TC07689

VALUE ADDED TAX – default surcharge – fraud by finance director – whether reasonable excuse. Appeal allowed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2019/03092

BETWEEN

E.W.G.A. LTD **Appellant**

-and-

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

TRIBUNAL: JUDGE ABIGAIL HUDSON
MOHAMMED FAROOQ

Sitting in public at Manchester Tax Tribunal on 9 March 2020

The Appellant appeared in person.

Sophie Brown, litigator of HM Revenue and Customs' Solicitor's Office, for the Respondents

DECISION

Introduction

1. This is an appeal by E.W.G.A. Ltd ('the Appellant') against default surcharge assessments for the periods 07/16, 10/16, 01/17, 07/17, 10/17 and 04/18. Surcharges in the amount of £115,474.70 were imposed by the Respondents ('HMRC') under Section 59 of VAT Act 1994, for failures to submit payment on time.
2. Section 59 Value Added Tax Act 1994 ("VATA 1994") sets out the provisions in relation to the default surcharge regime. Under s 59(1) a taxable person is regarded as being in default if he fails to make his return for a VAT quarterly period by the due date or if he makes his return by that due date but does not pay by that due date the amount of VAT shown on the return. HMRC may then serve a surcharge liability notice on the defaulting taxable person, which brings him within the default surcharge regime so that any subsequent defaults within a specified period result in assessment to default surcharges at the prescribed percentage rates. The specified percentage rates are determined by reference to the number of periods in respect of which the taxable person is in default during the surcharge liability period. In relation to the first chargeable default the specified percentage is 2%. The percentage ascends to 5%, 10% and 15% for the second, third and fourth default.

3. It is not disputed that the amount of the surcharge had been correctly calculated. The applicable surcharge rate was 2 % of the VAT due for the period 07/16, 5% for the period 10/16, 10% for the period 01/17 and 15% for the subsequent failures.

Background

4. The Appellant has been registered for VAT since 1 November 1980. The appellant paid VAT on a quarterly basis. Section 59 of the VAT Act 1994 requires a VAT return and payment of VAT due, on or before the end of the month following the relevant calendar quarter. [Reg 25(1) and Reg 40(1) VAT Regulations 1995.]

5. At present Adrian Moeckell and Janette Alison are directors of the company. Simon Mott was appointed as a director on 26 October 2016 and resigned on 16 September 2018. Prior to October 2016 he was employed by the company as finance manager.

6. It is not disputed that the payments were made late. The defaults were as follows:

Period	Due date	Amount paid after due date	Date return received	Surcharge
01/16	28/02/16	248,005.76	18/03/16	
07/16	31/08/16	201,106.85	07/09/16	4,022.13
10/16	30/11/16	197,188.42	16/01/17	20,274.72
01/17	28/02/17	200,523.22	07/03/17	20,052.32
07/17	31/08/17	213,589.21	14/09/17	32,038.38
10/17	30/11/17	189,818.39	07/12/17	28,472.75
04/18	31/05/18	140,198.96	07/06/18	21,029.84

7. The Appellant incurred default surcharges in the periods 10/11 and 07/12, however these periods are not under appeal. On those previous occasions, the Appellant had entered into time to pay (TTP) agreements with the Respondents, but has been advised that the business would not be allowed to apply for TTP again due to repeated use of the facility.

8. A telephone call was made to the Respondents on 7 March 2016 indicating that the company was having difficulty with their software. The caller was advised to submit the return as soon as possible.

9. A further telephone call was made on 11 December 2017 indicating that the monies due would be paid in three instalments. The caller conceded that the company did not have exceptional circumstances that would amount to a reasonable excuse for the late payment.

10. The Appellant appealed to the Tribunal on 24 April 2019.

Reasonable excuse

11. Section 59 of VAT Act 1994, provides that a surcharge does not arise in relation to a failure to submit a return and / or payment by the due date if the person satisfies HMRC (or on appeal, a Tribunal) that they had a reasonable excuse for the failure and they put right the failure without unreasonable delay after the excuse has ended.

12. The law (section 71 VATA 94) specifies two situations that are not reasonable excuse:

    (a) An insufficiency of funds, and

    (b) Reliance on another person to perform any task, either the fact of that reliance or any dilatoriness or inaccuracy on the part of the person relied upon.

13. There is no statutory definition of "reasonable excuse". Whether or not a person had a reasonable excuse is an objective test and "is a matter to be considered in the light of all the circumstances of the particular case" (*Rowland V HMRC* (2006) STC (SCD) 536 at paragraph 18).

14. The actions of the taxpayer should be considered from the perspective of a prudent person, exercising reasonable foresight and due diligence, having proper regard for their responsibilities under the Tax Acts. The decision depends upon the particular circumstances in which the failure occurred and the particular circumstances and abilities of the person who failed to file their return on time. The test is to determine what a reasonable taxpayer, in the position of the taxpayer, would have done in those circumstances and by reference to that test to determine whether the conduct of the taxpayer can be regarded as conforming to that standard.

Appellant's case

15. Mr Moeckell argued that the company had a reasonable excuse. He explained that the business had suffered fraud committed by the former finance director Mr Simon Mott. He is unable to explain what the nature of the fraud was, but asserts that Mr Mott ran a "shadow sales ledger" in order to draw down more funds from the bank than the sales invoices would support, presumably to support cash flow.

16. Mr Moeckell asserts that he personally checked the VAT returns by the due dates and was therefore assured that they were ready for filing, but unbeknownst to him Mr Mott then failed to file the returns or to pay the monies due. Mr Mott did not tell anyone else within

the business that surcharges were being incurred and concealed the fact that he was making payments pursuant to those charges.

17. Although the business incurred default surcharges in 2011 and 2012, the current directors were unaware of these penalties and the subsequent TTP agreements because they were concealed by Mr Mott.

18. Mr Mott then resigned from the business on 16 September 2018 which was the night before a bank audit was due. Prior to leaving the premises for the final time Mr Mott accessed the accounts databases for a prolonged period of time. It is not known what he was doing during that time.

19. The business is taking legal action against Mr Mott.

HMRC's case

20. Surcharges issued under section 59 VAT Act 1994 are a penalty based solely on the amount of VAT paid after the due date, no matter the length of delay, and in accordance with s70 of the said act neither the respondents nor the Tribunal have the power to reduce the amount because of mitigating circumstances.

21. The onus lies with HMRC to show that the penalties were issued correctly and within legislation. If the Tribunal find that HMRC have issued the penalties correctly the onus then reverts to the Appellant to show that there is a reasonable excuse for the late payment.

Reasonable Excuse

22. Under Section 59 VATA 1994 liability to a penalty does not arise in relation to failure to make a return and / or payment if the taxpayer has a reasonable excuse for failure.

23. 'Reasonable excuse' was considered in the case of *The Clean Car Company Ltd v The Commissioners of Customs & Excise* by Judge Medd who 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?" [Page 142 3rd line et seq.].

24. HMRC considers a reasonable excuse to be something that stops a person from meeting a tax obligation on time despite them having taken reasonable care to meet that obligation. HMRC's view is that the test is to consider what a reasonable person, who wanted to comply with their tax obligations, would have done in the same circumstances and decide if the actions of that person met that standard.

25. If there is a reasonable excuse it must exist throughout the failure period.

26. The Appellant has not provided a reasonable excuse for his failure to make payment for the VAT periods on time and accordingly the penalties have been correctly charged in accordance with the legislation.

27. The amount of the penalties charged is set within the legislation. HMRC has no discretion over the amount charged and must act in accordance with the legislation. By not applying legislation and as such not to have imposed the penalty would mean that HMRC was not adhering to its own legal obligations.

Findings of fact

28. Mr Mott was appointed as finance director in October 2016. Prior to that he was employed by the company in the same role – titled "finance manager". We accepted that he was made finance director in 2016 because the third director sadly passed away and a replacement was required. In her letter dated 21 June 2019 Miss Habberley indicated that "prior to being finance director Mr Mott was finance manager and completed the VAT returns which were reviewed by a director". The implication of that statement is that after he became finance director that review function ceased. Mr Moeckell says that this is in fact not the correct position. He told us in evidence that he continued to check the VAT returns by the due date after Mr Mott became a director. We accepted Mr Moeckell's evidence that Mr Mott's role remained the same throughout notwithstanding his appointment as director.

29. Mr Moeckell gave evidence before us, and we found him to be forthright and compelling. We accepted his evidence. The directors of the company met every Monday to discuss the financial position and any concerns. Mr Mott and Mr Moeckell met at minimum bi-monthly to discuss cash flow. Mr Moeckell personally reviewed the VAT returns prior to submission in order to confirm that they were correct. They were prepared two to three weeks before the due date. He did not thereafter physically observe the submission of the return, or the transfer of payment. In March / April 2018 Mr Moeckell and Mr Mott spent a full day examining the accounts and discussing cash flow. At no point did Mr Mott tell his fellow directors that he had failed to submit or pay on time, or that surcharges had been accrued.

30. VAT payments were not made on time for the periods under appeal.

31. A number of letters have been sent to the company over the relevant period and it is not in dispute that all would have been received by the company.

32. The company's Sage ledger (as submitted to the lender) "appears to have been manipulated at month-end to reflect a high outstanding balance, in line with the YBIF facility balance" - Yorkshire Bank Invoice Finance ('YBIF') Report. That report evidences a discrepancy of £477,952. The VAT surcharges were omitted from the accounts.

33. Armstrong Watson ('AW') prepared an audit on the company for the year ending April 2016. That report identified significant deficiencies in internal control. The current directors did not receive that report but instead it was sent to Mr Mott. Kuits solicitors have been instructed to pursue proceedings against AW for failing to draw those deficiencies to Mr Moeckell's attention. We considered it likely that AW would have a record of any communications sent to the company during the relevant period, and specifically a record of any communication sent directly to Mr Moeckell either enclosing the report or outlining its contents. In those circumstances it would be foolish to initiate legal proceedings against AW for that failure when AW could easily disprove the allegation. We accept therefore on the balance of probabilities that AW did not draw the failures to the attention of the remaining directors.

34. On the 16th September 2018 Mr Mott resigned from his position by letter. In that letter he states that he has succumbed to the pressures of the role and acknowledges that he has not dealt with some aspects of his job.

35. Shortly thereafter the company received a demand for payment for the 07/18 VAT return and a default surcharge notice dated 17/08/18. That was the first time Mr Moeckell became aware that VAT payments were overdue.

36. Surcharges for that period have been withdrawn by the Respondent, having accepted that the company had a reasonable excuse for that failure. It is not clear to us why that explanation has been deemed a reasonable excuse when the same explanation has not been deemed reasonable for the previous failures.

37. Upon discovering that the payments were outstanding, the company immediately made arrangements to repay those monies. Although Miss Brown was unable to confirm Mr Moeckell's assertions regarding repayment, she conceded his evidence that all monies have since been repaid and for in excess of 12 months all HMRC payments have been made on time. Within three months of Mr Mott's resignation the company made cuts of approximately £140,000 to its operating costs. It is therefore accepted that if the failure was not known of until Mr Mott's resignation, there has been no unreasonable delay post that discovery in remedying the failures.

38. The surcharges have been properly calculated given the amount of VAT paid after the due date.

39. There are no proposed criminal proceedings to be initiated against Mr Mott, however proceedings for breach of contract have been issued.

Discussion

40. There is no statutory definition of "reasonable excuse"; it is an objective test to be considered in the circumstances of the particular case. The test is what a reasonable and prudent taxpayer intending to comply with their tax obligations, in the position of the appellant, would have done in the same circumstances (*Perrin* [2018] UKUT 0156 (TC).

Supervision of filing:

41. Mr Mott was employed in the same role throughout the relevant period whilst initially an employee and later a director. The level of oversight and supervision was unchanging. The respondent criticises the Appellant for making Mr Mott a director after becoming aware of his failures, but of course the Appellant's case is that they had no idea that he was not paying the VAT on time.

42. HMRC argue that the company would have been aware that they had entered the surcharge regime following the receipt of the Surcharge Liability Notice. That particular notice was issued to the company at Hyning Home Farm rather than Mr Mott specifically, but of course it is the Appellant's case that any correspondence from HMRC would have been handed directly to Mr Mott. It would then be a matter for him whether he chose to share that information with his fellow directors. We considered it to be unlikely that when employing a finance director, the other directors would open correspondence which fell within Mr Mott's purview, and in those circumstances we accepted the evidence before us that correspondence from HMRC would be directed straight to Mr Mott and would not be opened by other members of the management team.

43. Prior to January 2016 the company was almost always making its VAT payments on time. There were surcharges incurred in 2011/12 but Mr Moeckell says that he was unaware of these. We have no evidence to suggest that that is not true, and it would be almost impossible to provide evidence of the position almost a decade later. Certainly in Ms Habberley's letter of 21 June 2019 she is under the impression (presumably upon instructions) that the company has not previously incurred default surcharges or made late payments. We could see no reason to deny knowledge of those earlier defaults and therefore accepted that Mr Moeckell and Ms McLaughlin were unaware of them. That supports their assertions that Mr Mott concealed those facts from them. The fact that he concealed previous failures, supports their assertions that he concealed the current

failures. We found the evidence of Mr Moeckell and Ms Mclaughlin to be consistent and thorough. They both appeared to be doing their best to assist the tribunal and we therefore accept their evidence that they were unaware of the failures until after Mr Mott left the business.

44. The central point at issue in this case is the nature, if any, of any concealment by Mr Mott from his fellow directors. Whether the other directors ought to have known of his failures. In its letter to the Respondents dated 29 November 2018, the VAT people state that Mr Mott "had sole control over the business and its bank account". Ms Habberley goes on to observe that "The company had taken reasonable care to explain to Mr Mott, an employee, that it was his duty to prepare and submit the return and payments on time." Those comments perhaps unsurprisingly led the Respondent to conclude that the company abdicated all responsibility for the VAT returns and payments to Mr Mott and exercised no due diligence over his submissions. Ms Habberley further observed in her letter dated 21 June 2019 that: "Completion of the quarterly VAT return was not a shared function between the directors or the accountants as the expectation was that the finance director, Mr Mott, would be competent to carry out this role." Mr Moeckell in his evidence told us that this does not in fact represent the true position. He tells us, and we accept, that he in fact reviewed the VAT returns on every occasion prior to submission.

45. In *Profile Security Services v Customs and Excise Commissioners* [1996] STC 808 the Appellant's accountant had failed to submit VAT returns on time, and then hidden the resulting surcharges from the company owner. It could feasibly be said that Mr Mott's failure to submit one return and pay on time was a lack of competence, but in this case he has failed to submit or pay numerous times and incurred resulting penalties. That suggests that he was aware of those potential failures prior to their commission. In addition in this case Mr Moeckell asserts that he actively oversaw and managed the preparation of the VAT returns ready for prompt filing. His failure of oversight was in failing to physically watch Mr Mott press the send button on his computer. We find that it is reasonable to accept an assertion from a fellow director that the VAT return has been sent, upon having seen that it is ready for filing, without the need to physically see confirmation of submission on screen. Specifically in the case cited, there was no finding of dishonesty being the cause of the late filing (as opposed to the concealment of the surcharges). In the present case, we do accept the evidence of Mr Moeckell that Mr Mott dishonestly misled him (both by failing to inform, but also by manipulating the accounts) as to the proper filing and payment of the returns.

Did the directors have reason to think that Mr Mott was failing to submit?

46. We have seen a copy of the RSM Short Term Cash Flow review dated 25 July 2018. The review indicates that the company can continue to trade within is overdraft facility, based on the short-term cash flow forecast prepared by Mr Mott.

47. The YBIF report concludes that Mr Mott manipulated the system. However, that conclusion is based on an assumption that the information supplied by Mr Moeckell and the other directors was correct – along with the fact of his sudden resignation and cancellation of audits.

48. Mr Mott's resignation occurred two days prior to the attendance of auditors Hilton-Baird Audit and Survey Ltd (HB). That report does indicate that "Mr Mott appears to have been allowed total control with regards to administration and reconciliation of the YBIF facility". The report observes that Mr Mott cancelled two previous audits at short notice and then proved unhelpful at the rearranged audit. We accept that Mr Mott has deliberately manipulated the submitted Sage account with the intent to conceal that from

the bank. That has had the effect of also concealing the VAT surcharges from the other directors.

49. The report indicates that the accurate Sage ledger did not reach the necessary levels of the YBIF overdraft facility for the previous 12 months. On that basis we conclude that it is likely that the manipulation was affected to ensure that the overdraft facility was not withdrawn.

50. There is a discrepancy of almost £500,000 in the accounts, however, no evidence has been found of Mr Mott (or for that matter Mr Moeckell or Ms McLaughlin) withdrawing or obtaining those monies. No unidentified payments or withdrawals appear to exist. We therefore conclude that it is unlikely that any person physically received those monies and the motivation for the manipulations was therefore not for personal financial gain. That being the case the only remaining motivation could be to ensure the stability of the company. Mr Mott would benefit from that by maintaining his employment, but the other directors would similarly benefit.

Should the directors have realised that Mr Mott was failing to submit?

51. Mr Moeckell told us that he would have had the ability to borrow monies in order to pay the outstanding VAT liabilities had he known about them. He has evidently subsequently done so and cleared the debt, even after his overdraft facility was withdrawn. The company immediately made significant cuts in spending at the end of 2018 and we accepted Mr Moeckell's evidence that those cuts could have been made two years earlier had he known that they were required. There does not appear to have been an unreasonable delay in doing so and the penalties incurred would far exceed the cost of interest repayments on a loan. It would be perverse to choose to pay penalties when loan facilities could have been obtained to cover the cost of the VAT payments. We accept the evidence of Mr Moeckell and Ms McLaughlin that they were not aware of the manipulation of the system and that the manipulation was not done with their agreement or authorisation.

52. Armstrong Watson prepared an audit report for the year 2015-16 which is critical of Mr Mott. That report was not received by Mr Moeckell and we have not seen it. Annual reviews in 2015-16 and 2016-17 were not carried out (although they were paid for). Mr Moeckell and Ms McLaughlin failed to note these omissions. However, the letter before action details, that the report indicates that "Mr Moeckell was considered to be "informed management" for the purposes of communication of "issues surrounding the audit". The lack of communication of the result of the audit to Mr Moeckell could easily be interpreted by him as an acknowledgement that there were no issues. There would be no reason for Ms McLaughlin to expect to receive the report. Legal proceedings against AW are being pursued by Kuits solicitors for failing to inform the company of the concerns and sending the report to Mr Mott alone. We accepted that the remaining directors could have had no reason to have chased the report or noted the failure to provide it.

53. We have had sight of the Final Management Report on the company prepared by AW and dated 30 April 2016. I note the observation at paragraph 3.3 that there had been some difficulty in the information requested being provided and a lack of some typical year end accounting procedures being completed. AW specifically thank Mr Mott for overcoming these hurdles. The report concluded that financial covenants with the bank have been breached and a recommendation that terms be reviewed. Within that report the company was reminded that the VAT return for the period 01/16 had been submitted late thus subjecting the company to a default surcharge period of 12 months. Again, that report was not provided to the other directors.

54. Some of the reports do make reference after Mr Mott's resignation to a general anecdotal view that he was a little disorganised. However, those comments are made with the benefit of hindsight. The company did have an audit in 2015/16 and Mr Moeckell told us that questions were raised over Mr Mott's accuracy. He was basically not following credit control as strictly as he should have. The result of that audit was that more responsibility was transferred to our credit controller. We concluded that although this may have raised some concern, there was nothing in the evidence available to the company to suggest that Mr Mott would fail to make payments on time, or dishonestly manipulate the accounts.

55. Reliance on a third party is specifically excluded by section 71(1)(b) of the VAT Act 1994 from constituting a reasonable excuse, unless the company had exercised due diligence in supervising that third party. The Respondents' compliance handbook provides guidance on reliance on third parties in the following terms:

> "Where a person has asked somebody else to do something on their behalf, that person is responsible for ensuring that the other person carries out the task. They cannot claim they had a reasonable excuse merely because the task was delegated to a third party and the third party failed to complete it.
>
> We expect the person to take reasonable care to explain to the third party what they require them to do, to set deadlines for the work and to make regular checks on progress, reminding where appropriate. We expect the person
>
> - To be able to tell us what action they took to ensure that the obligation to make payment on time was met, and
> - Normally, but not always, to know the reason why the failure occurred."

56. Having accepted that Mr Mott hid his failures to file from Mr Moeckell, and did not disclose the surcharges incurred at the regular finance meetings, we accept that action was taken to ensure that the obligation to pay on time was met. We further accept that it was reasonable to expect that VAT surcharges incurred would be visible from the accounts, and in this case the accounts were dishonestly manipulated to prevent that oversight. Review procedures were put in place with AW to ensure that any financial irregularities were brought to the attention of Mr Moeckell, and the external accountant failed in that duty. The remaining directors acted reasonably in relying on that safeguard.

CONCLUSION

57. For the reasons set out above, we find that E.W.G.A. Ltd have demonstrated a reasonable excuse for the late payment of VAT for the periods 07/16, 10/16, 01/17, 07/17, 10/17 and 04/18. The appeal is therefore allowed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

58. 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.

ABIGAIL HUDSON
TRIBUNAL JUDGE

Release date: 28 April 2020