



TC06399

Appeal number: TC/2017/03434

VALUE ADDED TAX – default surcharge – late payments of VAT over a period of nine years – whether general decline in business over the period was reasonable excuse – held not – appeal allowed in respect of two specific events but otherwise appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

PHILIP ASHLEY LEGG

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE PHILIP GILLETT
RICHARD LAW**

Sitting in public at Taylor House, London on 7 February 2018

The Appellant appeared in person

Siobhan Brown, Officer of HMRC, for the Respondents

DECISION

1. This was an appeal against HMRC's decision to impose 37 Default Surcharge assessments, in respect of all VAT accounting periods from 12/05 to 12/14 inclusive, under s59 Value Added Tax Act 1994. These surcharges totalled £5,436.25.

2. The surcharges had been subject to an internal review and, by letter dated 13 June 2017, HMRC accepted that Mr Legg had a reasonable excuse for the late payment of VAT for the periods 06/08 and 09/08, which reduced the surcharges under appeal to £5,304.63.

3. Mr Legg's appeal to the tribunal had been made out of time, but HMRC indicated that they did not object to the late admission of the appeal and we are therefore content to give permission for Mr Legg to make a late appeal.

Facts

4. The basic facts are agreed between the parties.

5. Mr Legg has carried on various businesses in the music industry for a number of years and has been registered for VAT since August 1998, and up to the period under review, his VAT payment record had been good. Up to around 2004 his business consisted primarily of making and selling CDs, predominantly of pop music produced by independent artistes. When this business began to decline, because of the increasing use of downloading and streaming, his profits were dramatically reduced and he found it extremely difficult to keep the business afloat. He therefore moved into promotion and streaming of music, hoping that these would produce a steadier flow of income. This business has now become reasonably successful and he receives a growing stream of royalties from the US. This move however involved the development of new contacts and required totally new ways of doing business.

6. During the periods in question all VAT payments made by Mr Legg were late, and in fact, between 14 September 2006 and 29 June 2012 he made only two payments, both on 16 November 2009, totalling £1,235.13. As a consequence HMRC raised 37 surcharges under s59 VATA 1994. The first four surcharges were at the rate of 0%, 2%, 5% and 10% respectively, and all subsequent surcharges were calculated at the rate of 15%.

7. HMRC has duly served all the Surcharge Liability Notices relating to these surcharges and Mr Legg acknowledges that all payments during this period were late and that the required HMRC notices were received by him.

8. Mr Legg contacted HMRC on many occasions during this period in order to discuss ways through his financial difficulties, and this was supported by records from both HMRC and Mr Legg, who kept meticulous records of his contacts. Time to Pay agreements, as provided for under s108 Finance Act 2009, were reached on two occasions, but Mr Legg was unable to keep up the required payment schedules.

9. Mr Legg referred to one specific letter exchange, in November 2008, when he wrote to HMRC offering to pay off his debt at £100 per month. Unfortunately however, according to HMRC's reply dated 28 November 2008, his outstanding liabilities at that time amounted to £7,383.85. The HMRC letter indicated that they might be prepared to consider a repayment plan spread over six months, but this would have involved payments of over £1,000 per month, which was simply beyond Mr Legg's means at that time.

10. Mr Legg said that he had paid off all VAT arrears by the end of 2014 and it was now only the default surcharges which were outstanding. For HMRC Ms Brown said that in fact, according to the way in which HMRC had accounted for the various receipts, the amounts outstanding as at the date of the hearing were £4,728.97, made up of default surcharges of £586.51 and VAT of £4,142.46, which related to the periods 06/14, 09/14 and 12/14.

11. Mr Legg said that his annual profits for the later years in question were:

2010	£5,347
2011	£14,879
2012	£9,993
2013	£17,945
2014	£10,627

This illustrated the difficult business environment in which he was operating.

12. Mr Legg also provided significant evidence regarding the recorded music industry, which we accept, and which fully supported his contention that the business had declined dramatically over the years in question.

13. Mr Legg also said that his turnover had at times been below the VAT threshold but he had taken the decision to remain VAT registered because this enabled him to recover VAT suffered on inputs and, in addition, being VAT registered was an indication to his customers that his was a well-established business.

Grounds of Appeal

14. Mr Legg's grounds of appeal were as follows:

- (1) He suffered a catastrophic hard-drive failure with his computer in August 2008, and was unable to recover any data. This therefore necessitated a complete rebuilding of his accounts and his customer database.
- (2) He suffered from a dramatic decline in his main business area during the period in question, which led to a shortfall in funds, meaning that he was unable to pay his VAT liabilities as they fell due.
- (3) In addition Mr Legg said that his father had been diagnosed with cancer in September 2010 and had died in February 2011, during which period he had been very heavily involved in his father's care.

Legal Framework

15. Section 59(7)(b) VATA 1994 provides that a surcharge will not arise if the taxpayer is considered to have a reasonable excuse for the late payment or return.

16. The expression “reasonable excuse” is not defined in the legislation but s71(1) VATA 1994 does specify two situations that are not to be regarded as a reasonable excuse:

“(a) an insufficiency of funds to pay any VAT due is not a reasonable excuse, and

(b) 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.”

17. The question of what “reasonable excuse” means has also been addressed in a number of cases and can be summarised as follows. The decision depends upon the particular circumstances in which the failure occurred and the particular circumstances and abilities of the person who failed to file their return on time. The test is to determine what a reasonable taxpayer, in the position of the taxpayer, would have done in those circumstances and by reference to that test to determine whether the conduct of the taxpayer can be regarded as conforming to that standard.

18. Importantly, the test is whether or not the taxpayer’s behaviour is reasonable in his particular circumstances, with his knowledge and understanding of tax issues. No higher standard, and no lower standard, than that.

Discussion

19. In his submissions, Mr Legg set out a very clear picture of the difficulties which he had faced during the period in question, which we accept were undoubtedly very severe. However, he was not alone in this respect and Ms Brown, for HMRC, argued that such difficulties were part of the normal challenges of running a business and that many businesses had encountered similar problems at that time. HMRC expected that a taxpayer should have adapted to the new environment and managed his tax affairs within that new environment.

20. Mr Legg explained that a number of his customers, including HMV and a number of small local record shops, had gone out of business during the period, and, although they had often owed him money when they failed, it was usually only a matter of £100/150, and this had not therefore been a major contributor to his payment difficulties.

21. It was however very clear to us that Mr Legg had taken his obligations to HMRC very seriously, and that he had made numerous attempts to resolve his problems with VAT by talking to HMRC. The simple fact remained however that Mr Legg did not have the funds to settle his VAT liabilities, even on an instalment basis.

22. As s71(1)(a) VATA 1994, set out above, states, an insufficiency of funds is not in itself a reasonable excuse. However, in some circumstances, the causes behind the insufficiency might be regarded as a reasonable excuse if they are reasonably unforeseeable or outside the control of the taxpayer. These issues have been
5 considered in a number of cases but, in general, those circumstances which have been regarded as amounting to a reasonable excuse have been relatively short term in their nature or have arisen suddenly and unexpectedly, in much the same way as Mr Legg's computer problems arose unexpectedly. Unexpected late payments from a major customer, or a major customer going into liquidation owing a material sum to the
10 taxpayer may also amount to a reasonable excuse. In our view however, difficult though it may have been for Mr Legg, we do not regard the long term decline of the recorded music industry as falling into this category. It was a dramatic decline, but it took place over a period of years and, once it had started, the direction of travel was reasonably foreseeable. It was not a sudden one-off event, nor was it unforeseeable
15 once the decline had commenced.

23. In addition, Mr Legg acknowledged that during this period he had charged his customers VAT, and that the VAT had been paid over to him. He had then however chosen to use those funds to pay his operating expenses rather than pay the money over to HMRC. He agreed that this was a conscious choice on his part and he
20 therefore effectively chose to borrow from HMRC in order to pay his operating expenses.

24. In summary, in all the circumstances, we cannot find that these long term cash flow difficulties, caused by the decline of the recorded music industry, can be considered to be a reasonable excuse for the late payment of Mr Legg's VAT.

25. Mr Legg has put forward two further excuses for the late payment of VAT, his computer failure and the illness and death of his father.

26. We have absolutely no problem in agreeing with HMRC that the computer failure was the sort of event giving rise to a reasonable excuse. We therefore agree with the HMRC reviewing officer that the surcharges for the periods 06/08 and 09/08
30 should be cancelled.

27. The death of a close relative can also, in our view, amount to a reasonable excuse, especially where this is exacerbated by the extremely difficult trading environment in which Mr Legg found himself. We therefore find that Mr Legg also had a reasonable excuse for the VAT periods 09/10, 12/10 and 03/11, which total
35 £511.84.

Decision

28. For the above reasons therefore we decided that Mr Legg's appeal should be **ALLOWED IN PART** in that the surcharges for 06/08 and 09/08, totalling £131.62, and those for 09/10, 12/10 and 03/11, totalling £511.84, should be cancelled.

40 29. 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.

**PHILIP GILLETT
TRIBUNAL JUDGE**

10

RELEASE DATE: 19 MARCH 2018