



TC07017

Appeal number: TC/2017/07450

VAT default surcharge - insufficiency of funds caused by appellant's customer not making payment under contract on time - no evidence provided to show that the insufficiency of funds was unavoidable and unforeseeable - whether reasonable excuse - on the facts, no - appeal dismissed

FIRST-TIER TRIBUNAL

TAX

BARD ELECTRICS LIMITED

Appellant

- and -

**THE COMMISSIONERS FOR HER MAJESTY'S
REVENUE AND CUSTOMS**

Respondents

TRIBUNAL: JUDGE MICHAEL CONNELL

The Tribunal determined the appeal on 8 February 2019 without a hearing under the provisions of Rule 26 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (default paper cases) having first read the Notice of Appeal dated 28 September 2017 and HMRC's Statement of Case received by the Tribunal and the Appellant on 9 November 2017 with enclosures. The Tribunal wrote to the Appellant on 18 November 2017 stating that if the Appellant wished to reply to HMRC's Statement of Case it should do so within 30 days. The Appellant did not reply.

DECISION

The Appeal

1. Bard Electrics Limited ('the appellant') appeals against a default surcharge of £417.65 imposed by HMRC, in respect of the VAT period ended 04/17, for its failure to submit, by the due date, payment of the VAT due. The surcharge was calculated at 5% of the VAT due of £8,353.19
2. The point at issue is whether or not the appellant has a reasonable excuse for making late payment.

Background

3. The appellant's business is that of electrical installations and is based in Huntingdon, Cambridgeshire. The business has been registered for VAT since April 1973 under the VAT reference 119 5211 87. The directors are Mr P Dixon and Mr R Dixon.
4. The appellant has been in the VAT default surcharge regime from period 10/16 when a non-financial Surcharge Liability Notice was issued. Following the initial default there was a further default for period 01/17. The penalty under appeal for period 04/17, is the appellant's third default.
5. No financial penalty was issued on the first default but a Surcharge Liability Notice was issued. No financial penalty was issued on the second default because the penalty fell below the £400 de minimis level.
6. The appellant was on a quarterly basis for VAT. Section 59 of the VAT Act 1994 requires VAT returns and payment of VAT to be made on or before the end of the month following each calendar quarter. [Reg 25(1) and Reg 40(1) VAT Regulations 1995].
7. 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. 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 electronic filing and payment.

9. If payment is by direct debit, HMRC will automatically collect payment from the businesses bank account three bank working days after the extra seven calendar days, following the standard due date. The appellant normally pays its VAT electronically by direct debit, and in the default quarter made payment by direct debit, but late.

10. The Period under appeal, 04/17, had a due date of 7 June 2017 for electronic payments and electronic VAT submission. The return was received prior to the due date but payment was received on 15 June 2017 being 8 days later than the due date.

11. The appellant appealed HMRC's decision to impose the surcharge for the Period 04/17 on 7 July 2017, saying:

"We are writing in connection with your recent letter of the 16/6/17, regarding our VAT payment.

We were unable to make the payment on the due time as a large part of the payment was for a particular contract that was significantly larger than our usual works.

We had invoiced the Builder we were working for during the VAT period of February 2017 and April 2017 at the beginning of the period, but did not receive any payments from the Builder until he was paid in June.

The money owed was a considerable payment as you can see from our previous periods that are usually around a £3500.00 payment to HMRC. We had already paid out significant sums to our staff and suppliers, for a number of months the late payment caused our company significant cash flow issues, resulting in the late payment to your selves. We were unable to pay the VAT owed until we had received the money.

Following the receipt of the money owed we are now in a much improved financial position, although we will not be carrying out any further works for this customer, due to the above issues. We are now in a position to be able to pay our VAT payments at the required times in future and we ask if you are able to cancel the surcharge. If we are late with any future payments we will have no issues paying a surcharge."

12. 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. 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 –

(a)

(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.'

13. Section 108 Finance Act 2009 specifies that there is no liability to a default surcharge for a period where contact is made with HMRC prior to the due date in order to arrange Time to Pay, and this is agreed by HMRC.

14. The onus of proof rests with HMRC to show that the surcharge was 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 the balance of probabilities.

15. HMRC rejected the appeal on the basis that an insufficiency of funds is not reasonable excuse unless the insufficiency was caused by circumstances unforeseen and outside their control. HMRC took the view that the appellant's lack of ability to pay arose through circumstances which were no more than the normal hazards of trade and did not warrant exceptional discretion. The appellant was advised of the decision by letter on 30 August 2017.

16. The appellant lodged a notice of appeal with the Tribunal on 28 September 2017.

17. On 13 October 2017, HMRC replied to the appellant's appeal to the Tribunal reiterating their earlier reasons for rejecting the appeal. HMRC referred to s71(1)(a) VATA 1994 which excludes insufficiency of funds as being a reasonable excuse for late payment of VAT and HMRC said:

“To be successful in establishing a reasonable excuse you may to be able to demonstrate that the causative event, giving rise to the lack of funds for each period was:

- Outside the normal hazard of trade in that there was some element of inescapable or unforeseeable misfortune, and;
- That any loss of income was outside your control and influence and was a significant percentage of the business income.
- You had done everything a prudent and competent business person mindful of their obligations to VAT would have done in the same or similar circumstances to try and pay the tax due, and;
- You would also need to clearly demonstrate why the specific shortage of funds meant you were unable to pay the VAT at the time due.

Kindly give full details, as above, of each circumstance which were applicable to your particular circumstances and please provide the following information:

- a) A breakdown of monies received, from 01 April 2017 to 07 June 2017.
- b) Copy Bank Statement(s) showing the balance for 1 week either side of the due date for period 04/17 (i.e. 31 May 2017 to 14 June 2017), including details of any overdraft limit in place at that time.
- c) Details of any action taken to obtain outstanding payment/credit.

- d) Details of the usual credit terms, including full details of any staged payment arrangements, if relevant.
- e) Any other information/documentation you wish to be considered.

I would be grateful for a reply by 03 November 2017, to enable my review to include any information provided.”

18. The appellant did not respond to HMRC’s letter.

Appellant’s contentions

19. The appellant’s grounds of appeal are that

“We are appealing against HMRC decision as detailed in our letter of the 7/7/2017 (enclosed) we were in an unforeseen situation after completing an unusually large contract, we had not received any payment from our completed works, that not only left us in financial difficulties, also resulted in us not having received the VAT payment to us that HMRC were requesting. As soon as we received the contract payment, we paid the VAT required.

The issue is highlighted by the large increase in our VAT payment from our usual payment of between £3000.00 to £4000.00 to the payment of nearly £8000.00. In the future we will not be carrying out any further works for the contractor in question.

The late payments were unforeseen by us as we had no previous payment issues with this contractor and despite chasing the payment had no control over the issue at the end of the contract.

As can be seen from the above detail and our letter of the 7/7/2017 we feel that we have met the conditions of a reasonable excuse as HMRCs review conclusion letter.”

HMRC’s contentions

20. HMRC contend that by submitting payment of their liability after the due date the appellant is not complying with the VAT Act and Regulations.

21. HMRC maintain that 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”.

22. VATA 1994, s 25 (1) states that VAT payments are to be made in such time and manner as determined by or under regulations.

23. Regulation 40 (2) of the VAT Regulations 1995, stipulate that VAT must be paid no later than the due date of the return.

24. HMRC contend that in accordance with VATA 1994 s 59 (4) a surcharge was correctly issued where payment was received after the due date.

25. The rates of surcharge are laid down in law and neither the Commissioners, nor the Tribunal have the power to reduce the amount because of mitigating circumstances, VATA 1994 s 70 not applying to surcharges issued under s 59 of said Act.

26. Liability to VAT surcharge is governed by VAT Act 1994 (VATA 1994) s 59 and the reverse of each notice details how surcharges are calculated and the percentages used in determining any financial surcharge in accordance with s 59(5) of the said Act.

27. Section 71(1)(a) of VATA 1994 specifically excludes an insufficiency of funds as providing a reasonable excuse for late payment and the removal of a surcharge issued in accordance with s 59(4) of the said Act.

28. Whilst a lack of funds is excluded from providing a reasonable excuse it has been established that the reason for the lack of funds can in itself provide a reasonable excuse. In order to ascertain the reasons for the lack of funds HMRC wrote to the appellant on 13 October 2017 requesting additional information in support of its appeal. No additional information has been received from the appellant.

29. As the appellant was awaiting payment from one of its customers, had they contacted HMRC prior to the due date to request a deferral of payment, as advised on the earlier surcharge notices, and had this been agreed, then no surcharge would have been issued. There is no record of any such request being made by the appellant.

30. In the appellant's letter of 7 July 2017 they state that they "had already paid out significant sums to our staff and suppliers, for a number of months the late payment caused our company significant cash flow issues, resulting in the late payment to yourselves. We were unable to pay the VAT owed until we had received the money." HMRC accept that a business has other expenses, however, VAT must be given priority. As a VAT registered company the appellant charged VAT to its customers and is required by law to pay this with the appropriate return by the due date

31. The appellant maintains in their letter of 7 July 2017, that *"following receipt of the money owed we are now in a much better financial position", and will no longer be carrying out further work for the customer due to the issues described. "We are now in a position to be able to pay our VAT payments at the required times in future. If we are late with any future payments we will have no issues paying a surcharge"*. Whilst HMRC appreciate the steps taken by the appellant to enable it to meet its future VAT obligations, this would not in itself provide a reasonable excuse for the removal of the surcharge

32. The potential affect that the payment of the surcharge may have on the appellant's finances would not be considered a reasonable excuse for removal of the surcharge for the period 04/17.

Conclusion

33. Legislation lays down the surcharges to be applied in the event of VAT being paid late and surcharges are applied at a rate which is fixed by statute and is determined by the number of defaults in any surcharge liability period

34. The burden of proof is on the appellant to show that it has a reasonable excuse for the late payment of VAT for the default periods. There is no definition of “reasonable excuse”.

35. The first default was recorded for Period 10/16 and the appellant entered the Default Surcharge regime. Given the information printed on the Surcharge Liability Notice issued, the potential financial consequences attached to the risk of further default would have been known to the appellant from that point onward.

36. The Surcharge Liability Notice V160 advises a trader how the surcharges are calculated and the percentages used. Subsequent Surcharge Notices advise the trader of the percentage used to calculate the current surcharge, if one has been issued, and/or the percentage which will be used in calculating the surcharge for any subsequent default. Each notice issued details on the reverse how surcharges are calculated and the percentages used in determining any financial surcharge in accordance with VATA 1994 s 59(5).

37. HMRC argue that the causes of the insufficiency of funds were not exceptional. They argue that they were foreseeable and attributable to the ordinary hazards of trade. As such, they say that they could not be regarded as a reasonable excuse for the appellant’s late payment of VAT.

38. Although an insufficiency of funds to pay any VAT due is not of itself a reasonable excuse, [s 71(1)(a) of the Vat Act 1994], the underlying cause of any insufficiency of funds if entirely unforeseen and outside the control of the taxpayer, may constitute a reasonable excuse – *Customs & Excise Commissioners v Steptoe* 1992 STC 757 (“*Steptoe*”).

39. The issue of reasonable excuse and s 71(1)(a) was considered in detail in *Steptoe*. The Court of Appeal held that although insufficiency of funds can never of itself constitute a reasonable excuse, the cause of that insufficiency, that is, the underlying cause of the taxpayer’s default, might do so and in considering that, as Lord Donaldson MR explained, the question is whether the late payment was “reasonably avoidable”. The test to apply can be found in his judgment where he said:

“... 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.”

40. That is the correct test to be applied and is binding upon the Tribunal. In *Steptoe* Lord Nolan said that it is necessary to distinguish between the reason for non-payment and excuse for non-payment. Lord Nolan quoting from his own decision in *Customs and Excise Commissioners v Salevon* [1989] STC 907 said:

“... It is worth bearing in mind that the penalties imposed for a delay or deficiency in payment, however slight, are fixed. Neither the commissioners nor the tribunal have any power to mitigate them by reference to the facts of the particular case. In these circumstances the wide discretion conferred on the commissioners and the tribunal by s 19(6) should not in my view, be regarded as having been cut down by s 33(2) to any greater extent than the language of the latter subsection strictly requires. The commissioners and the members of the tribunal are well qualified to distinguish between the trader who lacks the money to pay this tax by reason of culpable default and the trader who lacks the money by reason of unreasonable and inescapable misfortune.”

41. In this appeal, the taxpayer is saying that it should be excused from the surcharge because the shortage of funds was brought about by circumstances which were unforeseeable and over which it had no control.

42. HMRC wrote to the appellant on 10 October 2017 requesting information which may have assisted the appellant in the appeal. There is however no indication in the appeal papers that the appellant responded to the letter. The burden of proof is on the appellant to prove its case. The information requested by HMRC at a) to e) of its letter is fundamental to any further consideration of the appellant’s assertion that the cause of the insufficiency of funds was not only unforeseeable but also unavoidable.

43. The Tribunal wrote the appellant on 18 November 2017 enclosing a copy of HMRC’s statement of case, advising the appellant that if it wished to reply, it should do so within 30 days of receipt of the statement and send any further relevant documentation which the appellant wished the Tribunal to consider. There is no indication in the appeal bundle that the appellant responded.

44. On the available evidence I have to conclude that the appellant has not shown a reasonable excuse for the late VAT payment for period 04/17, and accordingly the appeal is dismissed and the surcharge in the sum of £417.65 is confirmed.

45. 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**

RELEASE DATE: 28 February 2019