[2017] UKFTT 572 (TC)

TC06017

Appeal number: TC/2017/00396

VAT default surcharges - payments made one day late by FPS - insufficiency of funds - Appellant was awaiting a family loan - whether reasonable excuse - on the facts, yes - whether penalty disproportionate - no - appeal allowed in part

FIRST-TIER TRIBUNAL

TAX

PRADA CONTRACT SERVICES LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE MICHAEL CONNELL
MEMBER DAVID EARLE

Sitting in public at Fox Court, Brooke Street, London on 4 April 2017

The Appellant did not attend and was not represented

Ms Rose Marie Thompson, Officer of HMRC, for the Respondents

DECISION

The Appeal

1. Prada Contract Services Limited ('the Appellant') appeals against a default surcharge of £880.58 imposed by HMRC, in respect of the VAT period ended 30 April 2016, and a default surcharge of £1,669.50 imposed by HMRC, in respect of the VAT period ended 31 July 2016 for its failure to submit, by the due dates, payment of the VAT due. The surcharges were calculated at 5% and 10% respectively of the VAT due.

2. The Appellant did not attend the hearing, having written to the Tribunal to say that they were content for the appeal hearing to go ahead in their absence. The Tribunal was therefore satisfied that the Appellant had been given notice of the time, date and venue of the appeal hearing and that it was in the interests of justice to proceed.

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

Background

4. The Appellant's business is that of commercial and domestic cleaning and maintenance business, based in London and the South East. The Appellant has been registered for VAT with effect from 6 July 2009.

5. The Appellant has been in the VAT default surcharge regime from period 05/15 when a non-financial Surcharge Liability Notice was issued. Prior to the defaults under appeal there had been two previous defaults.

6. No financial penalty is issued on the first default, but a Surcharge Liability Notice is issued. A financial penalty in respect of the second default was issued at 2% but waived because it fell below the de minimis level of £400, which allows HMRC a concessionary discretion not to levy a penalty. Nonetheless any further defaults would attract additional penalties as referred to in paragraph 8 below. The penalties under appeal are the Appellants third and fourth defaults.

7. 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.]

8. 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.

9. 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.

10. 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 its VAT electronically. No direct debit was set up.

11. In respect of the 04/16 default, as payment was made electronically (Faster Payment Scheme), the due date was 7 June 2016. The return was received on time on 12 May 2016, but the VAT payment was paid on 8 June 2016, one day late.

12. In respect of the 07/16 default, as payment was again made electronically (FPS), the due date was 7 September 2016. The return was received on time on 11 August 2016, but the VAT payment was paid on 8 September 2016, again one day late.

13. 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.'

14. 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

15. The Appellant's grounds of appeal are that the Company was suffering cash flow problems brought about by circumstances beyond the proprietors' control. The Appellant says:

- "Compulsory increase in the minimum wage by 7.5%.
- The reluctance of many of our clients to accept this increase.
- The pensions that we are now having to pay.
- Continuing late payment by some clients.
- All causing critical difficulties with cash flow.
- The lateness of our payments was only a matter of hours, not days".

16. The proprietors say they "attempted to put things right without unnecessary delay by organising loans from family and credit card withdrawals ... whilst trying to cope with the extra expenses. In fact our last payment for 10/16 was on time."

HMRC's contentions

17. The first default was recorded for Period 04/15 and 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.

28. The directors have ultimate responsibility for the timely submission of the VAT return and any tax due thereon.

18. 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.

19. 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."

20. Surcharge Liability Notice V160 advises 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.

21. 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).

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

23. 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.

24. 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.

25. HMRC has a statutory responsibility to ensure that tax due is not retained and used as working capital after the date when it is due to be paid.

26. HMRC maintain 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.

27. An employer's legal responsibility to pay their employees the National Minimum Wage and make workplace pension contributions is a foreseeable event and something that all businesses must factor into their business model.

28. Having traded since 2009, additional employee wages or contributions would clearly have become a known factor to take into account for which provision could reasonably be made in business planning.

29. HMRC contend that the Appellant has failed to show that they had a reasonable excuse. They failed to plan for a foreseeable event, which in itself cannot be a reasonable excuse.

30. HMRC consider that 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 was made on time or contacted HMRC to request a deferment of payment.

31. HMRC's website details what actions to take if a trader cannot pay their VAT on time and warns of surcharges. This web page can be found at the following addresses:
https://www.qoy.ukNat-returns/surcharges-and-penalties
https://www.00v.uk/difficulties-paying-hmrc

32. The Appellant had previously been advised how to avoid further Default Surcharge from the information contained on the Surcharge Liability Notices and HMRC's Advice Sheet which was issued 29 April 2014 and 1 August 2014

33. 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.

34. The Appellant has benefitted from Time To Pay ('TTP') agreements in the past as a result of having cash flow problems. HMRC's records show that the Appellant entered a TTP agreement for historic debt on 27 July 2015. The TTP proposal was requested and agreed after the relevant due dates and was therefore outside of the provisions of s 108(2).

35. HMRC contends that the Appellant did not ensure sufficient care was taken in relation to their financial and statutory obligations. The Appellant knew the consequences of payment failure and should have taken steps to protect the company from the consequences late payment.

36. 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.

37. 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."

38. HMRC also refer to the comments of Scott LJ in *Customs and Excise Commissioners v Steptoe 1992* BVC 147:

> "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."

39. 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).

40. The Appellant has not provided any information to show that any insufficiency of funds was unforeseeable or outside the normal hazards of trade

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

42. 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.

43. 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.

44. 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.

45. 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'

46. 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

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

48. 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 are determined by the number of defaults in any surcharge liability period

49. The Appellant says that the surcharge is unfair. For the reasons submitted by HMRC and set out in paragraphs 45 and 46 above, this is not a ground of appeal which can be considered by the Tribunal.

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

51. The payment of Period 04/16 was one day late. The Appellant's grounds of appeal are that the company was suffering a cash flow shortage and due to an insufficiency of funds was unable to discharge the VAT liability by the due date. An insufficiency of funds is not, without more, a reasonable excuse for late payment of VAT – s 71(1)(a) VATA 1994.

52. Although insufficiency of funds cannot itself constitute a reasonable excuse the reason for the insufficiency may do so. Late payment by customers or high wages and similar costs are foreseeable hazards of trade and a tax payer should make arrangements to finance his cash flow on that footing.

53. There can however be a difference between a trader who suffers an insufficiency of funds due to his own culpable default or lack of foresight on the one hand, and an event which is either inescapable or not readily or reasonably foreseeable on the other, particularly where there has been no dilatoriness on the part of the tax payer.

54. Lord Donaldson MR in *Steptoe* said:

> "Scott LJ 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 "foreseeablility" 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"

55. With regard to the 04/16 default the Appellant was awaiting receipt of a £7,000 family loan which, together with the company's own cash resources would allow payment of the £17,611.77 VAT due. The loan monies were received on 8 June 2016 and the VAT was paid on the same day. The proprietors of the company had organised a family loan in order to avoid the late payment in the event that overdue customer payments do not arrive in time. The Appellant was aware that a VAT default surcharge would be payable if the VAT was paid even one day late but appears to have been unable to raise the family loan any sooner.

56. As Lord Donaldson MR said, reasonable foreseeability is only relevant in the context of whether the cash flow problems were inescapable or reasonably avoidable. Given the accumulation of events, which gave rise to the long term cash flow problems, added to the uncertainty faced by the Appellant relating to significantly overdue and substantial customer payments and also the reasonably unforeseeable difficulties in raising a family loan at very short notice, we accept that the Appellant has shown a reasonable excuse for the 04/16 default.

57. The VAT payment for period 07/16 was again one day late. On that occasion the Appellant was again awaiting substantial customer payments (totalling £16,894.26) which arrived at the Appellant's bank account on the 8 September 2016, allowing payment of the VAT due of £16,695 the same day. It is not known whether the Appellant could once again have arranged a short term family loan, but in the event the proprietors of the company did not do so and it is difficult to conclude in respect of that default that the late payment was not reasonably foreseeable or was not reasonably avoidable. Having suffered similar cash flow difficulties in the previous quarter, the company's proprietors should have put in place measures to ensure that the VAT was paid on time, irrespective of the fact that some of its customers were settling their liabilities late, which is a normal hazard of trade. We therefore find that the Appellant has not shown a reasonable excuse in respect of the 07/16 default.

58. The appeal is accordingly allowed in part. The surcharge of £880.58 for period 04/16 is discharged. The default for period 07/16 is confirmed, but being a third default attracts a surcharge of 5% and is therefore reduced to £834.75.

59. 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: 21 JULY 2017