

Default surcharge - Shortage of funds - Debt overhang caused by loss-making contracts in earlier periods - Adverse weather conditions during accounting period - Impact of foot and mouth epidemic - Whether reasonable excuse - Yes, for first two periods - No, for third period

LONDON TRIBUNAL CENTRE

**LANDSCAPE MAINTENANCE LTD - Appellant
- and -
THE COMMISSIONERS OF CUSTOMS AND EXCISE - Respondents**

**Tribunal: STEPHEN OLIVER QC (Chairman)
ELIZABETH MACLEOD JP, CIPM**

Sitting in public in Plymouth on 16 January 2003

Peter Wright, company secretary, for the Appellant

Jonathan Holl for the Respondents

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DECISION

1. Landscape Maintenance Ltd ("LM") appeal against three default surcharge assessments. All are at 15%. The default surcharge for the 03/01 period is for £7,442: payments were received 2½ months late. The assessment for the 06/01 period is for £7,638: the tax was received nearly three months late. The assessment for the 09/01 period is for £8,002: we have no information when payment of tax was made.

3. We heard evidence from Peter Wright, the company secretary, for LM. He also presented LM's case. The case is, essentially, contained in a letter dated 16 January 2003 from which we now draw.

4. LM was established in 1961 and has carried out grounds maintenance contract work for the forces, for local authorities, English Heritage and large companies. The majority of the work is won by competitive tendering or quoting for work against other companies. LM have a workforce of between 50 and 60 employees and its area of work covers Norfolk, London, Portsmouth, Bournemouth and Plymouth. In the years ending 30 September 1999 and 2000 LM incurred severe losses of £156,000 and £154,000 respectively. These were in part due to some underpriced contracts coupled with an employment law set-back. £55,000 had been lost in connection with a contract with the MOD for the maintenance of

defence property in Norfolk. LM had failed to include in its bid the cost of mowing and maintaining the gardens of married quarters. The next loss resulted from a maintenance contract with the MOD for property at Chivenor Royal Marines Barracks. LM used its own staff for this work and did not engage the existing workforce. That resulted in an obligation, following a decision of the European Court of Justice, to pay redundancy and other statutory amounts to the existing workforce. Moreover LM had to work with an uncooperative local management and this caused unforeseen overheads. LM eventually had to pay out £80,000 to meet the employment law claims of the existing workforce and, over and above that, it made a loss on the contract.

5. By the start of the 12/00 period LM were at least £30,000 behind with their VAT. There was a downward trend in "sales" throughout the year 2000. The weather for the winter of 2000-2001 was bad. It was the wettest winter since records began. The effect of the high rainfall, Mr Wright said, was to increase costs and to reduce income. The additional costs had been caused by heavy demands on LM's machinery and in the change of workloads. During the intensively rainy period LM could only carry out work such as pruning and weeding and, on occasions, the men had to stop work altogether. They were still being paid for their time on site without being able to complete the grass cutting. And when the ground was wet their heavy machines caused ruts. They had to use lighter machines which increased the cost of cutting and affected the profit margins. What is more, the rain resulted in the growing season being extended and that increased their repair and maintenance bills. Because they had to use their machines for a longer period, they were unable to repair them in-house and, consequently, had to outsource the repairs machinery, incurring further unexpected expenses.

6. Then foot and mouth started in February 2001. This had the effect of increasing LM's costs due to the fact that in some areas they were not able to travel overland or to tip grass. As well as increasing costs, LM lost contracts that it had hoped to win on tender. For example it attempted to price and secure the contract for English Heritage for the maintenance of area around Old Sarum. That area had then been sealed off, and rather than enter into a contract at the incorrect price, LM withdrew its offer. On another contract site, HMS Raleigh, at Torpoint in Cornwall, LM had to move from one area to another taking with it men, vehicles and machines all of which had to be put through disinfectant baths and mats. The machine wheels and van wheels had to be pressure washed off and, in effect, this procedure had to take place every time they left the site to work on an adjoining area. Consequently the contracted work took more time than LM had originally estimated. Similar problems were encountered when working on LM's Norfolk sites. All these additional expenses were unexpected and unplanned.

The position in the 3/01 period

7. The year 2001 started badly. Heavy rain caused the problems already referred to. LM had an outstanding liability to the Commissioners of at least £30,000 (see the Commissioners' letter of 6 October 2000) plus a default surcharge outstanding of £5,401 in respect of the 9/00 period. LM were under threat of debt recovery proceedings by the Commissioners and, we assume, were marshalling all their cash resources to meet the Commissioners' claims for outstanding taxes.

8. 31 January 2001 was the date for payment of tax (£36,364) for the 12/00 period. This went unpaid; the return was not received by the Commissioners until

1 March. On 6 March the Commissioners issued a default surcharge assessment for £5,435. Also on 6 March LM wrote to the Commissioners as follows:

"Further to your letter dated 27 February ... please find enclosed bank draft for £18,000 to reduce our debt.

I note your comments but as you know the weather over the last six months has made it very difficult for us to operate. We do not like to lay our staff off and we have found that we have a temporary cashflow problem, which is the worst in our 40 years of trading. As I said in our last conversation our work picks up in March as the MOD try to use up all their allocated funds, I am confident that we will be able to reduce this debt by then.

We are grateful for your help and assistance that you have shown and trust that we can be given the time to clear this debt and you do not take the action that you threaten. We will make every effort to ensure that future returns are cleared as quickly as possible."

LM managed to pay £20,000 on 10 April explaining, in a letter of that date, that they were still waiting for some considerable sum of money to be released by the Army and the DHE and that as soon as this was cleared they would be in a position to pay off all the debt.

9. The time for payment of the 3/01 VAT was 30 April 2001. As already noted LM were fighting off the Commissioners' threat of liquidation and foot and mouth had, by the end of April, substantially impaired its trading operations. As compared with the average figure of sales shown in the returns for 2000 (see £340 a quarter), the sales figure for the 3/01 return was some £416,000. During the 3/01 quarter LM had issued invoices to the value of £487,000 and received cash of £465,000. With hindsight, it appears, they were moving from an annual trading loss position of some £155,000 to a break-even position for the year to 30 September 2001. Costs of sales and administrative expenses were being stabilized and, in some case, cut. There were no abnormally bad debts. We were told that in April 2001 LM made an area manager redundant so as to reduce its costs. Nonetheless, Mr Wright explained, there was a real danger in shedding their trained workforce. To do that would damage their ability to bid successfully for new contracts, which they had to do all the time to keep in business.

10. Shortly before the date for payment of the 3/01 tax, the debt management unit of the Commissioners was transferred from Poole to Southampton. Mr Wright contacted a Mr Renaut (who we assumed to be an officer of debt management unit) and explained that LM had problems caused by the foot and mouth outbreak. The amount of tax due was £49,616. The return and the payment were received by the Commissioners on 12 July 2001, i.e. shortly before the due date for the next VAT payment.

11. Shortage of funds is not a reasonable excuse. But the underlying reason may be. Here the immediate reasons are the large debt overhang from prior periods and adverse trading conditions in the current period that made it difficult to cut costs and so relieve the cashflow problem. The debt overhang resulted, as we see it, from the two disastrous contracts referred to above. That LM might, by better

business management, have avoided these is beside the point. The resultant losses from those contracts had driven LM into indebtedness and cashflow difficulties. Whether this was ever explained to the Commissioners we do not know. We suspect not. At all events by the end of April 2001 LM's freedom to control its cash resources had been bespoken by the Commissioners' debt management unit, backed up by the institution of insolvency proceedings through the solicitors instructed by the Commissioners. As we see it LM was using all available cash resources to pay off their outstanding VAT liabilities. Nothing was left to pay the current VAT. We conclude that because the substantial cause of LM's failure to pay tax for 03/01 was the inevitable knock-on effect of the earlier disastrous contracts, LM has demonstrated a reasonable excuse for that period.

12. The 6/01 return and the payment of tax (£50,921) were due with the Commissioners by 31 July 2001. On 2 July the default surcharge assessment for £7,442 for the 3/01 period was issued by the Commissioners; that relates to the default for which we have accepted a reasonable excuse. Mr Wright did not appeal this assessment at the time. By then his understanding was that the Commissioners were not minded to take steps to penalize late payers who were adversely affected by the foot and mouth outbreak. He had, he said, notified the Commissioners of this problem. This is clear from the correspondence that we have seen. Neither the Commissioners nor Mr Wright could produce any press release covering the foot and mouth epidemic. We are not therefore aware of whether there was an amnesty or whether LM were living in a sense of false security. We do know from LM's letter to the Controller at Southend of 6 July 2001 that LM was asking for "a sympathetic view" to be taken of the surcharges for 12/00 and 3/01. Throughout the 6/01 period LM were affected by foot and mouth and this meant that they could not substantially cut costs and in some areas they had to employ their staff for longer hours to cope with the practical problems presented by foot and mouth protection measures. Also in mid 2001 LM lost the contract to maintain HMS Cambridge, a shore station at Wembury. We cannot without more evidence say of this last factor what effect it had had on LM's cashflow position at the time.

13. By Friday 13 July 2001 LM had, if an undertaking in their letter of 6 July had been fulfilled, settled "the outstanding amounts". (These did not, we understand, include the outstanding default surcharge amounts for which no enforcement proceedings had been commenced.) By then the Commissioners' winding up petition had been withdrawn. There were, we infer, two weeks left in which to accumulate cash to pay the £50,921 due on 31 July.

14. Overall the figures for the 6/01 period look promising. LM had raised invoices of £477,000 (compared with £342,000 in the 6/00 period) and it had received cash of £387,000. The "purchases" box in LM's return for the period showed £140,000 which was well down on the comparable figure for 6/00.

15. So, has LM got a reasonable excuse for not paying the £50,921 due on 31 July 2001? This is an acutely difficult question of judgment which has, in common with the other problems raised by this appeal, taken us many hours to resolve. Without doubt the immediate reason was shortage of funds. Without doubt the underlying reason for the shortage was the problems resulting from the two disastrous contracts coupled with the cost-cutting constraints imposed by the foot and mouth epidemic. We understand that there was no way of raising more credit from the bank. We also know that LM had taken the conscious decision not to cut its workforce and so reduce costs that way. Mr Wright said (as we have already noted) that his understanding was that the Commissioners would not take steps to penalize late payers affected by the foot and mouth epidemic. It is clear from

almost every letter to the Commissioners that he was alerting them to LM's problems caused by the epidemic. Finally, in this connection, it is quite clear that a trader must not be allowed to finance his trade at the expense of the Commissioners.

16. Taking all those factors into account we think there is a reasonable excuse for the 6/01 period default. LM had just fought its way out of insolvency by deploying what we infer to have been all its cash reserve when it made the payments to the Commissioners in mid-July. There is no evidence that LM had any choice in the matter but to leave the 6/01 tax unpaid until they had recharged their coffers.

17. By the end of October 01 when the 9/01 payment (of £53,344) of VAT was due the clouds were clearing. LM had issued invoices for £435,543. It had received £534,000 in cash in the three months period. Its "purchases" were up from £140,000 to £160,000. By the end of the twelve months to 30 September 2001 LM was showing a modest operating profit of £73. There were still trading problems resulting partly from foot and mouth and partly from cut backs and government contracts.

18. The return for the 9/01 period was received on 19 December 2001, i.e. over 1½ months late. Mr Wright wrote on 17 December to the Southampton debt management unit reminding them that the cashflow problems had originated from the foot and mouth outbreak combined with the bad weather at the beginning of the year. The letter enclosed the cheque for £3,344 leaving a balance of £50,000 outstanding. Mr Wright went on to explain that they had had to pay out three weeks wages to cover the Christmas and the New Year period and that their MOD derived income was reduced at this time of the year. He made a proposal that they should clear the outstanding amount in three equal payments in each of the three succeeding months. The factors pointed to in that letter and the evidence generally does not satisfy us that LM has a reasonable excuse for the 9/01 period. They do not demonstrate a continuing impossibility to meet the quarterly VAT payments. At best they record LM's implicit assumption that the Commissioners would go easy on traders affected by the foot and mouth epidemic. That is not enough. We have concluded therefore that LM has not established a reasonable excuse for the 9/01 period.

19. We allow the appeal against the default surcharge assessments for the 3/01 and the 6/01 periods. We dismiss the appeal for the 9/01 period.

STEPHEN OLIVER QC

CHAIRMAN

RELEASED:

LON/02/355