



TC07086

Appeal number: TC/2017/08443

VAT default surcharge - insufficiency of funds - major customer of appellant defaulted - whether reasonable excuse – on the facts, no - whether penalty disproportionate - no - appeal dismissed

FIRST-TIER TRIBUNAL

TAX

JEREMY ALAN HANSON

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE MICHAEL CONNELL
MEMBER JO NEILL**

**Sitting in public at Taylor House, 8 Rosebery Avenue, London EC1R 4QU on 12
September 2018**

The appellant in person

Ms Babita Hargun, Officer of HMRC, for the Respondents

DECISION

The Appeal

1. Jeremy Hanson ('the appellant') appeals against a default surcharge of £9,601.04 imposed by HMRC in respect of VAT period ended 31 May 2014, and a default surcharge of £5,337.12 reduced to £2,187.13 imposed by HMRC, in respect of VAT period ended 31 August 2014 for his failure to submit, by the due dates, payment of the VAT due. The surcharges were each calculated at 15% of the amount due.
2. The point at issue is whether the appellant has a reasonable excuse for making the late payments.

Background

3. The appellant's business is that of a labour provider in the construction industry, trading as LJS recruitment. He is based in Bromley, Kent and has been registered for VAT since 2000.
4. The appellant has been in the VAT default surcharge regime from period 08/08 when a non-financial Surcharge Liability Notice was issued. Following the initial default and prior to the defaults under appeal there had been fifteen previous defaults. The appellant reached and remained at the highest rate of surcharge (15%) from period 02/10 onwards.
5. 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].
6. 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.
7. 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.
8. The appellant has been rendering returns and paying the tax due electronically since 2010.

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 paid his VAT electronically. No direct debit was set up.

10. In respect of the 05/14 default, payment was made by transfers in from the appellant's self-assessment account with HMRC. The due date was 7 July 2014. The return was received in time, on 26 June 2014, but the VAT due of £64,006.99 was paid late by six instalments, the last one being on 29 October 2015.

11. In respect of the 08/14 default, payment was made in part electronically and in part by transfers in from the appellant's self-assessment account. The due date was 7 October 2014. The return was received on time on 11 August 2016, but the VAT due of £35,580.85 was part paid in two instalments: £21,000 on 7 October 2014 – on time, and £4,190.18 on 29 October 2015. £10,390.67 remains outstanding. The original surcharge of £5,337.12 was reduced to £2,187.13 as £21,000 was paid on time.

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) 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.’

13. 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

14. The appellant's grounds of appeal are that he was suffering cash flow problems brought about by circumstances beyond his control. He says that a major customer, Right Angle Limited, which was developing a property, failed to pay substantial invoices relating to the provision of labour by the appellant, and this critically affected his working capital in the period December 2012 to February 2013.

15. The appellant says that despite legal action being initiated, the customer entered voluntary liquidation in August 2014 which resulted in unsecured creditors receiving nothing in settlement. This led to a bad debt of £135,510 which impacted business cash flow and led to his inability to pay the VAT for periods 05/14 and 08/14 when due. In the appeal to HMRC, via his accountants, they say:

“[Mr Hanson] is not disputing the fact that the penalties and the outstanding liability exist, however, he feels that the surcharges are due to the circumstances surrounding the reasons why the VAT was unpaid. He says:

‘Our cash flow problems were caused when we encountered the catastrophic bad debt with Right Angle.

We had worked with this company for several months and been paid every month on submission of invoices. We had no reason to assume that we would not be paid, when in the December of 2012 we were asked to work over the Xmas period to finish all the projects, while the “family” attended a wedding in America.

To do this we had to flood the sites with personnel and as a result drew up a significant debt with the client. On their return we were informed that none of our work was good enough and that there would be no further payment. We sought legal advice and were left under no illusion that this should be an open and shut case. It was argued by our solicitor that our work had always been to standard and this was borne out by the fact that we had received payment for all our works over the period leading up to the break with no argument. Including a substantial sum that was collected and banked the day before the Xmas holiday.

Because of a delay in the legal system, we had to wait two years for a Court date, but, as this became forthcoming, Right Angle put themselves into voluntary liquidation, leaving us with further legal debts and no hope of any payment from the client.

I would point out that Right Angle were part of a very successful family business which included a property empire of several thousand commercial and residential buildings, worth tens of millions. It was quickly concluded that we had been the victim of a fraud and it was this that strengthened our resolve to pursue them through the courts.

Myself and my wife used all our savings and re-mortgaged our home to pay as much as we could, while keeping our staff employed.

As a result of this bad debt, we found ourselves in difficulty, as the cash flow in our business had been effectively wiped out.

Our frustration with the situation has been compounded by the application of surcharges. To date, we have already paid a number of these, although they have considerably affected our ability to pay the principal sum. When we have been able to communicate our dilemma, we have been told more than once that because of the circumstances under which the debt was created, HMRC would look very favourably at our case.’

Mr Hanson acknowledges the unpaid VAT portion, but would like to draw your attention to the volume of surcharges he has already paid that have made it impossible to pay the principal outstanding amounts and so further surcharges accrue.”

16. In a further letter to HMRC the appellant said that he and his wife had re-mortgaged their property for £60,000 and paid these monies to HMRC which were credited to his self-assessment account. There were then delays in transferring the money in order to discharge outstanding VAT.

17. The appellant also says that he encountered problems chasing HMRC for a refund of PAYE and overpaid CIS payments.

HMRC’s contentions

18. The first default was recorded for Period 08/08 when the appellant entered the Default Surcharge regime. The potential financial consequences attached to the risk of further default would have been known to the appellant from that point onward given the information printed on the Surcharge Liability Notice issued.

19. Having incurred ten surcharges, at the highest rate (15%) prior to period 02/13 (when the customer debt referred to arose) HMRC consider that the appellant would have been aware of the potential financial consequence of further defaults

20. 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
- E-VAT return acknowledgement.

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

“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”

“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.”

22. 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.

23. 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).

24. 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”. There is a statutory obligation on a person required to make a return to pay the VAT to HMRC.

25. 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.

26. HMRC note that there had been ongoing contact with the appellant regarding outstanding debt with their Debt Management Unit (“DMU”) during 2012, culminating in August 2012 with the appellant advising that cash flow was currently an issue because approximately £140,000 was outstanding from a customer.

27. As contact with DMU continued the amount of tax debt increased until January 2014, when it exceeded £100,000. When DMU contacted the appellant on 21 January 2014 to discuss the debt, the appellant made reference to a pending court case, and recovering payment of the £140,000, potentially enabling the outstanding tax debt to be settled.

28. As the debt referred to (i.e. the £140,000) relating to period 02/13 remained outstanding the appellant would have been eligible to claim bad debt relief for that debt six months after payment had been due. The appellant has not suggested that bad debt relief was not claimed.

29. The appellant advised DMU on 21 March 2014 that a re-mortgage was being arranged to settle outstanding arrears.

30. An interim Time to Pay arrangement, for reducing the arrears, was agreed on 3 April 2014 but subsequently cancelled, on 8 July 2014.

31. No return was due for period 02/14 and the period 05/14 return therefore covered six months rather than the usual three months.

32. HMRC consider that in retaining within the business any tax which might otherwise have been due for period 02/14, the appellant had derived a benefit to its trading position not normally arising.

33. HMRC note that there is no suggestion Time to Pay proposals were initiated prior to the relevant due date. Nor was there any agreement, as provided for under Finance Act 2009 s 108 (2) (b).

34. The tax due was received via multiple set-offs from the appellant's self-assessment account between 29 October 2014 and 20 February 2015. All payments were therefore received late.

35. The appellant has not offered an explanation of the way(s) the historic bad debt from period 02/13 specifically impacted periods 05/14 and 08/14 to inhibit timely payment.

36. The appellant has not suggested that insufficient monies were received in periods 05/14 or 08/14 to pay the tax when due, nor provided any evidence that insufficient funds were available on the due dates, of 7 July 2014 or 7 October 2014, to pay the tax when due.

37. HMRC note that the appellant had confirmed on 27 October 2014 that the re-mortgage funds had been received to pay the VAT and PAYE debts.

38. The appellant has referred to HMRC, in requesting payment of PAYE and CIS, in the context of contributing to his financial problems. HMRC understand that this relates to contact with DMU from early August 2014, after the period 05/14 default had arisen, to early December 2014, during which the appellant was asked to clarify where any contended incorrect allocation of monies may have occurred.

39. In January 2015, substantially after both defaults had arisen, having cleared both self-assessment and PAYE liabilities, the amount then available to be off set against the appellant's VAT liability, in the absence of his 12/13 SA return, was agreed.

40. HMRC note, in the context of when set offs are agreed, the persuasive direction issued in the case of *UK Tradecorp Ltd v Customs and Excise Commissioners* - [2005] STC 138 with regard to repayment claims. In this case it was decided by the Tribunal that:

“Until the claim was accepted or established there was no right to payment.”

41. HMRC also note that no explanation is provided as to why tax remains outstanding for period 08/14, over three years later.

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

43. HMRC contend that the appellant has failed to show that he had a reasonable excuse other than his failure to plan for a unforeseeable event, which in itself cannot

be a reasonable excuse. Having traded since 2000, and after the passage of time, the possibility of default by a major customer would clearly have become a known factor to take into account and within the normal hazards of trade for which provision could reasonably be made in business planning. The debt from Right Angle occurred in December 2012, and it must have been regarded as a possibility that despite the litigation which ensued, the debt may eventually have to be written off as irrecoverable.

44. 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 of VAT was made on time or contacted HMRC to request a deferment of payment.

45. 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.

46. Whilst HMRC accept that a business has other expenses, VAT law requires payment of the VAT due for a particular period by the due date (Value Added Tax Regulations 1995 Part V). Although there is nothing to prevent the appellant using the VAT collected in their business, the amount of VAT due to Revenue & Customs must be paid by the due date.

47. Whilst it is accepted that a business has other expenses, VAT must be given priority. As a VAT registered company the appellant charged VAT to their customers and are required by law to pay this with the appropriate return by the due date. In the case of *Salevon Nolan LJ* said:

“... 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 trader receiving (or at least being entitled to receive) from his customers the amount of tax which he must subsequently pay over to the commissioners. There is nothing in law to prevent him from mixing this 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 it 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.”

48. HMRC also refer to the comments of Scott LJ:

“Insufficiency of funds cannot per se constitute a reasonable excuse. The reason for the insufficiency may do so but the reason must, in my judgment, amount to something more than that the business of the taxpayer has been carried on unprofitably or that conditions of trade produce cash flow problems.”

49. In order to accommodate the varying needs of traders HMRC provide different schemes for the accounting of VAT.

50. The Cash Accounting scheme allows a trader to account for VAT on the basis of payments received and made, rather than tax invoices issued and received. It is particularly beneficial if a trader gives their customers lengthy periods of credit or if a trader has a high level of bad debts. It may have been prudent for the appellant to consider accounting for their VAT using this scheme, given the cash flow issues.

51. 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.

52. 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.

53. 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.
- 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:
 - (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'

54. 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.

Conclusion

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

56. 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.

57. The burden of proof is on the appellant to show that he has a reasonable excuse for the late payment of VAT for the default periods.

58. Given the details provided by the appellant regarding the cash flow issues in period 02/13, any impact on his business's cash flow might be expected to have

occurred prior to the default periods 05/14 and 08/14. The bad debt with Right Angle occurred in early 2013.

59. The appellant appears to have been consistently late in paying his VAT. In evidence the appellant was very vague regarding the impact on his business of the £135,000 bad debt he suffered. Also he did not appear to know whether he had claimed VAT bad debt relief on the £135,000.

60. He would also have been aware that he could have applied for Time to Pay. Whilst he had defaulted on previous Time to Pay arrangements, he could nonetheless, given the significant bad debt he had suffered, applied to HMRC again.

61. Section 71(1)(a) of the VAT Act 1994 specifically excludes insufficiency of funds from being a reasonable excuse for the late payment of VAT. The delay in payment by customers does not seem to go beyond normal hazards of business and as such HMRC contend that this is not a reasonable excuse for the purposes of VAT Act 1994 s 59(7).

62. The Tribunal sympathises with the appellant, particularly with regard to the substantial bad debt which undoubtedly affected his business and its cash flow. However, he has not produced any evidence in the form of bank statements or copy business accounts to verify how the cash flow difficulties impacted on his ability to pay VAT which fell due for payment in May and August 2014, some twelve months or more after the bad debt with Right Angle Limited, arose.

63. Although the Tribunal accepts, as evidenced by correspondence from the appellant's solicitors, that there were inordinate delays in pursuing the debt owed by Right Angle and seemingly no defence to the appellant's claim, nonetheless he should have provided for the possibility that either the claim would not succeed or ultimately would fail for other reasons such as the eventual liquidation of the debtor.

64. The VAT on invoices that went unpaid could have been claimed at the time as a bad debt. The Tribunal accepts that the appellant lost a significant amount when Right Angle Limited went into liquidation in August 2014, but the VAT that was paid late arose in May and August 2014 on other contracts. The invoices which generated that VAT must, without evidence to contrary, have been paid and was due to HMRC. Whilst it may have temporarily formed part of the appellant's working capital, it belonged to the Crown and the appellant should have put appropriate safeguards in place to ensure that he could comply with his VAT payment obligations and pay over the VAT as and when due.

65. Furthermore HMRC previously cancelled surcharges that had been imposed for period 05/13 when the impact of the bad debt was clearly relevant. The due dates under appeal are more than a year after that.

66. The appellant has not explained why £10,390.67 of the 08/14 period is still outstanding.

67. The appellant has not provided any information to show that any insufficiency of funds was unforeseeable, out of his control and outside the normal hazards of trade. He has failed to discharge that burden.

68. The appellant says that the surcharge is unfair. For the reasons submitted by HMRC and set out above, this is not a ground of appeal which can be considered by the Tribunal.

69. The appeal is accordingly dismissed and the surcharges of £9,601.04 and £2,187.13 are confirmed.

70. 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: 11 APRIL 2019