Neutral Citation: [2023] UKFTT 494 (TC)

Case Number: TC08836

FIRST-TIER TRIBUNAL
TAX CHAMBER

By remote video hearing

Appeal reference: TC/2022/11107

VAT Default Surcharge - whether reasonable excuse

Heard on: 5 May 2023
Judgment date: 18 May 2023

Before

TRIBUNAL JUDGE HOWARD WATKINSON
PATRICIA GORDON

Between

NATIONS RECRUITMENT LIMITED

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Mr. Taiwo Bodunrin of the Appellant

For the Respondents: Mr. Kieran Gargan, Presenting Officer for HM Revenue and Customs

DECISION

INTRODUCTION

1. With the consent of the parties, the form of the hearing was by video. The documents to which we were referred were a bundle of documents running to 24 pps., HMRC's Statement of Reasons and a legislation and authorities bundle running to 157 pps.

2. Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

3. This is an appeal by the Appellant against a VAT default surcharge under s.59(c) of the Value Added Tax Act for VAT period 03/22 @ 10% £523.23.

BACKGROUND

4. The Appellant is a recruitment company which has been registered for VAT since 7.8.19. If making a paper VAT return a taxpayer is required to submit a VAT return, and any payment due, not later than the last day of the month following the period to which the return related (Regulation 25(1) of the VAT Regulations 1995 (**"VATR**")). If a taxpayer files VAT returns electronically a taxpayer is permitted a further seven days to submit a VAT return, and make any payment due (by a direction made under Regulations 25, 25A(20) and 40(3)-(4) VATR).

5. The Respondents' case is that having entered the default surcharge regime the Appellant defaulted for a fourth time in paying its VAT due of £5,232.34 for VAT period 03/22 late on 22.6.22, 4.7.22 and 13.7.22. The Appellant says that it has a reasonable excuse for the 03/22 VAT payment being late because it had been having financial difficulties due to Covid-19 and was trying its best to make sure that it cleared the outstanding balance.

THE RELEVANT LAW

6. The VAT default surcharge is imposed by Section 59 VATA, which states, in as far as is relevant:

> "**59.— The default surcharge.**
>
> (1) … 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.
>
> …
>
> (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.
…"

7. Under Section 59(7)(b) VATA, if the Appellant satisfies the Tribunal that there is a reasonable excuse for the default in question then it will not be liable to the surcharge. Section 71(1) VATA provides that for the purpose of any provision of Sections 59-70 of VATA which refers to a reasonable excuse (a) an insufficiency of funds is not a reasonable excuse, and (b) where reliance is placed 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.

8. There is no statutory definition of "reasonable excuse". In *Rowland v Revenue & Customs Commissioners* [2006] STC (SCD) 536 the Tribunal noted at [19] that the issue was to be considered in the light of all the circumstances of the particular case. In *The Clean Car Company Ltd v The Commissioners of Customs and Excise* [1991] VATTR 234 Judge Medd QC set out that the test is an objective one, where the Tribunal must ask itself: "was what the taxpayer did a reasonable thing for a responsible trader conscious of and intending to comply with his obligations regarding tax, but having the experience and other relevant attributes of the taxpayer and placed in the situation that the taxpayer found himself at the relevant time, a reasonable thing to do?"

9. The Respondents referred the Tribunal to *Christin Perrin v The Commissioners for Her Majesty's Revenue and Customs* [2018] UKUT 156 (TC) where at [81] the Upper Tribunal set out a useful approach that the First-tier Tribunal can take in considering the issue of reasonable excuse.

"81. When considering a "reasonable excuse" defence, therefore, in our view the FTT can usefully approach matters in the following way:

(1) First, establish what facts the taxpayer asserts give rise to a reasonable excuse (this may include the belief, acts or omissions of the taxpayer or any other person, the taxpayer's own experience or relevant attributes, the situation of the taxpayer at any relevant time and any other relevant external facts).

(2) Second, decide which of those facts are proven.

(3) Third, decide whether, viewed objectively, those proven facts do indeed amount to an objectively reasonable excuse for the default and the time when that objectively reasonable excuse ceased. In doing so, it should take into account the experience and other relevant attributes of the taxpayer and the situation in which the taxpayer found himself at the relevant time or times. It might assist the FTT, in this context, to ask itself the question "was what the taxpayer did (or omitted to do or believed) objectively reasonable for this taxpayer in those circumstances?"

(4) Fourth, having decided when any reasonable excuse ceased, decide whether the taxpayer remedied the failure without unreasonable delay after that time (unless, exceptionally, the failure was remedied before the reasonable excuse ceased). In doing so, the FTT should again decide the matter objectively, but taking into account the experience and other relevant attributes of the taxpayer and the situation in which the taxpayer found himself at the relevant time or times."

10. *In Bicester Property Interiors Limited v Revenue & Customs* [2023] UKFTT 13 (TC) Judge Frost summarised the law in relation to cash flow problems and reasonable excuse at [67] – [79], with which we agree, and gratefully adopt:

"67. HMRC also drew our attention to two cases in which it was established that, although inability to pay is precluded by the statute from being a reasonable excuse, the underlying reason for the inability to pay may constitute a reasonable excuse.

68. The first such case was *Customs and Excise Commissioners v Salevon Ltd* [1989] STC 907 QBD (Nolan J) ("*Salevon*"). In *Salevon*, the former secretary of the taxpayer company had drawn cheques for the amounts of VAT due from the company and shown them in the company's records as having been paid. However, he had not in fact posted the cheques.

69. The company was purchased by a Mr Antony who, upon discovering the VAT debt made arrangements with the commissioners to make payment. However, the cash flow problems caused by the debts were then exacerbated by a number of bad debts. The cumulative result was that the company fell into arrears in respect of three subsequent accounting periods and became liable to default surcharges. At first instance the VAT tribunal had held that that the real cause of the default was the conduct of the former company secretary which led to the cash flow problem.

70. On appeal, Nolan J noted (at p911) noted:

> "The commissioners and the members of the tribunal are well qualified to distinguish between the trader who lacks the money to pay his tax by reason of culpable default and the trader who lacks the money by reason of unforeseeable and inescapable misfortune."

71. Nolan J expressed some reservations about the first instance Judge's conclusion that the bad debts could provide a reasonable excuse, as "The risk of bad debts is an incident of most, if not all, types of business activity". However, Nolan J took some comfort in the fact that "It is clear from his judgment that he would not have decided the case as he did if he had thought that the deficiency of cash was due to the normal hazards of trade".

72. HMRC drew our attention to the following passage:

> "...the cases in which a trader with insufficient funds to pay the tax can successfully invoke the defence of "reasonable excuse" must be rare. That is because the scheme of collection which I have outlined involves at the outset the amount of tax which he must subsequently pay over to the commissioners. There is nothing in law to prevent him from mixing his money with the rest of the funds of his business and using it for normal business expenses (including

> the payment of input tax), and no doubt he has every commercial incentive to do so. The tax which he has collected represents, in substance, an interest-free loan from the commissioners. But by using it in his business he puts it at risk. If by doing so he loses it, and so cannot hand it over to the commissioners when the date of payment arrives, he will normally be hard put to invoke s 19 (6) (b). in other words he will be hard put to it to persuade the commissioners or the tribunal that he had a reasonable excuse for venturing and thus losing money destined for the Exchequer of which he was the temporary custodian'."

73. The second case concerning insufficiency of funds to which we were referred was *Steptoe v Revenue and Customs Commissioners* [1992] STC 757 CA ("*Steptoe"*).

74. In that case, Scott LJ, giving a dissenting decision, considered the question of the significance of the 'normal hazards of trade', as follows (at p765):

> "The relevant question is not what the normal hazards of are commercial in general, but what are the normal hazards of the taxpayer's particular business. If the normal hazards of a taxpayer's particular business include the late payment of bills, then that taxpayer should make arrangements to finance his cash flow on that footing. If he cannot afford to do so, then as it seems to me, he is relying on nothing other than an insufficiency of funds. If he can afford to do so but does not do so, the reason for insufficiency of funds can hardly be a reasonable excuse. It is only if the events giving rise to the insufficiency of funds are outside the normal course of the taxpayers' business that a possibility of a reasonable excuse can arise'."

75. However, Nolan LJ, giving one of the majority judgments, indicated that the words "unforeseeable and inescapable misfortune" used in *Salevon* set the bar for a reasonable excuse too high (at p768):

> "My references in Salevon to 'the wrongful act of another' and to the distinction between 'the trader who lacks the money to pay his tax by reason of culpable default and the trader who lacks the money by reason of unforeseeable and inescapable misfortune' were directed to the facts of that case. They cannot be regarded as an all-purpose test of what constitutes a reasonable excuse."

76. Thus, the underlying cause of the insufficiency need not be restricted to unforeseeable or inescapable events. Lord Donaldson MR noted (at p770) that:

> "If the exercise of reasonable foresight and 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 taxpayer's default, then the taxpayer might well have reasonable excuse for non-payment, but that excuse would be exhausted by the date on which such foresight, diligence and regard would have overcome the insufficiency of funds."

77. We would also note an *obiter* comment made by Nolan LJ in Steptoe (at p769), which may have some relevance to the VAT accounting arrangements in place in the present case:

> "I would repeat that as a general rule a small trader dealing with larger organisations and having difficulty in securing the prompt payment of his bills should elect to account for his value added tax on the cash basis and would have no reasonable excuse for failing to do so."

78. Scott LJ made the following additional comment on VAT accounting arrangements (at p758):

> "In general, traders must account for output tax and input tax on the basis of invoices issued in respect of the supply of the goods or services in question (see ss 4, 5 and 14). It is an inevitable consequence of this scheme that a trader may become liable to account to the commissioners for output tax at a time before he has been paid by his customer the price of the goods or services supplied or the tax thereon. It may seem a hardship that traders should be placed under this liability but the hardship is the consequence of a tax collection scheme under which the trader is responsible for collecting the tax from the customer and is accountable to the commissioners not on the basis of receipts but on the basis of invoices. The hardship to which I have referred is mitigated to some extent by the 'Cash Accounting Scheme' introduced by the Value Added Tax (Cash Accounting) Regulations 1987."

79. Overall, we conclude that the proper approach to be applied is that set out in *Perrin*. When considering the question to be considered at the third stage of that approach (i.e. "was what the taxpayer did (or omitted to do or believed) objectively reasonable for this taxpayer in those circumstances?") we consider that we must take into account that:

(1) a taxpayer who has collected funds representing VAT on behalf of HMRC in advance of the date for payment to HMRC will only rarely be able to establish that he has a reasonable excuse for using those funds for a purpose other than making payment to HMRC

(2) an event outside the normal course of the taxpayer's business (but potentially falling short of an unforeseeable or inescapable event) may give rise to such a reasonable excuse

(3) such an event can only be considered to provide a reasonable excuse for so long as the exercise of reasonable foresight and due diligence and a proper regard for the fact that the tax would become due would not have avoided the insufficiency of funds

(4) where a taxpayer does not routinely collect funds representing VAT from customers prior to the date for payment to HMRC, the fact that the taxpayer has not adopted the cash accounting scheme is a factor to be given some weight in determining whether the taxpayer has exercised such reasonable foresight, due diligence and proper regard."

FINDINGS OF FACT

11. From the documents produced to us, and from what the Appellant said at the hearing, we find the following facts.

12. As set out in the "Schedule of Defaults (and Payments)", the Appellant entered the default surcharge regime because its payment for the 12/20 quarterly VAT period of VAT due of £1,348.47 was paid late on 8.2.21. As this was the first default no surcharge was payable, but a surcharge liability notice ("SLN") was issued on 12.2.21 with a standard surcharge liability period.

13. Within the surcharge liability period the Appellant defaulted again, paying its 06/21 period VAT due of £1,699.54 late on 20.5.22. The Appellant was therefore liable to a 2% surcharge, but this was below the threshold for HMRC to issue a surcharge. HMRC issued a further SLN to the Appellant on 19.7.21.

14. Within the ongoing surcharge liability period the Appellant defaulted again, paying its 12/21 period VAT due of £2,756.32 late on 14 and 20.6.22. The Appellant was therefore liable to a 5% surcharge but, this was below the threshold for HMRC to issue a surcharge. HMRC issued a further SLN to the Appellant on 17.2.22.

15. Within the ongoing surcharge liability period the Appellant defaulted again, paying its 03/22 period VAT due of £5,232.34 late on 22.6.22 and 4 and 13.7.22. The Appellant was therefore liable to a 10% surcharge of £523.23, which has been correctly calculated.

16. Mr. Bodunrin confirmed that the Appellant received each of the SLNs and the surcharge in issue (albeit he said that he did not open them at the time). We find that they were sent to the Appellant, and that the Appellant received them.

17. We find the following facts in relation to the Appellant.

18. The Appellant is a recruitment agency. It does not pay VAT to its workers but charges VAT to its customers. The Appellant's input VAT is mainly incurred on overheads. Mr. Bodunrin is the Appellant's director, accountant and the business developer. As the Appellant's accountant Mr. Bodunrin knew that the VAT due from the company was required to be paid on time. However, a lot of the time Mr. Bodunrim forgot to check the period for payment of the VAT due.

19. The Appellant's business model was to pay the workers weekly but only bill its customers at six-weekly intervals. The Appellant's business model required it to fund this cashflow gap from the outset. Mr. Bodunrin had put his own funds in to the Appellant for this purpose but then withdrew them. The Appellant could not obtain a loan from a bank.

20. The Appellant paid for some advertising pre-lockdown in the sum of £500. During the pandemic the company accrued debts because it was paying its workers but not receiving payment from its customers until some time later. The company used the VAT that it did receive to pay its workers. The Appellant did not consider moving to cash accounting.

21. Mr. Bodunrin telephoned HMRC twice for advice, was told to apply for something (he could not remember what) and forgot to apply for whatever it was he had been advised to apply for.

DISCUSSION

22. The Appellant's business model, adopted from the outset, meant that it was entirely predictable that the Appellant would not have the cash to pay its VAT due bill every quarter whilst it continued to trade in that manner, unless it had some form of finance available to it, either from Mr. Bodunrin's funds that he had injected into the business, or from a loan (or some other arrangement such as factoring). Once Mr. Bodunrin withdrew his funds and no alternative financing was put in place he, and therefore the Appellant, full well knew that the Appellant would not be able to pay its VAT due on time, because it was using the VAT that it did receive to pay the workers instead.

23. The exercise of reasonable foresight and due diligence and a proper regard for the fact that the tax would become due would have avoided the insufficiency of funds. The Appellant had ample opportunity to seek a cashflow solution prior to the default in paying the 03/22 VAT due.

24. We find that Mr. Bodunrin had little, if any, regard to the Appellant's duty to pay VAT that it owed. The Appellant instead deliberately chose to use the VAT that it did owe to operate its business. The default surcharge is a result of that decision. Applying *Perrin* what the taxpayer did was not objectively reasonable for this taxpayer in those circumstances.

25. Payment of £500 for advertising pre-lockdown as a matter of fact does not begin to justify the late payment of VAT in the cumulative sum of thousands of pounds over a long period of time.

26. Further, it was not reasonable for the Appellant to take advice from HMRC only to effectively ignore it.

27. The Tribunal does not accept that it was reasonable for the Appellant to act as it did. The Tribunal therefore finds that the Appellant did not have a reasonable excuse for the late payment of the 03/22 VAT due.

DECISION

28. For the above reasons the appeal is dismissed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

29. 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.

HOWARD WATKINSON
TRIBUNAL JUDGE

Release date: 18th May 2023