[2019] UKFTT 281 (TC)

TC07120

Appeal number: TC/2017/02673

VALUE ADDED TAX – default surcharge – reasonable excuse – no – penalty proportionate – yes – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

SECCO MURO LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE NIGEL POPPLEWELL
ANDREW PERRIN

Sitting in public at Cardiff on 15 April 2019

The Appellant did not appear and was not represented

Mrs Comfort Iyiewuare Officer of HMRC for the Respondents

DECISION

INTRODUCTION

1. This is a VAT case. It concerns the default surcharge. The respondents (or "**HMRC**") have assessed the appellant to default surcharges (the "**surcharges**" or "**penalties**") for late payment of VAT for two VAT periods (the "**default periods**" each a "**default period**"), details of which are set out below.

Period	Amount
04/16	£541.46
07/16	£1108.66

2. There is little or no dispute about the relevant law. The main issue in this appeal is whether the appellant has a reasonable excuse for the late payments.

3. For the reasons given below we have decided to dismiss the Appeal.

APPELLANT'S NON ATTENDANCE

4. The hearing was scheduled to start at 10 am. Another case had also been listed to be heard at that time which we took first. This appeal did not come on until 11 am. At that time no one representing the appellant was in attendance. We were satisfied that a notice informing the appellant to attend half an hour before the scheduled time had been properly given to it by HMCTS. Although attempts were made by HMCTS and the tribunal clerk to contact the appellant, they were unable to do so.

5. The respondents submitted that we should hear the appeal in the appellant's absence. We were told that the hearing had already been postponed once, on the day of that hearing, and at the appellant's request. This matter has been going on for some time. There is little more that the appellant could add to the information that it has already given to HMRC in correspondence which was in the bundle. It is unlikely that the appellant could provide new evidence to change HMRC's mind.

6. We agreed, and considered that it was in the interests of justice to hear the appeal in the absence of the appellant.

SUMMARY OF THE LAW

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

8. 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 (2), 40(2)]. Under that discretion, HMRC allow a further seven days for filing and payment.

9. Section 59 VATA 1994 sets out the provisions in relation to the default surcharge regime. Under s 59(1) a taxable person is regarded as being in default if he fails to make his return for a VAT quarterly period by the due date or if he makes his return by that due date but does not pay by that due date the amount of VAT shown on the return. HMRC 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 chargeable default the specified percentage is 2%. The percentage ascends to 5%, 10% and 15% for the second, third and fourth default.

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

> "(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 -
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> (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
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> (b) there is a reasonable excuse for the return or VAT not having been so despatched then he shall not be liable to the surcharge and for the purposes of the preceding provisions of this section he shall be treated as not having been in default in respect of the prescribed accounting period in question .."

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

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

> '(1) For the purposes of any provision of section 59 which refers to a reasonable excuse for any conduct -
>
> (a) any insufficiency of funds to pay any VAT due is not a reasonable excuse.'

13. The test we adopt in determining whether the appellant has a reasonable excuse is that set out in *The Clean Car Co Ltd v C&E Commissioners* [1991] VATTR 234, in which Judge Medd QC said:

> "The test of whether or not there is a reasonable excuse is an objective one. 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?"

14. Although an insufficiency of funds to pay any VAT due is not a reasonable excuse, case law, most importantly the case of *C&E Commissioners v Steptoe* [1992] STC 757 ("*Steptoe*") has established the principle that the underlying cause of any insufficiency of funds may constitute a reasonable excuse. In *Jonathan Skuce v HMRC* [2018] UKFTT 003 ("*Skuce*") Judge Poon summarised the relevant case law as follows:

> "57. Section 71(1)(a) specifically precludes an insufficiency of funds from being a reasonable excuse. This statutory exclusion is qualified, to a limited extent, by case law authority such as *Steptoe*, which establishes the principle that there is a distinction between the direct or proximate cause and the underlying cause for the shortage of funds.
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> 58. In *Steptoe*, the taxpayer was an electrical contractor with 95% of his work being done for a Local Council, which was 'virtually his only customer', and 'an extremely slow payer'. The tribunal of first instance described the council as having 'never paid the amount owing on an invoice less than six weeks after it was delivered and usually it was paid upwards of two months late'.
>
> 59. The taxpayer in *Steptoe* was not on cash accounting, and was late in paying his VAT for two periods (11/86 and 08/87) and then continued to be in default for the four successive periods of 11/87, 02/88, 05/88 and 11/88. The payments were late by about two months, and the taxpayer pleaded cash flow difficulties as his reasonable excuse. The Commissioners rejected the taxpayer's grounds for reasonable excuse, but the VAT tribunal (as it was then) allowed the taxpayer's appeal on the ground of the Council's pattern of paying late. The Commissioners appealed to the High Court, and Kennedy J confirmed the tribunal's decision. The Commissioners' appeal to the Court of Appeal was dismissed by a majority (Lord Donaldson MR and Nolan LJ, Scott LJ dissenting).
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> 60. The reasoning of the majority in *Steptoe*, according to Lord Donaldson, as regards the legislative intention of the predecessor provision of s 71(1)(a), 'is that insufficiency of funds can never of itself constitute a reasonable excuse, but that the cause of that insufficiency, ie the underlying cause of the default, might do so'.

61. That said, Lord Donaldson states that 'there must be limits to what could be regarded as a reasonable excuse'. As to what those limits could be, Lord Donaldson agrees with Nolan LJ's reasoning in this respect:

> 'Nolan LJ, as I read his judgment in *Customs and Excise Comrs v Salevon Ltd* [1989] STC 907, is saying that 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.'

62. In contrast, Scott LJ's opinion that the underlying cause of the insufficiency of funds must be an 'unforeseeable or inescapable event' is considered as 'too narrow' by Lord Donaldson for the following reasons:

> '(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.'

63. According to Lord Donaldson therefore, the appropriate test concerning whether an insufficiency of funds amounts to a reasonable excuse is to examine if the underlying cause of the insufficiency is 'reasonably avoidable'. It is important to distinguish what is foreseeable from what is avoidable. The foreseeability of the insufficiency has no relevance in its own right, and foreseeability is only relevant in assessing whether the shortage of funds could have been avoided. Shortly stated, what is unforeseen cannot be avoided; only the foreseeable is avoidable".

15. Although not binding on us, we consider this summary to be an accurate synopsis of the legal position and we gratefully adopt it for the purposes of this Decision.

FINDINGS OF FACT

16. We were provided with a bundle of documents. From this we find the following facts.

(1) The appellant has been registered for VAT as a plastering contractor since September 2014 and has been obliged to both render returns and pay tax electronically. Its usual method of payment has been via Bill Pay.

(2) The appellant has been in the default surcharge regime since period 10/15. For the default period 04/16, which had a due date for submitting the return and

making payment of 07/06/16, the return was made on time but payment was made late. For the default period 07/16, the due date was 7/09/16, but both the return and the tax were paid late.

(3) The amount of VAT due for the period 04/16 was £10,829.21. The amount of VAT due for the period 07/16 was £11,086.67.

(4) Valid surcharge liability notices were served on the appellant for both of the default periods.

(5) Having requested a review of the penalties, the appellant provided detailed background circumstances relating to the defaults to HMRC.

(6) In its letter to HMRC ostensibly dated 03/11/16 (but which appears from the date stamps to have been received by HMRC only on 13 December 2016) the appellant states that

> "*Our biggest client has just gone into administration owing us £24,000 and that is the second company this year to do so to us*"

(7) A winding up petition was served on Seren Contractors Ltd ("**Seren**") by or on behalf of the appellant on 23 November 2016. Seren was one of, if not the, major customer of the appellant during the default periods, and during June 2016 the appellant sent it several emails chasing payments on outstanding invoices. The appellant also chased other customers who had failed to pay invoices on time.

(8) From June 2016, Lino Malnati, who we believe to be an officer of the appellant, sensed that "*something wasn't right from June onwards*" as regards Seren. The appellant was committed to projects and were tied to Seren until the end of the year financially even though it had decided not to undertake any more projects for them.

(9) Mr Malnati also indicated to HMRC in his email of 21 February 2017 that "*if I am honest, the workforce always comes first before me also. I know that the VAT money isn't ours and perhaps this is the wrong thing to say but we just figured that the VAT can wait a week or two but men have to be paid as they have families to feed and mortgages to pay.*"

(10) The appellant's bank statement shows that on 7 September 2016, the due date for payment of the VAT for the default period 07/16, the sum of £20,173.82 was paid into the appellant's bank account by Seren.

(11) On 3 November 2016 the appellant sought a review of HMRC's decision to assess it to the penalties. On 27 February 2017, HMRC wrote to Mr Malnati explaining that the outcome of the review was that HMRC had decided not to cancel the default surcharge assessments. On 10 March 2017 the appellant appealed against the penalties to the tribunal.

BURDEN AND STANDARD OF PROOF

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

DISCUSSION

Appellant's grounds of appeal

18. The appellant puts forward several grounds of appeal.

(1) It was unable to pay the VAT because customers were late paying its invoices.

(2) Customers pay their VAT bills on time because they pay that VAT to HMRC instead of paying their subcontractors.

(3) Customers went into liquidation and so couldn't pay.

(4) PAYE and corporation tax had been paid on time.

(5) The penalties do nothing to make the appellant pay its VAT on time.

(6) It seems a little unjust and unfair.

Respondents' submissions

19. HMRC submits as follows:

(1) There is a statutory obligation to pay VAT on time. The appellant knows this and also knows the consequences of late payment.

(2) HMRC publish a great deal of information to assist taxpayers. If the appellant knew that it couldn't pay its VAT on time because a major customer had stopped paying it, it should have contacted HMRC and availed itself of the options given by HMRC to customers who cannot pay on time (for example time to pay or deferring payments).

(3) HMRC are sympathetic to the cash flow problems faced by the appellant but lack of funds cannot be a reasonable excuse.

(4) The appellant had sufficient funds in its bank account to cover the VAT payment due for the period 06/17.

(5) The VAT as a percentage of receipts for the default periods was less than 10% for the period 04/16 and less than 8% for the period 07/16.

Discussion

20. The main submission made by the appellant is basically that it had cash flow difficulties resulting from firstly, a number of significant customers failing to pay its invoices on time and secondly that one of those significant customers, Seren, went into an insolvency process in November 2016 which prevented it from paying the appellant substantial outstanding sums.

21. An insufficiency of funds cannot be a reasonable excuse by virtue of Section 71(1) VATA 1994.

22. But, as set out in *Steptoe* and as interpreted in *Skuce* it is clear that a shortage of funds might comprise a reasonable excuse, especially where a significant customer defaults in payment.

23. Following *Steptoe* and *Skuce*, we believe that the tests we should apply when deciding whether an insufficiency of funds may give a rise to reasonable excuse is as follows:

> (1) If the insufficiency of funds was unforeseeable, then the taxpayer has a reasonable excuse.
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> (2) Even if the insufficiency of funds was foreseeable, the taxpayer may still have a reasonable excuse if that insufficiency was not reasonably avoidable.
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> (3) However, that reasonable excuse does not last for ever. It will cease when a previously unforeseeable shortage becomes foreseeable, and where a previously foreseeable shortage, (which is a reasonable excuse by dint of the fact that it was not reasonably avoidable), becomes reasonably avoidable.

24. Applying these principles to the circumstances in which the appellant found itself, we find that the appellant does not have a reasonable excuse by dint of the cash flow difficulties mentioned above. We say this for four reasons:

> (1) Firstly, the evidence shows that the winding up petition was served on Seren on 23 November 2016. The due date for paying the VAT for the default periods was 7 June 2016 and 7 September 2016. Both of these dates significantly preceed the date of that winding up petition.
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> (2) Secondly, according to Mr Malnati, he had realised that "*something wasn't right from June onwards*" as far as Seren was concerned. He was therefore on notice that Seren's cash flow difficulties might put the appellant in financial difficulties too. So it was open to him to put in place some other sources of funds with which to fund the VAT, or at least investigate whether such sources were available to the appellant. There is no evidence that he did this, nor is there any evidence that he contacted HMRC to make them aware of the situation so that he might, perhaps, negotiate a time to pay arrangement, or take advantage of the other opportunities which HMRC offer to taxpayers who find themselves in difficulty paying VAT.

(3) Thirdly the evidence shows that on the due date for payment of the VAT for the period 07/16 (i.e. 7 September 2016) Seren had paid over £20,000 into the appellant's bank account which was sufficient to discharge the VAT for that default period if payment had been made by online banking or faster payments on that day.

(4) Fourthly, it seems clear to us that Mr Malnati's statement set out at [16(9)] above, i.e. that payment of VAT to HMRC was less important than paying wages, is the nub of it. This is wholly commendable and humane behaviour but is a foot shooting exercise as far as reasonable excuse is concerned. It clearly implies that, contrary to what Mr Malnati had said regarding shortage of funds because of defaulting customers, the appellant had sufficient funds to pay some but not all of its "creditors". It made a conscious decision to pay staff before paying HMRC.

25. So for all these reasons we do not believe that there was unforeseeable shortage of funds caused, as the appellant alleges, either by the winding up of Seren or by failure by it and other significant customers to pay the appellant's invoices on time. If there was such a shortage of funds (which there clearly was not for the period 07/16) then that shortage was reasonably avoidable. As we say above, the appellant was a notice of the cash flow difficulties it faced because of late payment by Seren and other significant customers. It could have put in place alternative arrangements or discussed the position with HMRC. There is no evidence that it sought to do either.

26. The appellant says that the penalties are a little unjust and unfair. This tribunal has no jurisdiction to consider whether HMRC have acted unjustly or unfairly, but we can consider whether the penalties are proportionate.

27. The level of a default surcharge is specified in s 59 VATA 1994 and as such HMRC have no discretion as to the amounts to be levied.

28. 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'

29. 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.

30. Furthermore, notwithstanding that the application of a proportionate regime can theoretically be disproportionate in its application to the circumstances of a particular taxpayer, we do not consider that it is disproportionate in this case. The penalties are modest in both absolute and relative terms and are very far from being harsh, let alone plainly unfair, the test that must be applied in the circumstances.

31. Finally we do not consider that the appellant's other submissions evidence a reasonable excuse for failing to pay the VAT on time. The fact that other taxes were paid by the appellant on time is not relevant to its failure to pay VAT late. Nor is the submission that the penalties will have no impact on the appellant's likelihood of paying future VAT on time. If it fails to do so it will be liable to further penalties. It seems to us that payment of a financial penalty for late payment of VAT, something of which the appellant is aware since it had been the default surcharge regime for a number of VAT periods, is something that the appellant must weigh up (and it seems it is already doing this) against the other issues which might be caused by failing to pay other creditors. It has already come to a conscious decision to pay wages rather than VAT. But if it continues to do so, it will simply suffer further surcharges at increasing rates.

DECISION

32. For the foregoing reasons we dismiss the appeal.

APPEAL RIGHTS

33. 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.

NIGEL POPPLEWELL
TRIBUNAL JUDGE

RELEASE DATE: 28 APRIL 2019