TC02527

Appeal number: TC/2012/03262

INCOME TAX – surcharge for failure to pay on time – time to pay agreement – failure to comply with the terms of the agreement – money used instead to support taxpayer's company by paying company's outstanding tax liabilities – whether Tribunal had jurisdiction to consider proportionality of surcharge – no – whether reasonable excuse – yes – effect of default under time to pay agreement – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MR THOMAS JAMES **Appellant**

- and -

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

TRIBUNAL: JUDGE MALCOLM GAMMIE CBE QC
MR DAVID E WILLIAMS CTA

Sitting in public at Bedford Square, London WC1 on 8 May 2012

Havish Shah of McCormack & Associates (Accountants) for the Appellant

Thomas Ellis, Inspector of Taxes, for the Respondents

DECISION

Introduction

1. Mr James appeals against a Self Assessment Late Payment Surcharge Notice of 19 August 2011 in respect of the late payment of tax for the tax year ended 5 April 2010. The surcharges were imposed under sections 59C(2) and (3) of the Taxes Management Act 1970 and originally amounted to £13,742.46. Following the filing of a revised tax return for the year the amount of the surcharge was reduced to £10,515.22.

2. We had before us the papers produced by both parties. In addition Mr James gave evidence and was cross-examined by Mr Ellis on behalf of HMRC. We start by setting out the payment history that underlies the Surcharge Notice and then the facts that underlie the payment history.

The payment history

3. The first self-assessment return made by Mr James for the year 2009/2010 showed a tax liability for the year of £265,917. This was subsequently revised to the figure of £233,644.60. No issue arises on these figures. On 2 February 2011 Mrs Chambers, a Debt Pursuit Officer of HMRC, spoke to Mr James and agreed a payment plan (a time to pay or "TTP agreement") for his outstanding tax liabilities, which at that time stood at £227,720.87 (including interest). The terms of the agreement envisaged that he would pay £40,000 by 11 February 2011, £60,000 by 30 March 2011 and the balance by 30 June 2011 "or sooner if the 'Heads of Terms' is agreed on the lease and you have the funds to pay". Whether or not the Heads of Terms were agreed Mr James did not in the event have the funds to pay sooner or, as it transpired, by 30 June 2011.

4. Mrs Chambers wrote to Mr James the same day setting out these payment terms, explaining the circumstances in which she would consider cancelling the arrangement and stating that, "As advised today no further time to pay will be extended to you, all future tax liabilities are to be paid in full and ontime" (*sic*).

5. Responsibility for Mr James' file was subsequently transferred from Mrs Chambers to other inspectors. From HMRC's internal records it appears that the February instalment was made by the due date. The March instalment, however, was late and on 8 April 2011 the inspector then dealing with the matter started to take action to recover the balance of £188,747.77 that was then due. On 14 April 2011, Mr James called the inspector. He explained that he had been in the USA on 30 March and had attempted to pay the instalment on line, but his attempt had failed. He had therefore paid the instalment on his return to the UK (being received by HMRC on 12 April 2011). Mr James requested that the TTP agreement should not be cancelled. The inspector agreed to reinstate the agreement but warned that payment in full should reach HMRC by 30 June 2011 as envisaged under the original agreement.

6. On 7 July 2011 the inspector noted that the amount due on 30 June 2011 had not been recorded on Mr James' self-assessment account. He waited until 11 July 2011 to confirm non-payment and then initiated action to recover the outstanding tax. Mr

Mearns, a Collector of Taxes, wrote to Mr James on 14 July 2011. He formally cancelled the TTP agreement and demanded immediate payment of the outstanding balance of £129,793.27. He advised Mr James to pay or to contact HMRC and warned that bankruptcy proceedings would be commenced if Mr James had not taken action within 7 working days of the letter.

7. Mr James telephoned HMRC on 21 July 2011 in response to this letter. According to HMRC's records, Mr James said that he had paid £25,000 on 18 July 2011 (in fact paid on 19 July 2011), that he would pay a further £15,000 on the day of his call (which he did), and that at least a further £40,000 (and possibly the balance) would follow in the week of 25 July 2011. In fact Mr James made further payments on 22 August 2011 (£10,000) and on 5 September 2011 (£20,000). In the meantime, HMRC continued with their action to recover the outstanding balance.

8. By 9 September 2011 that balance stood at £27,341.76 and on 12 September 2011 Mr Shah of McCormack & Associates telephoned HMRC to inform them that Mr James had paid that amount by CHAPS that day. HMRC do not have a record of the payment having been received by that day but it seems that at or around that time the outstanding balance was discharged. The summary of payments made presented to us by Mr Shah suggested that the balance had in fact been discharged on 9 September 2011. This may in fact be a day or so early but we adopt this date for the purposes of further reference in this decision.

The Surcharge Notice, appeal and review

9. In the meantime, the TTP agreement having been cancelled on 14 July 2011, HMRC issued the Surcharge Notice on 19 August 2011. On 12 September 2011 McCormack & Associates appealed on Mr James' behalf. The appeal letter refers to the TTP agreement of 2 February 2011 and claims that, as a result, surcharges are not chargeable. The letter goes on to explain that Mr James was experiencing considerable cash flow problems, in particular because he had to support financially his main trading company, Quattro (UK) Ltd ("QUK"), so that it could discharge its liabilities for PAYE, VAT and Corporation Tax. On this basis Mr James claimed that he had a reasonable excuse for not paying his personal tax on time.

10. On 16 September 2011 HMRC notified Mr James that it did not accept that he had any reasonable excuse that applied throughout the whole of the period that the tax was outstanding. It drew attention to his default under the TTP agreement in July 2011. This decision letter failed to offer any review but, subsequently, on 22 December 2011, HMRC advised that they would review the matter and on 20 January 2012 the reviewing officer notified Mr James that he was upholding the decision of 16 September 2011. The reviewing officer pointed out that having insufficient funds to pay was not a reasonable excuse and the fact that this arose because Mr James was assisting his company to meet its tax liabilities did not affect that conclusion.

11. Mr James continued his appeal to the Tribunal although it appears that on 26 March 2012 HMRC may have been having second thoughts because they invited McCormack & Associates to submit on Mr James' behalf a more detailed statement of the facts underlying his failure to pay on time. McCormack & Associates did this

on 17 April 2012 but on 25 April 2012 HMRC reaffirmed their decision and the matter accordingly proceeded to a hearing before us of Mr James' appeal.

The facts

12. Mr James owns 100 per cent of the issued share capital of QUK and of Quattro Holdings Limited ("QHL"). His principal sources of income comprise his employment income from QUK, dividends from QUK and QHL, rental income and interest income. His basic employment income from his companies for the two years 2009/2010 and 2010/2011 was unchanged at £90,000 but his investment income for 2010/2011 was significantly reduced. Broadly speaking in 2010/2011 his only investment income comprised rental income of approximately £135,000 from QUK (see paragraph 18 below) whereas in the previous year his investment income, including dividends, rental income and interest, had exceeded £750,000. A major reason for this significant reduction in income between the two years was the absence of any dividends from QUK and QHL in 2010/2011. These had amounted to £388,000 in 2009/2010.

13. QUK is a company engaged in the construction industry, the principal activity of which is that of haulier, tipper contractors and waste recycling. QHL's principal activity is that of hiring plant and equipment, letting of properties and servicing a waste transfer station. The average monthly number of QUK's employees (including directors) during 2010 was 104 (96 in 2009).

14. The accounts for QUK for the year ended 31 December 2010 record the difficult trading conditions and the impact of the recession on the company over the year. Turnover between 2009 and 2010 remained the same although the operating profit almost halved in 2010 due to increased cost of sales and additional administrative expenses (see paragraph 15 below). As between 2009 and 2010 the balance sheet shows substantial expenditure in the period on plant and equipment and motor vehicles (see paragraph 16 below), an increase in work-in-progress, a reduction in debtors (see paragraph 16 below), a slight reduction in creditors falling due within one year (see paragraph 17 below) and an insignificant amount of cash at bank and in hand in both years.

15. The schedule of administrative expenses indicates that the charge for bad and doubtful debts for the 2010 year was £217,702 as compared to £85,490 for 2009. The equivalent figure for 2008 was £228,527, although turnover in that and previous years had been higher. In his evidence in chief Mr James said that the company had had bad debts in excess of £1 million over the last 3 to 4 years.

16. Trade debtors in fact increased slightly as compared to 2009 but there was a large reduction in 'other debtors' and prepayments and accrued income. The debtor figures include amounts due from related companies owned and controlled by Mr James. These amounts represented some 43 per cent of debtors in 2009 and 44.5 per cent in 2010. The details in the 2010 accounts of related party transactions indicate that QUK paid service charges (part of cost of sales) and rent (part of administrative expenses) to QHL amounting to £1,620,000 in 2010 (£2,100,000 in 2009). It also received £515,000 from QHL for work done during the year. It appears that QUK's investment in tangible assets in 2010 was purchasing equipment from QHL.

17. Although creditors falling due within one year were broadly unchanged (a small reduction of £213,000 to a figure of just over £5 million), within that figure bank loans and overdrafts had been reduced by some £418,000, trade creditors had increased by some £365,000 and tax and social security creditors had increased by £239,000. The principal source of finance is recorded as Close Invoice Finance ("CIF") which in 2009 accounted for approximately 45.3 per cent of creditors and in 2010 had slightly increased to 46.8 per cent. The accounts explain that QUK had entered into an arrangement to discount its sales invoices with CIF and that in accordance with FRS 5 the gross debtors outstanding are shown under trade debtors and the amounts payable to CIF are shown under creditors. Interest paid on invoices discounted during the year is charged to profit and loss account.

18. Apart from liabilities to short-term creditors, the balance sheet indicates that there was a small amount of called up share capital and otherwise QUK was largely funded by retained profits, which increased in 2010 by around £239,000 to just over £2.5 million. The 2010 accounts record that no dividends were paid during the year, as compared to an interim dividend of £175,000 in the 2009 year. The 2009 accounts indicate that no final dividend was paid in 2009 and that dividends of £480,000 were paid in the 2008 period. The details of related party transactions in QUK's 2010 accounts indicate that QUK paid rent to Mr James for the use of land of £135,000 in 2010 (£230,000 in 2009).

19. QUK's cash flow statement for the 2010 year records a significant cash inflow from operating activities in the year as compared to 2009. This is matched by its substantial net investment in tangible assets and a reduction in net bank debt. The reconciliation to operating profit reflects in particular the reduction in debtors for the year as the principal component of the net cash inflow.

20. An analytical review of QUK's activities for the 2010 year as compared to the 2009 year indicates declining gross and net profit as a percentage of sales and total assets. It also shows declining liquidity ratios between the two years, an increase in the number of days that debtors took to pay QUK and a similar increase in the number of days that QUK took to pay its creditors, an increase in the average number of days to turn over stock, a reduction in gearing but also a reduction in interest cover. Broadly speaking, the corresponding analysis for 2009 shows that this represented a further decline in the various ratios and percentages as compared to 2008. A five year summary illustrates that turnover had increased significantly between 2006 and 2008 but had then fallen substantially in 2009 (although the 2009 level then remained unchanged in 2010). Profitability, which was slightly better in 2009 as compared to 2008 and 2007, had fallen in 2010 back to the level achieved in 2006.

21. QHL owns property that it rents and owns or leases the plant and equipment that it hires to QUK. Its accounts for the year ended 2010 disclose some reduction in turnover for the year but show a large reduction in operating profit caused largely by a significant increase in the cost of sales, which was attributable in part to a reduction in the profit on disposal of tangible fixed assets. There was no significant amount of debtors and only a small amount of cash at bank and in hand, which was reduced as compared to 2009. There had been a small fall in 2010 in creditors falling due within one year to £5.7 million, of which £2.56 million was represented by amounts owed to group undertakings and undertakings in which QHL had a participating interest.

Bank loans and overdrafts had increased from £254,791 to £774,629 between 2009 and 2010. Longer term QHL was financing its investments through bank loans and hire purchase contracts. Its capital and reserves included a small amount of called up share capital, revaluation reserves and retained profits. No dividends were paid in 2010 as compared to an interim dividend of £175,000 in 2009. The 2009 accounts indicate that dividends of £1 million had been paid in 2008.

22. As noted in paragraph 17 above, a significant amount of QUK's short term funding in 2010 was provided by CIF. Its original invoice discounting agreement had been with GMAC Commercial Finance plc. Under an agreement between GMAC and QUK of 25 June 2008 the maximum debit balance on the account was not to exceed £3,500,000. The GMAC factoring and invoice discounting business was sold to CIF on 1 January 2010.

23. On 5 January 2011 CIF e-mailed QUK regarding its facility. It recorded some concerned about QUK's liquidity position following a particular bad debt and indicated that CIF's credit committee required additional security to mitigate their concerns and to maintain the funding parameters at an 85 per cent level. QUK replied by letter dated 6 January 2011 indicating that QHL was prepared to provide a limited guarantee (subject to the agreement of its bank, the Allied Irish Bank). QUK confirmed that until such guarantee was forthcoming the personal guarantee given by Mr James in July 2010 would remain in place and would not cease on 31 December 2010. We were not told whether QHL provided any guarantee. We assume that it did not. CIF's e-mail of 19 April 2011 (see below) refers to additional security being a charge over personal property, which we take to relate to Mr James. As matters developed, CIF did not maintain the funding parameters at 85 per cent but reduced them to 75 per cent. Mr James also said that CIF refused to allow any discounting on sales of plant and equipment, on which GMAC had allowed 85%, and which had been a useful way of raising cash quickly.

24. On 19 April 2011 CIF e-mailed again to express concerns on this occasion with the credit worthiness of one of QUK's major customers. The customer in question accounted at the time for 19 per cent of QUK's sales ledger and represented debt of £615,000. CIF raised its concern that if this customer defaulted it could in turn lead to the failure of QUK. CIF expressed its desire to reduce the debtor concentration to 10 per cent, subject to exceptions where the credit worthiness of the debtor justified it. Subsequently on 29 June 2011 CIF varied the terms of its debt purchase agreement with QUK to reduce the review limit to £3,000,000 from the previous level of £3,500,000. The variation was countersigned on behalf of QUK by Mr James.

25. QUK's position, therefore, was that the major funder of its working capital was reducing its facilities in the midst of difficult trading conditions. In his evidence in chief Mr James explained more fully the issues to which this gave rise and the debtor problems that QUK faced at the time, in particular in relation to the Crossrail project involving construction work at Tottenham Court Road station. A reduction in debtor concentration from 85 per cent to 75 per cent on debts that ordinarily were around £5,000,000 amounted to a reduction in working capital availability of £500,000.

26. As appears from its accounts, QUK did not have any significant bank borrowings but it had no existing borrowing facilities with its bank, Allied Irish Bank ("AIB"), on

which it could draw. In addition, it was unable to access other bank finance. QHL had established relationships with AIB and Royal Bank of Scotland, from which it had borrowed (long and short-term) to finance its investments. It was unable at the time, however, to raise further funds from either bank. QUK had had some dealings with Lloyds TSB, which had sold it an interest rate swap (which had proved expensive). The group had also attempted since 2009 to build a relationship with Barclays to improve its funding opportunities. In March 2011 Barclays was provided with forecasts for 2011 for both QUK and QHL but it had refused to offer any facilities because it did not want to increase its exposure to the property sector.

27. QUK was therefore without the necessary facilities to discharge its PAYE, VAT and corporation tax liabilities. It was for that reason that Mr James had provided QUK with the necessary funds to enable it to discharge its liabilities to HMRC even though that meant that he was unable to comply fully with the TTP agreement or to discharge his personal tax liabilities in full until 9 September 2011. In his evidence in chief, Mr James said that when he entered into the TTP agreement there would have been funds in QUK to settle his personal tax on the due date but he had considered it commercially imprudent to adopt that course because many of the business's basic everyday suppliers, for example for cement and fuel, were only accepting payment by direct debit and he could not afford to allow such arrangements to lapse because of insufficient funds in QUK.

28. Given the substantial amount of income that Mr James had received from his companies, which was the basis of the personal tax liability in question, a large part of his evidence, and the focus of Mr Ellis' cross-examination, related to why he did not have the funds needed to discharge his tax liabilities at the appropriate time. An internal note in HMRC's papers indicates that one of the inspectors who acquired responsibility for Mr James' file queried why Mr James had ever been offered the benefit of a TTP agreement.

29. The fact remains, however, that HMRC made such an agreement and furthermore they did agree to reinstate it in April 2011 following Mr James' explanation as to why the March instalment had been paid late. HMRC's Debt Management and Banking Manual outlines the procedures that must be followed before a TTP agreement is made or allowed to remain in place following a failure to pay. We assume that these were followed in this case. The TTP agreement was only cancelled on 14 July 2011 following his failure to discharge the outstanding balance on 30 June 2011. The excuse that he offers for that failure is his need to support QUK in the absence of any other sources of finance when QUK would otherwise have been in default to HMRC. Given the absence of alternative sources of finance and the concerns that had been expressed by CIF in 2011, coupled with CIF's reduction in facilities, we accept that such a default by QUK could have had serious implications for its ability to continue trading. Mr James recognised that one option have been to wind up his companies on the basis that on a full liquidation he would not suffer financially given that the companies were not insolvent: QUK's difficulties were cash flow difficulties. This was not, however, a step that he was prepared to take given the 20 years that he had spent building the companies up and given QUK's many long-serving employees whose futures would then be put at risk.

30. In this regard, Mr Ellis did not seek to challenge the reasons that Mr James offered for his failure to discharge the outstanding balance of his personal tax liability on 30 June 2011. Our analysis of the accounts for both QUK and QHL supports a conclusion that QUK could well have had severe cash flow problems in the June to September 2011 period and that the approach adopted by CIF in the April to June 2011 period would have contributed to this situation. We also accept that the companies had sought to access but had failed to secure alternative sources of finance. We therefore accept Mr James' explanation of his failure as a truthful explanation.

31. The question is whether that represents a reasonable excuse and, if so, whether in the circumstances that should lead to the cancellation of the surcharge. As we have noted, Mr Ellis was more concerned to understand why Mr James could not fund his personal tax liability in any event, presumably as well as support his company at the same time. We return to this question in due course.

The law

32. Section 59C Taxes Management Act 1970 provides that—

> "(1) This section applies in relation to any income tax or capital gains tax which has become payable by a person (the taxpayer) in accordance with section 55 or 59B of this Act.
>
> (2) Where any of the tax remains unpaid on the day following the expiry of 28 days from the due date, the taxpayer shall be liable to a surcharge equal to 5 per cent of the unpaid tax.
>
> (3) Where any of the tax remains unpaid on the day following the expiry of 6 months from the due date, the taxpayer shall be liable to a further surcharge equal to 5 per cent of the unpaid tax.
>
> …
>
> (9) On an appeal [against the imposition of a surcharge] … the tribunal may—
>
> (a) if it appears that, throughout the period of default, the taxpayer had a reasonable excuse for not paying the tax, set aside the imposition of the surcharge; or
>
> (b) if it does not so appear, confirm the imposition of the surcharge.
>
> (10) Inability to pay the tax shall not be regarded as a reasonable excuse for the purposes of subsection (9) above.
>
> (11) The Board may in their discretion—
>
> (a) mitigate any surcharge under subsection (2) or (3) …
>
> (12) In this section—
>
> "the due date" in relation to any tax, means the date on which the tax becomes due and payable;

"the period of default", in relation to any tax which remained unpaid after the due date, means the period beginning with that date and ending with the day before that on which the tax was paid."

33. Section 108 Finance Act 2009 deals with time to pay agreements that are made on or after 24 November 2008 (see section 108(11)). It provides as follows—

"(1) This section applies if—

(a) A person ("P") fails to pay an amount of tax falling within the Table in subsection (5) when it becomes due and payable,

(b) P makes a request to an officer of Revenue and Customs that payment of the amount of tax be deferred, and

(c) An officer of Revenue and Customs agrees that payment of that amount may be deferred for a period ("the deferral period").

(2) P is not liable to a penalty for failing to pay the amount mentioned in subsection (1) if—

(a) The penalty falls within the Table, and

(b) P would (apart from this subsection) become liable to it between the date on which P makes the request and the end of the deferral period.

(3) But if—

(a) P breaks the agreement (see subsection (4)), and

(b) An officer of Revenue and Customs serves on P a notice specifying any penalty to which P would become liable apart from subsection (2),

P becomes liable, at the date of the notice, to that penalty.

(4) P breaks an agreement if—

(a) P fails to pay the amount of tax in question when the deferral period ends, or

(b) The deferral is subject to P complying with a condition (including a condition that part of the amount be paid during the deferral period) and P fails to comply with it.

(5) The taxes and penalties referred to in subsections (1) and (2) are … [income tax and capital gains tax and surcharge under section 59C(2) or (3) TMA 1970] …

(6) If the agreement mentioned in subsection (1)(c) is varied at any time by a further agreement between P and an officer of Revenue and Customs, this section applies from that time to the agreement as varied."

The parties' contentions

34. Mr Shah, on behalf of Mr James, explained QUK's financial position in 2011. He also drew our attention to a facility agreement between Mr James and AIB of 3 May 2011 under which AIB extended facilities of £4,100,000 to Mr James for a term ending on 31 May 2013. This replaced facilities extended by AIB to Mr James on 28 March, 28 May and 20 May 2008 and extended further on 25 February 2011. Mr Shah explained that the facility agreement of 3 May 2011 consolidated Mr James' previous borrowings and represented additional spare funds of £100,000 only. This would have been available to discharge the outstanding balance of his personal tax liability on 30 June 2011 but had been used to support QUK instead.

35. Mr Shah accepted that Mr James had not adhered to the terms of the TTP agreement but contended that Mr James had not foreseen the level of bad debts being incurred by QUK, the change in policy regarding discounting that followed the sale of GMAC's discounting business to CIF, the failure to negotiate financial support from Barclays and the inability to generate resources in QHL that could be used to support QUK. He also produced some summary information of various substantial loans that members of Mr James' family and his friends had made to Mr James in a period stretching from April 2010 through to September 2011, to enable him to consolidate his financial position.

36. Mr Shah drew our attention to two cases, *Dudman Group Ltd v HMRC* (TC01608) [2011] UKFTT 771 (TC) and *Miss Maxine Barron v HMRC* (TC01329) [2011] UKFTT 482 (TC), in support of his proposition that Mr James had a reasonable excuse for his failure to pay on time. He accepted that it was not enough to show that Mr James had insufficient funds to discharge his tax liability. He argued, however, that it was the cause of the insufficiency that mattered. In this case he said that the insufficiency was caused by an unanticipated cash flow crisis within QUK, which had diverted the money that Mr James would otherwise have used to discharge his personal tax obligations in accordance with the TTP agreement on 30 June 2011 and delayed a full discharge until 9 September 2011.

37. Mr Shah also argued that the surcharge was disproportionate. The delay in payment in full from 30 June until 9 September 2011 amounted to 71 days, in respect of an amount of £97,341.70 (including interest). A surcharge of £10,515.22 was disproportionate in relation to the amount unpaid by the due date.

38. For HMRC Mr Ellis noted that Mr James had not complied with the TTP agreement and had not contacted HMRC at the end of June 2011 to explain his position. When he had contacted HMRC on 21 July 2011, following their letter of 14 July 2011, HMRC had considered his explanation for failure to pay but had decided that he should be given no further time to pay. Once the TTP agreement had been cancelled on 14 July 2011 the issue of the Surcharge Notice was triggered at the end of July. Mr Ellis said that HMRC had reviewed the matter subsequently but had chosen not to exercise their discretion under section 59C(11). This remained the position.

39. Mr Ellis contended that the surcharge for failure to pay by the due date was still legally due under section 59C notwithstanding the TTP agreement. The effect of

section 108 Finance Act 2009 was to suspend the surcharge, which would then be discharged if the terms of the TTP agreement were met. He noted that the TTP agreement had to be in place before the surcharge had arisen (as it was in this case) but the agreement had to be adhered to (which was not the case). He referred to *Kofteros v HMRC* (TC01969) [2012] UKFTT 281 (TC) as authority for the proposition that the surcharge is payable if the TTP agreement is not complied with.

40. In relation to the question whether there was a reasonable excuse for non payment, Mr Ellis referred to *Dudley Electrical Contractors Ltd v HMRC* (TC01124) [2011] UKFTT 260 (TC), *Anthony Leachman t/a Whitely and Leachman v HMRC* (TC01125) [2011] UKFTT 261 (TC), *Julie Dovey v HMRC* (TC01885) [2012] UKFTT 190 (TC) and *Toby Foster v HMRC* (TC01959) [2012] UKFTT 266 (TC).

41. Mr Ellis contended that Mr James had received substantial income in 2009/2010 comprising a substantial amount of untaxed interest, untaxed property income and dividends subject only to the 10 per tax credit. He knew that he would have to pay tax on those amounts. He said that the Act contained no entitlement for a taxpayer to pay by instalments and Mr James should have provided for his liability accordingly. HMRC could always consider a time to pay agreement but it was not a matter of right for any taxpayer and that the normal rules for surcharge liability should apply. Mr Ellis noted that this was not the first year that Mr James had requested a time to pay agreement. He had benefited from such agreements in previous years. Mr Ellis submitted that Mr James should not regard this as the normal way in which he could discharge his annual tax liabilities. He noted that the surcharge was imposed to encourage non-default. Given that Mr James knew that he would have to pay the tax he should have planned accordingly and could therefore have no reasonable excuse. Mr Ellis also said that this was a case of insufficiency of funds falling within section 59C(10).

42. Mr Ellis argued that the surcharge was not a disproportionate measure generally or in this particular case. The surcharge was in line with the self-assessment regime and served the purpose of encouraging compliance. He referred to *Julie Dovey v HMRC* (TC01885) [2012] UKFTT 190 (TC) and *HMD Response International v HMRC* [2011] SFTD 1017. He noted that the surcharge only applied one and six months after the due date, that HMRC had discretion to mitigate, that taxpayers would avoid the surcharge if they had a reasonable excuse and that they could always seek a time to pay agreement. In the present case HMRC's refusal to mitigate was perfectly fair in the circumstances.

Discussion of the issues

43. We deal first with proportionality. One ground of appeal was that the Surcharge Notice charged an excessive amount given the reduction in liability following submission of a revised return. Mr Ellis accepted that this was the case and noted that the figures had been corrected (see paragraph 1 above). Correction apart, we accept Mr Ellis' arguments on proportionality and therefore reject Mr James' suggestion that the surcharge is disproportionate. We agree with the reasons given by the Presiding Member in paragraph 71 of *Julie Dovey v HMRC* [2012] UKFTT 190 (TC). Since that decision was delivered, the Upper Tribunal has also given its decision in *HMRC v Hok Limited* [2012] UKUT 363 (TCC), confirming that this Tribunal has no

jurisdiction to set aside surcharges or penalties on grounds of proportionality or fairness. Accordingly, even if we thought that there was something disproportionate or unfair about the surcharges imposed in this case, we have no jurisdiction to deal with them.

44. We deal next with the question of reasonable excuse. It is clear that QUK's cash flow position was a matter of concern to CIF from the beginning of 2011. The 2010 accounts reflect the deteriorating position of the business due to the recession and are consistent with worsening cash flow. Overall, the business remained profitable and, compared to many businesses, may be thought to have weathered the recession reasonably well. Its overall financial position might be thought to be broadly comparable to where it was around 2006. Nevertheless, on the evidence that we have before us, it appears that the cash flow problems had come to a head by the end of June 2011, by the time that Mr James on behalf of QUK acceded to CIF's requirement to reduce the review limit from £3.5 million to £3 million. We were not provided with full information of QUK's position at that time or of the use that QUK made of the money that Mr James said he had made available to QUK. However, Mr Ellis on behalf of HMRC did not challenge the veracity of Mr James' account and we have accepted it as a truthful account.

45. The position may therefore be summarised as follows: on the due date for payment of the tax at the end of January 2011 and at the time at which the first surcharge would have become due at the end of February 2011, Mr James had no reasonable excuse for the non-payment of his personal tax for the year ended 2009/2010 based on the cash-flow circumstances of QUK. He did not contend otherwise. By the time the first surcharge would have become due at the end of February, however, the TTP agreement was in place. Accordingly, the surcharge was at that point 'suspended' by agreement.

46. Mr James would not become liable for the surcharge otherwise due at the end of February 2011 provided he complied with the terms of the TTP agreement. We can ignore his failure to pay the instalment due at the end of March because in the circumstances HMRC agreed not to cancel the agreement. The final instalment was not paid as required at the end of June 2011 because Mr James used the money to support QUK through its cash flow difficulties, in particular with a view to ensuring that it could continue to pay (in whole or in part) its outstanding tax liabilities to HMRC.

47. Inability to pay is not a reasonable excuse but it is well established that the reasons why a person is unable to pay can constitute a reasonable excuse (see e.g. *Customs & Excise Commissioners v Steptoe* [1992] STC 757). We do not agree entirely with Mr Shah's characterisation of the cash flow difficulties that QUK faced at the end of June as unanticipated. These difficulties appear to have been a developing situation during the course of 2011, compounded by CIF's concerns and the action that it took and by the failure to secure alternative sources of finance. What happened at the end of June was that the difficulties came to a head and Mr James was faced with a choice: either to use his available funds to comply with the time to pay agreement or to fund QUK. He chose the latter because, in his own words, he considered that it would be imprudent to neglect QUK's position which at the time

was the more important (both to him and his employees and also to HMRC in terms of the loss of tax that might ensue if the business were to fail).

48. No doubt he would have been well advised to have approached HMRC at the time to explain the position and to have sought an extension to the time to pay agreement, rather than to await their cancelling the agreement in July. From the authorities that Mr Ellis cited, however, it is clear that a "reasonable excuse" does not depend upon the existence of exceptional circumstances and that whether an excuse is reasonable or not is to be judged objectively according to the ordinary meaning of the words. On that basis we conclude that Mr James had a reasonable excuse for not paying the final instalment of his personal tax on the due date under the time to pay agreement.

49. In this respect we reject Mr Ellis' contention that Mr James could not have had a reasonable excuse for non-payment because he knew well in advance what his tax liability was and should have provided for it accordingly. That is nothing to the point. Most tax liabilities (in particular those arising in respect of savings income and gains) arise from the actual receipt of cash (as contrasted with business profits, which may reflect accrued entitlements to cash payments) and if Mr Ellis were correct on this point very few individuals would be entitled to claim the benefit of the relief that Parliament has provided in section 59C(9) TMA 1970 or in section 108 FA 2009.

50. As it is Parliament does not require individuals to account immediately for tax on the income and gains with which we are concerned in this case and a considerable time may elapse between the receipt of the income in question and the time at which the final liability to tax on it must be settled. As we have noted, Mr Ellis was principally concerned in his cross-examination to investigate how Mr James had used the money that he had derived from QUK in 2009/2010 in the intervening period. No doubt this could be relevant to the question of reasonable excuse in establishing whether Mr James in fact had the resources to pay the tax at the due date. HMRC's Debt Management and Banking Manual, however, requires officers to ascertain whether a taxpayer falls into the category of "can't pay" or "won't pay" and only to agree a time to pay agreement in respect of the former. We assume therefore that Mr James must be taken to be someone whom HMRC was satisfied in February 2011 fell into the "can't pay" category.

51. Furthermore, the statutory question is whether "throughout the period of default, the taxpayer had a reasonable excuse for not paying the tax". The Act does not impose an obligation to set aside money for payment of substantial tax liabilities, even if that might be thought a prudent thing to do (possibly to avoid proceedings such as these in the tribunal). Nor does it deny Mr James his reasonable excuse because he is shown not to have adopted that course but to have used the money in other ways. In the present case Mr James freely admitted that if he had been able to foresee QUK's financial position in June 2011 he might not have chosen to withdraw the sums that he did in previous periods or to have used them as he had. Mr Ellis did not establish in cross-examination, however, nor suggest that Mr James had other resources that would have enabled Mr James in June 2011 both to have supported his company and to have complied in full with the TTP agreement. We therefore reject Mr Ellis' arguments on this point.

52. It also seems to us that the points that Mr Ellis made regarding Mr James' payment record for earlier years and the fact that he had previously sought time to pay agreements are irrelevant. We have no relevant information to assess those matters but even if we did, we cannot see what relevance they would have to the circumstances that arose in 2011 and which we have to consider in arriving at our decision.

53. The question then arises as to how section 59C TMA 1970 interacts with section 108 FA 2009 in a case such as this. The due date for payment of the tax was 31 January 2011 and tax remained unpaid 28 days and six months thereafter. The period of default is the period to 8 September 2011 (being the day before that on which the tax was paid). Did Mr James have a reasonable excuse for non-payment throughout the period of dispute? We consider that he did. Up to 30 June 2011 the tax remained outstanding because HMRC had entered into the TTP agreement and it does not seem to us that HMRC can subsequently say that Mr James did not have a reasonable excuse for the tax remaining unpaid during the currency of the agreement. They had agreed that it could remain outstanding (subject to the TTP terms) and even if one inspector doubted the wisdom of that agreement, HMRC cannot (and do not) deny that they agreed to that in February 2011 (and subsequently reaffirmed the TTP agreement in April 2011). As HMRC's Debt Management and Banking Manual indicates, the fact that the agreement was made after the due date for payment (but before the first surcharge date) does not affect the matter. No doubt on 1 February 2011 Mr James hoped and expected that HMRC would agree time to pay in accordance with their established procedures and his hope and expectation proved well founded.

54. Between 30 June and 8 September 2011 we have found that he had a reasonable excuse due to the support that he had to provide to QUK given its cash flow circumstances. The fact that after 30 June 2011 he was in breach of the TTP agreement, and that it was cancelled from 14 July 2011, does not seem to affect the position (subject to anything to the contrary in section 108 FA 2009). There is no requirement that the same reasonable excuse must subsist during the period of default, so long as there is a reasonable excuse for not paying the tax throughout that period. We believe that this produces a sensible (and the correct) result and accords with HMRC's arguments in *Toby Foster v HMRC* (TC01959) [2012] UKFTT 266 (TC), where HMRC and the tribunal appear to have proceeded on the basis that the surcharges should be set aside if the taxpayer had a reasonable excuse for failing to make payments as envisaged by the time to pay agreement.

55. As we recorded his arguments, Mr Ellis appeared to go further on the basis that section 108 only operates to suspend the liability to the surcharge and that the liability is only 'discharged' if the taxpayer complies in full with the agreement. If he fails to do so, Mr Ellis appeared to suggest that the surcharge liability is resurrected. Thus, the fact that Mr James had failed to comply with the terms of the agreement and had been served with a Surcharge Notice was sufficient to establish liability in any event. It may be that Mr Ellis did not intend to go that far in his argument but if he did, we do not think that he is correct on the matter.

56. Section 108(2) states that a taxpayer is not liable to a surcharge under section 59C in circumstances in which a time to pay agreement is entered into. The liability can

then only arise under section 108(3) if there is a breach of the agreement, notably a failure to pay the tax in question when the deferral period ends (section 108(4)(a)). Section 108 says nothing about the situation in which a taxpayer has a reasonable excuse for his failure to pay as required by the agreement. If HMRC are satisfied that the taxpayer has a reasonable excuse we imagine that they would ordinarily agree to vary the terms of the agreement to allow further time to pay. However, if this were to be purely a matter of HMRC's discretion as to whether to vary the agreement or not, a taxpayer would potentially have no recourse to the Tribunal in a case (such as the present) where there is a dispute about the existence of a reasonable excuse.

57. Section 108(3)(b), however, requires that an officer of Revenue and Customs must serve a notice specifying, "any penalty to which P would become liable apart from subsection (2)". The liability that then arises at the date of the notice is a liability to "that penalty". In determining what surcharge the taxpayer would become liable to under section 59C apart from section 108(2) it does not seem to us that one ignores the fact of the TTP agreement altogether. The agreement is the reason why the tax has not been paid and must, in our view, represent a reasonable excuse for non-payment over the period that it was in existence. If the taxpayer has no reasonable excuse for non-payment under the agreement, or otherwise for any failure to comply with the terms of the agreement, he will inevitably be unable to demonstrate that he has a reasonable excuse throughout the period of default and will be liable to the surcharge in any event. That is not the case here.

Conclusion

58. In this case Mr James has demonstrated that he had a reasonable excuse throughout the period of default and we therefore exercise our power to set aside the imposition of the surcharge. We allow his appeal accordingly.

59. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

MALCOLM GAMMIE CBE QC
TRIBUNAL JUDGE

RELEASE DATE: 7 February 2013