[2016] UKFTT 191 (TC)

TC04976

Appeal number: TC/2015/02184

VALUE ADDED TAX – s 84(3B) VATA 1994 - whether appellant could pay tax without hardship – application allowed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

ELBROOK CASH & CARRY LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE RICHARD THOMAS
DAVID EARLE

Sitting in public at Fox Court, London EC1 on 3 February 2016

Geraint Jones QC, instructed by Rainer Hughes, for the Appellant

Howard Watkinson and James Jackson, instructed by the General Counsel and Solicitor to Her Majesty's Revenue and Customs for the Respondents

DECISION

1. This was an application to the Tribunal by Elbrook Cash & Carry Ltd ("the appellant") asking us to decide whether we are satisfied that it would cause the appellant hardship to require it to pay the tax charged on it by an assessment to VAT in the sum of £771,430.20p before its appeal against the assessment could be entertained.

The evidence

2. We had a witness statement from Mr Perosha Tengra, a chartered accountant and partner in the firm Mehta & Tengra which prepared the appellant's accounts. His statement had attached to it unaudited management accounts of the appellant for the year ended 31 July 2015, and included his comments on certain aspects of the accounts.

3. We had two witness statements from Mr Amjad Khalid, one dated 28 October 2015 and the other 3 February 2016, the day of the hearing. Mr Khalid is a director of the appellant (the other being his brother) and he holds shares in the appellant together with his brother and other members of the family. His first statement was not made for the purpose of this hearing, but for the purposes of an application for judicial review in the Administrative Court following the revocation in March 2015 by HMRC of its authorisation under the Warehouse-keepers and Owners of Warehoused Goods Regulations 1999 ("WOWGR"). That statement was made to indicate to the Administrative Court the effect on its business of the revocation of the WOWGR authorisation. The statement also revealed that the appellant has appealed to this Tribunal against the revocation under s 16 Finance Act 1994.

4. Mr Khalid's second statement put in evidence to us up-to-date financial and trading information. The appellant had also put in evidence further documents of a financial nature which had been supplied to HMRC in support of its application.

5. HMRC also put in a bundle consisting of the Notice of Appeal, a "To whom it may concern" letter from Mehta & Tengra ("TWIMC letter") and correspondence between the parties, including the financial etc documents furnished by the appellant or requested by HMRC in the course of the hardship application.

6. Mr Tengra's evidence in his witness statement and his TWIMC letter were not put forward as expert evidence and so to the extent they consist of his opinions we give it no weight.

7. Although Mr Khalid was present for some of the hearing before us he was not called to speak to his witness statement or otherwise give oral evidence.

The facts

8. From the documentary evidence we were supplied with we set out a chronological account of the background to the application.

9. On 18 December 2014 HMRC notified the appellant that it was denying credit for input tax of £771,430.20 for the five consecutive periods from 01/13 to 04/14 inclusive.

10. On 6 January 2015 an assessment for that amount was issued by HMRC.

11. Following a statutory review upholding the decision to deny credit and the assessment giving effect to that denial decision, the appellant appealed to this Tribunal on 4 March 2015 informing the Tribunal that it was seeking relief from any requirement to pay or deposit the tax assessed on the grounds of hardship.

12. In March 2015 HMRC cancelled the appellant's WOWGR authorisation.

13. On 28 April 2015 the TWIMC letter was sent to HMRC in support of the hardship application. The letter stated that as a result of the WOWGR cancellation:

> (1) Payment of £750,000 was made to a warehouse to enable the release of goods
>
> (2) Payment in advance of supply of goods now has to be made to certain suppliers
>
> (3) Payments were made to professionals to defend the cancellation of the WOWGR licence

and that as a result the company has used up its available loan facilities of £5m. Various attachments were included to show proof of these four matters, together with bank statements showing that £5m deposited with the bank had reduced to approximately £300,000 by 2 April 2015, and that there was a drop in both turnover and margins.

14. On 1 June 2015 one of HMRC's hardship team, Mrs Pledger, wrote to the appellant seeking further details about the points in the TWIMC letter and further financial information, including the most recently filed "business accounts, including the non-statutory page", from which no doubt the company was expected to divine that this was a reference to the accounts filed under the Companies Act 2006. The letter asked for details of any investments held by the business and of properties together with mortgages etc on them and current valuations. It further asked what steps the company had taken to raise funds to pay the tax.

15. On 6 July 2015 a letter dated 17 June 2015 from Mehta & Tengra was forwarded to HMRC. The letter provided approximately 190 pages of documentation in response and a statement that the appellant's bank was not approached as they did not wish to panic the bank, but that they had approached American Express (and included details of approaches to that and other potential lenders). The documentation included the statutory accounts for the year ended 31 July 2014, management accounts for nine months to 31 May 2015 and a cash flow forecast to 30 November 2015, lists of investments and properties and bank statements for six months to 29 May 2015.

16. On 17 July Mrs Pledger (referring oddly to her letter of 1 June as a "hardship reminder" letter, though it seems to have been the first response by HMRC) raised further queries with the appellant, including among the 13 separate queries an enquiry about £746 of bank interest. Also included in her queries was a request to know why the VAT charged had not been provided for. She asked for a reply by 7 August or she would decide on the then available information.

17. On 20 August Mrs Pledger wrote again summarising all the information she had considered and said that the Commissioners of [*sic*] HMRC "are not entirely satisfied you would suffer hardship" if required to pay £771,430 before the appeal could be heard.

18. The Tribunal having been informed of the outcome of the application, directions were issued. There followed a great deal of procedural wrangling between the parties and the Tribunal, culminating in an application by HMRC to strike out the application for relief from payment of the tax. We do not intend to narrate any of these matters, nor to comment on the substantial amount of time devoted to this aspect of the case in both skeletons and in submissions before us, except to say that Mr Jones apologised on behalf of the solicitors instructing him for their "intemperate language" and that HMRC did not press their application to strike out. This may be because shortly before the hearing further financial information was provided by the appellant. This material consisted of unaudited management accounts for the year to 31 July 2015 and 1 August to 31 October 2015; "2014 activity reports" for customers to whom they use to sell duty suspended goods before the loss of the WOWGR licence; a facility letter from Barclay's Bank and a response dated 12 January 2016 to Mrs Pledger's letter of 17 July 2015.

19. Finally Mr Khalid's second witness statement of 3 February 2016 exhibited an invoice from Gallaher Ltd in an amount of £860,167 paid by direct debit on 3 February 2016 (which Mr Khalid says is a direct debit taken every month, though he does not say whether the amount is always the same); a bank statement as at that date; a short cash flow forecast on a weekly basis of liabilities payable and monies receivable.

20. In the witness statement Mr Khalid also avers that the appellant is "always under pressure in terms of cash flow" and that "in view of the Barclays Bank Loan commitment, should [the appellant] be directed to make payment to HMRC In relation to the disputed amount, this would cause severe hardship to the business as [the appellant] would simply have no or very little float in which to operate. ECC is a predominantly cash business and it would not survive without a float."

21. That the statements described above were made and the documents submitted we find as facts. Any inferences to be drawn from the statements and documents are matters we consider below under the heading "Discussion".

The law

22. The statute law in this case falls within a small compass. Section 84 Value Added Tax Act 1994 ("VATA") says (relevantly):

> "(3) Subject to subsections (3B) and (3C), where the appeal is against a decision with respect to any of the matters mentioned in section 83(1)(b), (n), (p), (q), (ra) or (zb), it shall not be entertained unless the amount which HMRC have determined to be payable as VAT has been paid or deposited with them.
>
> …
>
> (3B) In a case where the amount determined to be payable as VAT or the amount notified by the recovery assessment has not been paid or deposited an appeal shall be entertained if—
>
> (a) HMRC are satisfied (on the application of the appellant), or
>
> (b) the tribunal decides (HMRC not being so satisfied and on the application of the appellant),
>
> that the requirement to pay or deposit the amount determined would cause the appellant to suffer hardship."

It is not in dispute that there is a decision falling within s 83(1)(p) VATA in this case.

23. In their skeletons and in oral argument the parties referred to four cases on the issue of hardship:

(1) *R (on the application of ToTel Ltd) v First-tier Tribunal (Tax Chamber) and another (HM Treasury, interested party)* [2011] EWHC 652 (Admin) (Simon J) ("*ToTel 1*")

(2) *ToTel Ltd v HMRC* [2014] UKUT 485 (TCC) (Nugee J) ("*ToTel 2*")

(3) *Buyco Ltd & Sellco Ltd v HMRC* [2006] UKVAT V19752 (Dr John Avery Jones) ("*Buyco*")

(4) *Peter & Linda Kemp v HMRC* [2005] UKVAT V19752 (Dr David Williams and Ms West) ("*Kemp*")

and *ToTel 1* and *ToTel 2* both refer to:

(5) *Seymour Limousines Ltd v HMRC* [2009] VAT Decision 20966 ("*Seymour*") (Theodore Wallace)

(6) *Tricell (UK) Ltd v CCE* [2003] VATTR 18127 (Colin Bishopp)

24. While there was a substantial measure of agreement on the principles to be derived from the cases, there were differences of nuance, and in the case of *Peter & Linda Kemp* a submission by the appellant that it was wrongly decided. We have therefore decided to restate in our own words the principles we see as governing how we should approach the facts in this case. We bear in mind that both *ToTel* cases are binding on us, but that *Buyco* and *Kemp* are not. We should say however that we prefer *Buyco* on the one issue (borrowing) where it is inconsistent with *Kemp* so we do not follow that case. In relation to this disagreement we note for what it is worth that in *ToTel 1* Simon J (as he then was) derives his principles at [82] from previous decisions of the Tribunal and its predecessors. These include *Buyco*, but *Kemp* is not mentioned.

25. The principles that we see as governing the case (with our observations if any) are:

(1) Decisions on hardship should not stifle meritorious appeals. (*ToTel* 1 at [82(i)])

(2) The test is one of capacity to pay without financial hardship, not just capacity to pay. (*ToTel 1* at [82(ii)], *ToTel 2* at [55] approving *Seymour* at [57])

(3) The time at which the question is to be asked is the time of the hearing. (*ToTel 1* at [77] approving *Buyco* at [6], *ToTel 2* at [37]).

This may be qualified if the appellant has put themselves in a current position of hardship deliberately (eg by extraction of funds otherwise readily available from a company by way of dividend), or if there is significant delay on the part of the appellant (*ToTel 1* at [78], *ToTel 2* at [44-47], *Buyco* at [6]).

(4) The question should be capable of decision promptly from readily available material. (*ToTel 1* at [82(iii)],

(5) The enquiry should be directed to the ability of an appellant to pay from resources which are immediately or readily available. (*ToTel 1* at [82(iii)], *Buyco* at [8])

A corollary of this is that a business is not expected to look outside its normal sources for funding, nor is it required to sell assets, especially if to do so would take time. (*Buyco* at 6, *Tricell* at [55, 56] – to the contrary *Kemp*.)

(6) The test is all or nothing: ability to pay part of the VAT without hardship does not matter. (*Buyco* at [6])

(7) If the tribunal has fixed a cut off point for the admission of material, it is not an error of law for the Tribunal to ignore any later furnished evidence. (*ToTel 1* at [86])

(8) The absence of contemporaneous accounting information is a justification for the tribunal to conclude that it can place little if any weight on the appellant's assertion that it is unable to afford to pay. (*ToTel 2* at [79]).

Submissions

The appellant's submissions.

26. For the appellant Mr Jones points out that the assessment in this case arises because of a decision by HMRC that input VAT on the appellant's purchases of fizzy drinks should not be deducted as the appellant should have known that those purchases were connected with fraud in the supply chain, something which is vehemently denied by the appellant. Further HMRC have cancelled the appellant's WOWGR registration, an act by HMRC which has had a very substantial impact on turnover and profitability and caused substantial expense, and it is directly relevant to the question whether the VAT can be paid from resources which are immediately and readily available.

27. The financial information supplied by the appellant shows that the net profit for the three months to 31 October 2015 (the latest available) was £58,995, compared with a full years' profit for the year ended 31 July 2015 of £1,132,745. On an annualised basis the reduction is 79.2%.

28. None of the fixed assets are liquid, consisting of unlisted investments and investment property.

29. While the company has at times had over £1 million in its Barclay's account this is insignificant compared with turnover of £111 million – it needs that kind of amount to trade and stay solvent. The balance fluctuates widely between £1.9m to -£22,000. It would be wrong to say that the appellant could borrow or sell fixed assets to pay the tax without hardship. *ToTel 1* shows that is not the case.

30. While it is admitted that the appellant could have approached its bankers for an increase in its facility, it is easy to see that their reaction would not only to have been a refusal, but probably a pulling of the plug. But the company nevertheless approached other bankers.

31. It is a powerful reason not to stifle an appeal that another decision taken by HMRC for which the appellant cannot obtain interim relief has itself caused the appellant's financial predicament.

32. The threshold is not a high one, and the appellant amply surmounts it.

HMRC's submissions.

33. For HMRC Mr Watkinson submitted that since at 29 May 2015, the date of the last bank statement provided by the appellant there was over £1.5 million, the appellant could have paid the tax without hardship. Similarly its management accounts show that at 31 October 2015 it had £1,124,709 in the bank. Its failure to provide contemporaneous information should be taken into account when it says it cannot pay "now".

34. It has fixed assets of over £20 million and can therefore sell assets or securitise them to pay the tax. It has not stated whether it has approached other lenders to allow it to pay the tax. Its cash flow forecasts are seriously inaccurate and cannot be relied on. The appellant cannot make out its claim of hardship.

Discussion

35. In our view an application of this sort should not require the Tribunal to carry out a lengthy forensic analysis of the financial and other material placed before it. We have seen nothing in the two *ToTel* cases that causes us not to follow what Dr Avery Jones said in *Buyco* at [8], and we set it out here.

> "The issue is whether each of the Appellants would suffer hardship if required to pay the tax in dispute. I interpret hardship to mean that the business will be harmed if the tax, which is by definition in dispute and may not ultimately be payable, has to be paid. The real issue is if they

> do not have the cash available, and so would clearly suffer hardship if the tax were required to be paid, what further steps should the Appellants be expected to take to raise cash in order to avoid suffering hardship. The legislation is silent on this but might have been expected to spell out if steps outside the normal course of trading, such as selling assets for the purpose of raising funds to pay the tax, were required. The legislation merely poses the question whether the tax can be paid without suffering hardship, which suggests that one looks at the existing situation and implies that taking such steps is not expected. So far as borrowing is concerned I accept that a business may need to borrow in order to pay VAT in dispute if the business had existing unused borrowing facilities (or could obtain such facilities or an increase in them merely by asking the bank). Like Mr Bishopp in *Tricell* I do not consider that, if a business's normal bankers will not lend, it should be expected to pursue other sources of finance purely for the purpose of paying the tax in dispute. I consider that I should rely on the fact that a business that needs finance for the business will already have taken reasonable steps to obtain it, and if a business knows that a bank is unlikely to lend in the circumstances I can understand its being reluctant to make a definite request and risk receiving a refusal which might make borrowing more difficult in the future. I also bear in mind that investigating new sources of borrowing may require the incurring of significant expenses, such as valuations of land and legal fees, which might not ultimately achieve any results. In relation to disposals outside the ordinary course of business of assets that were properly purchased for the business, I consider that it would involve hardship for the business to take the irrevocable step of selling them in order to pay VAT in dispute, whether or not the assets are currently used in the business. The hardship would also include the expenses incurred in selling."

36. We are also mindful of the need not to stifle meritorious appeals, or as it might be expressed, appeals which are not frivolous or obviously designed to delay the evil hour at which tax should be paid. Here we do not think the appeal is frivolous or designed to delay the inevitable. We do not have the materials on which to come to any view on the merits of the appeal against the assessment, but we would say this. VAT is a tax on value added, ie the additional profit or margin which a taxable person adds. In the classic MTIC fraud the party who is denied credit on a *Kittel* basis is the exporter – their sales are exempt but with credit (ie zero rated in UK terms) as exports so denial of the input tax as credit simply ensures that the exporter's margin is afforded the same treatment as domestic sales. Here the input tax has been denied credit, but the output tax is still charged. This may be the correct outcome in law, but it does mean that someone whose outputs remain taxable but whose inputs are denied would not be able or be expected to conduct its affairs so as to provide for and to be able to pay the VAT arising from the denial of credit for input tax.

37. And on the question of making a provision for the disputed VAT, an issue raised by Mrs Pledger, we think that it is irrelevant: making an accounting provision for VAT does not establish a liability to pay and not making a provision does not mean there will not be a liability in the future. Until the dispute is settled any liability is contingent and does not affect the current liquid resources of the appellant.

38. Bearing in mind the factors set out in *ToTel 1* and *Buyco* we consider that we should simply look at the appellant's ordinary trading transactions, not at what it might be able to sell from fixed assets, or be able (realistically) to borrow from its normal resources or what it might at any given moment be capable of paying. We find that a company in the appellant's business with its level of turnover needs a cash float and we have seen that its available resources from its trading operations fluctuates between less than a positive number and £2 million. This suggests to us that the payment of £750,000 in this kind of business would cause hardship, especially given the effect of the HMRC action on its bonded warehouse operations which undoubtedly caused a reputational and accordingly a financial loss in its other activities.

39. The appellant's normal resources might well include its banking facilities if these have not been exhausted. But in this case we accept, and find as a fact, that to approach its bankers for additional funds when it had had its WOWGR authorisation cancelled and been given a large VAT bill on a basis consistent with its participation to some degree in an MTIC-type fraud could well have caused its bankers to panic. This is why we qualified ability to borrow with the adverb "realistically" in the previous paragraph.

40. For these reasons we think that the company has shown that to pay VAT of £771,430 would cause it hardship. It is not without significance that Mrs Pledger considered that she was "not *entirely* satisfied" that the appellant had not proved its case, suggesting it was in HMRC's eyes a very marginal call. We are entirely satisfied that, on the balance of probabilities, to pay the tax demanded in the light of all the circumstances, especially the actions of HMRC in cancelling the WOWGR authorisation, would cause it hardship.

Decision

41. The application is allowed.

42. 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.

RICHARD THOMAS
TRIBUNAL JUDGE

RELEASE DATE: 21 MARCH 2016