TC03316

Appeal number: TC/2013/07857

VALUE ADDED TAX – default surcharge – surcharge at 10% rate - fourth alleged default- whether reasonable excuse – on the facts yes –whether first non-appealable default a material default in relation to fourth default - meaning of section 59(8) Value Added Tax Act 1993- whether reasonable excuse for first default –on the facts yes – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MICHAEL STRUEBEL (TRADING AS TWO STROKE TO TURBO) **Appellant**

- and -

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

TRIBUNAL: JUDGE GUY BRANNAN
HELEN MYERSCOUGH ACA

Sitting in public at Cambridge on 30 January 2014

Michael Struebel in person

Erika Carroll, Presenting Officer, for the Respondents

DECISION

Introduction

1. This is an appeal against a VAT default surcharge for the appellant's VAT return period ending 31 July 2013 ("07/13"). The surcharge was charged at the rate of 10% and amounted to £2130.11.

The facts

2. The appellant, Mr Michael Struebel, trades as Two Stroke to Turbo, and specialises in repairing and servicing Saab motor cars. He also sold used cars. The appellant set up the business 30 years ago when he was 18.

3. Saab ran into financial problems. At the end of 2011, Saab filed for bankruptcy. Amidst its financial difficulties, Saab ceased to produce cars. Mr Struebel's evidence, which we accept, was that the pipeline of new Saab cars dried up about 2 1/2 years ago.

4. Saab's difficulties and the cessation of car production had a serious adverse effect on Mr Struebel's business. A significant part of his business consisted of servicing and repairing (including spares for) Saab cars after the warranty period had expired. If no new cars were being produced then there were fewer cars to service. The cars he sold were typically one year old or pre-registered so these soon dried up after production ceased.

5. Around 2 – 2 1/2 years ago Mr Struebel decided to restructure his business. As soon as he realised that Saab were not going to resume production of motor cars (there had been failed discussions with potential Chinese and Dutch buyers for Saab), he joined the Bosch franchise called AutoCrew. This involved rebranding and dealing with all makes and models of cars. In the event, the joint-venture with Bosch was not successful. Mr Struebel said the Bosch "offered a lot, charged a lot, but provided little."

6. Approximately 6 months ago, Mr Struebel left the AutoCrew franchise and marketed his business under its own name. He has been working with a coach to restructure the business. This involved downsizing.

7. The business disposed of six leased courtesy cars in December 2013 and January 2014. There were difficulties in reducing rental liabilities of equipment and premises by early termination of the leases. The business also had substantial liabilities on its leased diagnostic equipment. Mr Struebel subsequently bought this equipment outright at a nominal price.

8. The business also occupied two warehouses. Mr Struebel had previously tried to negotiate with his landlord the early termination of one of the warehouse leases but without success. Mr Struebel has now negotiated with his landlord to keep one

warehouse which will be used partly as the workshop and partly for storage when the leases expire in October 2014. The workshop will be reduced from 10 ramps to 5 ramps. Overall, Mr Struebel estimated the saving as being £40,000 per annum.

9. Mr Struebel also changed the way the business purchased stock. Formerly, he had bought stock upfront but now only bought stock as and when he could sell it.

10. At around the time that Saab ceased production, Mr Struebel had also attempted to diversify the business into coach-building. He had entered into a contract to convert 2 vehicles. He had subcontracted the coating to the inside of one of the vehicles, but it transpired that the coating had been incorrectly applied. After unsuccessful attempts to rectify the problem, Mr Struebel's customer rejected the first vehicle, which Mr Struebel was then forced to sell at scrap value, and cancelled the contract on the second vehicle. Mr Struebel commenced legal proceedings against the subcontractor, which are still continuing. Had the difficulties not arisen, Mr Struebel would have anticipated being paid on the first contract in February or March 2012. Mr Struebel estimated his loss at around £25,000 in respect of the first vehicle.

11. As a result of downsizing the business, Mr Struebel informed us that turnover had fallen from £1.3 million in 2010 to £750,000 (the forecast for the year ending 31 March 2014). In 2010 the business employed 22 people but now employed only 11 people.

12. Mrs Carroll pointed out that the appellant's turnover for the tax period 4/12 was higher than in the immediately preceding period and in all subsequent periods. Mr Struebel explained that in that period he had disposed of a number of used cars on his forecourt. The profit margins on these cars were very low (a number were on sale or return) with the result that although turnover was boosted there was little impact on profits. We accept Mr Struebel's evidence on this point

13. The default history of the appellant's business was as follows (all VAT periods being three months):

(1) In respect of period 04/12, £5,096.45 was paid by the due date. However, £16,200 VAT had been paid after the due date. The full amount was paid by instalments. This resulted in the issue of a surcharge liability notice on 15 June 2012 ("the first default").

(2) In relation to the period 07/12 the appellant again paid some of the liability late. He paid £2,400 by the due date. This time £13,872.66 was paid late (again by instalments). Because the surcharge at a rate of 2% was less than £400, HMRC did not (in accordance with its usual practice) impose a default surcharge but rather issued a surcharge liability notice extending the surcharge period ("the second default").

(3) The next late payment was made in respect of the period 10/12. £3,200 was paid by the due date, but£13,814.56 was paid late (again by instalments). A 5% surcharge was issued on 14 December 2012 in the amount of £690.72 ("the third default"). The surcharge was not appealed.

(4) Finally, in relation to the period under appeal (07/13), £1,925 was paid by the due date, but £21,301.10 was paid late (again by instalments). Because HMRC viewed this as a fourth default within the surcharge period a 10% surcharge was issued on 13 September 2013 in the amount of £2,130.11 ("the fourth default").

14. Mr Struebel had entered into certain Time To Pay ("TTP") agreements in respect of some VAT periods with HMRC. Because the TTP in some of these cases had been concluded after the due date in respect of the relevant periods, surcharges still arose. In other cases the TTP was concluded before the due date and therefore no surcharges arose.

Submissions

15. Mrs Carroll accepted that Mr Struebel had done everything possible to get his business out of financial difficulties. However, she submitted that his problems were no different from those experienced by many other businesses over the past few years. Consequently, HMRC did not accept that Mr Struebel had a reasonable excuse for the late payment of VAT.

16. We asked Mrs Carroll whether, if there was a reasonable excuse for the first default in 04/12, that would have the effect of reducing the surcharge in respect of 07/12 for the period 07/13 to 5% (instead of 10%). She acknowledged that it would.

Discussion

17. In our view, it is relevant first to consider whether the appellant had a reasonable excuse within the meaning of section 59 (7) Value Added Tax Act 1994 ("VATA") (when read with section 71 VATA) for the period 07/13.

18. In approaching this question we are mindful of Section 71(1)(a) VATA which provides that "*an insufficiency of funds to pay any VAT due is not a reasonable excuse*". Following the decision of the Court of Appeal in *Customs and Excise Commissioners v Steptoe* [1992] STC 757 ("*Steptoe*"), it is necessary to consider the underlying causes of the insufficiency of funds to determine whether there is a reasonable excuse for the default.

19. In *Steptoe*, Lord Donaldson MR said [at 770]:

> "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."

20. Lord Donaldson MR continued by disapproving the narrower test put forward by Scott LJ and emphasised the importance of whether the late payment of VAT was reasonably avoidable [at 770]:

> "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."

21. In our view, as Mrs Carroll accepted, Mr Struebel seems to have taken all the steps that could be reasonably expected of a businessman in his position to avoid the late payment of VAT. The cessation of car production by Saab was an event entirely outside his control and one which was bound to have profound consequences for a business like the appellant's which specialised in servicing and repair of Saab cars. These effects were in our view bound to be severe and long-lasting. Moreover, Mr Struebel was not passive in the face of his difficulties. He attempted unsuccessfully to diversify via the AutoCrew joint-venture and also by moving into coach-building. He tried unsuccessfully at first negotiating with his landlord to reduce his lease rental liabilities on his premises. When eventually able to do so he has reduced his lease obligations in respect of his premises and equipment and has reduced the size of his workforce.

22. We do not think that the misfortunes suffered by Mr Struebel were those of a general nature similar to those experienced by many businesses in the recent recession. The cessation of the production of new Saab cars was an entirely different type of event, although it was evident that the economic down-turn made it a difficult time at which to refocus or diversify his business.

23. We also note that Mr Struebel, conscious of his tax obligations, settled his VAT liabilities in full, albeit late. Indeed, our overall impression of Mr Struebel was that of a conscientious man doing his best in difficult circumstances. It is true that the problems which beset Mr Struebel's business cannot be an indefinite reasonable excuse. However, on balance, we have concluded that these problems existed through the period 07/13. Accordingly, we have concluded that Mr Struebel had a reasonable excuse for that period.

24. Although the period 04/12 period is not under appeal, we should perhaps comment on this period because it is the surcharge liability notice issued in respect of that VAT period which started the surcharge period running in accordance with section 59. The surcharge period, which would have ended on the first anniversary of the last day of the 04/12 period, was then extended by the second and third defaults.

25. It appears that there is no right of appeal in respect of the first default. No liability to a surcharge arises in respect of the first default because the default did not occur within the surcharge period. Section 83 (1) (n) VATA provides that an appeal to this Tribunal can be made in respect of "any liability to a penalty or surcharge by virtue of section[..] 59." Because no liability to a surcharge arose there could be no right of appeal in respect of the first default (period 04/12).

26. The first default is important because, as we have said, it sets the surcharge period running. If the first default was not genuinely a "default" (e.g. because there was a reasonable excuse for that default) this would effectively set back all the other defaults. In other words, the second default would become the first default, the third default would become the second default and so on. This would have the effect that the rate at which the default surcharge is charged would diminish in relation to the second, third and fourth defaults.

27. That the question whether a reasonable excuse existed for the first default is relevant to the determination of the correct surcharge rate in respect of the fourth default is, in our view, confirmed by section 58 (8) VATA. In order to understand this provision, however, it is necessary to read it together with section 58 (7) VATA.

28. Sections 58 (7) and (8) provide as follows:

> "(7) If a person who, apart from this subsection, would be liable to a surcharge under subsection (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,
>
> 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 (and, accordingly, any surcharge liability notice the service of which depended upon that default shall be deemed not to have been served).
>
> (8) For the purposes of subsection (7) above, a default is material to a surcharge if—
>
> (a) it is the default which, by virtue of subsection (4) above, gives rise to the surcharge; or
>
> (b) it is a default which was taken into account in the service of the surcharge liability notice upon which the surcharge depends and the person concerned has not previously been liable to a surcharge in respect of a prescribed accounting period ending within the surcharge period specified in or extended by that notice."

29. As the VAT and Duties Tribunal (Mr Hellier and Mr Cork) said in *Aardvark Excavations Ltd v HMRC* [2007] V 20468 at [39]:

> "The interpretation of paragraph (b) [of section 59 (8)] is not without its difficulties."

30. The Tribunal carefully unravelled the mysteries of section 59(8) and reached the following conclusion at [58] that:

> "the tribunal is entitled to have regard in the application of section 59(7) to a prima facie default other than that directly giving rise to the surcharge under appeal for the purpose of determining whether such a default whose existence may affect the amount or existence of the default under appeal, may be ignored."

31. This conclusion commended itself to the tribunal in *R P Griffin & D M Griffen v Revenue & Customs* [2010] UKFTT 220 (TC) (Judge Brooks and Mr James). We respectfully agree with the conclusions reached in *Aaardvark* and *Griffin*.

32. We consider that the intention of section 59 (8) (b) is certainly to enable the tribunal to take account of a default in respect of which no appeal could be brought because no surcharge liability arose. For example, as we have explained, no appeal could be taken in respect of the first default (period 04/12). The wording of section 83 (1) (n) echoes the wording used in section 59(8)(b) – both provisions refer to a liability to a surcharge. We think the purpose of section 59(8)(b) is to allow, as we have said, account to be taken of the first default which, because it falls before the surcharge period, results in no surcharge liability (and thus carries no right of appeal) but account should not be taken of the surcharges in respect of which a surcharge liability arose under the legislation and in respect of which an appeal could have been taken. Had it be necessary for us to decide the question, we would have reached the conclusion that there was a reasonable excuse for the late payment of VAT in respect of the period 04/12.

33. The cessation of production of Saab cars plainly had a very adverse impact on Mr Struebel's business – a business which specialised in the spares for and servicing and repair of Saab cars. We saw no reason to doubt that the cessation of Saab car production resulted in a significant diminution in Mr Struebel's business. At the same time, we accept his evidence that many of the overheads of his business (e.g. lease rentals in relation to premises and equipment) could not immediately be reduced. In addition, the alleged failure by Mr Struebel's subcontractor, leading to subsequent litigation, deprived Mr Struebel of approximately £25,000 of income in the 04/12 period. We therefore conclude that Mr Struebel had a reasonable excuse for the failure to pay the VAT due in respect of the 04/12 period.

34. Given our conclusion on relation to the period under appeal, it is also unnecessary for us to reach a conclusion on the question whether, in respect of the second default for the period 07/12, there was (and whether we are entitled to find that there was) a reasonable excuse. In this case, no surcharge was imposed because it is HMRC's practice not to impose a surcharge where the applicable rate is 2% or 5% if the amount of the surcharge is less than £400 (Notice 700/50). This is a perfectly understandable administrative practice in itself, but it does mean that the question whether there was a "true" default (eg whether there was a reasonable excuse for the default) cannot in practice be appealed. However, for what it is worth, had we been called upon to decide the point we would have concluded, for the same reasons as we have given for 04/12 (save in respect of the sub-contractor's failure), the appellant had a reasonable excuse for 07/12. It is clear to us that Mr Struebel's business was still suffering badly from the cessation of Saab car production.

35. For these reasons we allow this appeal.

36. 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.

GUY BRANNAN
TRIBUNAL JUDGE

RELEASE DATE: 10 February 2014