been able to speak to anyone who had the authority to make that decision and in fact appeared to have been led to believe that the individuals he had spoken to were part of the Debt Management Service when in fact they were not.

HMRC's Case

21. 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 in September 2011, given the information contained in the Notice. Included within the notes on the reverse of the Surcharge Liability Notice, is the following, standard, paragraph:

> ‘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.’

22. 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.

23. 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).

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

25. 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.

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

27. Insofar as the Appellant argues that the surcharge is excessive or disproportionate to the modest delays which occurred, the case of *Total Technology (Engineering) Limited v HMRC* heard in the Upper Tribunal held that:

(1) There is nothing in the architecture of the Default Surcharge system which makes it fatally flawed.

(2) In order to determine whether or not a penalty is disproportionate, the Upper Tier Tribunal addressed the following factors:

(a) The number of days of the default

(b) The absolute amount of the penalty

(c) The ‘inexact correlation of turnover and penalty’

(d) The ‘absence of any power to mitigate’

and decided that none of these leads to the conclusion that the Default Surcharge regime infringes the principle of proportionality.

28. A time to pay arrangement is a matter which is entirely within the discretion of HMRC. It has to be clear that the taxpayer has the means of payment and would be able to adhere to the arrangement. Also any request for a time to pay arrangement had to be made before the due date for payment. HMRC had no record of Mr Fall contacting them to request a time to pay arrangement prior to the defaults.

Conclusion

29. The Appellant was clearly aware of the due date for payments of its VAT and the potential consequences of late payment.

30. The Appellant's first ground of appeal is that it suffered cash flow shortages caused by a decline in business following the onset of the recession.

31. In *Customs & Excise Commissioners –v- Steptoe [1992] STC 757* the taxpayer argued that although the proximate cause of his default was insufficiency of funds, the underlying cause of that insufficiency, namely the unexpected failure by a major customer to pay him on time, amounted to a reasonable excuse. The Court determined on a majority that the statutory exclusion of insufficiency of funds as an excuse did not preclude consideration of the underlying cause of insufficiency and that a trader might have a reasonable excuse if it were caused by an unforeseeable or inescapable event or when, despite the exercise of reasonable forethought and due diligence, it could not have been avoided. The Court nevertheless made it clear that the test had to be applied strictly.

32. To decide whether a reasonable excuse exists where insufficiency of funds causes the failure the Tribunal must 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 should then ask itself, with that comparable person in mind, whether notwithstanding that person's exercise of reasonable foresight, 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.

33. In our view the Appellant has not shown a reasonable excuse by reason of insufficiency of funds. There were no unforeseen circumstances entirely outside the control of the Appellant which caused the insufficiency of funds.

34. With regard to the Appellant's assertion that the penalties are disproportionate, we concur with the Revenue's submissions at paragraph 27 above. The penalties were therefore not disproportionate or excessive.

35. We are satisfied however that Mr Fall made attempts to agree a time to pay arrangement with HMRC. Mr Fall was able to produce telephone records to show that he contacted HMRC prior to the defaults. The Appellant company paid its VAT in full for each of the default periods, albeit late and in three instalments for each period. We are therefore satisfied that the Appellant would have adhered to a time to pay arrangement had one been in place. It appears that Mr Fall was never given the opportunity of speaking to a decision maker within HMRC's Debt Management

Division. Had he been able to, it is likely that a time to pay arrangement would have been agreed. Whether or not HMRC agree a time to pay arrangement is entirely within their discretion, but the decision must be exercised with diligence. Mr Fall was not given the opportunity of putting forward his proposals and therefore whether or not to agree a time to pay arrangement was not properly considered.

36. In the Tribunal's view, the Appellant has shown a reasonable excuse for its late payment of VAT for the 06/2 and 09/12 periods.

37. The appeal is accordingly allowed and the surcharges cancelled.

38. 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

TRIBUNAL JUDGE

RELEASE DATE: 2 December 2013