[2018] UKFTT 84 (TC)

# TC06342

**Appeal number: TC/2017/08338**

***VAT – default surcharge – liabilities 'effectively settled' as CIS balance existed – whether reasonable excuse – no – appeal dismissed***

**FIRST-TIER TRIBUNAL**
**TAX CHAMBER**

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| **SKYTONE EVENTS LTD** | **Appellant** |
| **- and -** | |
| **THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS** | **Respondents** |

**TRIBUNAL: JUDGE ANNE FAIRPO**

**The Tribunal determined the appeal on 12 February 2018 without a hearing under the provisions of Rule 26 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (default paper cases) having first read the Notice of Appeal dated 20 November 2017 (with enclosures), HMRC's Statement of Case (with enclosures) acknowledged by the Tribunal on 18 December 2017 and the Appellant's Reply dated 3 January 2017 (with enclosures).**

DECISION

## Introduction

1. This is an appeal against a VAT default surcharge assessment for the VAT period 06/17 issued on 11 August 2017 in the amount of £448.20

## Background

2. The appellant provides glazing services, and operates as a subcontractor in the construction industry. It has been registered for VAT since 7 June 2015.

3. The appellant submitted their VAT return electronically for the 06/17 period on 7 August 2017. The VAT due in respect of that return was £2,988. This was paid via Bill Pay in two tranches: £2,150 paid on 8 August 2017, and £838 on 9 August 2017. The due date for payment made electronically was 7 August 2017.

4. The appellant has paid VAT late in a number of VAT periods since registering for VAT. The first late payment, for the 12/15 period, was dealt with by way of a help letter from HMRC and so no default surcharge was recorded for that period. The appellant entered the default surcharge regime with the second late payment, in the 06/16 period. The appellant has paid VAT late for each of the subsequent periods: 09/16, 12/16, 03/17 and the period under appeal, 06/17. The VAT payments have been made by a combination of Bill Pay and set-off of Construction Industry Scheme (CIS) overpayments.

## Appellant's submissions

5. The appellant accepts that the payment of VAT for the 06/17 period was made late, but that there was a reasonable excuse for the late payment and that, overall, there was no loss to the Exchequer. Further, the payment of the penalty would cause hardship to the appellant.

6. The appellant explained that they were unable to settle the VAT by the due date because the deduction of CIS by their customers meant that the company had cash flow problems: the company made very little profit and was in a net overpayment position with regard to CIS. For the year ended 30 November 2016, which includes the relevant VAT period, the appellant had turnover of £22,753 and profits of £97. The effect was that the company was unable to meet VAT payments when they fell due. In May 2017, the appellant applied for and subsequently obtained a CIS gross payment certificate to reduce the cash flow problems.

7. The appellant had written to the Respondents (HMRC) and had requested a set-off of the CIS overpayments against the VAT due. This had been refused by HMRC on the basis that CIS overpayments could not be set against VAT due until after those CIS overpayments have become repayable. Such overpayments do not become repayable until after the end of the tax year in which the CIS deductions have been made, and the

Final Payment Summary has been submitted, and all amounts due to HMRC for the tax year in respect of the relevant trader under PAYE and NICs have been paid. HMRC had therefore refused the request for set-off as the relevant tax year had not yet ended.

8. The appellant had also requested that the penalties be waived because the balance of CIS overpayments standing to the appellant's self-assessment account with HMRC meant that there was no overall loss to the Exchequer.

9. On the basis of natural justice, the appellant submitted that the liabilities had been effectively settled as HMRC had the funds in the appellant's self-assessment account from CIS and so requested that the penalties be dismissed.

**HMRC submissions**

10. HMRC submitted that, as the appellant has been registered for VAT since 7 June 2015, the appellant should have been aware of their statutory and financial obligations at the relevant time. Further, HMRC's help letter to the appellant on the occasion of their first late payment for the 12/15 period advised the appellant that late payment would be a default and may give rise to a surcharge. It was submitted that the appellant must, from at least this letter, been aware of the potential financial consequences of further default.

11. The surcharge liability notices issued to the appellant for the periods 06/16 onwards included information on contacting HMRC before the due date for payment if problems were anticipated in future with regard to paying the VAT due on time.

12. HMRC submitted that the appellant's contention that the cash flow problems arising from the CIS deductions cannot be a reasonable excuse. s71(1)(a) VATA 1994 specifically excludes an insufficiency of funds as a reasonable excuse for late payment.

13. HMRC submitted that the appellant's application for CIS gross payment status in May 2017 had no relevance to the normal operation of the VAT system and could not be considered to be a reasonable excuse for delayed payment.

14. HMRC further submitted that the fact that the appellant is subject to CIS deductions does not go beyond the 'normal hazards' of a business and as such cannot be a reasonable excuse for the insufficiency of funds leading to late payment of VAT.

15. With regard to the appellant's contentions that the CIS overpayments should be treated as having offset the VAT liability, HMRC submitted that if the appellant or their adviser had undertaken appropriate research, they would have been aware that such a set-off could not be made until the end of the tax year.

16. HMRC submitted that s62(3) FA 2004 requires that CIS deductions be treated as paid on account of any 'relevant liabilities' of the appellant. In this context, 'relevant liabilities' are the appellant's obligations to account for PAYE, NICs, CIS deductions or Student Loan liabilities. Accordingly, CIS overpayments (that is, excess deductions) cannot be determined until after the end of the tax year once the appellant has submitted all relevant returns. It is not until an overpayment has been determined in this way that

it can be allowed as a credit against another tax liability under s130 FA 2008. In this case, the overpayment was not determined until after the due date for payment of the VAT.

17. In a letter from the appellant's advisers to HMRC dated 8 February 2017, it is clear that the advisers were aware that CIS overpayments could not be credited against VAT liabilities until after the end of the tax year, once the relevant returns had been filed.

18. It was therefore submitted for HMRC that a business which proposed to offset a CIS overpayment against a VAT liability would have ensured that the CIS overpayment had been determined before requesting the offset.

19. The appellant's requests for set-off of CIS overpayments against VAT had been made as follows:

(1) For the 09/16 period: set-off requested on 7 November 2016. HMRC submitted that, as this was the due date for payment, the appellant could not have had a reasonable expectation that the set-off would be agreed by the due date even if the CIS overpayment had been determined.

(2) For the 12/16 period: set-off requested on 8 February 2017, after the due date for payment. No set-off under s108 FA 2008 can be agreed where the payment is overdue.

(3) For the 03/17 period: set off requested on 2 May 2017. The request was made on a Friday, with the due date being the following Wednesday. HMRC submitted that the appellant could not have had a reasonable expectation that the set-off would be agreed by the due date even if the CIS overpayment had been determined.

20. Further, HMRC submitted that even if a repayment of CIS existed, the appellant should have received the VAT due for the 06/17 period and had this available at the due date to pay the VAT due. This is supported by the comment in *CG Steel Structures* (TC/2014/00456) that "It should be remembered that VAT is never the property of the company, the money belongs to the Crown at all times and must be paid over as the law requires".

21. Evidence provided by HMRC showed that the CIS overpayment for the 16/17 tax year had in fact been used to discharge outstanding VAT liabilities for the 09/16, 12/16 and 03/17 VAT periods once the CIS overpayment had been established. The overpayment had been fully utilised in discharging these liabilities, as a very small amount remained outstanding for the 03/17 period.

22. HMRC also submitted that the appellant's financial position cannot be considered to be a reasonable excuse for removal of the surcharge.

23. HMRC therefore requested that the appeal be dismissed and the surcharge upheld as correctly issued and confirmed.

## Discussion

24. We note that there was no dispute about the surcharge itself: i.e. the fact that it had been incurred and the basis on which it had been calculated. The only submission raised by the appellant is that of reasonable excuse.

25. s59(7) VATA 1994 states, as relevant:

> *"(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 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 . . ."*

26. The burden of proof is therefore on the appellant to satisfy HMRC or the Tribunal that there is a reasonable excuse for the failure to pay the VAT within the appropriate time limit.

27. It is clear that, under s71(1)(a) VATA 1994, insufficiency of funds to pay any VAT due cannot be a reasonable excuse. Nevertheless, if there is an underlying major issue which affects an appellant's financial position at the time when it is due to pay the VAT, that underlying issue may amount to a reasonable excuse (as established in *Commissioners of Customs and Excise v Steptoe* [1992] STC 757 amongst other cases). To be a reasonable excuse, that underlying major issue must normally an unexpected event, something unforeseeable, something out of the appellant's control.

28. The question, therefore, is whether the appellant's submission that the CIS deductions which were required to be made from payments to the appellant that the time constitute such an underlying major issue capable of being a reasonable excuse.

29. However, the CIS deductions were not unexpected: indeed, such deductions are required in the construction industry and the appellant would have been clearly aware of this in the relevant VAT period as the appellant had been receiving payments under CIS for some time.

30. Accordingly, it cannot be the case that the CIS deductions were unforeseeable and constituted an unexpected event leading to an insufficiency of funds.

31. With regard to the appellant's claim that the VAT liability could have been set-off against the CIS overpayment, we note that by the CIS overpayment for 2016/17 had been utilised against earlier VAT liabilities such no amounts remained for set-off against VAT of the 06/17 period. Correspondence between the appellant's advisers and

HMRC in February 2017 makes it clear that they were aware that CIS overpayments could not be credited until after the end of the tax year and so the appellant cannot have reasonably expected that the CIS overpayments for 17/18 would be available in time to meet the VAT liability for the 06/17 period.

32. The appellant has argued that it is "against the course of natural justice" to impose the penalties and that it would be "just and reasonable" for the penalties to be waived as there has been no loss to the Exchequer and the payment would cause hardship to the appellant.

33. s70(4)(a) VATA 1994 states that "insufficiency of … funds available … for paying the amount of the penalty" cannot be taken into consideration by the Tribunal when considering whether to mitigate a penalty. The effect on the appellant's financial position is not something which this Tribunal has power to take into account. Further, the Tribunal agrees with the comment in *CG Steel Structures* (TC/2014/00456) that "It should be remembered that VAT is never the property of the company, the money belongs to the Crown at all times and must be paid over as the law requires". The appellant has apparently chosen to register for VAT, as the turnover disclosed in evidence is well below the VAT threshold for registration, and has to bear the consequences of doing so, including accounting for VAT in full by the due date.

34. Although not specifically argued as such, I have treated the appellant's argument as to "natural justice" as being a submission on the proportionality of the surcharge assessment.

35. The question of whether the amount of a surcharge is disproportionate was discussed at length in the Upper Tribunal's decision in the case of *Total Technology Engineering Ltd* [2011] UKFTT 473 (TC)] and the system of surcharges was found to be proportionate. The decision also discussed the fact that there is no power of mitigation available to the Tribunal. The only power in this respect is that if the tribunal considers the amount of the penalty is wholly disproportionate to the gravity of the offence, if it is not merely harsh, but plainly unfair, then the penalty can be discharged.

36. The level of the surcharge has been laid down by parliament and as the default surcharge has issued in accordance with legislation and has been calculated accurately the Tribunal has no power to discharge or adjust it other unless it is wholly disproportionate. The Tribunal does not consider that a surcharge of £448.20 which is 15% of the tax due which is the culmination of previous failures to submit VAT returns and/or payments of VAT due on time, is wholly disproportionate to the failure to pay on time nor plainly unfair.

**Decision**

37. As the appellant has not established a reasonable excuse, and the level of the surcharge assessment is not disproportionate, the appeal is dismissed and the surcharge assessment confirmed and payable.

38. 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.

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**TRIBUNAL JUDGE**
**RELEASE DATE: 15 February 2018**