[2016] UKFTT 773 (TC)

TC05500

Appeal number: TC/2015/07251

VAT – default surcharge – payment late by two days – misunderstanding that a direct debit facility was in place for payment – reliance of a third party – insufficiency of funds – exceptional circumstances – whether any reasonable excuse; no – whether surcharge disproportionate; no – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

EUROVISION LOGISTICS LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE HEIDI POON
MRS GAY WEBB

Sitting in public at the Tribunal Centre, 11 Albion Street, Leeds, on 7 September 2016

Mr Jeremy Blakey and Mr James White, Directors for the Appellant

Mr Aidan Boal, Presenting Officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. The appellant, Eurovision Logistics Ltd, appealed against the default surcharge notice for VAT period 08/15 in the sum of £8,689.37.

2. Mr Blakey and Mr White, both directors of the appellant company, gave evidence, which is accepted without qualification.

3. The principal issue for the Tribunal to determine is whether the appellant had a reasonable excuse under s 59(a) of the Value Added Tax Act 1994 ('VATA') for making the VAT payment late for 08/15.

The Law

4. The Tribunal is provided with a generic bundle of legislation in relation to the default surcharge regime. The legislation includes sections 59-59A (on default surcharge), 70-71 (on mitigation of penalties), 83 (on appeal), of the VATA 1994 ('VATA'), and regulations 25, 25A and 40 of VAT Regulations 1995 on accounting, payment and records.

5. The provisions for the default surcharge regime are under s 59 of VATA. Of direct relevance to this appeal is sub-s 59(1)(b) VATA, which states that a taxable person shall be regarded as being in default in respect of a prescribed accounting period if, by the statutory due date, the Commissioners have not received the amount of VAT shown on the return as payable by him in respect of that period.

6. By virtue of s 59(7), a taxable person is not liable to the surcharge if he had a reasonable excuse for the default. What amounts to a reasonable excuse is largely determined by the facts of the case, with reference to case law authorities.

7. Section 71 of VATA contains two specific exclusions to the meaning of reasonable excuse, and the exclusions are stated as follows –

> '(a) an insufficiency of funds to pay any VAT due is not a reasonable excuse; and
>
> (b) where reliance is placed on any other person to perform any task, neither the fact of that reliance nor any dilatoriness or inaccuracy on the part of the person relied upon is a reasonable excuse.'

8. The authorities referred to in this decision are: *Profile Security Services (South) Ltd & Anor v C&E Comrs* [1996] STC 808 ('*Profile Security*'); *Garnmoss Ltd T/A Parham Builders v HMRC* [2012] UKFTT 315 (TC) ('*Garnmoss*'); Coales *v HMRC* [2012] UKFTT 477 (TC) ('*Coales*'); *The Clean Car Company Ltd v C&E Comrs* [1991] VATTR 239 ('*Clean Car*'); *C&E Comrs v Salevon Ltd* [1989] STC 907, and *Savelon Ltd v C&E Comrs* [1988] VATTR 169 ('*Salevon*'); *C& E Comrs v Steptoe* [1992] STC 757 ('*Steptoe*'); *HMRC v Total Technology (Engineering) Ltd* [2012]

UKUT 418 (TCC) ('*Total Technology*'); and *HMRC v Trinity Mirror Plc* [2015] UKUT 0421 (TCC) ('*Trinity Mirror*').

The Facts

Background

9. In evidence, Mr Blakey related that the appellant is a haulage company incorporated in 2007 by purchasing the two business entities known as I J Blakey Haulage and European Road Freight with the issue of 400,000 ordinary shares. Mr Blakey was the principal owner of these two subsidiaries and became a shareholder director of the appellant company. In November 2010, the assets of the two subsidiaries were 'hived up' into the appellant company, and the appellant's first audit was carried out in 2010 by a registered firm of auditors.

10. Mr Frankish, who started as an apprentice in Mr Blakey's business in 1998, was the incumbent accountant of the subsidiaries and became the company accountant of the appellant. With his long years of service, Mr Frankish became a highly trusted employee of Mr Blakey's over time. His employment came to a dramatic and abrupt end in May 2015, when he gave himself in to the police and confessed that he had been embezzling from his employer over a period of time.

11. The annual audits did not foil Mr Frankish's attempt to defraud the appellant. It would seem that Mr Frankish had managed to create accounting entries to conceal the unlawful extraction of funds, and to falsify the accounting statements by overstating profits on the profit and loss account, thereby returning a stronger balance sheet year on year. Between January 2008 and May 2015, the total amount attributable to Mr Frankish's embezzlement was in the region of £250,000 and a further £400,000 remained unaccounted for on the balance sheet at the date of the hearing. The extent of the damage to the appellant's financial position is still under investigation by forensic accountants for the purpose of bringing an action for damages against the auditors' professional indemnity.

12. On 22 July 2015, Mr Frankish's father entered into a settlement agreement with the appellant. Mr Frankish Senior undertook by that agreement to cause the total sum of settlement of £255,000 to be paid to the appellant on conclusion of the sale of the house owned by his son. The payment is in consideration that the appellant is bound by the agreement not to bring criminal proceedings against Mr Frankish.

Appellant's history of defaults

13. Unbeknown to the management, Mr Frankish had also been paying the company's VAT liabilities late, bringing the appellant into the surcharge regime in the quarter ended 30 November 2011 and occasioned a Surcharge Liability Notice being served for period 11/11. The appellant's history of defaults shows eight further defaults occurring for periods 05/12, 08/12, 11/12, 05/13, 08/13, 11/13, 11/14 and the period under appeal 08/15.

14. The continuous defaults meant that the surcharge rate had been at 15% from period 05/13 onwards, and surcharges imposed on the appellant since the second default for 05/12 total £55,977.54, which is inclusive of £8,689.37 for the period 08/15 under appeal.

15. The Schedule of Payments for the VAT liabilities for those periods in which a default occurred shows a consistent pattern up to and including period 11/13 that part of the quarter's liability was paid on time, with the balance being paid late in instalments. Mr Blakey stated he was 'ignorant of the circumstances that produced the defaults'; that Mr Frankish would be 'the only one who can explain'.

16. It would seem that all the surcharges up to and including period 11/13 had been paid under Mr Frankish's direction without the knowledge of the management.

Measures after accountant's departure

17. Mr White's evidence focused on how the management dealt with the situation in the wake of Mr Frankish's abrupt departure in May 2015. Mr White described the business as having been 'turned upside down'; many extra hours of work were required to re-construct the ledgers; that the business was 'left in shock and in a position where it was all hands on deck to resolve the situation' (per email of 16 November 2015 to HMRC).

18. In June 2015, the management became aware that the VAT liability of £82,987.86 for period 11/14 remained outstanding. The managing director of the appellant negotiated a Time-to-Pay arrangement with HMRC's debt management team to settle the liability by monthly instalments through direct debit.

19. Apart from the VAT arrears, there were also outstanding liabilities for PAYE. Mr White explained that the VAT and PAYE outstanding liabilities were consolidated into one payment plan, and the monthly payments are allocated against PAYE liabilities first because they are interest accruing.

20. The management also had to recruit an accountant quickly and this was done through an agency. The new accountant, Ms Liliana Marsden came as a 'temporary' placement some time in June 2014 to help deal with the VAT period 05/15.

21. The Tribunal notes that the period 05/15 did not go into default, and it was the *first* period after Mr Frankish's departure and asked how the company dealt with the filing of return and payment for 05/15, which were due on 7 July 2015.

22. Mr White informed the Tribunal that Ms Marsden prepared the VAT return for submission, and raised a payment request for the managing director to 'approve'. Mr White was able to be more specific later by stating that the managing director 'processed' the payment, that it was a 'direct settlement' out of the 'MD's account'.

23. Mr White also added that Ms Marsden was aware of the Time-to-Pay arrangement though she did not play a part in the negotiation process.

24. The engagement of Ms Marsden's service moved from being a temporary placement to a more permanent basis by a contract of employment that took effect from 1 August 2015. Instead of just having one person in control of the financial side of the business, the appellant employed another staff member called Dominique.

Circumstances leading to the VAT payment being made on 9 October 2015

25. Mr White described the VAT quarter of 08/15 leading up to the due date of the return and payment as 'the worst period we ever worked through'. The business had to produce a cash flow for the bank on a daily basis, and a report update every two days. The management also had to work out an internal control mechanism acceptable to the bank whereby the two accounts staff members would not be able to make fraudulent payments without being noticed.

26. The VAT return for period 08/15 was filed on time, but the VAT payment was made by EBP (Electronic Bill Payment) on 9 October 2015, two days after the due date of 7 October 2015. A default therefore occurred and the surcharge was at 15%.

Review and appeal

27. By letter dated 26 October 2015 to HMRC, Mr White appealed against the surcharge notice for 08/15. (The letter is not included in the production but is referred to in Mr White's email of 16 November 2015.) Referring to his October letter, Mr White said that he had stated that:

> '… the accountant had left the company and was replaced on the 1st August 2015, which arose to a misunderstanding by the new accountant that the facility was on a direct debit and unfortunately, therefore instead of paying the [sic] HMRC on the 7th, it was paid only 2 days later on the 9th, I believe I did not explain the circumstances well enough for you to take into consideration.'

28. Mr White's email of 16 November 2015 provided additional circumstantial information (see § 25) for HMRC to consider, and concluded as follows:

> 'The mess created by the previous accountant and the amount of work to be caught up on by the new accountant contributed enormously to this oversight. Whilst I accept the error in making the payment did happen, it was one due to exceptional circumstances and it was rectified almost immediately.'

29. HMRC undertook a further review, noting that it was exceptional since the practice is that a trader is only entitled to one review. The second review upheld and confirmed the surcharge, and Mr White was advised to seek permission to make a late appeal to the Tribunal. This was done by notice dated 4 February 2016, and the late appeal was admitted.

The Appellant's Grounds of Appeal

30. The Notice of Appeal was accompanied by Mr White's letter of 15 December 2015, a copy of the Settlement Agreement between Mr Frankish Senior and the appellant, the bank statement showing the late VAT payment, and the employment contract of Ms Marsden stating her commencement date as 1 August 2015.

31. A few days prior to the hearing date, the appellant also submitted some 55 pages of chains of email communications between Mr Blakey, Mr White and the forensic accountants, and a ten-page letter sent to the firm of auditors in respect of the quantification of damages. We have perused these latest submissions and have concluded that the substance of these communications is of no direct relevance to the appeal that is in front of us, other than to support Mr Blakey's evidence that the appellant has been defrauded, which we accept without qualification.

32. No specific grounds are stated on the Notice other than a reference to Mr White's letter, the contents of which are related earlier. From Mr White's letter of 15 December 2015, and from the representations made by both directors at the hearing, it would seem that the appellant's grounds of appeal are:

> (1) that it was an error made by the new accountant mistaking that there was a direct debit facility in place to meet the VAT payment; that the direct debit arrangement under the Time-to-Pay agreement for the arrears was the reason for the 'misunderstanding';
>
> (2) exceptional circumstances had contributed to such an error;
>
> (3) the error was rectified immediately; and
>
> (4) that the delay was only by two days.

HMRC's Contentions

33. HMRC contend that the late payment under appeal was due on 7 October 2015, while the facts concerning the direct debit agreement to settle the arrears are:

> (1) that the direct debit agreement is for pre-set amounts for a specified period of time and differs from the VAT online direct debit option, 'whereby future tax due may be collected on a date specified on the relevant return acknowledgement screen';
>
> (2) that the direct debit payments for the arrears did not commence until 29 January 2016;
>
> (3) that the first direct debit payment for the arrears was for a sum of £2,560.63;
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> (4) that the second and subsequent monthly direct debit amount was for £13,827.20 and commenced from 29 February 2016.

34. Furthermore, the appellant was aware of the former accountant's misdemeanours before the Settlement Agreement signed on 22 July 2015. With this knowledge before the appointment of a new accountant on 1 August, HMRC would not consider it unreasonable to expect the appellant 'to fully acquaint themselves with

their VAT obligations regarding the submissions of VAT returns and payments', and would have taken 'all necessary steps to ensure the next VAT return and payment were submitted on time'.

35. HMRC further contend that the submission of the VAT return online on 6 October 2015 would have been acknowledged by an automated screen display, which would have requested electronic payment by 7 October 2015 and would *not* have displayed a date on which a direct debit payment would be taken. If the acknowledgment had differed from what apparently was expected by the accountant, there is no suggestion that HMRC were contacted to clarify the difference.

36. In his submissions, Mr Boal highlighted that the VAT payment of £57,929.16 for period 08/15 by Faster Payment Service was not processed until after a sum for £80,610.95 was credited from RBS Invoice Finance. The timing of the transactions could suggest that the VAT payment for period 08/15 was delayed due to an insufficiency of funds, which is specifically excluded as a reasonable excuse under s 71(1)(a) of VATA.

37. Finally, Mr Boal referred to *Profile Security* for his conclusion that reliance of the new accountant could not amount to a reasonable excuse either.

Discussion

Whether misunderstanding amounted to a reasonable excuse

38. The appellant's principal ground of appeal would seem to be that the late payment was due to an error of the new accountant, who had misunderstood that there was a direct debit facility in place to meet the VAT payment for period 08/15; that the direct debit arrangement to meet the arrears in VAT and PAYE had given rise to this misunderstanding.

39. In *Garnmoss*, where there was a bona fide mistake made, Judge Hellier states at [12] that while the mistake 'was not a blameworthy one, the Act does not provide shelter for mistakes, only for reasonable excuse.'

40. In *Coales*, Judge Brannan states at [32]: 'The test contained in the statute is not whether the taxpayer has an honest and genuine belief but whether there is a reasonable excuse.' He rejects the notion that an honest and genuine belief, even if unreasonable, can amount to a reasonable excuse, and that the reasonableness of a belief has to be subject to the same *objective* test for reasonable excuse as set out by Judge Medd in *Clean Car*:

> '… can the fact that the taxpayer honestly and genuinely believed that what he did was in accordance with his duty in relation to claiming input tax, by itself provide him with a reasonable excuse. In my view, it cannot. … In my judgment it is an objective test in this sense. One must ask oneself: was what the taxpayer did a reasonable thing for a responsible trader conscious of and intending to comply with his obligations regarding tax, but having the experience and other relevant

attributes of the taxpayer and placed in the situation that the taxpayer found himself at the relevant time, a reasonable thing to do?'

41. Here we are not dealing with the mistaken belief of the taxpayer, but the belief of an employee of the taxpayer. We will still address the substance of this mistaken belief (even when it was entertained by a third party relied upon by the appellant) to see if it could amount to a reasonable excuse before addressing the issue as regards reliance on an employee. The question for the Tribunal is whether the belief that there was a direct debit facility in place in the instant case was reasonable.

42. The essential distinction with a direct debit arrangement is that the initiative lies with HMRC to apply for the payment, while with other methods of payment, the taxpayer has to take the initiative to process a payment. If a direct debit payment facility is in place to meet the VAT liability every quarter, HMRC cannot apply for a direct debit payment until the related VAT return is submitted to notify the correct amount to be requested for payment. This means a direct debit payment is normally applied for on the seventh in the month of payment, and will normally take three working days to process, to reach HMRC's account on the tenth of the month. A VAT payment by direct debit is therefore allowed three extra working days for the purpose of reckoning the due date of payment.

43. Mr Boal has outlined clearly what would have happened if the appellant had a direct debit payment facility in place. On submission of the VAT return on 6 October 2015, the automated acknowledgement would have displayed the relevant date on which HMRC would apply for the direct debit payment. Given that the direct debit facility was not in place, the displayed message for the appellant would have been to make payment by 7 October 2015. Notwithstanding the alleged misunderstanding, someone in the business did take notice by 9 October to action the payment *before* waiting till the tenth of the month to find out that no direct debit had gone out of the account to meet the VAT payment. Mr White gave no details as regards who within the business came to realise the mistake, or what caused the mistake to be noticed.

44. Furthermore, as Mr Boal pointed out, the direct debit arrangement to pay the arrears did not commence until January of 2016, which was months after the VAT payment for 08/15 was due. We conclude that it is not reasonable to assume that there was a direct debit facility to cover the payment for the disputed period, even against the background of the Time-to-Pay agreement.

45. We note that Ms Marsden, while being aware of the Time-to-Pay agreement, did not play a part in its negotiation. That awareness should have alerted her to the direct debit arrangement being in relation to the payment plan for the arrears specifically. It is not a reasonable assumption to make that the direct debit arrangement is a blanket facility covering all future payments of VAT. For this reason, we do not consider the fact that Ms Marsden's formal employment only commenced on 1 August 2015 to be of any direct significance. If anything, the fact that she was 'new' to her employment should make such an assumption more unreasonable, not less. A prudent person on starting a job would have ascertained in such circumstances whether such an assumption was well founded.

46. The Tribunal also has regard to the fact that the period 05/15 did not go into default, and that was the first VAT period Ms Marsden dealt with. For that period, the VAT payment had to be 'requested' by Ms Marsden for the managing director to process the payment. The procedure involved to meet the payment for 05/15 would seem to displace any assumption that there could have been a direct debit facility in place to meet the payment for the subsequent quarter.

47. Against these background facts, the Tribunal also has regard to the attributes and experience of Ms Marsden. We draw inference from the employment contract that she must be of a level of professional competence to be employed as the company accountant for a business with a sizeable turnover. She would have the professional knowledge that certain indicators need to be in place for a direct debit facility to exist.

48. The aforesaid, of course, is based on Mr White's interpretation of the situation, or his explanation of what gave rise to the error, which we find on the whole tended towards vagueness. We do not have the benefit of Ms Marsden's evidence to establish what she had actually misunderstood. Whether Mr White's account would have accorded with Ms Marsden's understanding of the situation is not a fact open to the Tribunal to find, and we make no further comments as regards the origin of the misunderstanding, save to conclude that whoever within the business had held that mistaken assumption, that assumption could not amount to a reasonable excuse.

Whether reliance of a third party a reasonable excuse

49. 'Reasonable excuse' cannot be considered at large, and is circumscribed by statute and precedent. The relevant statutory exclusion comes under s 71(1)(b) of VATA, which provides that:

> 'where reliance is placed on any other person to perform any task, neither the fact of that reliance nor any dilatoriness or inaccuracy on the part of the person relied upon is a reasonable excuse.'

50. The statutory exclusion of reliance of a third party being a reasonable excuse has a very pragmatic reason behind it, and Parliament's intention for incorporating this statutory exclusion was evidenced by the minister's statement as recorded in *Hansard*: 'If all one had to do to have a reasonable excuse was to find an accountant who would delay everything, there would be easy pickings to be made.'[1]

51. In *Profile Security*, Macpherson of Cluny J concluded that the 'reliance upon a trusted employee, to whom the relevant tasks were delegated' falls within the meaning of the statutory exclusion under s 33(2)(b) of the Finance Act 1995, which was the predecessor provision of s 71(1)(b).

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[1] *Hansard* 21 May 1985 (HC Official report) SC B (Finance Bill) 21 May 1985, col 173. The statutory exclusion referred to in the minister's statement in respect of the Finance Bill became legislated under section 33(2)(b) of Finance Act 1985, and section 33(2)(b) is, to all intents and purposes, the predecessor of section 71(1)(b) of VATA 1994 which applies to the current case. See also the decision *Profile Security Services (South) Ltd v C&E Commissioners* [1996] STC 808.

52. While the Tribunal has great sympathy for the situation in which the appellant finds itself, the appellant's reliance on its employees, whether it was on Ms Marsden for the period under appeal, or on Mr Frankish previously for any of the defaults which occurred when he had overall charge of the books of account, cannot amount to a reasonable excuse by dint of the statutory exclusion.

Whether exceptional circumstances gave rise to a reasonable excuse

53. It is accepted that the embezzlement by the former accountant had thrown the management of the business into turmoil, and that the months from the departure of the previous accountant all the way to the VAT payment due date of 7 October 2015 was 'the worst period we ever worked through', as Mr White described.

54. The exceptional circumstances had given rise to a work situation that prevailed at the time, but in order for the exceptional circumstances to give rise to a reasonable excuse *specific* to the late payment of the VAT for 08/15, a direct causal link had to subsist between the exceptional circumstances and the failure to make payment on time. The case has not been made that the exceptional circumstances directly caused the late payment. What has been claimed is that the exceptional circumstances had contributed to the error that caused the late payment. The contribution to the error is not of itself the cause of the error. The cause of the error, as related to the Tribunal, was the misunderstanding on the part of the new accountant, which we have already analysed and rejected as constituting a reasonable excuse.

Whether insufficiency of funds amounted to a reasonable excuse

55. HMRC's submission that the delay of payment might have been due to an insufficiency of funds as the credit from RBS Invoice Finance had to reach the account before the VAT payment could be made. Mr White explained that the credit entry was an inter-account transfer, which means the funds were within the business. The Tribunal is satisfied with this explanation, that the RBS Invoice Finance account is a feeder account where funds are held. The bank statement shows other credit transactions from RBS Invoice Finance, and the timing of these credits is an indication that the paying account is being 'fed' by funds from RBS Invoice Finance account to meet its payments.

56. The evidence by the directors did cover the embezzlement to some extent, and the majority of the documents produced by the appellant relate to the history and consequences of specific amounts of funds being defrauded. However, no argument has been advanced in respect of an insufficiency of funds that might have been caused by the embezzlement, either for the period 08/15 or in relation to earlier defaults.

57. Even if such an argument had been advanced, we are of the view that it is unlikely that it would have succeeded. Section 71(a) of VATA, which specifically excludes an insufficiency of funds from being a reasonable excuse, has wide meaning. Rarely can the factual matrix of a case be accorded the narrow case law interpretation of how an insufficiency of funds occasioned by some underlying causes can amount to a reasonable excuse as established by *Salevon* and *Steptoe*.

Whether the surcharge disproportionate

58. Mr White has emphasised that the appellant remedied the failure to make the VAT payment promptly and that the delay was only by two days.

59. The Tribunal does not have jurisdiction to consider issues concerning proportionality in terms of fairness or reasonableness in the judicial review sense, as there is no statutory authorisation in this respect.

60. Applying the principles from *Total Technology*, the surcharge regime is 'for failure to file and pay by the due date, not for delay after the due date' (at [89]). The scaling in the surcharge regime is not by reference to the number of days a payment is made late, but by the number of defaults in a surcharge rolling period, which gives rise to an escalating percentage of surcharge rate, at 2%, 5%, 10% and 15%, in proportion to the number of defaults in a rolling period. The Upper Tribunal decision in *Trinity Mirror* supports the conclusions reached in *Total Technology*, and states that the surcharge regime, viewed as whole, is a rational scheme that does not infringe Convention rights or the principle of proportionality under EU law.

Decision

61. The appeal is accordingly dismissed. The surcharge of £8,689.37 for the period 08/15 is confirmed.

62. 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.

DR HEIDI POON

TRIBUNAL JUDGE
RELEASE DATE: 18 NOVEMBER 2016