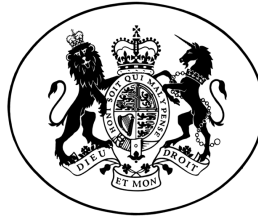


[2016] UKFTT 226 (TC)



TC05000

Appeal number: TC/2015/05677

VALUE ADDED TAX – default surcharge – insufficiency of funds – whether exceptional underlying reasons for lack of funds – for one period, held no – for the subsequent period, particular circumstances leading to limited availability of funds – appeal dismissed in respect of first period, allowed in respect of second period

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

SDI-UNISTRIDE (SOUTHERN) LIMITED

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE JOHN CLARK
MICHAEL SHARP FCA**

Sitting in public at Southampton on 23 February 2016

Samuel Howell, Director, for the Appellant

Les Bingham, officer of HM Revenue and Customs, for the Respondents

DECISION

1. The Appellant, (“SDI-U”) appeals against VAT default surcharges imposed by the Respondents (“HMRC) for the periods 11/14 and 02/15.

The background facts

2. The evidence consisted of a bundle of documents. In addition, Mr Howell made statements in the course of putting the case for SDI-U; where appropriate, we have accepted these as evidence.
3. From the evidence we find the following background facts.
4. SDI-U had been brought within the default surcharge regime from VAT period 11/13 onwards. Its returns for all those periods had been submitted on time, but (with very limited exceptions) its payments of VAT had been made after the respective due dates.
5. On 7 April 2015, Mr Howell wrote to HMRC, referring to a request made that day for SDI-U to be allowed to defer payment of the VAT due for 02/15 until 10 April 2015. HMRC had refused this on the grounds that the VAT due for the previous quarter had still not been paid in full. SDI-U was therefore appealing against the HMRC officer’s decision on the grounds that incurring a surcharge for the delay of three days in paying the VAT was highly inequitable and that incurring a surcharge would simply create further arrears and penalise SDI-U through no fault of its own.
6. He described SDI-U’s business:
- “This Company is a specialist in “No dig” drainage repairs and as such virtually all our work is for major UK construction Companies who, regardless of our 30 day credit terms, pay us from 76 days to 90 days. Their payment dates are always after the month end and invariably between the 10th and 15th of the month probably to pay their VAT on time. To obtain payment from them at any time except when they choose is impossible. Our current situation is that we are due to receive and have received from two reliable major customers confirmation that we will be paid on 10th April which will enable us to pay the VAT for the current quarter due for payment today. A further customer who promised a payment for today has failed to do so.”
7. According to HMRC’s records, the payments in respect of period 02/15 were made over a longer period than that referred to by Mr Howell (after clearing the liabilities in respect of period 11/14).
8. On 21 July 2015, Mr Howell wrote to HMRC, referring to the surcharges incurred for late payment of VAT. He had looked into the reasons for late payment, and had established that the late payment was because SDI-U was “a victim of HMRC regulations”. He gave the following explanation:

5 “The Company is engaged on drainage and repair work and perhaps as high as 90% of this work is as a sub contractor to National Construction Companies. The Company is registered for the Contractor to make payment under deduction of tax at 20%. Under the scheme the tax deducted can be used to offset PAYE and NHI [*sic*] liabilities. The problem for this Company is that the tax deductions exceed the PAYE liability by a considerable sum, for example at the beginning of June the deductions were £53,000 more than the liability for PAYE and NHI contributions. The Company had therefore effectively paid in advance PAYE and NHI contributions on nearly 10 three months wages and salaries which had not yet been paid.

The 20% deductions are of course the money which would have been available to pay the VAT but which is already held in the hands of HMG by another department.”

15 9. He also referred to the impossibility for SDI-U to pay its VAT on time as a result of the fact that the contractors never paid their accounts on the due date and always paid after the due date for SDI-U to pay its VAT. He argued that the surcharges were inequitable in these circumstances. He asked for a dispensation for the due date for payment of each quarter’s VAT to be deferred to the 21st of the 20 relevant month.

10. HMRC replied on 20 August 2015. Although they sympathised with the position that SDI-U found itself in, insufficiency of funds was excluded by the legislation from being a reasonable excuse; therefore, relying on a repayment from another area within HMRC to cover the VAT payment for the 08/12 period was not a 25 reasonable excuse. [The reference to 08/12 appears to be erroneous.]

11. However, HMRC had agreed to amend the surcharges for a series of VAT periods. As a result, the first default surcharge liability notice was given in respect of 08/14, as a result of which the surcharge for 11/14 was amended to 2 per cent and the surcharge for 02/15 was amended to 5 per cent.

30 12. Mr Howell wrote on 21 July 2015 to the Chancellor of the Exchequer, referring to the difficulties which he had previously described in the correspondence with HMRC.

35 13. On 21 August 2015 HMRC’s Complaints Office replied to Mr Howell’s letter, responding to the points made, and stating that a dispensation could not be given to extend the period in which VAT had to be paid.

14. SDI-U gave Notice of Appeal to HM Courts & Tribunals Service on 15 September 2015.

40 15. An HMRC Review Officer wrote to SDI-U on 5 October 2015 asking for any information which might indicate that there was some causative event giving rise to the lack of funds which demonstrated that the underlying cause of the lack of funds constituted a reasonable excuse. He set out a series of criteria, and asked for information to be provided in respect of a number of specific points.

16. Mr Howell replied on 14 October 2015. He gave a detailed explanation of SDI-U's position, and provided the information requested.

17. On 13 November 2015, the Review Officer (referring to himself as an Appeals Officer) wrote to SDI-U to say that he had been notified of the appeal to the Tribunal.
5 He set out a summary of the facts which would be presented by HMRC at the hearing and the reasons why HMRC considered that the surcharge should be upheld.

18. In that letter the Appeals Officer stated:

10 "I would point out that we did remove the surcharges for the periods 11/13, 02/14 and 05/14 following you [*sic*] initial request for a review as the reviewing officers [*sic*] understanding was there had been a sudden and unexpected extension in the time being taken by your main customers to make payment. My investigations however lead me to conclude that this was not in fact the case and the situation had been ongoing for some time.

15 The above notwithstanding I do not intend to reinstate those surcharges.

20 Whilst HMRC cannot grant a discretionary agreement to extend you [*sic*] quarterly payment date you currently have you can apply to use Non Standard Tax Periods (NSTP's) which would alter the quarterly end dates to a date chosen by you which would the [*sic*] alter the due date for submission of your returns and payments."

Arguments for SDI-U

19. Mr Howell explained that he was an accountant; he also dealt with human resources and had a number of other responsibilities. He referred to the absence of
25 offset by HMRC for one tax liability against another, especially for Construction Industry Scheme ("CIS") deductions, which were very large in SDI-U's case. He emphasised the collection difficulties in respect of invoices rendered to contractors. Banks were unwilling to advance money to cover tax payments.

20. In respect of the CIS, the deductions were such that SDI-U rarely had any
30 liability to make PAYE payments on the 19th of any month. Its activities were very labour-intensive.

21. It had no alternative but to accept the payment terms imposed on it by the contractors. In practice it had to invoice on the 20th of the month, which added 20
35 days to the delay in payment. Mr Howell explained the basis on which SDI-U approached the management of its cash position. As all contractors paid around the 18th or 20th of the month, this meant that the funds were received too late to pay the VAT, which SDI-U did by direct transfer.

22. With reference to HMRC's letter dated 13 November 2015, he explained
40 particular circumstances which had arisen after the end of 2014; we consider those circumstances at a later point below. He believed these circumstances were quite exceptional, and that as a result there should be a concession in this case.

23. HMRC were saying that it was not an unexpected event for customers to pay late. Mr Howell referred again to the practical difficulties in getting the contractors to make payment, in particular the delays caused by the time taken for quantity surveyors to “pass” invoices for payment.

5 24. He argued that SDI-U always honoured Time to Pay agreements. He was unable to understand the logic behind removing the previous surcharges while retaining the two still under appeal; these were more liable to extenuation circumstances. He explained that SDI-U had now changed to Non Standard Tax Periods, although he was trying to confirm aspects of this arrangement.

10 25. He explained that he could not make head or tail of HMRC’s figures. A payment of £25,000 was missing from the schedule provided by HMRC. That schedule did not show how SDI-U met its Time to Pay obligations. He referred to the complication caused by the bank restricting the total level of a payment on each occasion. He had attempted to reconcile HMRC’s figures, but had been unable to do
15 so.

Arguments for HMRC

26. Mr Bingham referred to the potentially missing amounts; these did not affect the surcharge situation. He referred to the history of defaults, and the withdrawals of surcharge liabilities for earlier periods. HMRC had thought that the cash problems
20 were unexpected; the withdrawals had affected the rates of surcharge for the periods under appeal.

27. SDI-U had not sought to dispute that the surcharges had been incurred; they were due for both periods. It was for SDI-U to show reasonable excuse. The difficulty in payment was due to insufficiency of funds. Mr Bingham referred to the
25 correspondence, including HMRC’s letter dated 13 November 2015 which was effectively a Statement of Case for HMRC.

28. In HMRC’s submission, there was no reasonable excuse either for period 11/14 or for period 02/15. Mr Bingham referred to s 59 of the Value Added Tax Act 1994 (“VATA 1994”), which imposed the default surcharge. There was no provision for
30 mitigation of default surcharges. He argued that the surcharges should remain as made, as no reasonable excuse had been demonstrated.

Discussion and conclusions

29. At the hearing, we adjourned to consider whether we were able to arrive at a decision and announce it to the parties. We considered the appeal and resumed the
35 hearing to make the following announcement of our decision:

40 “We have considered the position for both quarters. On the evidence, we are not satisfied that the Appellant had a reasonable excuse in respect of the payment due for 11/14. However, we consider that the circumstances relating to the Enfield contract (as mentioned to HMRC in the Appellant’s letter dated 14 October 2015) were exceptional in

their effect on the Appellant's financial position in relation to the payment due for period 02/15. We therefore confirm the surcharge for period 11/14 and find that the Appellant had a reasonable excuse for the late payment of the tax due for period 02/15.

5 Thus we dismiss the appeal in respect of the surcharge for 11/14 and allow the appeal in respect of the surcharge for period 02/15.”

30. We indicated that we would set out our detailed reasons in this decision.

31. We are satisfied that SDI-U was in default for the periods 11/14 and 02/15 as a result of making late payments of the VAT due for those periods. The issue is
10 therefore whether it had a reasonable excuse for making its payments late.

32. Section 71(1)(a) VATA 1994 provides that an insufficiency of funds to pay any VAT due is not a reasonable excuse. This is subject to the principle to be derived from *Customs and Excise Commissioners v Steptoe* [1992] STC 757 (CA) and similar
15 cases. In *Steptoe*, Lord Donaldson MR approved the view of Nolan LJ in the following terms:

“ . . . 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
20 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.”

33. We approve and endorse the analysis of *Steptoe* by the Tribunal (Judge Brannan and Toby Simon) in *Electrical Installation Solutions Ltd v Revenue and Customs Commissioners* [2013] UKFTT 419 (TC), TC02813 at [31]-[36] and the Tribunal's
25 criticisms of HMRC's VAT Civil Penalties Manual at [50]-[52]. The relevant paragraph in that Manual appears to have remained unchanged despite the Tribunal's comments.

34. We fully understand the difficulties for an “invoice trader” who is dependent on
30 payment of the amounts invoiced in order to be able to finance the operation of the business. Unlike a “cash trader”, who will have received payment for most or all of the amounts giving rise to the VAT liability, the invoice trader is put into the position of having to finance the VAT payments without necessarily having received payment of the invoices which have resulted in the VAT becoming due.

35. We also acknowledge the problem for SDI-U of having to make CIS payments
35 at a level which amounts in effect to making advance payments on account of PAYE which exceed the ultimate PAYE liability. We recognise that there may have been certain problems leading to delay in repayment of amounts to be refunded in respect of PAYE.

40 36. However, applying the principle expressed by Nolan LJ and approved by Donaldson MR in *Steptoe*, these difficulties do not appear to have been unforeseeable.

What is required in the light of *Steptoe* is something which could not have been predicted, even with the exercise of reasonable foresight.

37. In his letter to HMRC dated 14 October 2015, Mr Howell included the following two paragraphs:

5 “There were particularly severe problems in the two quarters 12/14 and
02/15. The Company undertook two major contracts through Ringway
Jacobs, the completion of which required the use of Combination
Tankers at a substantial cost to SDI. These tankers were hired from a
Company Roe Environmental and at one time SDI owed Roe
10 Environmental in excess of £112,000. SDI had negotiated 60 day terms
with Roe Environmental on the basis that SDI would be paid on similar
terms.

15 Interim payments were scheduled on these contracts but were not paid
on the due dates. Vigorous efforts were made to collect the money
even up as far as the Financial Director of Ringway Jacobs but without
success until a substantial payment was received on 18th May and then
only after threatening to report the lack of payment to TFL. We also
had to negotiate with Roe Environmental to pay them only when SDI
had been paid. Meanwhile interim payments were made to HMRC on
20 11th May and 28th May.”

38. At the hearing, Mr Howell gave further details of these circumstances. He
emphasised that these two quarters had been particularly special because of the
tankers. SDI-U had had to go to the tanker company and get its agreement to defer
part of the account. The tanker company was itself being debited with the costs of
25 environmental waste disposal.

39. In reply to our questions, Mr Howell explained that the work had taken place
between January and March 2015; he did not know the exact dates. It had not been
possible to start the work for some time; the flow had had to be blocked off upstream.
The waste had turned out to be toxic, which was a complete surprise. This sort of
30 situation did not occur very often, and the problem was huge. SDI-U was not able to
carry out a survey. The work overran on time, and twice there was a subsequent
increase in the value of the contract. The quotation had to be changed.

40. When asked whether it had been possible to put pressure on Enfield Council,
the local authority involved, Mr Howell explained that they employed Ringway
35 Jacobs as a service provider. Ringway Jacobs were less than efficient in rendering
their invoices. These were very late; none at all were presented for the first month.
SDI-U had put pressure directly through Enfield Borough Council, and then Ringway
Jacobs had paid two months’ invoices at once. SDI-U was concerned to retain its
status as a preferred or specified contractor.

40 41. We asked Mr Bingham if these circumstances formed a basis for some
concession on HMRC’s part. Mr Bingham stated that these circumstances had not
been advised to HMRC.

42. In considering our decision, we reviewed the correspondence and concluded that HMRC had been informed of these circumstances in Mr Howell's letter dated 14 October 2015. We accepted that no previous indication had been given to HMRC.

5 43. We considered the combination of circumstances and their effects on the financial position of SDI-U. In relation to period 11/14 (not 12/14 as referred to by Mr Howell in his letter), we did not think that there was sufficient evidence that the additional costs were building up in January 2015; Mr Howell had not been able to give specific dates, but had said that it had not been possible to start work for some time. We therefore concluded that there was insufficient evidence to support the
10 argument that unforeseeable circumstances applied in respect of period 1/14.

44. However, we were satisfied that for period 02/15, there were exceptional, unforeseeable and unforeseen circumstances giving rise to insufficiency of funds. Accordingly, we found that the approach referred to in *Steptoe* applied to SDI-U for that period, and that it had a reasonable excuse for not making payment on or before
15 the due date of the VAT due in respect of that period.

45. On the basis that there was no reasonable excuse in relation to period 11/14, we confirmed the surcharge and dismissed the appeal to that extent. As there was a reasonable excuse for late payment of the VAT for that period, we held that no surcharge was due and allowed the appeal in respect of 11/14.

20 46. We understand that SDI-U has subsequently changed to a Non Standard Tax Period, and that this appears to have alleviated the difficulties arising from late payment of invoices by its customers. We hope that this change will prevent it from suffering late payment surcharges in future.

Right to apply for permission to appeal

25 47. 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
30 "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

35 **JOHN CLARK**
TRIBUNAL JUDGE

RELEASE DATE: 1 APRIL 2016