



TC06216

Appeal number: TC/2017/01176

VAT default surcharges - insufficiency of funds - Appellant awaiting 'in year' CIS refund from HMRC - whether reasonable excuse - no - whether penalty disproportionate - no - Appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

DEEP SOIL MIXING LIMITED

Appellant

- and -

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

**TRIBUNAL: JUDGE: MICHAEL CONNELL
MEMBER: SUSAN LOUSADA**

**Sitting in public at Alexandra House, The Parsonage, Manchester on 14
September 2017**

Mr Robert McGall, Director of the Appellant Company for the Appellant

Ms Samantha Carr, Officer of HMRC, for the Respondents

DECISION

The Appeal

5 1. Deep Soil Mixing Limited (“the Appellant”) appeals against VAT default surcharges of:

£9,354.96, for its failure to submit in respect of its VAT period 01/16, by the due date, payment of VAT due. The surcharge was calculated at 15% of the VAT due of £62,613.18.

10 £7,201.38, for its failure to submit in respect of its VAT period 04/16, by the due date, payment of the VAT due. The surcharge was calculated at 15% of the VAT due of £48,009.26. Further, the Appellant’s VAT return for this period was submitted late.

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

15 Background

3. The Appellant has been VAT registered since August 2012 and trades within the civil engineering and site preparation industry.

4. Prior to the defaults under appeal the Appellant had previously defaulted on VAT payments in periods in 04/14 when a surcharge liability notice was issued and again in 20 five further periods. The Appellant has been at the highest rate of surcharge (15%) from period 04/15 onwards.

5. The Appellant has been mandated to both render returns and pay the tax due electronically from 2013. Its usual method of payment from period 04/14 onwards has been via the Faster Payment Service

25 6. Period 01/16 VAT fell due on 29 February 2016. The amount payable of £62,613.18 was settled by monthly instalments and finally paid on 1 April 2016.

7. Period 04/16 VAT fell due on 31 May 2016. The amount payable of £48,009.26 was finally settled on 1 August 2016 from a CIS rebate due for the 2015-16 tax year.

30 8. 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].

35 9. 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.

10. 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.

11. 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 : -

15 ‘(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 -

20 (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

25 (b) there is a reasonable excuse for the return or 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 ..’

12. 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.

30 13. 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 -

35 (a) any insufficiency of funds to pay any VAT due is not a reasonable excuse.’

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

40 15. The initial onus of proof rests with HMRC to show that a surcharge has been correctly imposed. If so established, the onus then rests with the Appellant to demonstrate that there was a reasonable excuse for late payment of the tax. The standard of proof is the ordinary civil standard on a balance of probabilities.

Appellant’s Case

16. The Appellant does not dispute that its VAT payments for the periods under appeal were late.

17. The Appellant's stated grounds of appeal in its Notice of Appeal to the Tribunal are that with regard to both the late payments for 01/16 and 04/16, an insufficiency of funds was created by circumstances outside its control. The Appellant says that the shortage of funds significantly impacted upon its ability to discharge VAT on time and that HMRC owed the Appellant £248,310.85 in overpaid CIS tax. Had this been repaid to the Appellant it would have been able to discharge its VAT on time in each period of default. It argues that the principles of 'set off' and 'legitimate expectation' should apply.

18. The Appellant also says that an IT interface problem between the Appellant's new accounting software and HMRC's website resulted in the period 04/16 return not being successfully transmitted. It was finally transmitted 62 days late, on 9 August 2016.

19. At the hearing Mr McGall for the Appellant Company said that the Company had to some extent been let down by its previous accountants who should have advised them to apply for a Time to Pay arrangement, but failed to do so. The accountants had also set up the computer accounting system but initially it failed to work properly and that caused the 04/16 return to be late.

20. Mr McGall said that the Company's turnover had increased from £250,000 in 2013 to £500,000 in 2014, £1.5m in 2015 and £3.4m in 2016. At one time the Company, although taking on increasingly bigger contracts, was on the brink of insolvency because of cash flow problems. Mr McGall said it was clear that the insufficiency of funds which had contributed to the VAT defaults arose not from normal hazards of trade but from causes beyond the Company's control.

HMRC's Case

21. Ms Carr for HMRC said that the onus of proof rests with HMRC to demonstrate that a penalty is due. Once so established, the onus is then on the Appellant to demonstrate there is a reasonable excuse for late payment. The standard of proof is the ordinary civil standard, which is the balance of probabilities.

22. There is a statutory obligation on a person required to make a return to pay the VAT to HMRC. Value Added Tax Regulations 1995, at Regulation 40, state that any person required to make a return "shall pay" to HMRC "such amount of VAT as is payable by him in respect of the period to which the return relates not later than the last day on which he is required to make that return."

23. The first default was recorded for period 04/14 and the Appellant entered the default surcharge liability regime. The potential financial consequences attached to the risk of further default would have been known to the Appellant from this point onward, given the information printed on the Surcharge Liability Notice issued.

24. Given the default history and information available, the Appellant would have been aware of the potential fiscal consequence of a further default prior to the periods subject to appeal.

25. An insufficiency of funds is, of itself, precluded from providing a reasonable excuse for default by s 71(1)(a) VATA.

Period 01/16

5 26. The Appellant's return was received prior to the due date, on 4 March 2016. The calculation of tax due was therefore completed on or before that date. An unallocated credit of £246.78 was on hand at the due date, the balance of the tax due was received via the Faster Payment Service, 25 days after the due date, on 1 April 2016.

10 27. There is no indication that the Appellant contacted HMRC by the due date of 7 March 2016, with payment proposals, or to request a Time to Pay arrangement. Had such an arrangement been agreed, as provided for by s 108(2)(b) Finance Act 2009, the surcharge may have been avoided.

28. The Appellant was not reliant on receipt of any CIS set off for payment of period 01/16 as payment was rendered, prior to the receipt by the Appellant of any CIS refund.

15 Period 04/16

20 29. The return due on 7 June 2016, was received on 9 August 2016, which was 62 days after the relevant due date. Whilst the Appellant has referred to having cash flow issues, no reason was initially suggested for the delay in rendering the return. The Appellant now says that they were having problems with their new computer accounting system, but HMRC do not regard that as something which was unforeseeable or beyond their control.

30. In respect of this default period, there is again no indication the Appellant contacted HMRC to seek a Time to Pay agreement prior to the default arising.

25 31. The Appellant has suggested that the unused CIS overpayment available for set off for the years 2013-14, 2014-15 and 2015-16 had not been finalised.

30 32. HMRC have produced a schedule showing VAT, Corporation tax, NIC and PAYE owing for each of the years 2013-14, 2014-15 and 2015-16, which shows that there was no credit balance due to the Appellant for 2013-14 or 2014-15. The CIS credit balance for 2015-16 was not due for repayment to the Appellant until after the 04/16 VAT payment fell due.

33. Further, the Appellant has included with the appeal, correspondence from HMRC dated 24 October 2016, detailing the calculation of the 2014-15 and 2015-16 repayments, which confirms that there was no unused CIS balance for 2014-15 available to be offset against VAT.

35 34. Having been involved in the CIS for several years the Appellant would have been familiar with the system for dealing with repayments as explained on the 'Repayment Claims for Limited Company Subcontractor's' helpcard, which details the criteria for settling any claim.

35. Having CIS deductions is a normal hazard in the construction industry and a foreseeable event; it is a reasonable expectation that a prudent business would put the necessary precautions in place to ensure they meet their legal obligations to submit VAT returns and payment by the due date.

5 36. The Appellant has not suggested they were unaware that any claim relating to 2015-16 had yet to be agreed at the due date for either period 01/16 or 04/16.

37. It was not until 2 June 2016 that the Appellant contacted HMRC to request the overpayment of CIS be offset against any VAT liability. This was the first contact HMRC had received relating to the 2015-16 CIS overpayments. The Appellant's
10 Corporation Tax return for 31 August 2015 was received on 14 April 2016, therefore this liability was not known to allow offset until after this date. On the 17 June 2016, the Appellant's agent contacted HMRC to request offsetting CIS overpayments against the Corporation Tax liability. Following that, the CIS claims were checked, verified and tax and VAT liabilities offset as requested.

15 38. In any event there is no provision that allows HMRC to offset CIS deductions against the Company's VAT liability "in year". The Income Tax (Construction Industry Scheme) Regulations 2005 Regulation 56(5) stipulates that HMRC shall not repay any sum deducted under FA 2004 s 61 to a company sub-contractor until:

20 "The tax year in which the deduction was made, has ended and the qualifying sub-contractor has delivered the return required by regulation 73 of the PAYE Regulations (annual return of relevant payments liable to deductions of tax)."

39. Regulation 56(2) stipulates the order in which any CIS credits should be discharged and Regulation 56(3) states any sum deducted as is not required to discharge the sub-contractor's liabilities specified in paragraph (2) shall be repaid to
25 the qualifying sub-contractor.

40. Where the sub-contractor is a company, the legislation states at FA 2004 s 62(3) that deductions are first to be treated as paid on account of any "relevant liabilities" of the sub-contractor. "Relevant liabilities" in this context means the company's obligations to pay over to HMRC any PAYE, NICs, and CIS deductions. Any excess
30 deductions determined at the end of the tax year when the company has submitted its employer's annual return on form P35 for non-Real Time Information ("RTI") year, or Employer Payment Summary returns for RTI years, can be set against corporation tax liabilities or repaid.

41. For RTI years, the company will complete monthly Employer Payment Summary
35 returns showing cumulative CIS deductions taken from its own income during the tax year. These amounts are off-set against the PAYE and other deductions it is due to pay for the tax year. Any excess of CIS deductions taken from the company's own income is carried forwarded month by month until all of the CIS deductions for the tax year are used, or the end of the tax year is reached.

40 42. Repayment and off-set claims for limited company subcontractors can only be dealt with when the company has filed its final Employer Payment Summary and all associated Full Payment Submissions for the tax year. If HMRC cannot agree the company's whole claim, they will ask the company for their payment and deduction

statements and supporting evidence of receipt. HMRC can still consider a part repayment/off-set for the deductions they can agree. Where there is a mis-match, HMRC will need to take up the discrepancy with the company.

5 43. It is not until the end of the tax year that excess CIS deductions which cannot be set-off and are still available may be refunded or set against other liabilities.

44. Having CIS deductions is a normal hazard of trade in the construction industry and a foreseeable event. It is a reasonable expectation that a prudent business would put the necessary precautions in place to ensure they meet their legal obligations to submit VAT returns and payment by the due date.

10 45. HMRC refer to the Tribunal's comments that the right to deduct does not arise as soon as a claim to deduct is made. As stated in *R (on the application of UK Tradecorp Ltd) v Customs and Excise Commissioners*:

15 “there is a distinction between an unadjudicated claim to input tax and an admitted or established claim. Until a claim is accepted or established there is no right to payment. It was incumbent on the Appellant to satisfy HMRC of its entitlement to a deduction. It is not sufficient merely to make a claim, to be entitled or treated by the law as entitled to receive payment. Accordingly, there was no prima facie duty on the part of HMRC to repay input tax unless and until the claim had been agreed or upheld.”

20 46. HMRC say that the potential financial consequences attached to the risk of further defaults would have been known to the Appellant after issue of the Surcharge Liability Notice for period 06/15, when a Surcharge Liability Notice was issued, particularly given the information contained in the Notice which on the reverse states:

25 “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.”

47. The requirements for submitting timely electronic payments can also be found -

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- 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.

35 48. Also, the reverse of each default notice details how surcharges are calculated and the percentages used in determining any financial surcharge in accordance with VATA s 59(5).

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

50. Although the Appellant was suffering cash flow difficulties, this is not something which was attributable to anything other than the normal hazards of trading. The Appellant had not produced any bank statements, copy accounts or other documentation to substantiate its assertion that it was suffering an insufficiency of funds due to unavoidable and unforeseen circumstances beyond its control.

Conclusion

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

52. The Appellant's grounds of appeal are that it suffered a cash flow shortage caused by constraints on its cash flow as result of the fact that in year CIS credits due to the company had not been refunded by HMRC.

53. As HMRC say, the Income Tax (Construction Industry Scheme) Regulations 2005 and Finance Act 2004 ss 61- 62 cover the requirement to deduct amounts under CIS and the treatment of the sums so deducted.

54. There is no provision that allows HMRC to offset CIS deductions against the company's VAT liability 'in year'. As such a limited company that has an excess of CIS deductions over and above the amount of tax/NIC/CIS that it is due to pay to HMRC, will not be able to claim a repayment of those CIS deductions until:

- the final Employer Payment Summary for the year has been submitted (due by 19 April each year where payments to employees are made in the period 6 March to 5 April)
- the company has paid all amounts due to HMRC for the tax year, in its capacity as an employer/contractor
- and the tax year in which the CIS deductions were made from the company has ended.

55. VATA, ss 59 and 71 set out the reasonable excuse provisions which apply to the default surcharge. As regards the Appellant Company's cash flow shortages generally, it is clear from s 71(a) VATA, that an insufficiency of funds to pay any VAT due is not in itself a reasonable excuse.

56. 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 tax-payer 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.

57. Having considered the background facts and circumstances leading up to the defaults, the underlying cause of the Company's cash flow shortages was not an unforeseeable or unexpected event outside its control. The primary cause of the

defaults was a cash flow shortage caused by its rapidly increasing turnover and one assumes the terms of business it had agreed with its customers. However, this was something which should have been factored into the Company's business projections. Whilst CIS credits had built up during the two default periods in 2016, these were not repayable to the Company until the year end.

58. There was also nothing unforeseeable about the CIS deductions. As a sub-contractor within the CIS that did not qualify for 'gross payment' status, the deductions were clearly required by law and without set off. They were an ordinary incident of trade.

59. The Company has not provided any evidence that it could not pay the VAT as it fell due, and was unable to raise funds or arrange borrowing facilities to do so. The Appellant should have had in place cash flow controls that ensured VAT was paid on time as and when it fell due.

60. The burden of proof is on the Appellant to show that the underlying cause of its failure to meet its VAT payment obligations was due to unforeseen circumstances or events beyond its control. In the Tribunal's view, for the reasons given above, that burden has not been discharged and there was no reasonable excuse for the Appellant's late payment of VAT for the 01 /16 and 04/16 periods.

61. The appeal is accordingly dismissed and the surcharges upheld.

62. 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 CONNELL

TRIBUNAL JUDGE

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RELEASE DATE: 13 NOVEMBER 2017