



**TC06075**

**Appeal numbers: TC/2017/02297 and TC/2017/02299**

*VAT default surcharges - conjoined appeals – Managing Director suffering from undiagnosed illness which diminished his ability to manage the businesses - whether reasonable excuse - yes - but not in respect of a subsequent late payment following a management restructure - appeal allowed in part*

**FIRST-TIER TRIBUNAL**

**TAX**

**HARDY ACCESS SERVICES LIMITED  
MICHAEL F HARDY LIMITED**

**Appellants**

**- and -**

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

**Respondents**

**TRIBUNAL: JUDGE MICHAEL CONNELL  
MEMBER PETER SHEPPARD**

**Sitting in public at Alexandra House, The Parsonage, Manchester on 22 May 2017**

**Mr David Birnie, Operations Manager and Julie Woods Book-keeper of Appellant Companies**

**Ms Sophie Brown, Officer of HMRC, for the Respondents**

## DECISION

### The Appeal

- 5 1. Hardy Access Services Limited appeals against a decision by HMRC to impose a default surcharge of £1,580.67, in respect of the VAT period ended 11/16, for its failure to submit, by the due date, payment of the VAT due. The surcharge was calculated at 10%.
- 10 2. Michael F Hardy Limited appeals against a decision by HMRC to impose a default surcharge of £7,425.90, in respect of the VAT period ended 11/16, for its failure to submit, by the due date, payment of the VAT due. The surcharge was calculated at 10%.
3. Appeal TC/2017/02299 for Hardy Access Services Ltd was heard concurrently with Appeal TC/2017/02297 for Michael F Hardy Ltd on the grounds that the companies (“the Appellants”) are associated and have identical grounds of appeal.
- 15 4. The point at issue is whether or not the Appellants have a reasonable excuse for making late payments.

### Background

- 20 5. The business of Michael F Hardy Limited (“Co 1”) is engineering and manufacture of metal structures. The company has been VAT registered since June 2000. The business of Hardy Access Services Limited (“Co 2”) is scaffolding. The company has been VAT registered since May 2011. The Appellants are sister companies and are based in Burnley, Lancashire. The directors are Paul Hardy and his father Michael Hardy.
- 25 6. Co 1 has been in the VAT default surcharge regime from period 08/15. Prior to the defaults under appeal there had been three previous defaults. No financial penalty was issued on the first default but a Surcharge Liability Notice was issued. The penalty under appeal is therefore Co 1’s fourth default.
- 30 7. Co 2 has also been in the VAT default surcharge regime from period 08/15. Prior to the defaults under appeal there had been three previous defaults. No financial penalty was issued on the first default but a Surcharge Liability Notice was issued. A financial penalty in respect of the second default was issued at 2% but waived because it fell below the de minimis level of £400, which allows HMRC a concessionary discretion not to levy a penalty. The penalty under appeal is Co 2’s fourth default.
- 35 8. The Appellants are 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.]

9. 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.
10. 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.
11. 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 paid its VAT electronically. No direct debit was set up.
12. In respect of Co 1 and the 11/16 default, as payment was made electronically (Faster Payment Scheme), the due date was 7 January 2017. The return was received three days late on 10 January 2017. The VAT payment was paid on the same date.
13. Co 1 had defaulted in period 11/15. The VAT was due no later than 7 January 2016. The return was received late on 8 January 2016, and the VAT payment was also paid late in part on 3 February 2016, and the balance on 13 April 2016. A 2% surcharge was imposed.
14. Co 1 also defaulted in period 02/16. The VAT was due no later than 7 April 2016. The return was received on 6 April 2016, and the VAT payment was paid late in part on 13 April 2016 and the balance on 27 May 2016. A 5% surcharge was imposed.
15. In respect of Co 2 and the 11/16 default, again as payment was made electronically, the due date was 7 January 2017. The return was received late on 10 January 2017, and the VAT payment was also paid on 10 January 2017, again three days late.
16. Co 2 had defaulted in period 11/15. The VAT was due no later than 7 January 2016. The return was received late on 8 January 2016, and the VAT payment was also paid late in part on 29 February 2016, in part on 31 March 2016 and the balance on 29 April 2016. A 2% surcharge was imposed.
17. Co 2 also defaulted in period 02/16. The VAT was due no later than 7 April 2016. The return was received on 6 April 2016, and the VAT payment was paid late in part on 2 June 2016, and the balance on 17 June 2016. A 5% surcharge was imposed.

18. 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) 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 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.’

19. 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.

### **Appellant’s contentions**

20. Co 1’s grounds of appeal are contained in a letter from Mr Birnie to the Tribunal dated 8 March 2017:

“We would be grateful if you could independently review HMRC’s decision to issue a 10% surcharge amounting to £7425.90 to Michael F Hardy Ltd for late submission and payment of VAT by 3 days, quarter ending 30th November 2016.

After several months of striving to pay VAT on time due to illness within the company and cash flow problems, we have turned the company around and now make provision for the VAT.

2016 was a very difficult time for the company. Our Managing Director was diagnosed with a serious illness in October 2015. Subsequently I took over financial responsibility. From November 2015 our VAT record has been as follows:

- Vat period end 30 November 2015 - £51,292.37 paid by instalments as agreed with HMRC. Paid in full by 27th May inc. surcharge of £1079.59.
- Vat period end 29th Feb 2016 - £21,591.74 - £10k paid on 14th April and balance paid in full as agreed on above date 27th May 2016.
- Vat period end May 2016 - £23,027.36 submitted on time and paid in full 6<sup>th</sup> July 2016

- Vat period end 31st Aug 2016 - £69,159.80 submitted on time and paid in full 4th October 2016.
  - Vat period end 30th November 2016 - £74,259.08 submitted and paid on 10th January 2017 which was 3 days late (this date would have been acceptable if we had paid by direct debit but it was paid in full by immediate bank transfer). The person we now employ to submit the vat return was unfortunately unwell the first week in January which was following the festive period and it was only brought to my attention on the 10 January 2017 and action was taken immediately, contacting HMRC to inform them that we had made full payment three days late.
- On the 17th January 2017 we received a letter informing us that there would be a surcharge of £7425.90 added to our account. We contacted the VAT helpline on the 10th January and again on the 17 January 2017, explained the situation and the advisor took details and asked for a review on our behalf, this was apparently incorrect procedure and we appealed in writing on the 8th February.
- We do understand and appreciate that HMRC need to charge penalties for late payment so that companies don't become complacent, but feel that on this occasion to issue a 10% surcharge to a company that has worked hard to get through a very difficult time is not only harsh but damaging to the company.
- I have attached a copy of our bank statement which is evidence that we now make provision for VAT, PAYE, etc. on time and our reasonable excuse due to illness and clerical error following Christmas holidays and office closure. We have now not only made financial provision but now have another member of staff responsible for VAT return submissions in the event of staff absence.”
21. Co 2's grounds of appeal are virtually identical and are contained in a second letter from Mr Birnie to the Tribunal dated 8 March 2017 in which he sets out the company's VAT payment history:
- Vat periods 1st September 2015 to 29th February 2016 - Instalment plan was agreed with HMRC.
  - Vat period end 31st May 2016 - £10,734.90 - paid in full on 12 July 2016.
  - Vat period end 31st August 2016 submitted on time and paid in full on 4th October 2016.
  - Vat period end 30th November 2016 - £15,806.79 - submitted and paid on 10th January 2017 which was 3 days late (this date would have been acceptable if we had paid by direct debit but it was paid in full by immediate bank transfer). The person we now employ to submit the vat return was unfortunately unwell the first week in January 2017 which was following the festive period and it was only brought to my attention on 10 January and action was taken immediately, contacting HMRC to inform them that we had made full payment three days late.
- On the 17th January 2017 we received a letter informing us that there would be a surcharge of £1580.67 added to our account. We contacted the VAT helpline on the 10th January and again on the 17th January 2017, explained the situation and the advisor took

details and asked for a review on our behalf, this was apparently incorrect procedure and we appealed in writing on the 8th February.

5 We do understand and appreciate that HMRC need to charge penalties for late payment so that companies don't become complacent but feel that on this occasion to issue a 10% surcharge to a company that has worked hard to get through a very difficult time is not only harsh but damaging to the company.”

10 22. At the hearing Mr Birnie for the Appellants acknowledged that on reflection, and having reviewed HMRC's reason for imposing the penalties in respect of the 11/16 period, the Appellants had no grounds of appeal. Although the companies book-keeper had been ill, someone else in the organisation should have arranged for the VAT payments to be made on time. He said however that the penalties appeared disproportionate given the fact that payment was only 3 days late

23. He said that looking back however it was clear that the Appellants had a reasonable excuse for the late payments in periods 11/15 and 02/16.

15 24. Mr Birnie explained that Mr Paul Hardy, the managing director of both companies, a man in his thirties, was the driving force behind the businesses. He had been fit and well until mid-2015 but then became ill. Initially he suffered from a loss of balance and other symptoms, but gradually his condition deteriorated. Unknown to others in the organisation and very unusually Mr Hardy had not been making sound business decisions and was not the diligent and energetic person they knew him to be. It was not until October 2015 following an emergency admission to hospital that Mr Hardy was diagnosed as suffering from a brain tumour. It was then realised that Mr Hardy's illness had been affecting his mental and physical abilities.

25 25. Prior to 08/15 both companies paid VAT due punctually each quarter. The companies started to suffer cash flow problems in late 2015 due to one particular customer, United Utilities, usually making late payments. Prior to his admission to hospital, Mr Hardy had undertaken all invoicing and chasing of customers particularly for late payments. All that stopped with the onset of Mr Hardy's illness. The hospital said that Mr Hardy's condition would have affected his ability to apply sound business judgement.

30 26. Mr Birnie said that United Utilities was by some margin the Appellants biggest customer accounting for over 80% of business. For approximately 18 months prior to Mr Hardy's illness being diagnosed, United Utilities started paying late, creating cash flow problems. The company's terms of business was 30 days but United Utilities started to take one or two months and then two to three months to settle accounts, without Mr Hardy having taken remedial action.

40 27. It was decided that Mr Birnie, previously the operations manager, should take over financial responsibility. Immediately he did so he recognised the reasons for the cash flow difficulties and put in place effective credit control measures together with systems and procedures to ensure that VAT was kept in a separate account and paid promptly when due. There have been no further VAT defaults since 11/16.

28. Mr Birnie said that Mr Hardy's illness was not a foreseeable event and until recognised was totally out of the control of others in the company. He said it was clear from the companies' record before Mr Hardy's illness and after the company put in place measures to ensure VAT was paid on time, that the period of default was limited solely to the time when Mr Hardy was ill. Had the diagnosis been made sooner, the company would have put in place more stringent credit control measures or if necessary applied to HMRC for a time to pay arrangement, until cash flow was back under control.

29. Mr Hardy is still undergoing treatment, and as yet has not returned to work.

#### 10 **HMRC's contentions**

30. The first default recorded for Co 1 was Period 08/15. The first default recorded for Co 2 was also Period 08/15. Both Appellants therefore entered the Default Surcharge regime in the same period. The potential financial consequences attached to the risk of further default would have been known to the Appellants from that point onward, given the information printed on the Surcharge Liability Notice.

28. The directors have ultimate responsibility for the timely submission of the VAT return and any tax due thereon.

31. The requirements for submitting timely electronic payments can be found —

- In Notice 700 'The VAT Guide' para 21.3.1(the notice represents HMRC's policy and understanding of the relevant legislation)
- On the HMRC website [www.gov.uk/hmrc](http://www.gov.uk/hmrc)
- E-VAT return acknowledgement.

32. Included within the notes on the reverse of Surcharge Liability Notices(s), issued for the periods 01/13 onwards, are the following, standard paragraphs:

25 *"Submit your return on time*

Make a note of when your return is due."

*"Pay your VAT on time*

Don't rely on HMRC to remind you — go to [www.hmrc.gov.uk/payinghmrc/vat.htm](http://www.hmrc.gov.uk/payinghmrc/vat.htm)"

*"Think ahead*

- If the person who normally does your VAT return will be absent, make alternative arrangements.
- If you can't pay the full amount on time, pay as much as you can. By paying as much as you can by the due date, you will reduce the size of any surcharge. It may even prevent you getting a surcharge altogether."

- 5 33. With effect from the period 01/13 the Surcharge Liability Notice V160 advised 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.
34. With effect from the period 04/15 each notice issued, details on the reverse how surcharges are calculated and the percentages used in determining any financial surcharge in accordance with VATA s 59(5).
- 10 35. Value Added Tax Regulations 1995, at Regulation 40, states 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.” There is a statutory obligation on a person required to make a return to pay the VAT to HMRC.
- 15 36. The Default Surcharge system seeks to ensure businesses that fail to pay VAT on time do not gain a commercial advantage (by way of an interest free loan) over the majority that do. The system therefore imposes a financial penalty on traders who are persistently late paying their VAT.
37. It is reasonable to expect a business to have procedures in place to cover for absences such as illness.
- 20 38. The lateness of a return or payment is largely a question of fact and once it occurs a surcharge accrues. The length of the delay is immaterial. The surcharge applies even if payment is one day late.
- 25 39. HMRC consider that a person exercising reasonable foresight, due diligence and a proper regard for the fact that the tax would become payable on the particular dates, would have put measures in place to ensure payment was made on time or contacted HMRC to request a deferment of payment.
40. Section 108 of the 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 a payment deferment and this is agreed by HMRC.
- 30 41. The Appellants have benefitted from Time to Pay (TTP) agreements in the past as a result of having cash flow problems. The Time to Pay proposal was requested and agreed after the relevant due dates and outside of the provisions of s 108(2).
- 35 42. HMRC contend that the Appellants did not ensure sufficient care was taken in relation to their financial and statutory obligations. The Appellants knew the consequences of payment failure and should have taken steps to protect the companies from the consequences of late payment.
43. HMRC contend that the Appellants have failed to show that they had a reasonable excuse other than them failing to plan for a foreseeable event, which in itself cannot be a reasonable excuse.



44. The surcharges have been correctly issued in accordance with s 59(4) of the VAT Act 1994, payment having been received by HMRC after the due date.

45. The level of the Default Surcharge is specified in s 59 VATA 1994 and as such HMRC have no discretion as to the amounts to be levied.

5 46. The Appellant says that the surcharge is unfair given the one day delay which has occurred. The case of *Total Technology (Engineering) Limited v HMRC* was heard in the Upper Tribunal when it was held that:

- 1) There is nothing in the architecture of the Default Surcharge system which makes it fatally flawed.
- 10 2) The Tribunal found that the DS penalty does not breach EU law on the principle of proportionality.
- 3) In order to determine whether or not a penalty is disproportionate, the Upper Tier Tribunal addressed the following factors:
  - 15 (a) The number of days of the default
  - (b) The absolute amount of the penalty
  - (c) The 'inexact correlation of turnover and penalty'
  - (d) The 'absence of any power to mitigate'

20 47. The Upper Tribunal Chamber President, Mr Justice Warren and Judge Colin Bishopp decided that none of these leads to the conclusion that the Default Surcharge regime infringes the principle of proportionality

## 25 **Conclusion**

48. The burden of proof is on the Appellants to show that the Companies have a reasonable excuse for the late payment of VAT in the default periods.

30 49. No reasonable excuse has been shown for the late payment in 11/16. In fact the Appellants acknowledged this. The lateness of a payment is a question of fact and once it occurs a surcharge accrues. The length of the delay is immaterial. The surcharge applies even if payment is one day late.

50. The Appellants say that the surcharges are disproportionate. For the reasons submitted by HMRC and set out in paragraphs 44 to 47 above this is not a ground of appeal which can be considered by the Tribunal.

35 51. Legislation does not define what amounts to 'a reasonable excuse'. It is reasonable to expect a business to have procedures in place to cover for absences due to illness. It is clear however from the facts, that with regard to the VAT defaults in 11/15 and 02/16, particularly given that the defaults began after the onset of Mr Hardy's illness and ceased when Mr Birnie took over financial responsibility, the  
40 exercise of reasonable foresight, due diligence and a proper regard for the fact that the tax would become payable on the particular dates, would not in this case have

prevented the defaults. We accept that had the companies' management known of Mr Hardy's illness they would have put measures in place to ensure payment of VAT was made on time or because of the onset of temporary cash flow problems contacted HMRC to request a deferment of payment.

5 52. The Appellants have therefore shown a reasonable excuse for the earlier defaults  
in 11/15 and 02/16 for both Co 1 and Co 2. The surcharges imposed for those periods  
are discharged. In consequence, because those defaults fall out of account, the  
defaults in 11/16 become a second default subject to a reduced 2% surcharge. In  
10 respect of Co 1 the surcharge is reduced from £7,425.90 to £1,485.18 being 2% of the  
£74,259.08 of VAT paid late. In respect of Co 2 the surcharge is reduced from  
£1,580.67 to £316.14 being 2% of the £15,806.79 VAT paid late. In line with their  
normal practice HMRC may decide to waive the surcharge on Co 2 as it is below  
£400.

15 53. 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  
20 "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**

25 **RELEASE DATE: 21 AUGUST 2017**

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