[2018] UKFTT 9 (TC)

TC06288

Appeal number: TC/2016/05075

VALUE ADDED TAX – default surcharge – Late payment of VAT – said to be due to failure by HMRC to make CIS repayment in time – whether reasonable excuse – no – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

NSF UTILITIES LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE MALCOLM GAMMIE CBE QC
NIGEL COLLARD

Sitting in public at Colchester County Court, Colchester on 9 May 2017

The Appellant did not attend and was not represented

Ms Fatouma Yusuf, an Officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal by NSF Utilities Limited ("the Appellant") against a decision on review of 1 July 2016 to impose a default surcharge of £1,192.86 for late payment of VAT in respect of quarter 11/15, ending 30 November 2015.

2. Neither the Appellant nor any representative of the Appellant was present at the time set for the commencement of the hearing of the appeal. The file showed that notification of the appeal hearing had been sent by post to the Appellant. Having allowed additional time, the Chairman telephoned the Appellant's notified representative, Mr Richard Hexton. Mr Hexton informed the Chairman that he had no instructions to attend the hearing. He confirmed that he had advised the Appellant of the date, time and place of the hearing and that it would be the Appellant who attended, if at all. In the circumstances the Tribunal concluded that it should proceed with the hearing in the Appellant's absence as permitted by Rule 33 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 ("the Rules"). (The Appellant's attention is drawn to paragraph 33 below.)

3. The Tribunal had before it a bundle of papers prepared by the Respondents, together with those submitted by the Appellant. The Respondents were represented by Ms Yusuf. She did not call any witnesses.

The Facts

4. The facts are as follows:

(1) The Appellant was first registered for VAT on 22 September 2014. Its business is described as "construction for long distance and urban pipelines".

(2) The record shows that the Appellant's first default occurred in the period 05/15. The return was received in time and showed VAT due of £28,420.90 on turnover of £152,925. The value of purchases and all other inputs were stated to be £14,322. This was due to be collected by direct debit on 10 July 2015 but the direct debit was not met. Payment was eventually made in six instalments commencing on 20 July 2015 through on-line payment using a debit/credit card via an external website ("Bill Pay"), with the final instalment being made on 18 September 2015 by telephone using a debit or credit card ("TPS"). The Respondents' records show that the Appellant was contacted by telephone on two occasions to discuss the outstanding VAT debt, as part of which the Appellant was informed of the default surcharge regime. The reason given for late payment is recorded as outstanding invoices.

(3) The Appellant was also in default in the period 08/15. The return was again filed in time and showed VAT due of £15,078.70 on turnover of £133,219. The value of purchases and all other inputs were stated to be £59,767. A direct debit for that amount was not met on 12 October 2015. The

Appellant was again contacted by telephone. The Appellant indicated that a refund of tax deducted under the Construction Industry Scheme ("CIS") for 2014/15 was anticipated and that the VAT would be paid once the refund had been received. A surcharge notice was issued at the 2 per cent rate but we were told that the surcharge due was not collected as the amount was under £400. In the event the outstanding VAT was paid on 8 January 2016 by Bill Pay.

(4) For the period 11/15, the return was filed in time and showed VAT due of £23,857.31 on turnover of £151,715. The value of purchases and all other inputs were stated to be £33,848. The direct debit again failed to be met. The Appellant was contacted by telephone and again indicated that the problem was a dispute over the CIS refund for 2014/15. A surcharge notice at the 5 per cent rate was issued on 15 January 2016 in the amount of £1,192.86. The outstanding VAT was paid on 5 February 2016 by Bill Pay.

(5) On 13 May 2016 Mr Hexton wrote on behalf of the Appellant appealing the surcharge for 11/15. The reason given for failure to pay in time was that, "This was due to receiving late payment from HMRC of CIS suffered for the year ending 2014/15 which was not received until March 2016 and in turn had severe negative consequences on the client's cash flow as the sum due was in excess of £18,000. The refund was expected before this date."

(6) On 1 July 2016 wrote to the Appellant indicating that they had reviewed the Appellant's case and had decided not to cancel the default surcharge. The letter noted that no time to pay request had been agreed before the due date for payment and the Respondents did not regard the reason given by Mr Hexton on 13 May 2016 as constituting a reasonable excuse. The letter stated that it was neither an unexpected nor an unusual event that was unforeseeable or beyond the Appellant's control. In particular, the Respondents were of the view that the Appellant should not withhold payment of VAT when anticipating a refund under the Construction Industry Scheme that would be sent to it in due course.

(7) The review letter invited the Appellant to submit any additional information that might affect the Respondents' decision no later than 22 July 2016. It drew the Appellant's attention to its right to appeal to this Tribunal within 30 days of the date of the review letter.

(8) An appeal was lodged with the Tribunal on 19 September 2016. This was late but the Respondents made no objection to our hearing the Appellant's appeal and we agreed to extend time accordingly. The grounds of appeal were that the default was caused by the cash flow problems due in the main to the late repayment of CIS tax suffered. According to the grounds, numerous letters had been sent to HMRC seeking repayment of CIS tax suffered for 2014/15. The letters were said only to have been acknowledged on 29 February 2016 and payment was finally received on 16 March 2016 in the amount of £18,533.77.

(9) Pursuant to the Tribunal's directions, each party had served a list of the documents on which they sought to rely. In the Appellant's case, in addition to correspondence with HMRC and the appeal documents, this included the following material:

(a) an Employer Payment Summary dated 18 May 2015 showing CIS deductions suffered for the tax month April 2015 of £13,730.29 and for the year of £62,936.84;

(b) A single page bank statement starting with entries dated 5 February and ending with entries dated 9 February 2016, showing the payment on 8 February of £23,857.31 VAT;

(c) A single page bank statement starting with entries dated 15 February and ending with entries dated 17 February 2016, showing a deposit of £18,533.77 on 16 March 2016 identified in manuscript as the CIS Tax refund by HMRC.

Mr Hexton had confirmed to the Tribunal prior to the hearing date that there were no further documents on which the Appellant wished to rely. In particular, none of the 'numerous letters' relating to the CIS repayment were produced (see (8) above).

(10) We note from the first single page of bank account entries that on 5 February 2016 the account was overdrawn to the extent of £30,680.01 but that that overdraft was cleared by the end of the day by a direct credit from a third party of £15,232.75 and two internet banking transfers of £19,000 and £22,000, one from an account at the same branch and another from an account with the same bank (but a different branch), leaving the account in credit at the end of the day in the amount of £25,552.74. This provided the basis for the payment of VAT on 8 February 2016. Total payments on 8 February 2016 left the account in credit to the extent of £117.34, to which was added an internet banking transfer of £500 from the same account as the £22,000 credit on 5 February 2016.

(11) We note from the second single page of bank account entries that on 15 March 2016 there was an internet banking transfer of £247.54 to the account from which the £19,000 credit on 5 February 2015 had been derived. Following the deposit on 16 March 2016, various payments (mainly wages) were made on 17 March 2016, leaving the account in credit in the amount of £6,735.88, which was immediately supplemented by a transfer of £12,000 from the same account at the same branch as the £22,000 on 5 February 2016. This left a credit balance of £18,735.88 on the account, which may reflect that the deposit on 16 March would not at that stage have represented cleared funds against which the Appellant could draw, so requiring the transfer of sufficient funds from the other account at the same branch to cover the payments made on 17 March 2016.

(12) The second single page of bank account entries also indicates that the Appellant was paying wages to some 13 individuals, totalling £11,670 on 17 March 2016. These amounts would not be reflected in the Appellant's VAT returns. It seems, given the transfers made, that the Appellant may not have had an overdraft facility for the account in question but, in any event, was able to maintain the account in sufficient credit by appropriate transfers from other accounts at the same branch or with the same bank.

The Law

5. The VAT default surcharge regime is provided for by section 59 of the Value Added Tax Act 1994 ("VATA"). Under section 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 Respondents may then serve a surcharge liability notice on the defaulting taxpayer, which brings him within the default surcharge regime so that any subsequent defaults within a specified period result in an assessment to a default surcharge at the prescribed percentage rate.

6. A taxpayer who is otherwise liable to a default surcharge may nevertheless escape liability if he can establish that he has a reasonable excuse for the return or the VAT not having been despatched in time (section 59(7) VATA). While HMRC must show that there has been a default giving rise to the surcharge assessed, the burden falls on the taxpayer to establish that it has a reasonable excuse.

7. Section 71(1)(a) VATA, however, provides that an insufficiency of funds to pay any VAT due is not a reasonable excuse for the purposes of section 59. The difficulty that a taxpayer faces in this regard was expressed by Lord Justice Nolan in *Commissioners of Customs and Excise v Salevon* [1989] STC 907 when he said at 911:

> "… 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 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."

8. Nevertheless, as this indicates, the taxpayer's task in this respect is not insurmountable: the underlying cause of the insufficiency of funds may itself provide a reasonable excuse. This appears from the decision of the Court of Appeal in *Customs and Excise Commissioners v Steptoe* [1992] STC 757.

9. The relevant facts of *Steptoe* appear in the decision of Lord Justice Scott. Mr Steptoe was an electrical contractor who did 95 per cent of his work for the London Borough of Redbridge. The Redbridge Council was virtually his only customer and was an extremely slow payer. He was late in paying VAT in several quarters starting with that ending in November 1986 and continuing up to the end of November 1988.

The VAT Tribunal concluded that the conduct of the Council was such that Mr Steptoe had a reasonable excuse for three of the four default surcharges that had been imposed but not the fourth because by the time that was incurred the Council had mended its ways and he could not rely on the excuse that in the fourth period his accountants were responsible for the delay.

10. Scott LJ nevertheless concluded that Mr Steptoe did not have a reasonable excuse because late payment was not an unforeseeable event in the conduct by the taxpayer of his business, such that the taxpayer should have made arrangements to secure his cash flow. If his profit margins were so slim or his financial circumstances such that was unable to secure his cash flow, he was nevertheless caught by what is now section 71(1)(a): "*The reason for the insufficiency of funds is, in such a case, itself an insufficiency of funds.*"

11. Lord Justice Scott was, however, in a minority. The Master of the Rolls, Lord Donaldson, and Lord Justice Nolan upheld the Tribunal's decision, which had concluded in favour of Mr Steptoe. In doing so Lord Donaldson summarised the different approaches of Scott and Nolan LJJ in these terms ([1992] STC 757 at 770):

> "The difficulty which then arises is that Parliament has not specified what underlying causes of an insufficiency of funds which lead to a default are to be regarded as reasonable or as not being reasonable. … Nolan LJ, as I read his judgment explaining and expanding on his judgment in *Customs and Excise Comrs v Salevon Ltd* [1989] STC 907, is saying 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 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.
>
> Scott LJ on the other hand is of the opinion that the underlying cause of the insufficiency of funds must be an 'unforeseeable or inescapable event'. I have come to the conclusion that this is too narrow in that (a) it gives insufficient weight to the concept of reasonableness and (b) it treats foreseeability as relevant in its own right, whereas I think that 'foreseeability' or as I would say 'reasonable foreseeability' is only relevant in the context of whether the cash flow problem was 'inescapable' or, as I would say, 'reasonably avoidable'. It is more difficult to escape from the unforeseeable than from the foreseeable."

HMRC's submissions

12. Ms Yusuf noted that the Appellant had accepted in its grounds of appeal that payment of VAT had been received after the due date. She therefore submitted that the only remedy available to the Appellant was to demonstrate that it had a reasonable excuse for the late payment. In this respect, the only reason that the Appellant had offered for its late payment was cash flow. She submitted that this was excluded as a

reasonable excuse by section 71(1)(a) VATA, unless the Appellant could show that the lack of funds arose from a specific, unforeseen event.

13. While the Respondents were prepared to take at face value the Appellant's claim that it had cash flow problems, they did not accept that these arose from any circumstance that provided a reasonable excuse. Reliance on CIS repayments to pay VAT amounts due could not be considered an unforeseen exceptional circumstance that could provide a reasonable excuse for late payment of VAT. The Appellant had not requested any set off of the CIS repayment against its VAT liabilities.

14. Ms Yusuf noted that the Appellant had first referred to the CIS repayment during a telephone conversation on 10 November 2015 when the Respondents were pursuing the outstanding payment for 08/15. This was nearly two months prior to the due date of payment for the period 11/15 and she submitted that it would be reasonable for the Appellant to have sought alternative sources of finance or to have made alternative arrangements to ensure that it could meet its VAT obligations as they fell due.

15. She noted that the issue of excess CIS credit occurs when a company does not have gross payment status and any CIS credits cannot be repaid until:

(1) The tax year in which the deductions were made has ended, and

(2) The Final Payment Summary (FPS) for the year has been submitted (in the case of a Real Time Information (RTI) year) or an annual return made on Form P35 (for a non-RTI year); and

(3) All amounts due to HMRC for the tax year in the trader's capacity as an employer/contractor have been paid.

16. Section 62(3) Finance Act 2004 states that CIS deductions are first to be treated as paid on account of any 'relevant liabilities' of the company. 'Relevant liabilities' in this context means the company's obligations to pay any PAYE, NICs, CIS deductions or student loan liabilities. Any excess CIS deductions determined at the end of the tax year when the company has submitted its annual return can be set against corporation tax or repaid to the company.

17. Repayment or set-off claims can only be dealt with when the Respondents have reconciled the company's CIS credits. If the Respondents cannot agree the company's whole claim they will ask for documents and supporting evidence of receipt. The Respondents can consider a part repayment set off for the deductions they can agree. Where there is a mis-match, the Respondents will need to take up the discrepancy with the company or company agent.

18. Ms Yusuf said that the Respondents do not advise relying on one payment to pay the VAT due. The Appellant had stated that it had a repayment due but they should still have received the VAT due for the period 11/15 and have had this available at the due date to pay the VAT. The Respondents accepted that a business would have other expenses and that a business was free to use the VAT collected in the business, but that did not free the business from its obligation to pay the VAT on

the due date. In this respect, she relied in particular on *CG Steel Structures v HMRC* (TC03631) [2014] UKFTT 504 (TC).

19. She said that the fact that the Appellant is subject to CIS deductions, which must be verified at the end of a tax year before any CIS overpayment can be agreed, did not go beyond the normal hazards of business. Accordingly, the Respondents did not consider that it could form the basis of a reasonable excuse in the Appellant's case. Furthermore, any company acting in a reasonable and competent manner would have ensured that the claim had been agreed with the Respondents before depending upon it for payment of a VAT debt falling due.

20. Finally, she noted that the Appellant's grounds of appeal asserted that the outstanding VAT had been paid as soon as the CIS tax had been repaid. However, the Appellant had in fact cleared the VAT debt on 8 February 2016 with the transfers made on 5 February, whereas the CIS tax repayment was only credited to the Appellant's account on 16 March 2016. This suggested that the delay in receiving the CIS repayment was not the sole reason for the delay in paying the VAT due.

Our Decision

21. It is not disputed that VAT for the period 11/15 was paid late. This is apparent from the Appellant's own documents. The Appellant has also not disputed the two previous defaults for 05/15 and 08/15, which again are evidenced by the Respondents' records. It is also not in dispute that, as matters transpired, the Appellant was entitled to a repayment of CIS tax. As Ms Yusuf noted, however, the Appellant's documents also show that it was able to clear the VAT debt before it received the CIS repayment.

22. This does not necessarily mean that the Appellant's failure to pay VAT in time for the period 11/15, or indeed for the previous period 08/15, was wholly unrelated to its 'overpayment' of CIS tax and its entitlement, ultimately, to be repaid an amount of CIS tax. No doubt, a taxpayer who believes that it is due a repayment of tax from the Respondents on one account, may think it galling that the Respondents can insist on payment of tax on another account by a particular date, and impose a penalty for the taxpayer's failure to do so, when the Respondents face no equivalent sanction for an apparent delay in making repayment. Nevertheless, this alone is plainly not enough to entitle the taxpayer to delay payment of VAT or to attempt to set off one amount against the other.

23. HMRC in their review letter and subsequently in their Statement of Case and submissions put forward the Respondents' standard formulation that to constitute a reasonable excuse the cause of the insufficiency of funds must be due to 'an unexpected or unusual event that is either unforeseeable or beyond the taxpayer's control'. This formulation has previously been criticised as not fully recognising the majority's decision in *Steptoe* (see *Barrett v HMRC* [2015] UKFTT 329 (TC) per Judge Berner at §153 and, more recently, *DM Specialist Joinery Ltd v HMRC* [2017] UKFTT 413 (TC) per Judge Poon at §87).

24. In *CG Steel Structures Ltd v HMRC* (TC03631) [2014] UKFTT 504 (TC), the company argued that many of its customers were taking longer than the usual 60 days to settle their accounts and that the company had also suffered a £37,000 bad debt which had caused it to enter the default surcharge regime. It said that its financial situation was made worse because CIS repayments due on 19 May 2012 were not repaid by the Respondents until December 2012, which had contributed to a severe cash flow shortage throughout 2012 and contributed to earlier defaults (see §18).

25. The appeal in that case was against surcharges imposed for late payment in the periods 04/13 and 07/13 and it appears that in 2013 the company had filed its CIS return and claimed to have requested repayment on 16 April 2013. The amount in question was £23,731.26 and the company said that repayment should have been made on 19 May 2013. It suggested that the repayment should be set off against its VAT liability but a request to do so was only made on 26 June 2013 (after the due date for 04/13) and it received repayment on 28 August 2013 (shortly before the due date for 07/13) (see §20).

26. From this brief summary, it is clear that the Respondents' 'failure' to repay CIS tax earlier than they did was not the sole basis upon which the company sought to excuse its late payment. As the Tribunal noted, it was both trading conditions and the absence of a CIS refund (see §29). The Tribunal then referred to the decision in *Steptoe*, to conclude at §31 that:

> "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 kind, 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."

27. This reflects the test adopted by the majority in *Steptoe* and recognises that something may be foreseeable but, tested objectively, may not be reasonably avoidable. In *CG Steel Structures*, the Tribunal concluded that the combination of trading conditions and the delay in the CIS refund was the underlying and primary cause of the cash flow shortage leading to the default but nevertheless concluded that there was no evidence of a written request for set off prior to the VAT for 04/13 falling due. In the Tribunal's view, a prudent taxpayer in similar circumstances would have written to the Respondents in advance to explain the position and asked for time to pay. The Tribunal accordingly dismissed the company's appeal.

28. The Appellant in this case has not relied on trading conditions. Its grounds of appeal say that the late payment was due "in the main by late repayment of CIS suffered" but the grounds also state that "the only reason for late payment of VAT was due to CASHFLOW problems caused by the late recovery of CIS money". There is no suggestion in any of the Appellant's documents or any of the other material before us of any other cause for the period 11/15. In relation to the default in the

period 08/15, the Respondents' officer who telephoned the Appellant records that he was told that the Appellant was awaiting a CIS repayment of £13,500 and that the Appellant's accountant had said that the Appellant "would get it last week, now it is this week" and that the accountant had "been chasing the repayment for about 3 months". The Appellant had evidently suggested to its accountant that the CIS overpayment be set off against VAT but the accountant had said this would take even longer. The Appellant evidently told the Respondents' officer that as soon as it received the CIS repayment the VAT would be paid. The officer then recorded for 08/15 that, "I said I would review in 2 weeks in the hope of repayment received & VAT paid".

29. This telephone conversation (initiated by the Respondents' officer) does not amount to a request by the Appellant for set off nor does the officer's record of the conversation represent any agreement by the Respondents to do so. In any event, the VAT for 08/15 was in fact paid some 2 months before the CIS repayment was made and, as previously noted, the VAT for the period under appeal, 11/15, was also paid before any repayment was made.

30. Plainly the Appellant was conducting its business in an environment in which it knew that CIS tax had to be accounted for (and might be overpaid) and, at the same time, that it was accruing VAT liabilities on its turnover that would have to be paid on known dates at the end of the relevant VAT quarter. It appears from a later telephone record that by the 11/15 period, the Appellant knew that there was some dispute about the CIS repayment or, at least, that it was taking time for its accountant to sort out. As the Appellant has produced no correspondence regarding this we have no information to assess further this aspect of the matter. More to the point, the Appellant has provided no evidence to indicate what steps it took to deal with the further possible delay in repayment given the known liability to account for the VAT due.

31. We have set out above as much as we can glean from the documents as to the Appellant's financial position. From the limited information that we have about its financial position and the conduct of its financial affairs, as appears from the bank statements it has produced, it seems to have been in a position to maintain a positive balance on its account. The Appellant has, however, offered no evidence to suggest that it took any steps to arrange further sources of finance or otherwise to seek to avoid the situation that it says arose and could plainly be foreseen by 11/15, namely that it was unable to pay its VAT by the due date in the absence of the CIS repayment.

32. As the Tribunal concluded in *CS Steel Structures*, a prudent taxpayer would have sought to take some steps to guard against the possibility that the VAT fell due before the repayment was received (which in fact the Appellant was able to do, albeit late) but we have no evidence that the Appellant did anything. In the circumstances, we conclude that the Appellant had no reasonable excuse for its default. We therefore dismiss its appeal.

33. Under Rule 38 of the Tribunal Rules, the Tribunal may set aside a decision which disposes of proceedings and remake the decision if the Tribunal considers it in

the interests of justice to do so and one of more of the conditions in paragraph (2) is satisfied. Those conditions include a case in which the party or a party's representative was not present at a hearing related to the proceedings. A party who wishes to apply for a decision to be set aside must apply in writing to the Tribunal so that the application is received no later than 28 days after the date on which the Tribunal sends notice of the decision to the party.

34. 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 for permission to appeal 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.

MALCOLM GAMMIE
TRIBUNAL JUDGE

RELEASE DATE: 4 JANUARY 2018