[2019] UKUT 77 (TCC)

Appeal number: UT/2018/0049

VALUE ADDED TAX – application under section 85B of VATA 1994 – whether financial extremity might be reasonably expected to result from HMRC's decision to require payment of disputed VAT

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

BETWEEN:

SNOW FACTOR LIMITED

Applicant

- and –

THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS

Respondent

Tribunal: JUDGE ANDREW SCOTT

Sitting in public at George House, Edinburgh on 21 February 2019

Mr Philip Simpson QC, Counsel, instructed by Johnston Carmichael for the Applicant

Mr David Thomson QC, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondent

DECISION

Introduction

1. This is an application concerning the amount of value added tax which the applicant, Snow Factor Limited, is required to pay following a decision made in favour of Her Majesty's Revenue and Customs ("HMRC") by the First-tier Tribunal (Tax Chamber) ("FTT") released on 24 January 2018 (reference number TC/2016/01847) in circumstances where the FTT's decision is subject to an appeal to this tribunal and where there is an issue as to whether payment of some or all of the disputed VAT might be reasonably expected to result in financial extremity.

2. The FTT's decision related to the rate of value added tax applicable to receipts from lift passes sold by the applicant in running its indoor snow dome. Snow Factor Limited had unsuccessfully contended before the FTT that the supplies were liable to value added tax at the reduced rate of 5% as a result of falling within item 1 of Group 13 of Schedule 7A to the Value Added Tax Act 1994 ("VATA 1994"). The FTT agreed with HMRC that the supplies were liable to VAT at the standard rate.

3. The FTT's decision concerned two separate assessments to value added tax: (1) an assessment of £156,160 plus interest for the six accounting periods from 1 June 2013 to 30 November 2014; and (2) an assessment of £138,555 plus interest for the five accounting periods from 1 December 2014 to 29 February 2016. Those two assessments (totalling £294,715 plus interest) were consolidated together in a single appeal before the FTT.

4. Snow Factor Limited applied to the FTT for permission to appeal the FTT's decision on two different grounds (an issue of statutory construction and fiscal neutrality). The FTT refused permission on both of those grounds. Snow Factor Limited then made a successful application to this tribunal for permission to appeal: it was granted permission to appeal on the issue of statutory construction by Judge Timothy Herrington in July 2018 and by myself on the fiscal neutrality ground in September 2018.

5. Snow Factor Limited had not paid any of the disputed VAT before appealing the assessments made by HMRC. HMRC decided (on an application to it) that to require the payment of the VAT would cause hardship to the applicant. However, following the FTT's decision, the effect of section 85A(3) of VATA 1994 is that Snow Factor Limited is now required to pay the amount of VAT that the FTT had determined to be payable.

6. That is not, though, the end of matters. Section 85B of VATA 1994 entitles Snow Factor Limited to apply to HMRC for a decision to exercise one or more of the following powers: to stay the requirement to pay, to require the provision of adequate security or to reduce the amount required to be paid. HMRC was entitled to grant the application if satisfied that financial extremity might be reasonably expected to result if payment (of the full amount) was required.

7. In a letter of 15 November 2018 to the applicant, HMRC referred to the current assessed debt of £484,521.38 (plus interest) and decided that to pay the whole of that amount may cause financial extremity. But HMRC did consider that a lesser amount should be paid. They decided that it "would not cause 'financial extremity' to SFL [the applicant]" if it was required to pay £300,000 in three equal instalments: the first

instalment of £100,000 by 15 December 2018, the second instalment of £100,000 by 15 January 2019 and the final instalment of £100,000 by 15 February 2019.

8. It is not clear to me how HMRC considered that it could require the payment of an amount that appears to *exceed* the amount of VAT that was the subject of the appeal determined by the FTT. It may be that the amount to which HMRC referred includes further assessments made by HMRC in relation to the same underlying issue (and which may be subject to further appeals that have yet to be determined).

9. HMRC's decision letter referred to the possibility of Snow Factor Ltd bringing an appeal against its decision to the FTT. On 14 December 2018 Snow Factor Ltd made an application to this tribunal (and not to the FTT) under section 85B(5) of VATA 1994 on the ground that financial extremity might be reasonably expected to result from the decision by HMRC of 15 November 2018.

10. The application under section 85B(5) of VATA 1994 is required to be made to the "relevant tribunal or court". That expression is defined in subsection (8) to mean the tribunal or court from which permission or leave to appeal is sought. Permission to bring an appeal against a decision of the FTT must be made in the first instance to the FTT and then to this tribunal.

11. Accordingly, it would appear that, reading the provision literally, both the FTT and the Upper Tribunal qualify as "the relevant tribunal or court": the test is *not* which tribunal has granted permission to appeal.

12. It would seem to me, however, a strange outcome if the applicant had an unfettered discretion to choose the identity of the tribunal deciding the application, particularly if the discretion were then exercised in favour of the FTT in circumstances where the FTT had *refused* permission to appeal and where one might otherwise expect the tribunal to play no further part in the litigation.

13. However, in the context of this application, I consider that it is clear that the Upper Tribunal is capable of being "the" relevant tribunal or court even if (an issue about which I say no more) the FTT could also be regarded as "the" relevant tribunal or court for the purposes of section 85B of VATA 1994. Both parties were also of the view that the Upper Tribunal was properly seized of the application.

The relevant legislation

14. An appeal against HMRC's assessments to VAT falls to be made to the FTT under section 83(1)(p) of VATA 1994. Section 84 of that Act makes further provision relating to appeals under section 83. Of most relevance to this application are subsections (3) and (3B) of section 84, which provide as follows:

> "**84 Further provisions relating to appeals**
>
> …
>
> (3) Subject to subsections (3B) and (3C), where the appeal is against a decision with respect to any of the matters mentioned in section 83(1)(b), (n), (p), (q), (ra)[, (rb)] or (zb), it shall not be entertained unless the amount which HMRC have determined to be payable as VAT has been paid or deposited with them.

(3A) …

(3B) In a case where the amount determined to be payable as VAT or the amount notified by the recovery assessment has not been paid or deposited an appeal shall be entertained if—

(a) HMRC are satisfied (on the application of the appellant), or

(b) the tribunal decides (HMRC not being so satisfied and on the application of the appellant),

that the requirement to pay or deposit the amount determined would cause the appellant to suffer hardship."

15. Section 85A of VATA 1994 sets out the general rule (subject to the operation of section 85B) about the payment of disputed sums following the determination of an appeal by the FTT. So far as relevant to this application, it provides as follows:

"**85A Payment of tax on determination of appeal**

(1) This section applies where the tribunal has determined an appeal under section 83.

(2) […]

(3) Where on the appeal the tribunal has determined that—

(a) the whole or part of any disputed amount not paid or deposited is due, or

(b) the whole or part of any VAT credit paid was not payable,

so much of that amount, or of that credit, as the tribunal determines to be due or not payable shall be paid or repaid to HMRC with interest at the rate applicable under section 197 of the Finance Act 1996.

(4) […]

(5) […]."

16. The application for relief from payment of the VAT was brought under section 85B of VATA 1994 the provisions of which are central to this appeal. That section provides:

"85B Payment of tax where there is a further appeal

(1) Where a party makes a further appeal, notwithstanding that the further appeal is pending, value added tax or VAT credits, or a credit of overstated or overpaid value added tax shall be payable or repayable in accordance with the determination of the tribunal or court against which the further appeal is made.

(2) But if the amount payable or repayable is altered by the order or judgment of the tribunal or court on the further appeal—

(a) if too much value added tax has been paid or the whole or part of any VAT credit due to the appellant has not been paid the amount overpaid or not paid shall be refunded with such interest, if any, as the tribunal or court may allow; and

(b) if too little value added tax has been charged or the whole or part of any VAT credit paid was not payable so much of the amount as the tribunal or court determines to be due or not payable shall be due or repayable, as appropriate, at the

expiration of a period of thirty days beginning with the date on which HMRC issue to the other party a notice of the total amount payable in accordance with the order or judgment of that tribunal or court.

(3) If, on the application of HMRC, the relevant tribunal or court considers it necessary for the protection of the revenue, subsection (1) shall not apply and the relevant tribunal or court may—

(a) give permission to withhold any payment or repayment; or

(b) require the provision of adequate security before payment or repayment is made.

(4) If, on the application of the original appellant, HMRC are satisfied that financial extremity might be reasonably expected to result if payment or repayment is required or withheld as appropriate, HMRC may do one or more of the things listed in subsection (6).

(5) If on the application of the original appellant, the relevant tribunal or court decides that—

(a) the original appellant has applied to HMRC under subsection (4),

(b) HMRC have decided that application,

(c) financial extremity might be reasonably expected to result from that decision by HMRC,

the relevant tribunal or court may replace, vary or supplement the decision by HMRC by doing one or more of the things listed in subsection (6).

(6) These are the things which HMRC or the relevant tribunal or court may do under subsection (4) or (5)—

(a) decide how much, if any, of the amount under appeal should be paid or repaid as appropriate,

(b) require the provision of adequate security from the original appellant,

(c) stay the requirement to pay or repay under subsection (1).

(7) Subsections (3) to (6) cease to have effect when the further appeal has been determined.

(8) In this section—

"adequate security" means security that is of such amount and given in such manner—

(a) as the tribunal or court may determine (in a case falling within subsection (3) or (5)), or

(b) as HMRC consider adequate to protect the revenue (in a case falling within subsection (4));

"further appeal" means an appeal against—

(a) the tribunal's determination of an appeal under section 83, or

(b) a decision of the Upper Tribunal or a court that arises (directly or indirectly) from that determination;

> "original appellant" means the person who made the appeal to the tribunal under section 83;
>
> "relevant tribunal or court" means the tribunal or court from which permission or leave to appeal is sought."

17. It appears that this is the first determination of an application under section 85B(5) of VATA 1994, and, in deciding the application, there is, therefore, no directly relevant case law. Submissions were, however, made in relation to the case law relevant to hardship applications under section 84(3B) of VATA 1994.

18. It was submitted by Mr Simpson QC on behalf of the applicant that, although a test of financial extremity was a harder test to satisfy than one of hardship, the authorities relating to hardship applications were, nonetheless, relevant as showing how the courts approached a similar exercise. By contrast, Mr Thomson QC submitted that the case law had limited (if any) relevance to the application of, in his submission, the different, more stringent test under section 85B(5) of VATA 1994.

19. There was, though, broad agreement between the parties as to the principles relevant to hardship applications. The principles were reviewed by the Upper Tribunal in *HMRC v Elbrook (Cash & Carry) Limited* [2017] UKUT 181 (TCC) ("*Elbrook*").

20. At [19] and [20] of that decision, the tribunal noted that:

> "it is clear that s.84 VATA is intended to strike a balance between, on the one hand, the desire to prevent abuse of the appeal mechanism by employing it to delay payment of the disputed tax, and on the other to provide relief from the stricture of an appellant having to pay or deposit the disputed sum as the price for entering the appeal process, where to do so would cause hardship. … it has been established that the relief provided by s 84(3B) VATA in cases of hardship should not be applied so as to operate as a fetter."

21. It went on to note at [21] two of the observations of Simon J made in *Regina (ToTel Ltd) v First-tier Tribunal (Tax Chamber) and another* [2012] QB 358 at 380. The first was that the test was one of capacity to pay without financial hardship, a test which fell to be applied in a way which complied with the EU principle of proportionality. The second was that the hardship enquiry should be directed to the ability of an appellant to pay from resources which are immediately or readily available: it should not involve a lengthy investigation of assets and liabilities, and an ability to pay in the future. That reflected the fact that the issue of hardship ought to be capable of prompt resolution on readily available material.

22. The tribunal noted at [22] that the "requirement that the resources be immediately or readily available is a reflection of the structure of s 84(3B), which looks to the existing financial position of the appellant, and does not require enquiry as to possible future action or any potential resources that might become available in the future". At [26] it observed that "consistently with the need to consider immediately or readily available resources, the normal rule is that the tribunal should look at the position as at the date of the hearing".

23. But the statutory requirement for the payment of VAT to cause hardship allows the tribunal to have regard to facts predating the hearing if those facts are evidence that the causation of the hardship is something other than the payment of the VAT, eg if an

appellant could not pay the VAT because it had deliberately paid away a sum which would otherwise have been available: see the consideration at [28] in *Elbrook* of the decision of Nugee J in *ToTel Ltd v HMRC* [2015] STC 610.

Evidence in support of application

24. In making its application for relief, the applicant relied on a spreadsheet drawn up on 14 December 2018 showing the cash flow forecast for the applicant's group for the 12 months ending 30 November 2019. The forecast was prepared by the applicant's finance manager, Mr Scott McLauchlan.

25. The application was also supported by a witness statement given by Mr McLauchlan, who gave oral evidence before the tribunal (and was cross-examined by Mr Thomson QC on behalf of HMRC). I found Mr McLauchlan to be a reliable and credible witness.

26. The December 2018 forecast was an updated forecast from one provided to HMRC in August 2018 for the purpose of the application made by Snow Factor Ltd to HMRC for relief from the requirement to pay the disputed VAT.

27. I make the following findings.

28. The cash flow forecast was prepared on a group basis. It showed accounts for three separate companies: (1) the applicant (Snow Factor Limited); (2) Ice Factor Kinlochleven; and (3) Ice Factor International Limited.

29. Ice Factor International Limited was the holding company of the two other companies. Ice Factor Kinlochleven provided facilities for ice climbing and dry wall climbing.

30. The applicant considered that it was appropriate to draw up a group cash flow forecast because the banking arrangements were made on a group basis. The group had an overdraft facility with HSBC of £50,000.

31. Mr McLauchlan contended that the cash flow was an optimistic prediction of the expected outcomes for the year ahead. He explained that the previous year (2018) had been a difficult one because of the unusually hot summer, which had adversely affected revenues (as people tended in hot weather to prefer outdoor rather than indoor activities). The cash flow had been prepared on the basis that the weather in 2019 would revert to type. Mr McLauchlan accepted in cross-examination that the revenues for the next year could be better or worse than those predicted. Indeed, he noted that the new 'Santa' product range launched in 2018 (for which there would be no material development expenses in 2019) might provide a degree of 'cushioning'.

32. My view is that it would be more accurate to describe the cash flow forecast in more neutral terms. Assuming a repeat of 2018 might be considered to be pessimistic but the reverse is not the case: a forecast to do better than a bad year is not, in my view, the same as being optimistic. I consider that the applicant has done no more than make a reasonable assumption about future trading conditions. That assumption might be falsified in either direction.

33. So much was, in fact, borne out in evidence given by Mr McLauchlan about the expected accuracy of the cash flow forecast when asked to re-assess it as at the date of the hearing. The hearing was held just over two months after the December 2018 forecast had been prepared. Mr McLauchlan explained that Snow Factor Limited's receipts for January to March 2019 were expected to be lower than forecast (because of the lateness of this year's ski season) but that there would be a corresponding uplift in April and May 2019. The result was that the overall expectation of receipts to the end of May was, in his own words, a "reasonable" one.

34. The cash flow for Snow Factor Limited reveals the cyclical nature of its business. Mr McLauchlan confirmed in cross-examination that this was not expected to change. Cash receipts for the winter months were significantly higher than those for the summer. For example, the receipts for January 2019 were forecast to be £626,285 while those for June 2019 were forecast to be £172,728. This provided the company with cash reserves to enable it to continue to trade through the summer and autumn.

35. Expenditure was also subject to significant variation. For example, expected expenditure for January 2019 was £385,337.76 while for June 2019 it was £265,506.15.

36. The expenditure in the 12 month period included monthly payments of £62,000 in respect of rent and monthly payments of £10,000 in respect of non-domestic rates. Both those payments reflected sums in respect of arrears (£6,000 in the case of rent and £2,000 in the case of rates) which had arisen due to the difficult trading conditions in the summer of 2018.

37. The expenditure in the 12 month period also showed quarterly payments of VAT. Despite the FTT decision, the VAT payments were made by the applicant on the basis that the FTT was wrong in law.

38. The net cash flow for Snow Factor Limited showed a positive figure of £350,836.66. The net cash flow for each month varied in line with the cyclical nature of its business: for example, it was forecast to be a positive figure of £240,947.24 in January 2019 but to be a deficit of £92,778.15 in June 2019.

39. The cash flow for Ice Factor Kinlochleven showed a net cash flow of £23,721.53. The cash receipts were subject to significant variation from one month to the next. The receipts were forecast to be largest in August and September 2019 (£70,437.54 and £79,296.96 respectively) before tailing off to £30,457.91 in November 2019.

40. The cash flow for Ice Factor International Ltd showed a one-off non-cash receipt of £12,000 in December 2018 but for the rest of the 12 month period showed no other receipts. More than half of its recurring expenditure in January 2019 to November 2019 arose from payments in respect of fixed borrowings. The 12 month forecast for Ice Factor International Ltd showed a negative net cash flow of £401,732.64.

41. The cash flow forecast showed, on a group basis, that in the 12 month period there were total receipts of £4,530,864.81. The group net cash flow was a deficit of £27,174.45.

42. The cash flow forecast showed, on a group basis, that in December 2018 immediately available resources to the group stood at £175,369.38. Those resources comprised a group overall balance of £125,369.38 and full use of the £50,000 overdraft

facility. The figure for immediately available resources to the group stood at £369,285.85 in January 2019 and £480,436.02 in February 2019.

43. The figure for immediately available resources to the group then peaked at £492,952.48 in March 2019 before reducing to £69,659.79 in July 2019, £56,899.94 in August 2019, £64,860.62 in September 2019 and a low of £56,082.36 in October 2019. The final figure for November 2019 showed an uplift to £81,226.73.

44. Those are the figures that would result on the assumption that the applicant made no steps to pay any part of the amount to HMRC.

45. The applicant also prepared a cash flow forecast for the group on the assumption that it had paid the sums in accordance with HMRC's decision of 15 November 2018.

46. There are two points of significance to note from that forecast.

47. The first is that, if payments of £100,000 had been made to HMRC in each of December 2018, January 2019 and February 2019, the immediately available resources to the group would have stood at £75,369.38 for December 2018, £169,285.85 in January 2019 and £180,436.02 in February 2019. In other words, the group could have afforded to pay those amounts at those times and still end up with a positive figure for immediately available resources to the group.

48. But, as a result of the cyclical nature of the business, the immediately available resources to the group would then decline so that the figure would go into deficit for each of the months from June to November 2019. The figure for June 2019 would become a deficit of £105,230.37 with the figures for the five months from July 2019 to November 2019 ranging from a deficit of £218,773.27 to a deficit of £243,917.64.

49. Mr McLauchlan was asked about the group's overdraft and whether he had asked HSBC for an increase in the amount. His evidence was that he had not, and nor had he sought alternative financing from any other bank or financial institution. Mr McLauchlan gave evidence that the overdraft facility was increased only once in the past: that was an increase of £30,000 in August 2013 and lasted for one month only. He said that he expected any increase to be similar to the one authorised in August 2013 (£30,000) and to last for no more than six months. He considered that it was unrealistic to expect an overdraft on terms that would enable full payment to HMRC in accordance with their November 2018 decision. Accordingly, he had made no approach to the bank for any increase in the overdraft.

50. Mr McLauchlan was asked in cross-examination why he had given preferential treatment to debts in respect of rent and rates (in relation to which arrears totalling £96,000 would be paid in the 12 month forecast period) rather than arrange to pay any of the VAT subject to the FTT decision. His answer was that he would naturally favour paying operational creditors first: without premises, Snow Factor Ltd could not trade. He also confirmed that, with the exception of HMRC, every other class of creditor was being paid. His evidence was that he regarded the debt due to HMRC as a liability in relation to which there was a doubt as to its ultimate payment: if the applicant's appeal on the substantive issue was successful, the debt would disappear. Consequently, he saw no need to draw up plans to pay a debt which, in the event, might be taken never to have existed.

51. Although he had no particular recollection of the events leading up to HMRC's decision of 15 November 2018, it was put to him in cross-examination that Snow Factor Ltd had been contacted by HMRC about the payment of the VAT and that it was HMRC who had alerted the applicant to the possibility of making a financial extremity application under section 85B of VATA 1994. It was similarly put to him that there had been no response to HMRC's letter of 15 November 2018 until the applicant made an application directly to this tribunal under section 85B(5) of VATA 1994.

52. Although I am not in a position to determine the precise facts leading up to the December 2018 application, I do make a finding that, on the balance of probabilities, the applicant did not take steps to contact HMRC about the payment of the debt and did not respond to the November 2018 letter before making its application to this tribunal.

53. Mr McLauchlan was also asked about the possibility of increasing the prices charged for any of the goods or services that the group supplied in order to fund some or all of the payment of the disputed VAT. He responded that he would need to be careful about uplifting prices across the board. My assessment of Mr McLauchlan's evidence, taken as whole, is that an increase in prices was not a possibility that had been considered at all, even for a temporary period or in relation to only some of the goods or services sold by the group.

Discussion

Meaning of section 85B of VATA 1994

54. The provisions of section 85B of VATA 1994 fall to be construed in their context. The context includes the statutory provisions governing the bringing of appeals and the payment of amounts of disputed VAT pending the resolution of a dispute. In my view it is clear that different considerations apply at different points in the course of the appeal process.

55. In the case of the initial appeal against an assessment to VAT, the general rule is that an appeal is not capable of being heard by the tribunal unless the disputed VAT is paid. That rule is designed to prevent abuse by bringing appeals to delay payment. But the potential harshness of that rule is ameliorated by providing that the VAT need not be paid if to do so would cause hardship to the appellant.

56. Those rules are designed to set "the price for entering the appeal process" (see [20] of *Elbrook*). It is entirely consistent with that objective that the hardship enquiry should not be a lengthy one and should focus on immediately or readily available resources.

57. But once the appeal process has been entered, different considerations come into play. In particular, when the FTT determines a disputed issue in favour of HMRC, the effect of section 85A(3) of VATA 1994 is that the amount of VAT not previously paid to HMRC (because of hardship to the appellant) "shall be paid ... to HMRC". If the appellant is unsuccessful before the FTT, the VAT must be paid in accordance with the judicial determination, which seems to me to be a wholly unsurprising result.

58. But section 85A of VATA 1994 has the potential to operate harshly where an appeal is then brought against the decision of the FTT. It is with that case that section 85B of VATA 1994 is concerned. That section begins by making it clear that the simple fact of making a further appeal does not affect the requirement to pay the VAT in accordance

with the determination of the tribunal. This general rule is, however, subject to two exceptions: one designed to protect the public revenue (subsection (3)) and the other operating in favour of the taxpayer (subsections (4) to (6)).

59. Subsection (7) of section 85B of VATA 1994 provides for subsections (3) to (6) to cease to have effect when the further appeal is determined. The operation of the exceptions is, therefore, strictly time-limited. Once the substantive appeal is determined, the position would then be governed by section 85B(2) of VATA 1994 if there is any change in the amount of VAT payable. If the applicant were to succeed on its further appeal on the substantive issue, then any amount required to be paid by this tribunal under section 85B(5) of VATA 1994 would be refunded to the applicant. If the substantive appeal were dismissed, section 85A(3) of VATA 1994 would then be re-engaged and section 85B would be relevant only if there were a further appeal from the Upper Tribunal.

60. It is with the rule operating in favour of the taxpayer that this application is concerned. The test for relief in this case is whether "financial extremity might be reasonably expected to result" from the payment of the disputed VAT required to be paid by HMRC following its decision on an application to it under section 85B(4) of VATA 1994.

61. That test differs from the one operating before the taxpayer enters the appeal process ("would cause the appellant to suffer hardship") and it is no surprise that it does. There is no reason to suppose that a test designed to police the *entry* of taxpayers into the appeal process ought to be the same as the test operating once an appeal has been judicially determined (albeit that the determination is then subject to further appeal). Indeed, it would be somewhat surprising, in the light of the provision made by sections 85A(3) and 85B(1) of VATA 1994, if the test in section 85B(5) had replicated the section 84(3B) test. It is, of course, possible that the facts will change since the initial decision on hardship (whether made by HMRC or the FTT) so that the appellant would *not* suffer hardship if required to pay the VAT following the determination of the appeal. But in a great many cases that would not be the case.

62. Section 85B(5)(c) of VATA 1994 focuses instead on whether "financial extremity might be reasonably expected to result" from HMRC's decision. Although I consider that this phrase must be construed as a compendious whole in the context of the remainder of section 85B and the other provisions of VATA 1994, it is nonetheless helpful to consider in turn the three different elements of that test:

(1) there must be "financial extremity";

(2) the financial extremity must be such as "might be reasonably expected"; and

(3) the financial extremity must "result" from HMRC's decision.

63. It was common ground between the parties that "financial extremity" is a more onerous test to satisfy than "hardship". I agree. It is a matter of law as to what those words mean and, in this context, my judgment is that they must bear their ordinary meaning. The ordinary meaning of that expression takes matters beyond mere hardship. Extremity is just that: it is at the very far end of the spectrum of financial health. Life should not be merely hard. More is required. In addition, it would be inconsistent with the legislative purpose if the test were *easier* to satisfy than hardship. That is because what needs to be shown is that the result is one which "might be reasonably expected" and not what the

result "would" be. If financial extremity were no more than hardship, it would follow that, in many cases, the test in section 85B(5) of VATA 1994 would be *easier* to meet than the hardship test, which would, in turn, mean that the general rule given by section 85B(1) of VATA 1994 would operate as the exception.

64. Mr Simpson QC submitted that if the applicant (or, more accurately, the group of companies of which it is a member) were insolvent, that would constitute a state of financial extremity. He also submitted that circumstances falling short of insolvency ought, in principle, to be capable of constituting financial extremity. If Parliament had wanted to confine the test to insolvency, it could quite easily have done so. The fact that it had not showed that the test was a wider one.

65. In my view, it is not productive to come up with a list of generic cases which might, or might not, be within the meaning of the statutory words when applied to the particular facts of any given case. To do so would carry with it a real risk of supplying a judicial gloss to a simple expression and would, moreover, divert attention from a consideration of the various elements of the test working harmoniously together. Not all insolvencies are created equal: a momentary time at which the debts of a company cannot be paid as they fall due is very different from a case where a company has permanently lost its only sources of income while its (considerable) liabilities remain unaltered. It by no means follows that, having regard to the particular facts of the case (which may include the likelihood of any steps actually being taken by any person to commence insolvency proceedings), the former case will amount to financial extremity in the ordinary meaning of that expression. However, both cases might reasonably be regarded as ones where a company has become insolvent.

66. The statutory question is more nuanced than what would otherwise be a binary choice of viewing a financial state of affairs (financial extremity or not): the question is whether the circumstances are such that financial extremity "might be reasonably expected" to result from HMRC's decision. There are two aspects of that qualification that are critical to a proper understanding of the test to be applied under section 85B(5) of VATA 1994. The first is that the test is "might" not "would". It is a question of possibilities. The second is that not any old possibility will suffice: it must be "reasonable" in the sense explained below.

67. What might be reasonably expected is something more than a theoretical possibility. There must be some reasonable basis for thinking that the possibility might come to pass. The expectation is a reasonable one, and that is an issue to be decided by reference to what one considers might reasonably happen if payment were made in accordance with HMRC's decision. I consider that the test of reasonableness here is, in essence, an objective one: having regard to the totality of the circumstances, what steps would it be reasonable to expect to be taken to meet the liability. But the test also has subjective elements: account must be taken of the particular circumstances affecting the taxpayer and the way in which it has chosen to carry on its business.

68. The final element of the test is that the financial extremity must "result" from HMRC's decision. There must be a causative link between the decision to pay some or all of the disputed VAT and the financial extremity. But it was also submitted by Mr Thomson QC on behalf of HMRC that this result must be both direct and, more importantly, immediate.

69. I am unable to accept that submission. There clearly needs to be a causal nexus between the decision and the financial extremity but the directness of the causation is not, in my view, in point. That will be hard (if not impossible) to disentangle from the issue of reasonableness that I have just discussed. There is nothing in the statutory test that leads to an inference that "results" should be impliedly qualified by inserting "directly" before it.

70. As to the question of immediacy, I consider that there *is* a timeframe within which the financial extremity must result. That timeframe is indicated by section 85B(7) of VATA 1994, which definitively switches off the effect of subsections (4) and (5) once the further appeal is determined. Section 85B of VATA 1994 is focused on who is entitled to hold the disputed VAT pending the determination of the final appeal.

71. If Mr Thomson QC were right, it would produce some very odd outcomes, particularly in relation to the far from unusual case of cyclical businesses. There is no warrant, in my view, for taking such a restrictive approach to the meaning of section 85B(5) of VATA 1994. The reference to the result is unqualified. If it had been intended that the result would be "immediate" that qualification could quite easily have been added. A business might be able to pay the amount in one month and then suffer financial extremity the next (well before the appeal is determined). It is hard to see why that is a state of affairs that falls outside the relief provided for by section 85B(4) or (5) of VATA 1994.

72. In my view section 85B(5) of VATA 1994 has struck a careful balance between, on the one hand, the need to protect the public revenue (and, by extension, the general body of taxpayers) by requiring an amount of VAT judicially determined to be payable to be actually paid to HMRC and, on the other hand, the need to support the rule of law and the integrity of the appellate process by securing that appeals on points of law (for which permission has, by definition, been given) can actually be determined by the higher courts. An element of the test (financial extremity) is harder to satisfy than a section 84(3B) hardship application but that is balanced by the fact that, as the test is looking to the future to some extent (the determination of the final appeal), it requires an assessment of what might (rather than would) happen, itself qualified by reference to reasonable expectations.

73. Unlike section 84(3B) of VATA 1994, section 85B(5)(c) is silent as to the person who must be in a state of financial extremity. The silence is, in my view, meaningful. It contemplates that the impact of the decision might be felt beyond the applicant itself. That is apt to include the impact on a group of companies of which the applicant is a member (such as this case). Equally, the taking of the steps might, in a group context, be by some person other than the applicant (provided it is reasonable to expect that to happen).

74. HMRC's decision letter of 15 November 2018 did not include any reasoning to support its view. It stated the wrong test ("would" cause not "might be reasonably expected to result"). And it purported to require a payment that exceeded the disputed VAT being appealed: see [8] above. None of these observations are, however, relevant to the decision falling to be made in this application: what is required is not a supervisory review of what HMRC has done but a *de novo* assessment of whether the tests set out in section 85B(5)(a) to (c) of VATA 1994 are met. If they are, then the powers set out in section 85B(6) of VATA 1994 are available for this tribunal to exercise.

Application of law to facts of application

75. How then does section 85B(5)(c) of VATA 1994 apply in relation to HMRC's decision in this case?

76. The facts to which the applicant points in support of its application are that, as a result of HMRC's decision, the immediately available resources available to the group would go into a deficit of £105,230.37 in June 2019 with a deficit continuing until November 2019 of at least £218,773.27: see [48] above.

77. The appeal on the substantive matter was, at the time of HMRC's decision, set for a possible hearing at some time between March and June 2019. Allowing a reasonable period for the making of the determination by the Upper Tribunal, it would seem to me that there is a reasonable prospect that the further appeal would not be determined until the autumn of 2019 (September or October).

78. The critical issue in this application is, in my judgment, the extent to which (if at all) it is reasonable, before the determination of the substantive appeal, to expect steps to be taken so that the applicant is in a position to meet some or all of the liability to pay the disputed VAT without financial extremity resulting. It is not sufficient for the applicant simply to point to the projected cash flow drawn up on the basis that no steps are taken to meet any part of the liability to pay the disputed VAT and leave it at that.

79. In considering what steps might be reasonable I should have regard to all the circumstances. Those circumstances include the following:

(1) even though the disputed VAT became payable in accordance with section 85A(3) of VATA 1994 on 24 January 2018 when the FTT determined the appeal, the applicant has taken no steps to pay any part of that amount;

(2) the applicant did not approach HMRC to discuss payment and did not initiate an application to HMRC under section 85B(4) of VATA 1994;

(3) the applicant did, however, take steps to clear arrears on other debts (see [36] above) and make sure that all other creditors with the exception of HMRC were being paid;

(4) the applicant did not at any time approach its bank to discuss extending its overdraft and nor did it approach any other bank or financial institution for funding; and

(5) the applicant did not consider taking steps, whether by increasing prices or reducing expenses or by any other means, to increase its cash flow for a temporary period so as to be in a position to make any payments to HMRC.

80. The applicant is entitled to continue to account for VAT on the basis that the FTT's decision was wrong in law and then be assessed by HMRC accordingly (and presumably appeal the assessments). But, if it takes that approach, it seems to me only reasonable to hold the applicant to the same approach in relation to the payment of the disputed VAT: on its own view, any payment will be recoverable once the appeal is determined in its favour.

81. What steps would it then be reasonable to expect it to take to meet some or all of the liability for what it considers will be a temporary period?

82. In determining what those steps might be, it is relevant that the projected cash flow was a reasonable one. It was, as I say above, neither optimistic nor pessimistic. In my view, it is therefore reasonable to have expected the applicant to have taken *some* steps to trade through any temporary cash flow difficulties. I consider that it is reasonable to expect steps to have been taken to increase prices (or advance receipts) or reduce expenses (or delay payments) to at least some extent. And it is reasonable to expect the bank to have been approached for an extension of the overdraft, assessing its likely reaction by reference to its previous conduct.

83. Who should have taken the steps?

84. If it is right to take account of the group position, I also consider that it is relevant to take account of the steps which the applicant's sister company, Ice Factor Kinlochleven, could reasonably be expected to take. Although no evidence was led on this, it seems evident that the expenses of the applicant's holding company (Ice Factor International Ltd) will be funded by distributions made to it by its subsidiary companies. It might reasonably be expected that, in addition to action taken by the applicant, Ice Factor Kinlochleven would pick up some of the slack so that Ice Factor International Ltd was in a position to meet its liabilities.

85. However, different considerations seem to me to be applicable to the action expected to be taken by the holding company itself. Clearly, the applicant is not in a position to control this (the relationship of control is, of course, in the other direction). Furthermore, the majority of the expenses of Ice Factor International Ltd relate to fixed debt in relation to which short-term restructuring is unlikely; and its other expenses are already relatively modest. Accordingly, it seems to me reasonable to take account of possible steps to be taken by Ice Factor Kinlochleven but not by Ice Factor International Ltd.

86. In my judgment it is also reasonable to anticipate that the cash flow might move against the applicant. That factor is relevant in determining the steps which could be reasonably expected to be taken: to push the expected steps to the maximum might itself be unreasonable. It is reasonable to build in a 'cushion' to some degree against the forecast turning out to be worse than expected.

87. In my view the test that I need to apply involves, adapting the words of Lord Hoffman in *Designers Guild v Russell Williams (Textiles) Ltd (trading as Washington DC)* [2000] 1 WLR 2416, 2423, the application of a not altogether precise standard to a combination of uncertain features. I consider that, having regard to the matters set out above, the applicant could reasonably be expected to have taken a combination of steps: a temporary but modest increase in prices (or advancement of receipts), a temporary but modest decrease in expenses (or delay in their payment) and a temporary increase in its overdraft to £80,000.

88. To determine the level of the increase or decrease in receipts or expenses is a difficult task, particularly as I have relatively limited financial information before me and the determination involves the making of assumptions about future trading operations. Recognising the fact that the applicant operates within relative tight margins, it seems to me to be reasonable to assume that both the applicant and Ice Factor Kinlochleven could have increased their receipts by 2% and reduced expenses falling due by 2%. I consider

that a reasonable period for which the increases and decreases have effect would be a temporary period of six months.

89. As I mention above, those steps are premised on the fact that more might be possible; but more would not necessarily be reasonable. In particular, I think that it would not be reasonable to expect a movement in the cash flow of 10% or more. Accordingly, a figure of 2% for both receipts and expenses builds in an element of 'cushion' (and, of course, it may be that the easiest course of action would be to make changes to either receipts or expenses (rather than both)). In determining this figure of 2%, I have also had regard to the extent to which the applicant had arranged to pay arrears in respect of its rent and rates totalling £96,000 for the 12 month period. As a percentage increase in the rent and rates otherwise falling due, that is significantly more than 2%; but the assumption that I have made is a universal movement in amounts without exception. Clearly, in reality, the actual changes would be likely to be more varied than this.

90. I should also make it clear that any one of these things could reasonably be done to a greater or a lesser extent than others: eg, the overdraft could be bigger or an increase in prices could be more significant or receipts could be increased in other ways (eg, by advancing sales). There is, plainly, a very substantial element of judgment in this.

91. In the course of the hearing, HMRC agreed that, despite the fact that the application was against its decision to require payments in December 2018, January 2019 and February 2019, it would make little sense, if the application were to be dismissed (as they sought), to require payments to be made on dates that had already passed. Instead, they suggested that the payments should be made at the end of February, March and April 2019. In considering the application, however, the statutory question requires the tribunal to consider the effect of the decision that HMRC actually took.

92. In my view, the correct way to proceed is to recalculate the expected cash flow on the assumption that the payments were made to HMRC in accordance with its decision and on the assumption that the applicant takes the step outlined at [87] and [88] above. For this purpose I would assume that, in relation to the applicant and Ice Factor Kinlochleven, receipts were increased by 2%, and expenses were decreased by the same percentage, throughout the six-month period December 2018 to May 2019 and steps were also taken to increase the overdraft to £80,000 so that, before the determination of the substantive appeal, an increased facility were available (ie, the availability of the overdraft would extend beyond May 2019 until the time at which it might be reasonable to expect the appeal to be determined).

93. If the forecast is recalculated on the assumptions set out at [92] above, the result is that the immediately available resources to the group for December 2018 to May 2019 would (to the nearest £1,000) respectively become positive figures of £114,000, £239,000, £268,000, £294,000, £218,000 and £147,000. If the consideration stopped there, there would be no question of financial extremity resulting.

94. However, as I explain above, I do not consider that it would be right to stop there. Consideration also needs to be given to the position in the following months when those months could reasonably be expected to fall before the determination of the appeal (which could be October 2019, although, of course, it could be sooner or later than that).

95. On the above assumptions, the immediately available resources for June 2019 would (to the nearest £1,000) be a positive figure of £21,000 before becoming a deficit for July 2019 to October 2019 of respectively £104,000, £117,000, £109,000 and £118,000.

96. The question then is whether this state of affairs is, within the ordinary meaning of that expression, "financial extremity". I consider that it is. The deficit figures are, in my view, significant: in each case they exceed £100,000. The position lasts for a number of months. The applicant would have to consider taking much more significant action than I have assumed above in order to return the group to a more stable financial footing. Such action would, in my judgment, go beyond what can be reasonably expected.

97. I should point out that, even if the same 2% change in receipts and expenses were continued beyond the assumed six-month period, the deficit figures would still remain significant (with, approximately, a reduction in the deficit of £10,000 to £12,000 for each subsequent month, so that, for example, the deficit for July 2019 would be around £22,000 lower).

98. Accordingly, my decision is that, in relation to HMRC's decision of 15 November 2018, the tests in section 85B(5)(a) to (c) of VATA 1994 are met.

99. It does not, however, necessarily follow that the application succeeds. If the tests are met, the subsection provides that the tribunal "may" replace, vary or supplement HMRC's decision by doing one or more of the things listed in subsection (6). That is a power rather than a duty. In relation to the exercise of this power, there is nothing in terms that directs the tribunal to have regard to any particular factor in considering whether, and (if so) how, to exercise it.

100. In my view, the power available to me should, on first principles, be exercised judicially in the light of the purpose of section 85B of VATA 1994 as I have described it at [72] above. It is clear to me that, in assessing what would be a fair and just disposal of this application, regard must properly be had to the steps that might be reasonably expected to be taken to pay some or all of the disputed VAT.

101. In my view, it is relevant, therefore, to consider, as at the date of the disposal of this application, what would happen if the applicant and Ice Factor Kinlochleven took the steps described at [87] and [88] above in the six-month period from March to August 2019. I recognise that this takes no account of the fact that the applicant (or Ice Factor Kinlochleven) could reasonably have been expected to take steps sooner than that; but, at least in the case of this application, it seems to me to be fair and reasonable to consider only steps that can be taken once the application is disposed of.

102. The result would be that, if no payment of the VAT were required and those steps were taken, the immediately available resources to the group for March 2019 to August 2019 would (to the nearest £1,000) respectively become £537,000, £461,000, £390,000, £274,000, £161,000 and £160,000. The resources for September and October 2019 would then become £168,000 and £159,000 respectively.

103. In those circumstances, it seems to me that, in exercise of the power mentioned in section 85B(6)(a) of VATA 1994, the applicant should pay £155,000 of the disputed VAT to HMRC. Throughout the period beginning with March 2019 and ending with October

2019 the immediately available resources to the group would, if the above steps were taken and if £155,000 were paid to HMRC, be a positive figure. I note that the effect of this decision is that the applicant would be required to pay more than half of the disputed VAT, which, in all the circumstances, seems to me to be a just and reasonable outcome.

104. What those powers do not seem to contemplate is requiring payment in instalments (which is, of course, what HMRC decided to do in its November 2018 decision). Even if that is a possibility, I can see no reason why payment in instalments would be appropriate in this case, bearing in mind the expected resources available to the group in the next few months. The applicant currently has the resources to pay the sum of £155,000 in a single payment.

105. The section is also silent as to when the payment should be made. I note, however, that section 85B(2)(b) of VATA 1994 requires payment within 30 days in a case where a determination of the further appeal results in more VAT becoming payable. That would, in my view, be an appropriate period for the payment to be made in this case.

Disposal

106. For the above reasons, I decide that the tests in section 85B(5)(a) to (c) of VATA 1994 are met. I exercise the power conferred by that subsection (and subsection (6)(a)) to replace HMRC's decision by requiring the payment of £155,000 to HMRC. The payment must be made before the end of the period of 30 days beginning with the day on which this decision is released to the parties.

JUDGE ANDREW SCOTT

Release date: 8 March 2019