[2016] UKUT 0424 (TCC)

Appeal number: UT/2016/0005

VAT - PENALTIES – appeal against default surcharge – whether reasonable excuse - sections 59(7) and 71(1)(b) VAT Act 1994 - appeal dismissed by First-tier Tribunal – whether First-tier Tribunal erred - decision of First-tier Tribunal set aside and remade – default surcharge upheld

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

BETWEEN:

ETB (2014) LIMITED

Appellant

- and –

THE COMMISSIONERS FOR
HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Tribunal: Judge Greg Sinfield
Judge John Clark

Sitting in public in London on 1 September 2016

Edward Thackray, former director of ETB (2014) Limited, for the Appellant

Alice Carse, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. The Appellant ('ETB') appealed to the Tax Chamber of the First-tier Tribunal ('FTT') against a default surcharge of £972.11 imposed under section 59 of the VAT Act 1994 ('VATA94') because ETB had not paid VAT of £19,442.26 due for accounting period 12/14 on time. ETB did not dispute that it had paid the tax late but contended that it had a reasonable excuse for the default.

2. The appeal was categorised under rule 23 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 ('the FTT Rules') and in accordance with the Practice Statement on the categorisation of tax cases issued by the Chamber President on 29 April 2013 as a Default Paper case. Accordingly, the appeal was determined, in accordance with rule 26, without a hearing on the basis of written submissions and papers provided by the parties. The facts relevant to the appeal were not in dispute. In a decision released on 17 November 2015, [2015] UKFTT 0569 (TC), ('the Decision'), the FTT (Judge Dr K Khan) held that ETB did not have a reasonable excuse and dismissed the appeal.

3. ETB now appeals, with the permission of the FTT (Judge Richards), against the Decision on the ground that the FTT applied the wrong test for determining whether ETB had a reasonable excuse and the reasoning in the Decision was not sufficient to justify the conclusion. As is appropriate for an appeal originally heard on the papers, the hearing before us was brief and concentrated mostly on what documents were before the FTT as well, of course, as the contents of the Decision. Ms Alice Carse appeared for HMRC and we are grateful to her for her helpful submissions at the hearing. Conscious of her duty to the tribunal in view of the fact that ETB, represented at the hearing by its former director Mr Edward Thackray who is not a lawyer, was effectively a litigant in person, Ms Carse fairly set out all the relevant matters and accepted that some parts of the Decision could not be defended while maintaining that the FTT had not erred in the result.

4. For the reasons given below, we have decided that the Decision must be set aside and we should remake it. Having reviewed the evidence and submissions, our decision is that ETB's appeal against the default surcharge must be dismissed.

Liability for a default surcharge

5. Regulation 25(1) of the VAT Regulations 1995 provides that a person who is registered for VAT (or liable to be so registered) must submit a VAT return to HMRC no later than the last day of the month next following the end of the VAT accounting period to which it relates. There is a seven day extension for persons who submit returns electronically which is what ETB did. Under regulation 40(2), any person required to make a return must pay any VAT shown as payable on the return to HMRC not later than the last day on which that return is due.

6. Liability for a default surcharge arises under section 59 VATA94. Section 59(1) provides that a taxable person is in default where HMRC do not receive a VAT return and any VAT shown as payable on such return on or before the due date. Where a person is in default, HMRC may issue a surcharge liability notice ('SLN'). If, having been served with a SLN, the taxable person defaults again during the period of one year ('the Surcharge Liability Period') from the end of the period of default, the person

becomes liable to a surcharge. On each subsequent default, the Surcharge Liability Period is extended to run for 12 months from the end of the latest period of default.

7. The surcharge is the greater of £30 and a specified percentage of the outstanding VAT. The percentage specified increases according to the number of VAT periods in respect of which the person is in default during the Default Surcharge Period starting with 2% for the first period of default. For the second period in respect of which the taxable person is in default during the Default Surcharge Period, the specified percentage is 5%. The maximum percentage is 15% where there have been four or more periods in default during the Default Surcharge Period.

8. Section 59(7) VATA94 provides that a taxable person is not treated as in default in respect of any VAT period if the person satisfies HMRC, or on appeal the FTT, that in respect of the period:

> (1) the return or the VAT due was despatched at such a time and in such a manner that it was reasonable to expect that it would be received by HMRC within the time limit; or
>
> (2) there is a reasonable excuse for the return or VAT not having been so despatched.

9. Section 71(1)(a) VATA94 provides that for these purposes an insufficiency of funds to pay any VAT due is not a reasonable excuse. Section 71(1)(b) VATA94 further provides that, where reliance is placed on any other person to perform any task, neither the fact of that reliance nor any dilatoriness or inaccuracy on the part of the person relied upon is a reasonable excuse.

10. The Respondents have the burden of proving that the Appellant failed to pay the VAT on time and is liable to pay the default surcharge. The onus then passes to the Appellant to prove that he had a reasonable excuse for his failure to pay on time.

Test for reasonable excuse where late payment caused by insufficiency of funds

11. The leading case on the meaning of reasonable excuse in the context of an insufficiency of funds is the decision of the Court of Appeal in *Customs and Excise v Steptoe* [1992] STC 757 (‘*Steptoe’*). In that case, the Court of Appeal held unanimously that although insufficiency of funds can never of itself constitute a reasonable excuse, the cause of that insufficiency – the underlying cause of the taxpayer’s default – might do so. There was some disagreement, however, about what constitutes a reasonable excuse.

12. Lord Donaldson MR first set out the unanimous view of the Court on the construction of what is now section 71(1) VATA94 as follows at 769-770:

> “There is agreement between [Nolan and Scott LJJ] that section 33(2)(a) of the Finance Act 1985 is not to be construed in the way in which the Commissioners of Customs and Excise (the commissioners) would wish to construe it, namely, that an insufficiency of funds can in no circumstances amount to a reasonable excuse for failing to dispatch the tax due, however short the duration of that failure and whatever the reason for the insufficiency of funds. In practice this would mean that the

> taxpayer had always to demonstrate that he could have paid the tax, but failed to do so for some reason constituting a reasonable excuse. Not only is this an improbable construction, but it really cannot survive in the context of section 33(2)(b) [now section 71(1)(b) VATA94]. There the words 'neither the fact of that reliance nor any dilatoriness or inaccuracy on the part of the person relied upon is a reasonable excuse' show clearly that although reliance on another person is not of itself capable of constituting a reasonable excuse, the commissioners and the tribunal are expected to look behind that reliance and to ask themselves whether in such a case the underlying cause was dilatoriness or inaccuracy on the part of that person or whether, for example, he was run over by a bus. If the same approach is applied to section 33(2)(a) [now section 71(1)(a) VATA94], as clearly it should be, the legislative intention is that insufficiency of funds can never of itself constitute a reasonable excuse, but that the cause of that insufficiency, ie the underlying cause of the default, might do so."

13. Lord Donaldson then turned to the question of what constitutes a reasonable excuse in cases where the default occurred because of an insufficiency of funds. Lord Donaldson described the different views of the Court and the prevailing majority view as follows:

> "The difficulty which then arises is that Parliament has not specified what underlying causes of an insufficiency of funds which lead to a default are to be regarded as reasonable or as not being reasonable. Prima facie the legislative intention is the same as in the context of section 33(2)(b). This is that, save in so far as Parliament has given guidance, it is initially for the commissioners to decide whether the underlying cause constitutes a reasonable excuse and for the tribunal to decide this on an appeal. That said, there must be limits to what could be regarded as a reasonable cause. Nolan LJ, as I read his judgment explaining and expanding on his judgment in *Customs and Excise Comrs v Salevon Ltd* [1989] STC 907, is saying that if the exercise of reasonable foresight and of due diligence and a proper regard for the fact that the tax would become due on a particular date would not have avoided the insufficiency of funds which led to the default, then the taxpayer may well have a reasonable excuse for non-payment, but that excuse will be exhausted by the date on which such foresight, diligence and regard would have overcome the insufficiency of funds.
>
> Scott LJ on the other hand is of the opinion that the underlying cause of the insufficiency of funds must be an 'unforeseeable or inescapable event'. I have come to the conclusion that this is too narrow in that (a) it gives insufficient weight to the concept of reasonableness and (b) it treats foreseeability as relevant in its own right, whereas I think that 'foreseeability' or as I would say 'reasonable foreseeability' is only relevant in the context of

> whether the cash flow problem was 'inescapable' or, as I would say, 'reasonably avoidable'. It is more difficult to escape from the unforeseeable than from the foreseeable.
>
> It follows that if I have correctly interpreted the two judgments, I am in agreement with Nolan LJ rather than Scott LJ."

14. As an aside, we note that in July 2016 HMRC issued an updated version of factsheet CC/FS12 on penalties for VAT and excise wrongdoings. In that document, HMRC express the view that a "reasonable excuse is normally an unexpected or unusual event that's either unforeseeable or beyond your control". There are strong echoes there of Scott LJ's dissenting judgment in *Steptoe* and it certainly does not reflect the views of the majority in that case. The wording in CC/FS12 is unfortunate as it could lead a taxpayer or HMRC officer or even a tribunal into error when assessing whether particular circumstances constitute a reasonable excuse. The new VAT Default Surcharge Officer's Guide published online on 26 August 2016 avoids this error by not trying to define what is or is not a reasonable excuse. The Guide refers HMRC officers to the Compliance Handbook which contains further guidance on reasonable excuse in the context of late payment of tax due to a shortage of funds. The Handbook states, at CH555800, that a person may have a reasonable excuse for failing to pay on time when the failure resulted from a shortage of funds which:

> "… occurred despite the person exercising reasonable foresight and due diligence, having given proper regard to their tax due date obligations."

It seems to us that the statement in the Compliance Handbook at CH555800 is much better than the one found in factsheet CC/FS12 and more closely reflects the views of Lord Donaldson MR and Nolan LJ in *Steptoe*.

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

The Decision

16. As we have already stated, the appeal was a Default Paper case. The front sheet of the Decision states that the FTT determined the appeal on 6 October 2015 without a hearing, having first read the Notice of Appeal and HMRC's Statement of Case. Some Default Paper cases may contain complicated facts which can only ascertained by reviewing sometimes extensive correspondence between the parties. We are aware that a single judge sitting alone in the FTT is often given several Default Paper cases to deal with at a time, sometimes to fill a morning or afternoon when a hearing has gone short

or been unexpectedly vacated. In those circumstances, the judge may feel under pressure to determine the cases quickly but while that may explain, it cannot excuse a decision that contains, as this one does, errors varying from simple typographical errors or slips to more serious errors of law. We do not know the circumstances in which the judge determined the appeal in this case but if, as we think likely, the errors discussed below could have been avoided by the judge taking more time to consider the case, draft the Decision and review it before it was issued then we would support any judge in asking to be given that time.

17. Apart from the "Introduction", the Decision is not set out in consecutively numbered paragraphs. Instead, each section restarts the numbering and so contains the same numbered paragraphs as all the other sections save that some sections contain more paragraphs than others. For example, there are four paragraphs numbered "(1)". This makes referring to an individual paragraph unnecessarily difficult. We consider that all decisions should use a single series of consecutively numbered paragraphs, with sub-paragraphs as appropriate. There is a standard template for full decisions in Default Paper cases issued by the FTT which automatically uses the correct paragraph styles. The template should be used unless there are good reasons (and we cannot think of any) to the contrary.

18. In the "Introduction", which consists of three paragraphs, the FTT stated that the appeal was against a default surcharge for period 12/14 in the sum of £972.11 calculated at 5% of the tax due of £19,442.26; ETB had been registered for VAT since 1 April 1973 prior to changing to a group registration on 1 July 2013; and had been in the Default Surcharge Regime from period 12/13 onwards.

19. The section of the Decision headed "Background facts" is as follows:

> "(1) The Appellant requested a review of the surcharge in a letter dated 25 February 2015 and presented further information to assist their deliberations in a letter dated 18 March 2015. The Respondents upheld the surcharge by letter on 2 April 2015.
>
> (2) The Appellant sent additional information by letter dated 7 April 2015 which the Respondents considered and sent a reply maintaining the surcharge on 13 April 2015.
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> (3) There was yet further information provided by the Appellant on 24 April 2015 which the Respondents considered and maintained the Surcharge Penalty.
>
> (4) The Appellant acknowledges that the payment for the period 12/14 was rendered late and as a result a default occurred."

20. As Ms Carse accepted, this section of the Decision does not describe the background to the default at all. The first three paragraphs of the section describe the correspondence between ETB and HMRC after the surcharge had been imposed. The fourth paragraph sets out an admission by ETB that VAT due for period 12/14 was paid late.

21. The next section of the Decision is headed "The Appellant's submission" (*sic*) and is as follows:

> "(1) The Appellant has traded through a number of businesses over a twenty year period during which time they collected substantial VAT from customers and paid this to HMRC without penalty.
>
> (2) They sold the assets and goodwill of the business on 31 December 2014 and as a consequence had to crystallize all the debt and work in progress within the company. This had the effect of inflating the VAT due for the period subject to appeal.
>
> (3) On 1 January 2015, the Appellant no longer directly employed any staff since the business had effectively been sold.
>
> (4) In the period December 2014, the Appellant was taken ill with viruses and towards the end of 2015 it became clear that the cash flow within the business would prevent payment of VAT being made on time. The required funds were immediately raised through another common company and the VAT payment was made thirteen days late.
>
> (5) The Appellant has always been diligent and timely in their payment of their tax liability."

22. This section of the Decision describes ETB's evidence of facts relied on as showing that it had a reasonable excuse. Before us, both parties agreed that, in (4), "January" should be inserted before "2015".

23. The next section is headed "HMRC's submissions" and is as follows:

> "(1) HMRC say that the surcharge was correctly levied in accordance with the law and given the history of the Appellant's surcharge liability they would have known the date for the submission of the return and payment of VAT. Further they would have had the necessary HMRC contacts to assist if there were problems with the timely payment of the VAT. The Surcharge Liability Notice VAT 160 would have assisted the Appellant in understanding how the surcharges are calculated and the percentages used in those calculations
>
> (2) The Respondents say that since the director Edward Thackray, who had ultimate responsibility for the timely submission of the VAT return and payment, resigned on 31 December 2014 there was reliance on a third party to submit the return and to pay the VAT due. Such reliance on a third party precluded there being a reasonable excuse under the provisions of VATA 1994 Section 71(1) (b).
>
> (3) The sale of the business and its consequential effect on the liability to VAT was known by the directors at the time and therefore a foreseeable event. It would be reasonable to expect a prudent businessman to make provision for such liability and to allocate funds from the sale to meet the tax liability.
>
> (4) The Respondents say that since the Appellant explained that they were waiting for funds to be received to pay the VAT and

> in such case an insufficiency of funds at the due date is not a reasonable excuse. A better course of action would have been for the Appellant to contact the Respondents before the due date to explain the lack of funds and to make arrangements for payment.
>
> (5) Section 71(1)(a) VATA 1994 specifically excludes an insufficiency of funds as providing a reasonable excuse for late payment and the removal of the surcharge.
>
> (6) HMRC say that the Appellant sought to raise funds by selling shares held in an associated company and did not allow sufficient time for cleared funds to be received by the Appellant's bank account to enable them to pay the VAT on time. It is clear that the Appellant did not obtain an overdraft facility which would have facilitated an earlier payment."

24. The FTT then set out its conclusions in the next section under the heading "Conclusion":

> "(1) There is no question that the Appellant was late in making the payment. This is acknowledged and appears to be the result of an insufficiency of funds at the due date.
>
> (2) The burden of proof is on the Appellant to show that the underlying cause of its failure to meet its VAT payment obligations was due to unforeseen circumstances or events beyond its control. In the Tribunal's view, this burden has not been discharged and there is no reasonable excuse for the Appellant's late payment of VAT. It is sensible for traders in a difficult situation to enter into negotiations with HMRC before the due date for the payment of tax. The default surcharge is levied if payment is made late but not in cases where [the] Appellant had negotiated a time to pay arrangement and agreed a payment schedule. Sadly this was not done, (*sic*)
>
> (3) It is clear to the Tribunal that the Appellant through the Director dealing with this matter had a history of dealing with the Company's tax affairs in a diligent and timely fashion. There is no question that they would have wanted to do the right thing. This is quite clear from the correspondence between the parties. However, the Tribunal has very limited discretion in dealing with these matters. If a taxpayer is late with the payment of their tax then a penalty is applied. In this case, the penalty was applied in accordance with the law and the payment was late. There are no grounds for holding that there is a reasonable excuse and the appeal is accordingly dismissed and the surcharge in the sum of £972.11 is upheld."

25. In paragraph (2) of the "Conclusion", the FTT stated that, in order to establish that it had a reasonable excuse, ETB had to show that the late payment of VAT was due to unforeseen circumstances or events beyond its control. That view was consistent with HMRC's submission in their Statement of Case, although not recorded in the Decision, that the "late payment did not occur as a result of something which was entirely out of

[ETB's] control." It will be immediately apparent to the attentive reader that HMRC's submission and, more seriously, the FTT's description of what is required to show a reasonable excuse are not consistent with the views of the majority in *Steptoe*, which Ms Carse acknowledged. Ms Carse submitted that, although the FTT appears to have relied on the dissenting judgment of Scott LJ in *Steptoe* in paragraph (2) of the "Conclusion", its actual conclusions did not appear to be based on an analysis of whether the circumstances were unforeseen or beyond ETB's control. The conclusion of the FTT appeared to be that a reasonable businessman in ETB's position would have sought to agree a time to pay arrangement with HMRC. Ms Carse submitted that, although it referred to unforeseen circumstances and events beyond ETB's control, the FTT did not make an error of law in its legal analysis because the conclusion was consistent with the application of the approach of the majority in *Steptoe*.

26. We do not accept that submission. It amounts to saying that if the FTT reached the right conclusion then the fact that the FTT misstated the legal test to be applied does not amount to an error of law. In our view, there would still be an error of law even if the outcome of the appeal before the FTT would inevitably have been the same. In our opinion, the FTT made an error of law when it stated, in (2) of the "Conclusion", that ETB had to show that the late payment was due to unforeseen circumstances or events beyond its control and, as ETB could not do so, it did not have a reasonable excuse.

27. In the "Conclusion", the FTT states, which was not disputed, that ETB paid the VAT late and it appeared to the FTT (which we take to mean that it found) that this was because of an insufficiency of funds at the due date. Apart from stating that ETB had a history of dealing with its tax affairs in a diligent and timely fashion and that it wanted to "do the right thing", there are no findings of fact in relation to the circumstances leading up to the default. It is not possible to determine from the Decision whether the FTT accepted the description of the events put forward on behalf of ETB. Ms Carse submitted that the FTT did not err in law by being unclear about its findings of fact. She contended that the FTT made findings of fact in the "Background facts" section and also referred to the facts in the "Appellant's submission" section as well as in the "HMRC's submissions" section. We do not accept that the sections of the Decision that record the parties' submissions can be taken to be findings of fact. There is nothing in those parts of the Decision, or elsewhere, to indicate whether the FTT accepted a party's description of the facts. It would have been a simple matter, and helpful to us, for the FTT to set out its findings as a single narrative of the relevant facts in chronological order or simply to state that it accepted the parties' version of events as set out in their submissions.

28. In our view, the FTT failed to address the circumstances leading up to the default relied upon by ETB and analyse whether they could provide a reasonable excuse as explained in *Steptoe*. The FTT does not appear to have considered any of the facts relied on by ETB in its submissions, namely the effect of the sale of the assets and goodwill of the business on 31 December 2014, the fact that ETB no longer had any staff from that date, the illness of the director and that the director only realised what amount of VAT would fall due when preparing the return. We do not say that any or all of those facts necessarily constitute a reasonable excuse but we consider that, having been raised and noted by the FTT, they should have been discussed. Instead, the FTT seems to have focused exclusively on the fact that ETB did not try to negotiate a time to pay arrangement with HMRC in advance of the due date for payment. A failure to take steps to overcome a cash flow problem, such as agreeing time to pay or arranging a

loan, is obviously a relevant factor in a case such as this but it is not necessarily determinative and does not relieve the tribunal from considering other facts put forward as establishing a reasonable excuse. In the result, ETB could not be certain that the FTT had considered the facts relied on in its grounds of appeal and described in the Decision as its submissions or, if the FTT had considered them, why the FTT had rejected those matters as constituting a reasonable excuse. We consider that the failure to deal with the facts relied on by ETB in the Decision was a flaw in the reasoning of the FTT and an error of law.

29. As was pointed out by Lord Carnwath in *Pendragon Plc v HMRC* [2015] UKSC 37, where an error of law has been established (whether on the application of the *Edwards v Bairstow* principle or because of some other kind of error of law), the Upper Tribunal may exercise its power under section 12 of the TCEA 2007 to set aside the decision of the FTT and re-make it. In doing so, the Upper Tribunal may make such findings of fact as are appropriate (section 12(4)(b)). We have found that there are errors of law in the Decision. Accordingly, we set aside the Decision. As we have the same papers before us as the FTT had and the facts are not disputed, we consider that we are able to remake the decision on the material before us and there is no need to remit the case to the FTT.

Facts

30. The primary facts were not in dispute and we find them to be as set out below. Our description of the relevant facts is taken from the papers that were before the FTT. There is one difference between the facts below and those in the papers where we prefer the date given to us by Mr Thackray for his illness over that contained in his letter of 7 April 2015 to HMRC.

31. ETB, formerly Edward Thackray Building Limited, has been registered for VAT since 1 April 1973. It changed to a group registration on 1 July 2013.

32. In over 20 years of trading, ETB has paid approximately £3.5 million in VAT without incurring any penalties. Mr Thackray was a director of the company until the sale of the business. The only other director was Mr Thackray's daughter but she did not play any active part in the business at the time of its sale. We accept, as did the FTT, that Mr Thackray believes in paying tax where due and on time if at all possible. Mr Thackray's father had been a Tax Commissioner and that helped form his attitude to his tax obligations.

33. In period 12/13, ETB entered the default surcharge regime when it failed to pay £30,683.48 shown as due on its VAT return, which was also late, by the due date which was 7 February 2014. As this was the first default, no surcharge was imposed. On 4 March, ETB telephoned HMRC to make a promise of payment but, as the call was made after the due date, the relief granted by section 108 of the Finance Act 2009, which provides for the suspension of penalties when there is a deferred payment agreement, did not apply.

34. ETB was also late in paying the VAT of £7,868.51 due for the period 03/14 which was due on 7 May. The VAT return was received on 14 May and the payment was received on 16 May. HMRC issued a default surcharge. ETB requested a review in a letter dated 11 June and HMRC accepted that a reasonable excuse existed and removed the surcharge in a letter dated 7 July.

35. ETB was one day late in paying the VAT due for the period 06/14. ETB again asked for a review of the decision to impose a surcharge for that default. HMRC agreed to remove the surcharge in a letter dated 2 October 2014. HMRC state that they were wrong to remove the surcharge in relation to period 06/14. HMRC now consider that ETB had allowed insufficient time for the payment to reach HMRC by the due date because ETB had only initiated a three-day electronic payment one day before the due date. HMRC stated that they did not seek to re-impose the surcharge for that period.

36. The due date for receipt of a VAT return and any payment due for period 09/14 was 7 November. The return was received early on 31 October but the payment was received in two parts on 1 and 9 December. Someone from ETB telephoned HMRC on 25 November to make a promise of payment but, as the due date had passed, the relief under section 108 Finance Act 2009 did not apply. HMRC did not impose a surcharge in respect of this default as the amount of the surcharge was below the threshold for doing so.

37. On the reverse of each surcharge Liability Notice issued by HMRC were certain standard paragraphs which included the following:

> "Problems paying your VAT?
>
> If you can't pay the full amount on time, pay as much as you can and before the payment is due, contact the Business Payment Support Service."

38. On 6 June, 7 July and 2 October 2014, HMRC sent letters to ETB containing a fact sheet "How to avoid VAT Default Surcharges" or "Top tips on how to avoid VAT Surcharges".

39. On 31 December 2014, Mr Thackray sold the assets and goodwill of ETB and the company changed its name. As a result, all the debts and work in progress as at 31 December 2014 were brought into account and ETB was required to account for the VAT on them in period 12/14. The due date for submission of the electronic VAT return and payment of any VAT due for period 12/14 was 7 February 2015.

40. Mr Thackray told us that he had never resigned as director of ETB. He accepted that Companies House records showed that he had done so but he had no explanation for that unless his solicitor had arranged it without him realising it. On balance, we find that Mr Thackray resigned as a director of ETB with effect from 31 December 2014 although nothing in this appeal turns on that fact.

41. From December 2014 until the beginning of February 2015 when the VAT payment was due, Mr Thackray suffered from three separate viruses and lost three quarters of a stone in weight. In late December, Mr Thackray was ill while abroad. On 15 January (not 13 February, as stated in the letter of 7 April, which we accept was a mistake), Mr Thackray went to see his doctor who sent him for a blood test.

42. From 1 January 2015, ETB no longer employed any staff. Mr Thackray found himself in a completely different and strange operating environment. Towards the end of January, it became clear to Mr Thackray that a cash flow problem would prevent the payment being made on time.

43. On 4 February 2015, Mr Thackray took steps to raise funds to enable ETB to pay the VAT due. First, Mr Thackray instructed F&C Investments to sell shares in Foreign & Colonial Investment Trust for £21,014.72. Secondly, he made arrangements to withdraw all the savings in Edward Thackray Limited's Business Saver Account with Cambridge Building Society. That account normally required a three month notice period and so a forfeit was paid.

44. The VAT return for period 12/14 was received, in time, on 6 February 2015. The return showed that the VAT due for the period was £19,442.26. On 13 February, HMRC notified ETB that it was liable to pay a default surcharge. The amount of the surcharge was £972.11 being 5% of the tax not paid by the due date. Also on 13 February, ETB received a cheque for the proceeds of the sale of the shares in Foreign & Colonial Investment Trust which were paid into ETB's bank account on the same day.

45. The VAT due was received by HMRC on 25 February 2015 which was 18 days late. Also on 25 February, Mr Thackray wrote to HMRC seeking a review of the default surcharge. In the letter, Mr Thackray explained that, at the end of 2014, he had sold the goodwill and assets of ETB and changed the company name. He explained that, in the intervening period, he had been dealing with the transition transactions on a part-time basis and had been ill for a number of weeks.

46. In a letter dated 18 March 2015, HMRC asked Mr Thackray to provide further information. The information included evidence, such as bank statements, to show ETB had cleared funds at the due date or an overdraft and medical certificates or other evidence to confirm the nature and period of illness. HMRC asked for a response by 1 April. On 2 April, not having received the requested evidence, HMRC issued a letter upholding the default surcharge.

47. In a letter dated 7 April 2015, ETB provided some further information. Enclosed with the letter was a bank statement for the period 20 January to 27 February. The letter also stated:

> "Dealing with my illnesses these were a series of viruses that began in the two weeks before Christmas (I was abroad at the time and can provide a bill for medical consultation if required). Over New Year I suffered from a bout of diarrhoea and was confined to bed for two days. Then over the period that our VAT was due I had yet another virus that lasted three weeks with a complete loss of appetite (I lost ¾ stone over the period) and a high temperature. On 13 February I consulted a GP who sent me for a blood test.

48. HMRC considered the further information and sent a letter maintaining the default surcharge on 13 April 2015. In the letter, HMRC pointed out that the bank statement showed that, as at the due date, ETB did not have sufficient cleared funds to pay the VAT due. The letter also expressed sympathy in relation to Mr Thackray's health issues. They were not, however, accepted as constituting a reasonable excuse.

49. ETB sent HMRC a further letter dated 24 April 2015. In the letter, Mr Thackray stated that

> "I suffered from a number of viruses over the period that the VAT submission was due and I was also dealing single handedly with the complications of winding the business up. One of these areas of complication was collecting payments against bills raised up to the end of 31 December 2014 and therefore included in your VAT return. Large sums did not arrive into my account until well after the 'VAT due date' and so when I paid the VAT on 25 February 2014 I was in effect lending you the money.
>
> You have made the point that there were not sufficient cleared funds in my bank account at the due date. This is something that I had already foreseen and had arranged to sell £21,002.40 of stock-market investments in my associated Company, Edward Thackray Limited. There were unexpected delays in the realisation of these assets and the money did not actually arrive into that account until 13 February 2015 (see attached bank statement) when I was ill. By the time that I got back to work I found sufficient funds in the [ETB] account to pay you.

50. On 29 April 2015, HMRC replied maintaining the default surcharge in a letter incorrectly dated 20 April 2015. HMRC pointed out that, while Mr Thackray stated that he was unwell from a virus for three weeks over the period that the VAT was due, the bank statements provided showed that it was possible for online bill payments to be made during that time but that sufficient funds were not available in the ETB bank account until 18 February 2015. The payment of the VAT was not actually made until one week later on 25 February. HMRC confirmed that in their view, insufficiency of funds prevented ETB from making the payment by the due date and upheld the decision to impose a surcharge.

51. On 10 May 2015, ETB wrote again to HMRC setting out a diary of events and providing further information in relation to Mr Thackray's attempts to raise additional funding on 4 February. Those events are included in the description of the facts above.

52. HMRC maintained the default surcharge in a letter dated 21 May 2015, noting that Mr Thackray gave instructions for the sale of shares on 4 February which would not appear to allow sufficient time for cleared funds to reach him and thus ETB in time to pay the VAT due for period 12/14 on 7 February.

53. On 30 May 2015, ETB appealed to the FTT against the default surcharge.

Submissions and discussion

54. The only issue in the appeal is whether ETB had a reasonable excuse for its failure to pay the VAT due for period 12/14 on time. As can clearly be seen from the bank statements provided by ETB, the reason why the VAT due for period 12/14 was not paid by the due date was that ETB did not have sufficient funds in its bank account to pay the amount due. Insufficiency of funds cannot constitute a reasonable excuse (section 71(1)(a) VATA94) but the underlying cause may do so (see *Steptoe*). In the correspondence, ETB relies on two particular circumstances as providing a reasonable excuse for the late payment of VAT in this case. The first is the sale of the business and the second is Mr Thackray's illness. We consider each separately and then together.

55. In relation to the sale of the business, it appears from the correspondence that ETB contends that the VAT amount due for period 12/14 was exceptionally high because of the need to raise VAT invoices and account for VAT on all work in progress as at the date of the sale. ETB also stated that a large proportion of the invoices were unpaid by the due date of 7 February 2015.

56. We do not accept that the sale of the business and the consequences that followed from it, without more, are capable of constituting a reasonable excuse in this case. As stated above, the test for establishing a reasonable excuse for failing to pay an amount of tax on time because of a cash flow problem is whether the insufficiency of funds was reasonably avoidable ie could ETB have avoided the insufficiency of funds by the exercise of reasonable foresight and due diligence. In relation to the consequences of the sale of the business, the answer to that question in this case is plainly yes. It was, in our view, not only reasonably foreseeable but blindingly obvious that the issue of VAT invoices for all work in progress as at 31 December 2014 would lead to an obligation to account for the VAT shown on those invoices in the VAT return for that period.

57. Mr Thackray submitted that the effect of the sale of the business on ETB's VAT liability did not become apparent to him until he completed the VAT return at the end of January 2015. He suggests that this was because of all the other matters he had to deal with related to the sale of the business, with no staff and suffering from a bout of viruses which began in December 2014. We consider the effect of Mr Thackray's ill health below but, putting that to one side, we do not consider ETB has shown that the lack of funds was not reasonably avoidable. This is clear from the letter dated 24 April 2015 in which Mr Thackray said that he had foreseen that ETB would not have enough funds to satisfy its VAT liability on the due date which is why he took steps to raise funds. From the papers provided, we know that Mr Thackray did not start to take those steps until 4 February which was too late to secure the funds by the due date for payment of the VAT. It is clear, however, that had Mr Thackray exercised his foresight and taken action earlier then those funds could have been obtained and ETB would have been in a position to pay the VAT on the due date. Nothing (except possibly illness which we discuss below) explains why Mr Thackray did not start to raise the funds earlier. It is no answer for him to say, as he does, that he did not become aware of the VAT liability until the end of January. As we have already said, it should have been obvious when ETB raised the VAT invoices in December that it would have to account for the VAT on them in early February. Accordingly, we do not accept that such a lack of awareness of the looming VAT liability was reasonable. We bear in mind that the sale of the business resulted in a change in the working environment for Mr Thackray, including loss of staff, but it is clear that Mr Thackray is a capable and intelligent man who was, when he turned his mind to it, able to operate the VAT accounting software used by ETB and foresee the need to raise funds in order to settle the company's VAT liability. In this case, it appears that Mr Thackray did not turn his mind to the issue until it was too late. Without more, failing to think about the need to account for VAT on invoices issued during an accounting period cannot constitute a reasonable excuse in the sense explained by the Court of Appeal in *Steptoe*.

58. We have considered whether our analysis of the situation is altered by the fact of Mr Thackray's illnesses during the period from December 2014 to February 2015. Mr Thackray has not provided any evidence of the effects of the illnesses such as a doctor's letter or certificate despite being asked for one by HMRC in their letter of 18 March. It is clear that Mr Thackray was in sufficiently good health in December to go on holiday

abroad, where he unfortunately became ill. That bout of illness does not seem to be relevant as it was a planned absence and, in so far as anything needed to be done in relation to VAT accounting during that time, it is reasonable to assume that Mr Thackray would have made arrangements for it to be done in his absence. Mr Thackray stated that one virus lasted three weeks but we have no evidence of when the illness started, how it affected him and when he was well enough to resume work. If, when he saw the doctor on 15 January, he had just begun to feel ill then the three weeks would last almost until the due date of 7 February. It is clear, however, from Mr Thackray's own evidence that he was working at the end of January, because that was when he says that it became clear to him that ETB would not be able to pay the VAT on the due date, and on 4 February when he tried to raise funds to enable ETB to meet its liability. As to the third virus, it seems that Mr Thackray returned to work on 25 February so that bout of illness post-dated the default and cannot provide a reasonable excuse.

59. We are not satisfied, on the evidence presented, that ETB has established that Mr Thackray's ill health meant that ETB could not have avoided the insufficiency of funds. In saying this, we wish to make clear that we do not doubt that Mr Thackray suffered bouts of illness but there was simply no evidence to show that the illness prevented Mr Thackray dealing with ETB's lack of funds by raising alternative funding as he eventually did or contacting HMRC. For example, Mr Thackray could have contacted HMRC before the due date, eg at the end of January when he realised that ETB would not be able to pay the VAT due on 7 February. Mr Thackray submitted that ETB did not have any HMRC contacts and he would have made use of them if ETB had had such contacts. We do not accept this submission. It is clear from the telephone records included in the papers that Mr Thackray or someone else from ETB telephoned HMRC to make promises of payment when amounts of VAT were not paid on the due dates in relation to periods 12/13 and 09/14. No other explanation is given in the papers for ETB's failure to contact HMRC to discuss late payment.

60. Finally, we have considered whether the combination of the impact of the sale of the business and Mr Thackray's ill health, when viewed together, constitute a reasonable excuse for ETB's late payment of the VAT. We bear in mind that Mr Thackray was handling numerous issues single-handedly as he no longer employed any staff following the sale of the goodwill and assets of the company. It follows that his illness would have had a greater impact on ETB's ability to deal with its affairs than would have been the case if Mr Thackray had been ill when there were other members of staff who could deal with VAT matters. Although we have considerable sympathy for Mr Thackray and ETB, we have concluded that the combination of the sale of the business and the bouts of illness suffered by Mr Thackray are not such as to constitute a reasonable excuse because, notwithstanding the illness, Mr Thackray could reasonably have been expected to foresee the consequences of the sale of the business and anticipate them by arranging finance, as he eventually sought to do in February. Mr Thackray was not incapacitated by illness for the whole of the period between the sale of the business and the end of January 2015. Had he anticipated the cash flow problem earlier, the fact that he experienced some periods of illness would not have prevented him arranging funding so that ETB could pay the VAT on the due date or contacting HMRC as he had done in the past on two occasions (albeit after the due date) to discuss what could be done. In the circumstances, we conclude that ETB did not have a reasonable excuse.

Disposition

61. For the reasons given above, ETB's appeal against the Decision is allowed and the Decision is set aside. We remake the decision of the FTT and dismiss ETB's appeal against the default surcharge of £972.11.

Greg Sinfield
Upper Tribunal Judge

John Clark
Upper Tribunal Judge

Release date: 30 September 2016