TC01279

Appeal number TC/2011/01629

VALUE ADDED TAX – late payment of VAT – default surcharges appealed against – insufficiency of funds – whether the cause of the insufficiency amounted to a reasonable excuse within section 59)7)(b) VATA and having regard to section 71(1)(a) VATA* – Customs and Excise Commissioners v Steptoe [1992] STC 757 *considered and applied – the cause was cash flow difficulties resulting from a combination of defaulting debtors and the reluctance of the Appellant's bank to extend further borrowing facilities – held a reasonable excuse had been made out – appeal allowed

FIRST-TIER TRIBUNAL

TAX

JMS AGGREGATE SUPPLIES **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS (Value Added Tax) **Respondents**

TRIBUNAL: JOHN WALTERS QC
MRS. NORAH CLARKE

Sitting in public at Ty Nant, Swansea on 7 June 2011

Mrs. S. Morgan, Partner, for the Appellant

Mrs. Karen Evans, Officer of HMRC, for the Respondents

DECISION

1. JMS Aggregate Supplies ("the Appellant"), a partnership, appeals against 9 default surcharges in relation to late payment of VAT. The details, taken from a Schedule of Defaults prepared by the Respondents ("HMRC") are as follows:

Period	Due Date	Date Return Received	Date Payment Received
06/08	31-7-2008	11-8-2008	11-8-2008
09/08	31-10-2008	18-11-2008	18-11-2008
12/08	31-1-2009	10-2-2009	10-2-2009
03/09	30-4-2009	22-5-2009	22-5-2009
06/09	31-7-2009	2-9-2009	2-9-2009
09/09	31-10-2009	2-12-2009	2-12-2009
12/09	31-1-2010	2-3-2010	2-3-2010
03/10	30-4-2010	18-5-2010	18-5-2010
06/10	7-8-2010	15-3-2011	11-9-2010

2. It was not suggested that payment was not in full on any occasion, and from the above table it can be seen that the delay in payment being received varied from 10 days (in respect of period 12/08) to 42 days (in respect of period 06/10). The surcharges were all at the rate of 15%, and amounted to £6,904.77 in total. There had, in order to reach the 15% rate of surcharge, been periods before 06/08 when the Appellant had been in default. In relation to at least two of these periods (06/06 and 09/07) HMRC have recognised that the Appellant had a reasonable excuse for the default (a postal strike in re: 09/07). HMRC have also recognised that the Appellant had a reasonable excuse for the default relative to the period 09/10 (illness and computer crashes).

3. The return for the period 06/10 appears to have been the only one of the returns in issue which was submitted electronically. All the others, according to the file of papers before us, were submitted in paper form and all the paper returns appear to have been completed on or before their respective due dates.

4. We received oral evidence from Mrs. Sandra Morgan, the partner in the Appellant who submitted the Notice of Appeal and signed all the paper returns in evidence. We also had before us a bundle of documents including sample bank statements, correspondence with non-paying trade debtors, correspondence with solicitors regarding debt recovery and court papers relating to debt recovery proceedings brought by the Appellant. We also had before us the Appellant's (unaudited) financial statements for the year ended 31 March 2009.

5. The Appellant's Balance Sheet as at 31 March 2009 shows long-terms loan liabilities of £364,057 (including a commercial mortgage of £277,972) together with an overdraft at Barclays Bank of £75,295. The accounts also show a very low level of drawings from the business in the year ended 31 March 2009, £9,120 in Mrs. Morgan's case and £60 in the case of Mr. J.W. Morgan, which was more than offset by £1,364 capital introduced by him in that year.

6. The Appellant's evidence (which we accept) was that its business and cash flow had suffered by reason of several customers defaulting on their debts due to the Appellant. In a letter dated 8 April 2009, Mrs. Morgan informed HMRC that the Appellant's tenant owed it £18,000. The Appellant has been faced with the necessity of paying its suppliers while suffering customer defaults. Nine employees had also been retained, although on reduced hours, and the wages charge for the year ended 31 March 2009 was £101,745, accounting for some 42% of the Appellant's non-finance-related expenditure. The bad debt charge was in the year was £10,000. Recovery of debts by court action has proved expensive and, on Mrs. Morgan's evidence, relatively ineffective. She cites one example of a debtor being ordered by the court to pay £20 a month to discharge a debt of some £4,660. Admittedly this example related to 2007, before the period in issue, but it was presented to the Tribunal as an illustration of the difficulties the Appellant has experienced in getting legal redress against defaulting debtors.

7. The Appellant also told us (and we accept) that Barclays Bank had not provided extra support to ease its cash flow problems even though the Appellant's relationship with the Barclays Bank manager concerned remained satisfactory. Mrs. Morgan had also suffered a period of ill health.

8. The applicable legislation is contained in section 59(7)(b) VAT Act 1994 ("VATA") which provides that a person shall not be liable to a surcharge if he would otherwise be liable (as is this case in relation to all VAT periods in issue) but satisfies HMRC or, on appeal, a tribunal that, in the case of a default which is material to the surcharge there was a reasonable excuse for the return or the VAT not having been despatched on time.

9. It is further provided (by section 71(1)(a) VATA) that for these purposes an insufficiency of funds to pay any VAT due is not a reasonable excuse.

10. However, it has been established by the leading case of *Customs and Excise Commissioners v Steptoe* [1992] STC 757 that although insufficiency of funds can never of itself constitute a reasonable excuse, the cause of that insufficiency – the underlying cause of the taxpayer's default – might do so.

11. The facts of *Steptoe* were that the taxpayer was an electrical contractor in a relatively small way of business, 95% of whose work was for the London Borough of Redbridge, which was an extremely slow payer (paying on average 6 weeks to 2 months after delivery of a bill. The taxpayer was late in making his returns for two periods in a year (11/86 and 08/87). In each case the delay was about two months. He was again in default for the 11/87 period and for the 02/88, 05/88 and 11/88

periods. The excuse put up by the taxpayer for late payment in these periods was cash flow difficulties. That was rejected by the Commissioners, but accepted by the tribunal (on the grounds of Redbridge Council's conduct in paying late), and, on appeal to the High Court, by the Judge (Kennedy J).

12. Scott LJ's view was that although the reason for an insufficiency of funds can be put forward as a reasonable excuse, that reason must 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 (*ibid.* at p.765). He said that "absent some 'unforeseeable or inescapable' event, cash flow problems are, in my opinion, barred … from constituting a 'reasonable excuse'" and that "it is only if the events giving rise to the insufficiency of funds are outside the normal course of the taxpayer's business that a possibility of a reasonable excuse can arise" (*ibid.* at p.765). He would have held that no reasonable excuse was made out in the *Steptoe* case.

13. Nolan LJ reached the opposite conclusion. He accepted (albeit with some reluctance) the finding of fact by the tribunal that the conduct of Redbridge Council in paying consistently late had had the result that the taxpayer had found himself in the situation that at the due date for the relevant accounting periods he was without sufficient funds to pay the tax due. (*ibid.* p.769). He considered that Scott LJ's test for an acceptable cause of insufficiency of funds, that it would have to be caused by an 'unforeseeable or inescapable' event, was too narrow.

14. Lord Donaldson reached the same conclusion as Nolan LJ. He expressed the test, which must be taken as the test to be applied by us, as follows:

> "If the exercise of reasonable foresight and of 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." (*ibid.* p.770)

15. On the facts as found, we consider that Mrs. Morgan, for the Appellant, who impressed us as an honest and responsible witness, did indeed exercise reasonable foresight, due diligence and a proper regard for the fact that the tax would become due on the various due dates. This is demonstrated by the fact that the paper returns were made out on or before the respective due dates.

16. Nevertheless the insufficiency of funds was not avoided and the cause of that (as opposed to the excuse for late payment – a distinction drawn in *Customs and Excise Commissioners v Salevon Limited* [1989] STC 907 and cited in *Steptoe* (*ibid.* at p.767)) was, we have found, that the Appellant's business and cash flow suffered by reason of several customers defaulting on their debts due to the Appellant, coupled with the refusal of Barclays Bank to provide the Appellant with extra support to ease its cash flow problems. This is borne out by the high levels of indebtedness (including the overdraft debt) recorded in the Appellant's Balance Sheet as at 31 March 2009 and the very low level of partners' drawings recorded for the year ended on that date. (It is relevant to note that Mrs. Evans for HMRC told us that it was not

open to the Appellant to elect to account for its VAT on the cash basis – a topic discussed in *Steptoe*.)

17. We conclude therefore that the Appellant's exercise of reasonable foresight and of due diligence and the Appellant's proper regard for the fact that the tax would become due on a particular date did not avoid the insufficiency of funds which led to the default.

18. There is a further finding which is necessary for the Appellant's success in this appeal, which is that the Appellant's exercise of reasonable foresight and due diligence and its proper regard for the fact that the tax had become due on a particular date must have led to payment of the tax due as soon as the insufficiency of funds could be overcome.

19. On this aspect of the matter we note that payment was made in full after no more than 42 days in the case of any period in issue, and after as little as 10 days in the case of the period 12/08. We regard this fact as demonstrating that the Appellant took its obligations to pay VAT on time sufficiently seriously and, having regard to the exceptional difficulties being experienced in its trade, did all that could reasonably have been expected of it to make timely payment of the VAT due.

20. Some discussion took place at the hearing of the appeal of the availability after 24 November 2008 of HMRC's 'Business Support Service' in certain cases. We understand that where HMRC extend that service, no default surcharges are levied in cases of late payment of VAT made in accordance with a prior agreement concluded between HMRC and a particular taxpayer. The Appellant did not reach any agreement with HMRC pursuant to the 'Business Support Service', although it may well have qualified to do so. Mrs. Morgan told us of the many difficulties she had had in communicating with HMRC, which may be relevant in this regard. In any event, we regard these facts as irrelevant to the issue which we have had to decide, namely, whether the Appellant had a reasonable excuse for late payment within section 59(7)(b) VATA.

21. In the result, on the exceptional facts of this case and for the reasons given above, we conclude that the Appellant has shown a reasonable excuse for its late payment of VAT in the periods in issue for the purposes of section 59(7)(b) VATA and we allow the appeal.

22. 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.

JOHN WALTERS QC

TRIBUNAL JUDGE
RELEASE DATE: 29 JUNE 2011