



**TC04553**

**Appeal number: TC/2015/02332**

*VAT default surcharges for late payment – late filing of return online permitted and insufficiency of funds to pay accumulated VAT– possible offset of subsequent taxes against VAT due – whether a reasonable excuse – no – appeal dismissed*

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**HKR ARCHITECTURAL SERVICES LIMITED                      Appellant**

**- and -**

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

**TRIBUNAL: JUDGE THOMAS SCOTT  
GILL HUNTER**

**Sitting in public at Fox Court on 12 June 2015**

**Mr Simon Koirala, Finance Manager for the Appellant**

**Mrs Rita Pavely, HM Revenue and Customs for the Respondents**

## DECISION

### *The Appeal*

5 1.

This is an appeal by HKR Architectural Services Limited (“the Appellant”) against default surcharges imposed by HMRC for the late payments of VAT for the periods 07/13 and 10/13, for £3,878.04 and £2,130.92 respectively (total £6,008.96).

### *The Legislation*

10 2.

Section 59 of the Value Added Tax Act 1994 (“the 1994 Act”) provides that where a return or tax due is not received within the specified time, the taxable person is deemed to be in default in respect of that period.

3.

15 Section 59 also provides that a default surcharge applies, at the specified rates, where HMRC serve a surcharge liability notice on the person in default.

4.

20 Section 59(7)(b) states that, in the case of a default which is material to the surcharge, if the taxable person satisfies the Tribunal that there was a “reasonable excuse” for the failure to pay on time, then he is not liable to the surcharge.

5.

Section 71 of the 1994 Act states that an insufficiency of funds to pay any VAT due is not a reasonable excuse.

6.

25 Section 108 of the Finance Act 2009 provides that a person is not liable to a default surcharge if, before the due date for payment of the VAT, he asks an HMRC officer to defer the payment, and the officer then agrees. This is commonly called a “Time to Pay Agreement”.

### *Issues*

30 7.

The Appellant accepted that the VAT payments for the relevant periods were made late, and that the default surcharge regime applied.

8.

As regards both periods, the Appellant argued that it had a reasonable excuse for late payment.

*The facts*

5 9.

The Appellant was in the default surcharge regime from period 04/08, with periods 07/13 and 10/13 being its thirteenth and fourteenth defaults.

10.

The Appellant is no longer in the default surcharge regime.

10 11.

During the first six months of 2013, HMRC had failed to update its records to reflect the Appellant's change of address, and had erroneously treated the Appellant as a "missing company". As a result, during that period HMRC had blocked the Appellant's normal access to enable returns to be filed online.

15 12.

Once HMRC had amended its records to show the new address, HMRC agreed to the Appellant filing a nine-month VAT return on 9 October 2013, covering the period November 2012 to July 2013.

13.

20 The VAT return for the nine-month period 07/13 was filed on the due date, but the VAT due was paid several months late.

14.

The VAT return for period 10/13 was filed on the due date, but the VAT due was paid several months late.

25 15.

The Appellant asked HMRC to review its decision to issue default surcharge notices for the periods 07/13 and 10/13. The review confirmed the decision for both periods.

*The Appellant's case*

16.

30 The Appellant's arguments were as follows:

17.

HMRC told the Appellant that “no surcharge/late filing penalty will be imposed” in respect of the filing of the nine-month return. The default surcharge for that period is therefore unfair.

5 18.

VAT was paid late for the period 07/13 as a result of HMRC failing to update its records and disabling the Appellant’s online access. The Appellant would have had sufficient funds to pay the VAT due for the periods during which there was no online access. However, by September 2013, when the nine-month return was submitted,  
10 those funds had been disbursed elsewhere in the Appellant’s business, and it had insufficient funds at that time to pay the aggregate VAT due.

19.

The Appellant did not receive a letter from HMRC dated 2 May 2014 regarding the default surcharges for the periods 07/13 and 10/13 until 27 January 2015. The  
15 Appellant was therefore unaware until January 2015 that default surcharges were being pursued.

20.

For the period 10/13, the Appellant was due a refund of corporation tax, and possibly also of PAYE. Those refunds or overpayments should have been set against the VAT  
20 due for the 10/13 period.

21.

In relation to the corporation tax refund, the Appellant’s accountancy firm filed the relevant return late. This was the reason why the refund was not known to HMRC and agreed at the time VAT fell due for the 10/13 period.

25 22.

The surcharge for the 07/13 period has caused financial distress to the Appellant.

23.

During 2013, the Appellant suffered problems with its internal financial systems, and underwent numerous changes of senior personnel. Combined with cash flow  
30 difficulties, and the downsizing of the business, this was why cash to pay the VAT due for 07/13 was not put to one side.

***HMRC’s case***

24.

In agreeing to the filing of a nine-month return for 07/13, HMRC indicated to the Appellant that they would not seek penalties or surcharges on the basis that the returns or VAT for periods 01/13 and 04/13 had been made or paid late. They did not indicate that there would be no penalties or surcharges if the VAT due on 7 September 2013 in respect of the nine-month return was paid late.

**25.**

VAT was paid late for both periods and as a result default surcharges arose at the statutory rates.

**26.**

The Appellant has no reasonable excuse in respect of period 07/13 by virtue of an insufficiency of funds to pay the VAT on the due date. In effect, the Appellant had had the benefit of an interest-free loan of the VAT which would otherwise have been payable for periods 01/13 and 04/13. The Appellant made a decision not to retain and earmark those funds for VAT, but to disburse that cash elsewhere in the business.

**27.**

Insufficiency of funds is specifically excluded from being a reasonable excuse by section 71(1)(a) of the 1994 Act.

**28.**

The HMRC letter of 2 May 2014 regarding the default surcharges for the two relevant periods was not returned undelivered. It should therefore be assumed to have been delivered to the Appellant.

**29.**

In any event, given its long history of default surcharges, the Appellant must have known that default surcharges would arise if VAT was not paid when due.

**30.**

The Appellant does not dispute that default surcharge liability notices for the relevant periods have been validly served.

**31.**

Even if the Appellant was unable to render a VAT return online, there was nothing to prevent it from making VAT payments to HMRC when due.

**32.**

As regards the 10/13 period, the due date for VAT payment for this period was 7 December 2013. The corporation tax payment which the Appellant claims should have been offset was not received by HMRC until 3 February 2014. The Appellant

had been granted several Time to Pay Agreements previously, and would have known that any offset would need to have been evidenced to and agreed with HMRC before the VAT fell due.

### **Discussion and Decision**

5 ***Nine-month period 07/13***

**33.**

While the return for this period was filed on time, the VAT was paid several months late. The default surcharge is therefore valid unless the Appellant can show a reasonable excuse for the default.

10 **34.**

The Appellant's first argument concerned late receipt of a letter. The Appellant argued that a letter from HMRC dated 2 May 2014 regarding the default surcharges for this period and for period 10/13 was not received until 27 January 2015. HMRC pointed out that the letter was not returned marked undelivered.

15 **35.**

In our view, the possible late receipt of the letter of 2 May 2014 is not relevant to the validity of the surcharge. The Appellant accepted that a surcharge liability notice for the period was validly issued by HMRC. The correspondence file presented to the Tribunal contains a letter dated 19 February 2014, which the Appellant acknowledged receiving, setting out clearly the revised default surcharge of £3,878.04 for this period. Since the letter of 2 May 2014 post-dated both the due date for payment and the notice, it cannot form the basis of any reasonable excuse argument and has no relevance to the issues in the appeal.

**36.**

25 The Appellant's second argument was that there was a reasonable excuse for the default based on the extended VAT period for 2013. The extension resulted directly from HMRC's error in treating the Appellant as a "missing company" and blocking its access to the filing of online returns.

**37.**

30 The Appellant argued that while sufficient funds would have been available to pay the VAT due for periods 01/13 and 04/13 in the normal course, there were insufficient funds by the time VAT fell due for the nine-month period 07/13, as that liability reflected a nine-month period of trading.

**38.**

While the existence of a reasonable excuse for default is a question of fact, where the excuse is based on an insufficiency of funds the analysis must begin with section 71 of the 1994 Act. Section 71(1)(a) states that “an insufficiency of funds to pay any VAT due is not a reasonable excuse”.

5     **39.**

In interpreting this provision, the Tribunal considers that the correct starting point is that set out by Justice Nolan in *Customs & Excise Commissioners v Salevon Ltd [1989] STC 907*. It is necessary to distinguish between the reason, in the sense of the direct cause for non-payment, and the excuse for non-payment. That is because  
10     71(1)(a) should be interpreted such that while an insufficiency of funds could never of itself constitute a reasonable excuse, the cause of that insufficiency – the underlying cause of the taxpayer’s default – might do so. That approach was amplified by the Court of Appeal in *Customs & Excise Commissioners v Steptoe [1992] STC 754*.

**40.**

15     In the Tribunal’s view, the correct approach is summarised in *Judith Goldwater (Deceased) v HMRC [2011] UKFTT 483 (TC) at 40*:

“The Steptoe approach 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  
20     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”.

25     **41.**

The Tribunal applied this approach to the facts of this case.

**42.**

It should be made clear at the outset that, in allowing a nine-month return to be filed, HMRC did not seek at any stage to impose default surcharges in request of the late  
30     filings of returns for the 01/13 or 04/13 periods, or the late payment of VAT for those periods. In evidence before the Tribunal, the Appellant confirmed that while HMRC indicated that “no surcharge/late filing penalty will be imposed” in respect of the filing of the nine-month return, they did not indicate that there would be no surcharge if the VAT due for that nine-month period was not paid on time.

35     **43.**

In this case, the underlying cause of the insufficiency of funds was that the Appellant failed to set aside cash to pay the VAT liabilities which it knew were accumulating throughout the nine-month period. The Appellant made a decision to disburse those funds elsewhere in its business. While that decision may well have been influenced

by the various business problems identified by the Appellant during this period, the Appellant deliberately took the risk that it would still have the funds to pay VAT when it eventually fell due. Indeed, the Appellant effectively had the benefit of an interest-free loan equal to the VAT which would normally have fallen due for 01/13 and 04/13. It chose to allocate that amount to other expenses of the business.

5 **44.**

The evidence before the Tribunal established that the VAT due for the nine-month period was in fact substantially less than the VAT typically due for the Appellant's single quarter returns. So in cash-flow terms, that liability was not abnormally large.

10 **45.**

Insofar as the business was suffering problems during that period, the Tribunal finds that this was not particularly unusual or unpredictable. The Appellant's extensive experience of the default regime demonstrates its continuing difficulties until 2014 in meeting VAT liabilities as they fell due.

15 **46.**

Applying the Steptoe approach, the Tribunal finds that the Appellant did not have a reasonable excuse for the default in respect of the nine-month period 07/13. The Appellant failed to exercise reasonable foresight, and failed prudently to take account of the VAT becoming payable in respect of that period.

20 ***Period 10/13***

**47.**

As regards the default for period 10/13, the Appellant argued that they had a reasonable excuse because they were due a refund of corporation tax, and possibly also of PAYE, which should have been set against the VAT due. The refund of corporation tax would have been agreed earlier but for the Appellant's accounting firm being late in submitting to HMRC the relevant return.

25 **48.**

In previous periods, the Appellant had agreed Time to Pay Agreements with HMRC. Where such an agreement is reached, the taxpayer is excused a penalty such as a VAT default surcharge: section 108 of the Finance Act 2009.

30 **49.**

It is clear that the mere prospect or possibility of a tax refund could not amount to a reasonable excuse for the default in respect of period 10/13.

**50.**



Nor did any agreement under section 108 exist at that time based on the potential refunds. Under section 108, the relevant penalty is excused only if the taxpayer would otherwise become liable for that penalty between the date on which it requested a tax deferral from HMRC and the end of the period of deferral agreed by HMRC: section 108(2). In this case, no such request was made by the Appellant before the default surcharge liability arose. Indeed, the corporation tax which might have formed the subject of a refund was not paid until February 2014.

51.

The fact that the Appellant's accountancy firm may have delayed the corporation tax refund by submitting the return late did not give the Appellant a reasonable excuse for failing to pay the VAT due for period 10/13. The onus was on the Appellant to request a deferral, and it did not do so by the time the VAT fell due and the surcharge arose.

52.

The Tribunal therefore finds that the Appellant had no reasonable excuse for the default in respect of period 10/13.

53.

The surcharges are upheld, and the appeal is dismissed.

***Right of appeal***

54.

This document contains full findings of fact and reasons for the decisions. 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.

**THOMAS SCOTT  
TRIBUNAL JUDGE**

**RELEASE DATE: 24 JULY 2015**