



TC03631

Appeal number: TC/2014/00456

VAT default surcharge – insufficiency of funds - CIS refund due from HMRC to Appellant - whether reasonable excuse - no - whether penalty disproportionate - no - Appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

C G STEEL STRUCTURES LIMITED

Appellant

- and -

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

**TRIBUNAL: JUDGE MICHAEL S CONNELL
 MS ELIZABETH BRIDGE**

Sitting in public at Ministry of Justice Tribunals Service, Priory Courts, Bull Street, Birmingham on 27 March 2014

Gareth Munslow, accountant for the Appellant

Ms Catherine Douglas, Officer of HM Revenue and Customs, for the Respondents

DECISION

The Appeal

5 1. C G Steel Structures Limited (“the Appellant”) appeals against a default surcharge of £963.15, for its failure to submit in respect of its VAT period ended 30 April 2013 (04/13 period), by the due date, payment of the VAT due. The surcharge was calculated at 15% of the VAT due of £6421.01.

10 2. The Appellant also appeals against a default surcharge of £1,659.27, for its failure to submit in respect of its VAT period ended 30 July 2013 (07/13 period), by the due date, payment of the VAT due. The surcharge was calculated at 15% of the VAT due of £11,061.86.

3. The Appellant’s appeal against both surcharges was submitted to the Tribunal on 16 January 2014.

15 4. The point at issue is whether or not the Appellant has a reasonable excuse for making late payments

Background

5. Prior to the defaults under appeal the Appellant had previously defaulted on VAT payments in period 04/12, when a VAT surcharge liability notice was issued, and again in periods 07/12, 10/12, and 01/13.

20 6. The Appellant paid VAT on a quarterly basis. Section 59 of the VAT Act 1994 requires a VAT return and payment of VAT due, on or before the end of the month following the relevant calendar quarter. [Reg 25(1) and Reg 40(1) VAT Regulations 1995].

25 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 filing and payment. The due date for the 04/13 period if payment was made electronically was 7 June 2013. Payment was made by the Faster Payment System on 9 September 2013

30 8. The due date for the 07/13 period, if payment was made electronically, was 7 September 2013. Payment was made by the Faster Payment System on 9 September 2013, two days late.

35 9. Section 59 Value Added Tax Act 1994 (“VATA”) sets out the provisions in relation to the default surcharge regime. Under s 59(1) a taxable person is regarded as being in default if he fails to make his return for a VAT quarterly period by the due date or if he makes his return by that due date but does not pay by that due date the amount of VAT shown on the return. The Commissioners may then serve a surcharge liability notice on the defaulting taxable person, which brings him within the default surcharge regime so that any subsequent defaults within a specified period result in

assessment to default surcharges at the prescribed percentage rates. The specified percentage rates are determined by reference to the number of periods in respect of which the taxable person is in default during the surcharge liability period. In relation to the first default the specified percentage is 2%. The percentage ascends to 5%, 10% and 15% for the second, third and fourth default.

10. A taxable person who is otherwise liable to a default surcharge may nevertheless escape that liability if he can establish that he has a reasonable excuse for the late payment which gave rise to the default surcharge(s). Section 59 (7) VATA 1994 sets out the relevant provisions : -

10 ‘(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 –

15 (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

20 (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 ..’

11. It is s 59(7)(b) on which the Appellant seeks to rely. The burden falls on the Appellant to establish that it has a reasonable excuse for the late payment in question.

25 12. Section 59(7) must be applied subject to the limitation contained in s 71(1) VATA 1994 which provides as follows : -

 ‘(1) For the purposes of any provision of section 59 which refers to a reasonable excuse for any conduct -

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

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

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

Appellant’s Case

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

16. The Appellant's stated grounds of appeal in its Notice of Appeal to the Tribunal is that an insufficiency of funds was created by circumstances outside its control. The Appellant says that the shortage of funds significantly impacted upon its ability to discharge VAT on time.

5 17. The Appellant says that HMRC owed the Appellant £23,731.26 in overpaid CIS tax and had this been repaid to the Appellant on time, which is by 19 May 2013, it would have been able to discharge its VAT on time. The Appellant says that it filed its CIS return and requested repayment of the amount due on 16 April 2013. It argues that the principle of 'set off' should apply. The Appellant received repayment of its
10 overpaid tax on 28 August 2012 and then paid its VAT liability in full immediately.

18. At the hearing Mr Munslow, for the Appellant, said that the surcharges were unfair. The Appellant is a small owner managed business company. Many of the Appellant's customers were taking longer than the usual sixty days to settle their accounts. In late 2011 the Appellant had suffered a £37,000 bad debt which had
15 caused it to enter the VAT default surcharge regime. The financial situation was made worse because CIS repayments due to the Appellant on 19 May 2012 were not repaid by HMRC until December 2012. This had contributed to the severe cash flow shortage throughout 2012 which lead to the earlier defaults in 04/12, 07/12, and 10/12.

20 HMRC's case

19. At the hearing Ms Douglas for HMRC said that VAT had been paid three months late in respect of the 04/13 period. The VAT was due no later than 7 June 2013 and was not paid until 9 September 2013. The VAT due for period 07/13 was due no later than 7 September 2013 but was not paid until 9 September 2013. Although the latter
25 default was only two days late, the Appellant's bank statements show that it had the funds to pay the VAT having received the HMRC CIS repayment on 28 August 2013.

20. Ms Douglas said that although the Appellant states the agent sent the Employers Annual (CIS) Return to HMRC on 16 April 2013, a request for set off of the repayment was not received until 26 June 2013. This is after the due date of 7 June
30 2013 for the period 04/13. In respect of the 07/13 default, the Appellant has not offered a reason for the delay between receiving the repayment on 28 August 2013 and paying the VAT due on 9 September 2013.

21. Ms. Douglas said that although the Appellant was suffering cash flow difficulties, this is not something which was attributable to anything other than the normal hazards
35 of trading. It is specifically stated in s 71(1) VATA 1994 that any insufficiency of funds to pay any VAT is not reasonable excuse. The Appellant has produced no evidence to substantiate its assertion that it was suffering an insufficiency of funds due to unforeseen circumstances beyond its control.

22. HMRC contend that a company acting in a reasonable and competent manner
40 would have ensured the CIS repayment claim had been agreed prior to depending on the claim for payment of a VAT debt and that by failing to do so the company were

acting unreasonably. It should be remembered that VAT is never the property of the company, the money belongs to the Crown at all times and must be paid over as the law requires.

5 23. HMRC say that the potential financial consequences attached to the risk of further defaults would have been known to the Appellant after issue of the Surcharge Liability Notice for period 12/10, and a Surcharge Liability Extension Notice in period 03/11, particularly given the information contained in the Notice which on the reverse states:

10 ‘Please remember your VAT returns and any tax due must reach HMRC by the due date. If you expect to have any difficulties contact either your local VAT office, listed under HM Revenue & Customs in the phone book as soon as possible, or the National Advice Service on 0845 010 9000.’

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

- 15 • In notice 700 "the VAT guide" paragraph 21.3.1 which is issued to every trader upon registration.
- On the actual website www.hmrc.gov.uk
 - On the E-VAT return acknowledgement.

20 25. Also the reverse of each default notice details how surcharges are calculated and the percentages used in determining any financial surcharge in accordance with the VAT Act 1994 s 59(5).

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

25 27. Insofar as the Appellant argues that the surcharge is entirely unfair, in particular with regard to the second default which was just two days late, the case of *Total Technology (Engineering) Limited v HMRC* heard in the Upper Tribunal held that:

- (1) There is nothing in the architecture of the Default Surcharge system which makes it fatally flawed.
- (2) In order to determine whether or not a penalty is disproportionate, the Upper Tier Tribunal addressed the following factors:
- 30 (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’

5 - and decided that none of these leads to the conclusion that the Default Surcharge regime infringes the principle of proportionality or fairness. The penalty was therefore not excessive unfair or disproportionate. The penalty is tax geared and levied on the amount of VAT paid late at a percentage applicable to and commensurate with the number of defaults.

Conclusion

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

10 29. The Appellant's main ground of appeal is that it suffered cash flow shortages caused by constraints on its cash flow as result of both trading conditions and the fact that a CIS refund due to the company had not been made by HMRC.

15 30. In *Customs & Excise Commissioners –v- Steptoe [1992] STC 757* the taxpayer argued that although the proximate cause of his default was insufficiency of funds, the underlying cause of that insufficiency, namely the unexpected failure by a major customer to pay him on time, amounted to a reasonable excuse. The Court determined on a majority that the statutory exclusion of insufficiency of funds as an excuse did not preclude consideration of the underlying cause of insufficiency and that a trader might have a reasonable excuse if it were caused by an unforeseeable or inescapable event or when, despite the exercise of reasonable forethought and due diligence, it could not have been avoided. The Court nevertheless made it clear that the test had to be applied strictly.

25 31. To decide whether a reasonable excuse exists where insufficiency of funds causes the failure, the Tribunal must take for comparison a person in a similar situation to that of the actual taxpayer who is relying on the reasonable excuse defence. The Tribunal should then ask itself, with that comparable person in mind, whether notwithstanding that person's exercise of reasonable foresight, due diligence and a proper regard for the fact that the tax would become payable on the particular dates, those factors would not have avoided the insufficiency of funds which led to the failures.

30 32. Having considered the Appellant Company's circumstances and the background facts and circumstances leading up to the defaults the Tribunal finds that the underlying and primary cause of the default was a cash flow shortage caused by trading conditions and the fact that a CIS refund was due to the Appellant. However, as HMRC argue, no evidence of a written request for set off prior to the Vat falling due has been provided. Set off cannot be applied unilaterally by a taxpayer in such
35 circumstances. A request for repayment was made by the Appellant's accountants in June 2013 but this was after the first default. A prudent tax person in similar circumstances would have written to HMRC in advance to explain the position and ask for time to pay. The second default was entirely avoidable. The Appellant had the
40 funds to pay on time but did not do so.

33. The burden of proof is on the Appellant to show that the underlying cause of its failure to meet its VAT payment obligations was due to unforeseen circumstances or events beyond its control. In the Tribunal's view, for the reasons given above, that burden has not been discharged and there was no reasonable excuse for the Appellant's late payment of VAT for the 04/13 and 07/13 periods.

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

35. 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.

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MICHAEL S CONNELL

TRIBUNAL JUDGE

RELEASE DATE: 21 May 2014

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