

DEFAULT SURCHARGE -Reasonable excuse - Shortage of funds - Rapid and unforeseen expansion in business - Receipts never kept pace with expenditure - Appeal allowed for some periods dismissed for others

LONDON TRIBUNAL CENTRE

**RESPONSE CONSTRUCTION DEVELOPMENT (UK) LTD - Appellant
- and -
THE COMMISSIONERS OF CUSTOMS AND EXCISE - Respondents**

**Tribunal: STEPHEN OLIVER QC (Chairman)
LYNNETH SALISBURY**

Sitting in public in London on 27 November 2002

S Cason, director, for the Appellant

Jonathan Holl, for the Respondents

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DECISION

1. Response Construction Development (UK) Ltd ("RCD") appeal against six default surcharge assessments covering various periods from 01/00 until 01/02. Also covered by the appeal is the period 10/99 for which a surcharge liability notice was issued.

10/99

2. RCD started business in 1999. Two individuals were behind it. Mr S Cason (who attended the Tribunal, put RCD's case and gave evidence) is an electrician. His colleague, who also attended, is a plumber. The business of RCD has been that of providing planned maintenance facilities for high street clients. At the time they started to operate the business, they used a sub-contracted workforce. They soon found that they could not meet the demands of their customers using that sort of workforce and, if they were to continue that way, they would rapidly have gone out of business. They therefore decided to engage their own engineers to enable them to carry out the maintenance contracts direct. And they started to build up their own fleet of motor vehicles. For this purpose they entered into finance leasing arrangements and have built up a fleet of 38 vehicles. For these they were, according to S Cason's explanation, required to make up-front deposits and to enter into financing agreements.

3. RCD have never been on "cash accounting".

4. The returns for the period 10/99 show sales of £101,881 and purchases of £60,204. £8,642 was shown as tax payable. The return was 3-4 weeks late. Payment was not made in time. The tax assessed in the meantime was £1,558. Compared with the tax shown on the return of £8,642, this indicates a 5-fold increase in sales over the first year.

01/00

5. The return for this period was late. It showed tax due of £11,795. The return was not available to us. But the tax due give some indication of a steeply increasing volume of sales.

6. Why was RCD behind with its tax in those two periods? Mr Cason's explanation was quite simply this: they were short of funds. That, said Jonathan Holl for the Commissioners, was the end of the matter because section 71 of VAT Act 1994 rules out shortage of funds as a reasonable excuse. They should have exercised more diligence, put more pressure on their customers to pay more speedily and generally exercised much more rigorous credit control. But what really caused the shortage of funds? First, we infer, the two gentlemen controlling RCD were absolutely new to a business of this scale. They had no techniques for managing the change, save to ensure that they gave good service to their customers. Second, they were driven to enter into finance-leasing arrangements which committed them to meet regular cash demands as well as making up-front cash deposits. Third, they had to pay their own engineers on the nail, or otherwise lose them, while at the same time they found themselves owed more and more by customers, most of which paid 60-65 days in arrears. RCD did not have a credit control system in place and, said Mr Cason, to have put pressure on their customers would have been disastrous for business. RCD was too small and too new to be able to do this.

07/00 until 01/01

7. The 04/00 return appears to have been in time and payment duly made. But for 07/00 until 01/01 RCD was continuously behind. The 07/00 return was two weeks late. By then the cashflow problem was acute. Sales were shown as £125,033 while purchases were £163,263. Over the year purchases had nearly doubled whilst sales had increased by some 7%. RCD was still expanding. Mr Cason said that they had tried to institute a system of skimming 10% off each payment as it came in as a VAT provision; but this was quite inadequate and was more than eaten up by the increase in costs of maintaining the workforce and running the business.

8. The 10/00 return was 1½ months late. Sales were up by £50,000 but purchases were up by £70,000. The tax due of £21,901 went unpaid because RCD had no funds. There were very few bad debts, either then or at any other time, said Mr Cason. The greater the expenses, the greater were the cash shortage and the greater was the number of financing transactions for vehicles.

9. There was no change in the upward spiral in the 01/01 period. Sales were up by £70,000 over the previous period or purchases were up by £50,000. Purchases exceeded sales by some £26,000; the VAT of £25,300 went unpaid.

04/01

10. RCD was late with the 04/01 return. The papers do not record exactly why the default surcharge of £2,590 has not been pursued; but it was cancelled on 17 July 2001.

07/01

11. RCD managed to get their return in on time for the 07/01 period. By then, Mr Cason said, they still had in place their procedure of skimming off 10% of everything that came in. He tried to get onto monthly accounting so as to enable RCD to control its VAT obligations more effectively and to make them more easily payable out of incomings. They were, said Mr Cason, told by the local VAT office that this was not an available course so far as they were concerned. There may have been a misunderstanding here; but we do accept that that was Mr Cason's understanding of the position.

10/01

12. 10/01 return due in by 30 November 2001 was in on time but was not accompanied by any payment. £38,308 of VAT was shown as due. As the copy of the return is illegible, it has not been possible to draw any conclusions from it. On 19 November 2001, however, RCD were on a "time to pay" schedule for their outstanding VAT and default surcharges, i.e. £38,303 at that time. The first £10,000 instalment was due on 15 December 2001. We do not see that this could have affected RCD's ability to pay the amount due on 30 November.

01/02

13. The return for the 01/02 period was due on 31 March and was late by five weeks, not being received until 10 April 2002. £34,728 was shown as due. Since December 2001, £20,000 of the instalments of the outstanding tax had been discharged under the time to pay agreement. On 7 March 2002 the Commissioners threatened debt recovery proceedings for the then outstanding amount of £48,972. On 8 April 2002 RCD paid off £25,000 of that outstanding balance. The effect of the Commissioners' quite understandable steps to recover outstanding tax for earlier periods was that RCD was left with no funds with which to meet its current liability. At about that time RCD arranged bank finance and is, we trust, now out of a default syndrome.

14. As we mentioned at the start of this decision RCD had no personal representation. We have had to do a lot of constructive work ourselves. At the start of its operations, this very small business controlled by two technicians took a decision to engage their own staff and so to improve their business capacity. From the business point of view this was the right decision; but it resulted in an unplanned and, so far as they were concerned, unforeseen increase in costs at the expense of cash receipts. They simply were not experienced in growth management and it took them six months or so to get abreast of their VAT liabilities. We think that they have a reasonable excuse for those periods. This means discharging the surcharge liability notice for the 10/99 period and the assessments for £235.92 for the 01/00 period.

15. Regarding the next four defaults (07/00, 10/00, 01/01, and 10/01), we do not think that RCD have presented a reasonable excuse. RCD should, we think, have taken drastic steps to cope with the cashflow problems. They should have made financing arrangements either by borrowing or by introducing further

capital to improve the cashflow. As things were, RCD let things slide and got further and further behind. In effect they were financing their business out of VAT owed to the Commissioners.

16. The 01/02 default surcharge assessment is, we think, different. By then RCD was on a time to pay arrangement and was faced with debt recovery threats from the Commissioners. If they were to stay afloat they had no choice. They had to discharge the outstanding tax. The result was that they were left with no funds to meet their current liability. No amount of cash-flow management in that period could have rescued them from that fate. Looked at in this wider context, we think that RCD have established a reasonable excuse for the last period.

17. We allow the appeals for periods 1, 2 and 7. We dismiss the appeals for the remaining periods. The default surcharges should be recalculated accordingly.

STEPHEN OLIVER QC

CHAIRMAN

RELEASED:

LON/02/726