TC03201

Appeal number: TC/2013/04613

VAT – default surcharge – CIS deductions wrongly made by contractors – request made to HMRC for repayment – repayment made after the due date for VAT and on the same basis as CIS deductions properly made – whether reasonable excuse – whether within the* Steptoe *exception – yes to the extent that HMRC were holding incorrectly deducted CIS – appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

GRAFFITI BUSTERS LIMITED **Appellant**

- and -

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

TRIBUNAL: ANNE REDSTON (PRESIDING MEMBER)
HELEN MYERSCOUGH

Sitting in public at Copthall House, the Pavement, Sutton, Surrey on 12 December 2013

Mr Neil Winstone, director of the Appellant, for the Appellant

Mr Philip Rowe of HM Revenue & Customs' Appeals and Reviews Unit, for the Respondents

DECISION

1. This is the appeal of Graffiti Busters Limited ("the company") against a default surcharge of £681.37 in respect of the period ending 01/13.

2. The Tribunal decided that **the appeal was allowed in part and the surcharge reduced to £103.70**.

The issues in the case

3. The company accepted that its VAT for the quarter ended 01/13 had been paid late. The issues in the case were:

(1) whether the Tribunal should allow a late appeal;

(2) whether HMRC's retention of money wrongly treated as falling under the Construction Industry Scheme ("CIS") regime constituted a reasonable excuse for late payment; and

(3) whether the company's cash flow difficulties constituted a reasonable excuse for late payment.

The late appeal

4. The company's appeal should have been received by the Tribunal within 30 days of the date on the HMRC review letter. The date on that letter was 9 May 2013, but the company's appeal to the Tribunal was dated 2 July 2013. The Tribunal returned the appeal documents to the company on 9 July 2013 because no copy of the HMRC's decision letter was attached. This was then sent to the Tribunal on 10 July and received by the Tribunal on 12 July 2013.

5. The appeal was made late because Mr Winstone, the company's director, had sent the papers to their external accountant for a case review and they were returned late to the company.

6. It is well-established that the Tribunal will only give permission for a late appeal where there is good reason to do so and where the interests of justice would be served by granting permission, having regard to all relevant circumstances. We rely in particular on the decision of Morgan J in *Data Select Limited v R&C Commissioners* [2012] UKUT 187 (TCC); [2012] STC 2195.

7. In this case the delay was short, and was occasioned by a third party and not the company. If permission to make a late appeal was not given, the prejudice to the company would be significant, and the prejudice to HMRC slight. For HMRC, Mr Rowe did not object to the company's application for a late appeal.

8. Taking into account the facts and the relevant law, in our judgment it was in the interests of justice to allow a late appeal.

The evidence

9. The Tribunal was supplied with the correspondence between the parties. Mr Winstone also gave oral evidence to the Tribunal and was cross-examined by Mr Rowe.

10. In addition, Mr Winstone supplied an email from the company together with a copy of a letter dated 1 December 2010 from HMRC to the company and a page from the HMRC Guide for Contractors. We were told, and we accept, that these three documents form a standard package which is supplied to company's clients in order to demonstrate that the company is not within CIS and that CIS deductions should therefore not be made from payments to the company.

The facts

11. The company's business is the removal of graffiti from a wide range of buildings. HMRC have accepted that these services fall outside the scope of CIS as providing "external cleaning (other than painting or decorating) of buildings and structures".

12. Despite the company's standard client document package, referred to above, some clients nevertheless make CIS deductions from payments made to the company.

13. When this happens, the company writes to HMRC and asks for the deduction to be refunded as it has been made in error. HMRC does not repay the wrongly deducted CIS amounts on receipt of these letters. Instead, it retains the amounts until after the end of the tax year, and offsets them against the company's PAYE and corporation tax, repaying any excess. As a result, any net balance is not repaid to the company until around January after the end of the tax year, which is often more than a year after the deductions were made.

14. For example, in the year ending 6 April 2012, CIS amounts of £4,666.06 were wrongly deducted by clients. HMRC offset £122.86 of this amount against PAYE due for that period, and on 28 December 2012 offset a further £3,979.33 of corporation tax. The balance of £564.05 was repaid to the company on 7 January 2013.

15. For the year ending 6 April 2013, CIS amounts of £3,851.18 were incorrectly deducted by clients. Mr Winstone's recollection was that the full £3,851.18 had been deducted before 7 March 2013, the due date for the VAT payment and that refunds had been requested for all amounts before the end of the tax year, and we accepted his evidence.

16. The company has suffered in the recession, with cash-flow being particularly tight in the last two to three years due to cutbacks in expenditure by local government. Its bank has also tightened up and refused to bridge cashflow shortfalls. The company had at times borrowed money from friends and family of the director to tide it over.

17. The company entered the default surcharge regime as the result of a late payment made for the period ending 07/10. Payments were also made late for the

periods 10/10, 01/11, 07/11, 10/11, 01/12 and 04/12. Four out of these six payments were between one and three days late, and the other two were made within a month of the due date. Before the period under appeal, the company thus had three surcharges at the 15% rate. Mr Winstone said, and we accept, that these late payments reflected the company's cashflow difficulties.

18. For the quarter ended 01/13, the VAT due was £7,542.49. The company paid its VAT electronically using the Faster Payments Service ("FPS") and the due date was therefore 7 March 2013.

19. The company was only able to pay £3,000 by the due date: this was all that was in its bank account. As soon as further funds were received, these were paid over to HMRC. £2,000 was received by HMRC on 18 March 2013, and the balance of £2,542.49 on 22 March 2013.

20. On 4 April 2013 the company submitted its P35, showing total CIS deducted of £3,851.18 for the tax year, and PAYE due of £772.18.

21. On 15 March 2013 HMRC issued a surcharge of £681.37, being 15% of £4,542.49.

22. We were told that the surcharge for 04/12 had also been appealed, and that judgment was awaited. We noted that if that appeal were allowed, it would not change the rate of surcharge in this case - the default under appeal before this Tribunal was within 12 months of the previous default (for the 01/12 period), which was also charged at 15%.

The law

23. Value Added Tax Act 1994 ("VATA"), ss 59 and 71sets out the reasonable excuse provisions which apply to the default surcharge. Finance Act 2004 ("FA 2004") ss 61- 62 covers the requirement to deduct amounts under CIS and the treatment of the sums so deducted. These provisions are contained in the Appendix to this decision notice.

24. Section 71(1)(a) states that "an insufficiency of funds to pay any VAT due is not a reasonable excuse". This provision (in its earlier form as FA 1995, s 33(2)(a)) was considered in the leading case of *C&E Commrs v Steptoe* [1992] STC 757. The Court of Appeal (Lord Donaldson, Nolan J and Scott LJ) held that the cause of insufficiency of funds – the underlying cause of the taxpayer's default – might provide such a reasonable excuse. Lord Donaldson said [at pages 769-70] that:

> "the legislative intention is that insufficiency of funds can never of itself constitute a reasonable excuse, but that the cause of that insufficiency, ie the underlying cause of the default, might do so.
>
> 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.

> *Prima facie* the legislative intention is the same as in the context of s 33(2)(b). This is that, save in so far as Parliament has given guidance, it is initially for the commissioners to decide whether the underlying cause constitutes a reasonable excuse and for the tribunal to decide this on an appeal. That said, there must be limits to what could be regarded as a reasonable cause. 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 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."

25. Lord Donaldson went on to say that he agreed with Nolan J. The dissenting judgment was given by Scott LJ, who, while accepting that the underlying cause of an insufficiency of funds might provide a reasonable excuse, said that this would only apply if that insufficiency was caused by some "unforeseeable or inescapable event". This narrower interpretation was rejected by the majority. Lord Donaldson said (at 770):

> "Scott LJ…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."

Submissions by the parties

26. Mr Winstone said that the company had a reasonable excuse because HMRC were already holding money wrongly deducted and had consistently refused to repay that money other than under the CIS provisions.

27. Furthermore, the company had suffered severely from the recession. HMRC's refusal to repay the money wrongly deducted by contractors on request made a difficult situation impossible. He was doing all he could to pay the VAT by the due date. Under cross-examination by Mr Rowe he agreed that he could have asked for a time to pay ("TTP") arrangement, but had thought that it wasn't appropriate where the company expected to be able to settle the liability within 14 days. In answer to questions from the Tribunal he said that he had not asked friends or family to fund the VAT in this case, but that this might have been possible if he had only been required to fund the balance of the VAT (ie excluding the purported CIS amount).

28. For HMRC, Mr Rowe agreed that the company should not have had amounts deducted from payments under the CIS scheme. Nevertheless, it was HMRC's

position that "no overpayment can arise until the business submits its annual return at the end of a tax year." Further, the annual return was not submitted until 4 April 2013, almost a month after the due date of payment for the VAT quarter.

29. Mr Rowe also said that the fundamental reason why the company was claiming a reasonable excuse was shortage of funds, and that was precluded by statute from being a reasonable excuse. The company's position was, he said, not the same as that in *Steptoe*, as "cutbacks by local government are not an unforeseen or inescapable event."

Discussion and decision

The CIS provisions on repayment

30. Finance Act 2004 ("FA 2004") s 61 states that a contractor "must deduct" the CIS amount from "contract payments". Section 62 says that these amounts must be paid to HMRC. Where "the subcontractor is a company" then "a sum deducted under section 61 and paid to the Board is to be treated, in accordance with regulations, as paid on account of any relevant liabilities of the sub-contractor."

31. The "relevant liabilities" of a sub-contractor are defined as "any liabilities of the sub-contractor, whether arising before or after the deduction is made, to make a payment to the Inland Revenue in pursuance of an obligation as an employer or contractor." It is only when the "relevant liabilities" have been paid, that the excess is to be refunded to the subcontractor (s 62(3)(c)).

32. However, in this case the amounts were deducted from the payments due to the company, and paid over to HMRC in error. The services provided by the company fall outside of CIS, and the money paid to HMRC thus did not fall to be treated in accordance with FA 2004, s 62: that applies only to "contract payments" within the CIS regime. Instead, this is money which belonged to the company and which continued to held by HMRC despite the company having on a regular basis informed HMRC that the monies had been wrongly deducted and asking for repayment.

Reasonable excuse

33. A "reasonable excuse" is not defined in statute, but has been held to be "a matter to be considered in the light of all the circumstances of the particular case" (see *Rowland v R&C Commrs* [2006] STC (SCD) 536 at [18]). VATA s 71 prescribes two statutory restrictions on the "reasonable excuse defence" for the purposes of the default surcharge. The first of these says that "an insufficiency of funds" is not a reasonable excuse.

34. Mr Winstone said that the company had a reasonable excuse for two reasons:

(1) HMRC were already holding money which belonged to the company and which should have been repaid to it;

(2) As a consequence, the company did not have the funds to pay all of the VAT by the due date.

35. The first of these rests on the fact that money has been paid to HMRC in error. We note that the company is not making a claim for restitution (see *Test Claimants in the FII Group Litigation v R&C Commrs* [2012] UKSC 19 *per* Lord Walker at [79]); neither is it claiming an equitable right of set-off, for instance in line with the principle established in *Spargo's case (In re Harmony and Montague Tin and Copper Mining Co* (1873) LR 8 Ch App 407). Given our findings on reasonable excuse, and the lack of any submissions on rights of set-off, we make no decision on whether or not the company would have had such a right. The company's argument is that it should be able to rely on a reasonable excuse defence where it makes a late payment of VAT, to the extent that an equal amount of the company's money is held, without any statutory basis, by HMRC.

36. As this reasonable excuse submission does not rest on "insufficiency of funds", the jurisdiction of the Tribunal is thus at large: we have to consider, in all the circumstances of the case, whether HMRC's retention of an equal amount of money without any legal basis, provides the company with a reasonable excuse for the late payment. We agree with the company, and find that it has a reasonable excuse in relation to the £3,851.18 already held by HMRC.

37. The company's second submission is that it falls within the *Steptoe* exception at least to the extent of the £3,851.18. It was struggling with cashflow. It could not obtain further funds from the banks and although it had asked friends and family of the director to help in the past, it could not have found an amount sufficient to cover the £3,851.18 by this informal route. It had tried repeatedly to persuade HMRC to repay the money wrongly deducted, and it had procedures in place which sought to ensure that the money was not paid over by contractors in the first place. We agree that it exercised reasonable foresight and due diligence and had "a proper regard for the fact that the tax would become due on a particular date" and thus that *Steptoe* provides it with a further reasonable excuse defence.

38. HMRC submitted that the *Steptoe* defence did not apply because cutbacks by local government were not "an unforeseen or unexpected event". Not only does this ignore the purported CIS amount, but it also relies on the dissenting judgment in *Steptoe* rather than the judgment of the majority. That this is incorrect has recently been emphasised by the Tribunal (Judge Brannan and Mr Toby Simon) in *Electrical Installation Solutions Limited v R&C Commrs* [2013] UKFTT 419 (TC) and we endorse their comments.

39. Finally, we considered whether the *Steptoe* exception extended to the balance of the VAT owing, being £691.31 (4,542.49 – 3,851.18). The company's defence rested essentially on the problems caused by the purported CIS amount. Had this been taken into account by HMRC or been repaid to the company, Mr Winstone accepted that it might have been possible to find the small remaining balance of the funds, perhaps by asking friends or family.

40. We thus allowed the appeal in part, and reduced the surcharge to £103.70 (£691.31 x 15%).

Rights of appeal

41. 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.

42. 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.

ANNE REDSTON
TRIBUNAL PRESIDING MEMBER

RELEASE DATE: 10 January 2014

The Value Added Tax Act 1994

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—

(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,

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.

(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

(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.

(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 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,

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—

(a) in relation to the first such prescribed accounting period, the specified percentage is 2 per cent;

(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

(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.

(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—

(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

(b) there is a reasonable excuse for the return or VAT not having been so despatched,

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).

(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.

(9)–(11) ….

S71 Construction of sections 59 to 70

(1) For the purposes 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 reasonable excuse; and

(b) where reliance is place 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.

(2) …..

61. Deductions on account of tax from contract payments

(1) On making a contract payment the contractor (see section 57(3)) must deduct from it a sum equal to the relevant percentage of so much of the payment as is not shown to represent the direct cost to any other person of materials used or to be used in carrying out the construction operations to which the contract under which the payment is to be made relates.

(2) In subsection (1) "the relevant percentage" means such percentage as the Treasury may by order determine.

(3) That percentage must not exceed—

(a) if the person for whose labour (or for whose employees' or officers' labour) the payment in question is made is registered for payment under deduction, the percentage which is the basic rate for the year of assessment in which the payment is made, or

(b) if that person is not so registered, the percentage which is the higher rate for that year of assessment.

62 Treatment of sums deducted

(1) A sum deducted under section 61 from a payment made by a contractor—

(a) must be paid to the Board of Inland Revenue, and

(b) is to be treated for the purposes of income tax or, as the case may be, corporation tax as not diminishing the amount of the payment.

(2) If the sub-contractor is not a company a sum deducted under section 61 and paid to the Board is to be treated as being income tax paid in respect of the sub-contractor's relevant profits.

If the sum is more than sufficient to discharge his liability to income tax in respect of those profits, so much of the excess as is required to discharge any liability of his for Class 4 contributions is to be treated as being Class 4 contributions paid in respect of those profits.

(3) If the sub-contractor is a company—

(a) a sum deducted under section 61 and paid to the Board is to be treated, in accordance with regulations, as paid on account of any relevant liabilities of the sub-contractor;

(b) regulations must provide for the sum to be applied in discharging relevant liabilities of the year of assessment in which the deduction is made;

(c) if the amount is more than sufficient to discharge the sub-contractor's relevant liabilities, the excess may be treated, in accordance with the regulations, as being corporation tax paid in respect of the sub-contractor's relevant profits; and

(d) regulations must provide for the repayment to the sub-contractor of any amount not required for the purposes mentioned in paragraphs (b) and (c).

(4) For the purposes of subsection (3) the "relevant liabilities" of a sub-contractor are any liabilities of the sub-contractor, whether arising before or after the deduction is made, to make a payment to the Inland Revenue in pursuance of an obligation as an employer or contractor.

(5) In this section—

(a) "the sub-contractor" means the person for whose labour (or for whose employees' or officers' labour) the payment is made;

(b) references to the sub-contractor's "relevant profits" are to the profits from the trade, profession or vocation carried on by him in the course of which the payment was received;

(c) "Class 4 contributions" means Class 4 contributions within the meaning of the Social Security Contributions and Benefits Act 1992 (c 4) or the Social Security Contributions and Benefits (Northern Ireland) Act 1992 (c 7).

(6)-(7) …