TC04223

Appeal number: TC/2014/01973

VAT - PENALTIES - VAT – default surcharge – financial difficulties - whether reasonable excuse - section 59(7) VAT Act 1994 - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

IGLOOS LTD

Appellant

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS

Respondents

TRIBUNAL: JUDGE GREG SINFIELD
MR JOHN ROBINSON

Sitting in public at Fox Court, London WC1 on 18 December 2014

Luke Neale, director of Igloos Limited, for the Appellant

Mark Ratcliff, officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal by Igloos Limited ("the Company"), against default surcharges totalling £45,784.54 under section 59 of the Value Added Tax Act 1994 ("VATA94"). The Respondents ("HMRC") had imposed the surcharges on the Company for its failure to pay VAT on time in respect of VAT accounting periods 06/12, 09/12, 12/12, 03/13 and 06/13.

2. Mr Luke Neale, a director of the Company, accepted that the VAT due from the company had not been paid on the due dates. He told us that the reason for the late payments was the financial stress and cash flow difficulties faced by the company during 2012 and 2013, described more fully below. The only issue in the appeal was whether the Company had a reasonable excuse within the meaning of section 59(7) VATA94.

3. For the reasons set out below, we have decided that the Company did not have a reasonable excuse, as that term is defined for the purposes of the relevant legislation, for its failure to make the payments of VAT on time. Accordingly, the Company was liable to pay the default surcharges and the appeal must be dismissed.

Legislation

4. Liability to a default surcharge arises under section 59 VATA94. Section 59(1) provides that a taxable person is in default where HMRC do not receive a VAT return and any VAT shown as payable on such return on or before the due date. Where a person is in default, HMRC may issue a surcharge liability notice ("SLN"). If, having been served with a SLN, the taxable person defaults again during the period of one year ("the Surcharge Liability Period") from the end of the period of default, the person becomes liable to a surcharge. On each subsequent default, the Surcharge Liability Period is extended to run for 12 months from the end of the latest period of default.

5. The surcharge is the greater of £30 and a specified percentage of the outstanding VAT. The percentage specified increases according to the number of VAT periods in respect of which the person is in default during the surcharge period. The maximum percentage is 15% where there are four or more periods in default for which VAT remains unpaid.

6. Section 59(7) VATA94 provides that a taxable person is not treated as in default in respect of any period if the person satisfies HMRC, or on appeal to this Tribunal, that in respect of the period:

> (1) the return or the VAT due was despatched at such a time and in such a manner that it was reasonable to expect that it would be received by HMRC within the time limit; or
>
> (2) there is a reasonable excuse for the return or VAT not having been so despatched.

7. Section 71(1)(a) VATA further provides that for these purposes an insufficiency of funds to pay any VAT due is not a reasonable excuse. Section 71(1)(a) was considered by Court of Appeal in the leading case of *Customs and Excise v Steptoe* [1992] STC 757. The Court of Appeal held that although insufficiency of funds can never of itself constitute a reasonable excuse, the cause of that insufficiency – the underlying cause of the taxpayer's default – might do so.

Facts

8. The narrative that follows is drawn from the evidence given by Mr Neale and the documents provided by HMRC.

9. The Company is a specialist in both the supply and installation of luxury temporary and permanent toilets and washroom facilities. It builds washrooms for stadiums and hotels and also provides similar facilities for events such as Ascot and grand prix races. The Company registered for VAT on 1 March 1996. It was successful and traded profitably from 1993 to 2008. In 2009, the Company's turnover reduced from approximately £3 million to around £1.5 million or less very quickly. At the time, the Company owed Lombard some £500,000 and owed HMRC about the same. The Company entered a Company Voluntary Arrangement ("CVA") around April 2010 in order to pay its debt to HMRC. The Company made payments under the CVA of between £150,000 and £180,000 each year. At the same time, Lombard allowed the Company to suspend repayments until later in 2010 when the Company started to make payments of £26,000 per month. When the Company entered into the CVA, many of its suppliers withdrew the credit facilities that they had previously granted to the Company. In mid-2012, the Royal Bank of Scotland withdrew the Company's overdraft facility, which was £150,000, and converted it into a loan repayable at £8,000 or £9,000 per month. In 2012, the Company won contracts to provide facilities for hospitality events at the London Olympics. Mr Neale told us, and we accept, that this was a substantial amount of business but that the London Organising Committee of the Olympic Games ("LOCOG") and the Olympic Delivery Authority ("ODA") were good payers but slow payers. The Company repaid Lombard in full and the monthly payments finished in or around October 2012. The CVA finished in February 2014 with the Company having paid HMRC 70p for every pound owed.

10. The Company was served with a SLN as a result of a late payment in relation to VAT accounting period 06/11. A default in relation to period 09/11 did not lead to a penalty because the amount was below the de minimis threshold but it extended the Surcharge Liability Period. A further default in relation to period 12/11 resulted in a 5% penalty which the Company paid. The relevant defaults by the Company and the liability to surcharges that arose as a result were as follows:

VAT period	Due date	VAT unpaid	Date of payment	%	Surcharge
06/12	31/07/12	120,000	07/08/12 – 25/09/12	10	12,000
09/12	31/10/12	75,118.09	23/11/12 – 14/03/13	15	11,267.71
12/12	31/01/13	41,295.11	29/04/13	15	6,194.26
03/13	30/04/13	50,127.42	03/06/13 – 07/06/13	15	7,519.11
06/13	31/07/13	58,689.74	03/10/13 – 22/10/13	15	8,803.46

Submissions by the parties

11. Mr Neale accepted that the VAT had been paid late in periods 06/12, 09/12, 12/12, 03/13 and 06/13. He also accepted that the Company knew what payments it had to make to Lombard and to HMRC under the CVA during the period of the defaults. Mr Neale told us that he considered that those matters together with the withdrawal of the overdraft facility by RBS, the withdrawal of credit facilities by suppliers and slow payment of invoices by LOCOG and the ODA showed that the Company was experiencing considerable financial stress and onerous cash flow difficulties during the periods of the late payments. He considered that those difficulties should be regarded as a reasonable excuse for the Company's failure to pay the VAT on or before the due date in relation to all the periods under appeal.

12. Mr Ratcliff, for HMRC, contended that HMRC has imposed the surcharges because of the late payment. He said that HMRC did not accept that the Company had a reasonable excuse for failing to pay VAT on time. He submitted that an insufficiency of funds could not be a reasonable excuse although the underlying reason for the insufficiency could be. He accepted that the withdrawal of an overdraft facility without notice could be a reasonable excuse in some circumstances. He pointed out that, in this case, it led to the Company having to pay an additional £8,000 or £9,000 per month and that was only a small part of the VAT that was due. He acknowledged that the Company had faced severe cash flow problems but said that the Company should have approached HMRC's Debt Management Unit and requested a time to pay arrangement. He told us that the Company had done so in November 2011 and been granted time to pay. HMRC had no record of the Company asking for a time to pay arrangement in relation to the periods under appeal.

Discussion

13. The only issue in this appeal is whether the Company had a reasonable excuse within the meaning of section 59(7) VATA94 for the VAT not having been paid on time in relation to the periods 06/12, 09/12, 12/12, 03/13 and 06/13. For these

purposes, an insufficiency of funds cannot be a reasonable excuse for failing to pay any VAT due on time.

14. In *Steptoe*, Lord Donaldson MR, with whom Nolan LJ agreed, described reasonable excuse as follows:

> "… [I]f 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."

15. Lord Donaldson also said:

> "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."

16. In summary, if the exercise of reasonable foresight and of due diligence and a proper regard for the fact that the tax was due on a particular date would not have avoided the insufficiency of funds which resulted in the Company failing to the pay the VAT on time, then the Company could have a reasonable excuse for non-payment. However, if the cash flow problem was reasonably foreseeable then the mere fact that the Company could not afford to pay the VAT would not, without more, be a reasonable excuse.

17. In this case, it appears to us that the Company knew all too well that it faced cash flow difficulties. That is why it took the steps that it did to negotiate with Lombard and enter into the CVA. The Company was faced with the difficult choice of whether to meet the financing needs of its business or pay its VAT liabilities. The decision to defer payments of VAT in those circumstances cannot amount to a reasonable excuse. We are sympathetic to the difficulties experienced by the Company but we consider that they were not more than might be expected (and are often experienced) by many businesses. Our decision is that the Company does not have any reasonable excuse for its failure to pay the VAT due on time. In the circumstances, the penalty is confirmed and the appeal must be dismissed.

18. Mr Neale did not argue that the penalties were disproportionate. However, for the sake of completeness, we note that we are bound by the decision of the Upper Tribunal ("the UT") in *HMRC v Total Technology* [2012] UKUT 418 (TCC) which confirmed that the test when considering issues of the proportionality of a penalty is not whether the penalty is "harsh" but whether it is "plainly unfair" or "without reasonable foundation". The UT found that there is nothing in the VAT default surcharge regime which leads to the conclusion that its architecture is fatally flawed. It is necessary to consider whether an individual penalty fails the test of proportionality in the circumstances of the case. Although we accept that the

surcharges are a significant amount for the Company to pay, we do not regard them as disproportionate.

Decision

19. For the reasons set out above, we have decided that the Company did not have a reasonable excuse for its failure to make the payments of VAT on time. Accordingly, the Company was liable to pay the default surcharges and the appeal must be dismissed.

Right to apply for permission to appeal

20. 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.

GREG SINFIELD
TRIBUNAL JUDGE

RELEASE DATE: 12 January 2015