The Personal Tax Planning Review

SECURITY FOR PAYMENT OF VALUE ADDED TAX

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1. Introductory

It is, of course, widely known that there is a fairly extensive range of sanctions and penalties for various mistakes and defaults in relation to value added tax and that Customs and Excise are quite enthusiastic to collect and enforce such penalties. Indeed, their somewhat over-zealous application of certain of these penalties has led to political pressure producing modification of the penalties concerned. This "setback" does not seem to have deterred Customs and Excise from pressing hard on sanctions as a case recently referred to as a news item in the national press indicates. In that case the taxpayer was having certain financial difficulties in his business and owed Customs and Excise around £2,500. Apparently in spite of requests for time to pay, Customs and Excise seized the goods of the business, including certain fairly new computer equipment, which was then sold. As was to be expected, at this type of auction the price realised was fairly small. Indeed, it seems from the newspaper reports that the proceeds received were less than the costs involved so that, at the end of the day, not only had the taxpayer lost valuable business equipment but he was even further in debt to Customs and Excise. It is, therefore, very important to be fully aware of the powers of Customs and Excise.

2. Security for Payment

Paragraph 5(2) of Schedule 7 to the Value Added Tax Act 1983 provides:-

> "Where it appears to the Commissioners requisite to do so for the protection of the revenue they may require a taxable person, as a condition of his supplying goods or services under a taxable supply, to give security, or further security, of such amount and in such manner as they may determine, for the payment of any tax which is or may become due from him."

As will be seen from the above wording, security relates not only to value added tax currently due but also to value added tax that will or may arise in relation to the future conduct of the business. (See *United Haulage Holdings Ltd v Customs and Excise* LON/85/650).

It may seem rather strange that where a company is having difficulty paying its value added tax by reason of business difficulties it should be required to become even more embroiled in financial problems by having to raise additional resources or cash as security for future payments of value added tax. However, as will be seen, there may be cases where the security can be required even though there are no current pressing financial difficulties, although this is a factor which can be taken into account in setting the level of the security.

3. The Sanction

If the remedy seems rather bizarre in many contexts, the sanctions are particularly severe. Paragraph 5(2) as quoted above indicates that the giving of the security is a condition of making taxable supplies and section 39(5) of the Value Added Tax Act 1983 provides:-

> "If any person supplies goods or services in contravention of paragraph 5(2) of Schedule 7 to this Act, he shall be liable on summary conviction to a penalty of level 5 on the standard scale..."

The effect of this may, of course, force particular taxpayers completely out of business and, in consequence, the Value Added Tax Tribunal has been given what has recently been described as a "supervisory jurisdiction" (*Mr Wishmore Ltd v Customs and Excise* [1988] STC 723 followed in *Colette Ltd v Customs and Excise* LON/91/753), in order to review the appropriateness of the requiring of the security and the nature of the security required. Section 40(1)(n) of the Value Added Tax Act 1983 allows an appeal against the requirement of any security. Grounds for such an appeal would include where the requirement is excessive, unnecessary and unfair. The current approach of the Tribunal seems to be basically deciding whether there are grounds upon which a reasonable officer of Customs and Excise could come to the conclusion that security was required rather than a consideration of the case on its merits. With the approach of the Tribunal it is obviously important that all relevant materials and representations are made to Customs and Excise since it may not be easy to introduce new materials of sufficient strength on the appeal to overthrow the decision requiring security, although this new evidence may persuade the Tribunal to reduce the level of security required.

In *Gayton House Holdings Ltd v Customs and Excise* MAN/84/124 it was suggested that, where an appeal is entered into against security, an application should be made under rule 17(1) Value Added Tax Tribunal Rules 1972 at the same time to extend the time for compliance by the taxpayer with the requirement to give security, thereby avoiding trading illegally pending the outcome of the appeal.

Given the potential severity of the application of the sanction and the rather limited role currently taken by the Value Added Tax Tribunal on appeals, it is important to be aware of the circumstances when, in practice, Customs and Excise are likely to exercise this power. Unfortunately, Customs and Excise have not given any indication in either their leaflets or press releases as to the circumstances in which they regard the revenue as being at risk so that they are likely to exercise the power.

No doubt this is done with a degree of prudence on their part. To publish in advance might inhibit their use of the power in other situations. In consequence, therefore, the only guidance that is effectively available is from scrutinising decisions of the Tribunal and High Court where appeals under section 40 have been brought.

4. The Security

The form and the amount of the security are at the discretion of Customs and Excise, subject only to possible regulation by the Tribunal. Usually this takes the form of requiring some form of bond or third party guarantee for payment of future tax. In *Giddian Ltd v Customs and Excise* [1984] VATTR 161 a company with share capital of only £3 and funded by loans from the shareholder was required to provide security. The reason advanced by Customs and Excise for this was that the major participant in the company had a previous history when a group of five companies had become insolvent owing more than £50,000 in respect of value added tax. It was contended that the current company was under-capitalised and that security should be required. The security so required was a guarantee from a bank, insurance company or guarantee society approved by Customs and Excise for £5,000. A personal guarantee offered by the principal participant was not acceptable to the Commissioners given his other financial circumstances. Customs and Excise indicated that the size of the security had been fixed by reference to the first tax return of the taxpayer company and the last return of one of the previous companies. Whilst affirming that the Tribunal could only interfere if the decision was one "which no reasonable body of Commissioners could have reached and whether it was reached without the Commissioner taking into account some matter which they should have regarded or by the Commissioners taking into account some extraneous matter which they should not have regarded ... ", it was not for the Tribunal to substitute its decision for the disputed decision of the Commissioners, but to exercise a supervisory jurisdiction and the Tribunal held that although it might be appropriate to consider the mismanagement of the financial affairs of the previous companies, it was also necessary to consider whether there was any jeopardy to the revenue from the conduct of the current company. In this case, the sanction which would seem to be a multiple of an anticipated tax, was reduced from £5,000 to £4,000. It is suggested in De Voil at paragraph A15.85 that the practice of the Commissioners is to require security for an amount equal to six months tax in those cases where the taxpayer has three month accounting periods and four months tax where the taxpayer is on a monthly accounting basis.

In *Colette Ltd* (supra) the Tribunal held that the amount of security which could be required was to be determined by reference to the likely burden of tax on the trader, including consideration of both input and output tax.

5. The Use of the Sanction

As the *Giddian* case (supra) indicates, the sanction is likely to be applied where there is a serious suggestion (by reason of the possibilities of previous failure to pay arising because of mismanagement and current under-funding) that tax is not likely to be paid in the future. In *S Evans v Customs and Excise* [1979] VATTR 194 the taxpayer was required to give security in the form of a bond with a penalty of £10,000. The taxpayer had been engaged with four companies which had been assessed on value added tax of over £26,000 of which over £19,000 was due from one company which was insolvent and whose overdraft had been called in by the bank. The taxpayer contended that, by reason of litigation with the bank and other circumstances, he

would not be in a position to provide the bond and so be forced out of business. The taxpayer had also made arrangements with an accountant for dealings with the books and returns of the business. The Tribunal held that, in the absence of any allegation of fraud or evasion and the Draconian nature of being forced out of business, together with the arrangement to put the books in order, the taxpayer should be given a final opportunity to continue his business without having to give security. In *Docklair Ltd v Customs and Excise* LON/83/25 security was required in the case of a company which owed approximately £5,500 but the principal shareholder and director thereof had been involved in previous businesses in partnership with others and as a shareholder in other companies which had ceased to carry on business but owed considerable sums of money. He was also a partner in another firm which had not made any value added tax returns and which had been assessed for value added tax. Customs and Excise originally required a penalty bond for £7,500 but the taxpayer (who did not dispute that it would be reasonable to be required to give security) gave evidence that obtaining a bond would be impossible. Customs and Excise appear to have been willing to consider a cash deposit of £3,650 and the Tribunal concluded that in the circumstances the security should take the form of a cash deposit of £3,600 to be paid within 14 days and that the taxpayer should be put on a monthly accounting basis.

In *Mr Wishmore Ltd* (supra) the principal shareholder in the taxpayer company had been involved with two other companies carrying on business in the same area which had been wound up owing substantial amounts of unpaid value added tax. The taxpayer company failed to produce value added tax returns on time and fell into arrears with its tax payments. It was held that the Commissioners were fully justified in requiring the company to provide security of £26,700 given the repetition of the signs of previous trouble of failure to make returns and pay tax due. Furthermore, in *Dialrace v Customs and Excise* LON/90/1938 it was held that a bad compliance record and involvement by a major participant in the taxpayer company with a collapsed company could justify the making of a requirement for security and in *Longsight Cricket Club v Customs and Excise* MAN/89/90 the Tribunal upheld a decision of Customs and Excise to require security based solely on the failure of the taxpayer to supply value added tax returns on time (an average of 511 days late) notwithstanding the imposition of a surcharge.

Previous business failures are not, however, necessarily justification for imposing the requirement of security without more. In *Firepower Builders Ltd v Customs and Excise* LON/88/301Y, a major participant in the taxpayer company had been involved as a director of his other companies which had become insolvent owing value added tax. The taxpayer company, however, adopted a somewhat different approach and avoided cashflow difficulties by not taking on local authority contracts and it had a good compliance record, paying its creditors on time and had a satisfactory bookkeeping and accounting system. It was found on the evidence that a further business failure was unlikely and the loss of tax was extremely remote. In the circumstances the requirement of the security was discharged.

One factor that may be taken into account by the Tribunal in considering whether security is reasonably required or not is the subsequent conduct of the taxpayer. In *Highfire Ltd v Customs and Excise* LON/87/128, evidence was put forward that the taxpayer had reorganised the cash control and stock control of the business and that there was no tax currently outstanding and all returns had been filed on time. There was also evidence that the company had a substantial balance on its current account at the bank. In these circumstances the Tribunal reduced the security required from £11,800 to £5,000.

6. Conclusion

The powers of Customs and Excise to require security for value added tax, whilst reasonable in theory, do seem in practice to have been applied ruthlessly even to the extent of being prepared to force people out of business. However, they remain subject to the requirement of having to show risk to the revenue which is presumably showing a serious possibility that tax currently due or possibly due in the future will not be paid. The "supervisory jurisdiction" of the Tribunal is, by contrast, an inadequate means of protection for the taxpayer made more difficult by the absence of legal aid and the apparent, difficult onus of proof on the taxpayer to prove the unreasonableness of Customs' decision.

A problem for Customs and Excise is showing that there is a risk of non-payment, and previous association with defaulting taxpayers is obviously a useful starting point for them. In consequence, any trader who has, in the past, had the misfortune to go out of business owing any amount of value added tax is likely to find that his record haunts him ad infinitum in any future attempts to set up in business and may well find that the financial implications preclude such an attempt altogether, unless he can show that he is a reformed character and that his current business is on a sound financial footing and its compliance and other affairs are in good order.