



TC05573

Appeal number:TC/2016/03649

VAT – default surcharge – late payment of VAT – whether reasonable excuse for late payment – penalty alleged to be unfair and disproportionate – appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

ASSISTA CONSULTING (UK) LIMITED

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE JONATHAN CANNAN
MR DEREK ROBERTSON**

Sitting in public in Liverpool on 12 December 2016

Mr James Wilson, director appeared for the Appellant

Mr Anthony O’Grady of HM Revenue & Customs appeared for the Respondents

DECISION

Introduction

5 1. This is an appeal against a default surcharge in respect of the Appellant's VAT accounting period 01/16. The net VAT for that period was £25,137 and it was due for payment on or before Monday 7 March 2016. Payment was received by HMRC 3 days late on Thursday 10 March 2016.

2. The appellant had a number of previous defaults in periods 01/14, 07/14, 10/14,
10 01/15 and 04/15. The previous defaults caused the default for period 01/16 to fall within a surcharge period for the purposes of the default surcharge regime in section 59 VATA 1994. The rate of surcharge for 01/16 was therefore 15% giving rise to a default surcharge of £3,770 which is the matter under appeal. The grounds of appeal are broadly as follows:

15 (1) There was a reasonable excuse for late payment in relation to period 01/16 arising from the Appellant's dealings with various NHS Trusts which were habitually late in making payment to the Appellant for its services.

(2) The default surcharge imposed on the Appellant was grossly unfair and disproportionate.

20 3. The Appellant's case was presented by Mr James Wilson. Despite the obvious frustration he felt with the fact that late payments by NHS Trusts had given rise to significant default surcharges over the past 2 years, he was professional and measured in the way he put forward the Appellant's case. The Respondent's case was presented in a similar fashion by Mr O'Grady and we are grateful to both of them for the
25 approach taken.

The Law

4. Section 59 Value Added Tax Act 1994 ("VATA 1994") provides for penalties known as default surcharges in cases where there is late payment or late submission of VAT returns. Section 59(7) VATA 1994 provides as follows:

30 " (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—

35 (a) ...

(b) *there is a reasonable excuse for the return or VAT not having been so despatched,*

he shall not be liable to the surcharge ...”

5. *Section 108 Finance Act 2009* also provides that a taxpayer will not be liable to a default surcharge if the default arises between the date on which the taxpayer requests a deferral of the payment and the end of any agreed deferral period. These are known as “time to pay arrangements”. The request for such an arrangement must be made prior to the due date for payment if it is to prevent a default taking place.

6. The meaning of reasonable excuse in this context is well established. In *The Clean Car Co Ltd v Customs and Excise Comrs* [1991] VATTR 234 HH Judge Medd QC said:

“ It has been said before in cases arising from default surcharges that 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?”

7. Section 71 VATA 1994 provides that an insufficiency of funds to pay any VAT due is not a reasonable excuse. Having said that it has been well established since the decision of the Court of Appeal in *Customs and Excise Commissioners v Steptoe* [1992] STC 757 that the underlying cause of an insufficiency of funds may amount to a reasonable excuse in appropriate circumstances. The decision in Steptoe was recently considered by the Upper Tribunal in *ETB (2014) Limited v Commissioners for HM Revenue & Customs* [2016] UKUT 0424 (TCC). In the context of an insufficiency of funds the Upper Tribunal closely examined the judgments in Steptoe, noting that it was a decision by a majority of the Court of Appeal and summarised the test of reasonable excuse as follows:

“ 15. In summary, the question to be asked when considering whether someone has a reasonable excuse for failing to pay an amount of tax on time because of a cash flow problem is whether the insufficiency of funds was reasonably avoidable. A cash flow problem would usually be regarded as reasonably avoidable if the person, having a proper regard for the fact that the tax was due on a particular date, could have avoided the insufficiency of funds by the exercise of reasonable foresight and due diligence. If the cash flow problem was reasonably avoidable then the mere fact that the taxpayer could not afford to pay the VAT at the proper time would not, without more, be a reasonable excuse. On the other hand, if such foresight, diligence and regard would not have avoided the insufficiency of funds then the taxpayer will usually be regarded as having a reasonable excuse for the VAT having been paid late until it would be reasonable to expect the taxpayer to have found alternative funding or taken other action to counteract the insufficiency.”

8. That is the test we shall apply in determining whether the Appellant had a reasonable excuse for late payment for period 01/16. We now consider the application of the test to the facts of the present appeal.

Findings and Reasons

9. Based on the evidence before us we make the following findings of fact.

10. The Appellant is in business providing financial consulting services almost exclusively to the finance departments of NHS Trusts. It helps them to develop financial forecasting and costing systems and advises on software purchases. Mr James Wilson is a director of the Appellant and a Chartered Management Accountant. The Appellant has 4 employees and 11 contractors which it uses to provide services throughout the UK.

11. The Appellant contracts with NHS Trusts on terms which make provision for payment of fees within 30 days of the invoice date. There is also a provision for 8% interest on sums outstanding but the Appellant has never sought to obtain interest on sums paid late. In practice the Appellant is rarely paid within 1 months of the invoice date. It is far from typical that payments remain outstanding 8 months after the invoice date and in some cases more than 12 months. Mr Wilson would constantly phone the NHS Trusts to chase payment. He considered that was more effective than writing, but often he would be “sent round in circles”. He did not consider that “in the real world” he had any other remedy for late payment by the NHS Trusts. If he attempted more robust forms of debt collection then the Appellant would lose its client base.

12. Mr Wilson produced the Appellant’s aged debtor ledger as at March 2016. This showed total debtors of £120,690. Approximately half that sum was overdue. Some £27,000 was one month overdue and some £19,000 was two months overdue. The balance of approximately £11,000 was more than two months overdue.

13. The Appellant’s history of VAT payments and default surcharges is summarised in the following table:

VAT Period	Amount Due £	Due Date	Payments Made
01/14	21,729	07/03/14	10/3 and 30/3/15
07/14	31,537	05/09/14	22/10/14
10/14	24,065	05/12/14	Between 22/6/15 and 8/3/16
01/15	22,420	06/03/15	Between 8/3/16 and 24/3/16
04/15	23,026	05/06/15	24/3 and 13/5/16
07/15	44,486	07/09/15	On time
01/16	25,137	07/03/16	10/3/16

14. It can be seen that for some periods including 01/16 the payments made were a few days late, whilst for other periods they were considerably later. On 26 June 2015 the Appellant entered into a time to pay arrangement with HMRC for the outstanding sums relating to periods 10/14, 01/15 and 04/15. It complied with the terms of that arrangement and also there was no default for period 07/15.

15. In order to make payment for the 01/16 accounting period the Appellant had factored its debts with Bibby. It had not done that before because of the high cost associated with factoring.

16. The case of Steptoe bears some similarity to the present facts. In Steptoe the taxpayer was an electrical contractor working almost exclusively for the London Borough of Redbridge. Redbridge was consistently late in paying invoices. Invoices were often paid more than two months late leaving the taxpayer with insufficient funds to pay VAT for three accounting periods. It was found that if the taxpayer had brought pressure to bear on Redbridge then he would probably have received no further work and his livelihood would have disappeared.

17. The VAT Tribunal found that the council's persistent delay in paying its invoices could not be regarded as a normal hazard of trade. It held that there was a reasonable excuse because of the unexpected and continuing conduct of Redbridge. The High Court and the Court of Appeal upheld the VAT Tribunal. It was in the course of the majority judgments of the Court of Appeal that the test summarised by the Upper Tribunal in ETB (2014) Limited was first articulated.

18. The majority judgments were those of Nolan LJ and Lord Donaldson MR. Nolan LJ referred to the fact that the taxpayer could have used the cash accounting scheme entitling him to account for VAT by reference to receipts and payments received and made. He described a finding by the VAT Tribunal that late payment by Redbridge should be treated as having caused the insufficiency of funds as being "on the borderline of sustainability". Lord Donaldson agreed, but both judges upheld the decision of the VAT Tribunal.

19. It was not suggested in the present case that the Appellant qualified to use the cash accounting scheme and we shall assume that it would not have qualified. However it could have applied to HMRC for time to pay. Also, knowing the difficulties of obtaining payment from the NHS Trusts it could have sought alternative finance which in the end it did by way of debt factoring. There was nothing unexpected about the failure of NHS Trusts to pay on time. The Appellant had been trading with the NHS since 2011 and has been in the default surcharge regime since late payment of the VAT due for period 01/14.

20. Mr O'Grady for HMRC accepted that if the NHS had paid the Appellant on time then it would not have had an insufficiency of funds to make the VAT payments. However he submitted that the cashflow difficulties suffered by the Appellant were a normal hazard of business.

21. We agree with Mr O'Grady. The Appellant has encountered difficulties with NHS payments since it started in business. It seems that those difficulties have increased over the last 2 years. It remains the case however that the Appellant must finance its business with sufficient working capital to pay its debts, including VAT, on time. We acknowledge the frustration Mr Wilson feels that public bodies are delaying payment and causing the Appellant's cashflow difficulties. We sympathise with the position the Appellant finds itself in. However the fact the Appellant deals almost exclusively with NHS Trusts is not a relevant consideration. All businesses must aim to manage their working capital so that debts are paid on time. That is the case whatever the nature of the business and whatever the identity of the customers and suppliers.

22. Managing working capital might involve obtaining alternative sources of finance such as factoring. Even if additional finance is expensive it is a cost of doing business. It might also involve requesting a time to pay arrangement with HMRC prior to a VAT liability falling due in order to prevent a default from arising. In our view reasonable foresight and due diligence on the part of the Appellant would have avoided the late payment. The underlying cause of the late payment was inadequate working capital.

23. In short, we are not satisfied that late payment by the Appellant's clients can be viewed as a reasonable excuse for late payment of its VAT liability for period 01/16.

24. The Appellant's alternative argument was that the penalty was disproportionate and unfair in the circumstances. In particular, where the payment was only 3 days late and was caused by late payment by the NHS Trusts.

25. Mr Wilson considered that the NHS Trusts and HMRC were essentially the same person. He was clearly frustrated at what he saw as one arm of the state imposing surcharges for late payment caused by another arm of the state. He considered this was "grossly unfair". He acknowledged that the NHS was under serious financial strain but considered that he was bearing the brunt of it. In those circumstances he argued that it would be reasonable for HMRC to charge interest on late payment but it was disproportionate to charge such a high penalty.

26. We have had regard to the analysis of the principle of proportionality by the Upper Tribunal in the context of VAT default surcharges in *Commissioners for HM Revenue & Customs v Total Technology (Engineering) Limited [2012] UKUT 418 (TCC)* and *HM Revenue & Customs v Trinity Mirror plc [2015] UKUT 421 (TCC)*. Penalties must not go beyond what is strictly necessary for the objectives pursued, and a penalty must not be so disproportionate to the gravity of the infringement that it becomes an obstacle to the underlying aims of the VAT directive. However a court or tribunal must be astute not to substitute its own view of what is fair for the penalty which Parliament has imposed. Further, as appears from the Court of Appeal in *International Transport Roth GmbH v Secretary of State for the Home Dept [2003] QB 728* it must be asked whether the penalty is "not merely harsh but plainly unfair".

27. In the light of those principles and on the facts of the present case we do not consider that the default surcharge regime operated in a way that was disproportionate. Further, we have no jurisdiction to allow an appeal or reduce a penalty based on what amount to arguments of fairness, as recognised by the Upper Tribunal in *Commissioners for HM Revenue & Customs v HOK Ltd* [2012] UKUT 363 (TCC) at [56] – [58].

28. In all the circumstances and notwithstanding our sympathy for the Appellant we must dismiss the appeal.

29. 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.

**JONATHAN CANNAN
TRIBUNAL JUDGE**

RELEASE DATE: 21 DECEMBER 2016

© CROWN COPYRIGHT 2016