

Failure to submit annual VAT return on time

(Lecture B1100 – 12.25 minutes)

Background

This session considers the recent First-tier Tribunal case involving Curtises Ltd (T6460), a business that used the annual accounting scheme i.e. it submitted one annual VAT return to 31 December each year, a return that had to be legally submitted by 28 February (scheme users get an extra month to submit the return). Reference: VAT Notice 732, para 1.4. It was the quirks of the scheme that led to the business being issued with a penalty of £26,948 by HMRC.

History of events

To understand the background to this case, a timeline of events is useful.

The business was required to submit its December 2016 return by 28 February 2017 but it failed to submit the return by the due date, so HMRC estimated the liability and issued a central assessment for £35,578 on 17 March 2017. The company had already paid £32,499 on account during the year (payments on account are a condition of the scheme) but made an additional payment of £46,131 on 5 April as well.

HMRC wrote to the taxpayer on 18 May asking for the return to be submitted, which eventually happened on 7 June. But the amount owed on the return was actually £215,233.43. HMRC had greatly underestimated the liability for the period when it raised its estimated assessment for only £35,578.

The law

If a business accepts a central assessment that is too low, then it is subject to a potential penalty (para 2, Sch 24, FA2007). The business owner has 30 days from the receipt of the assessment to “take reasonable steps” to notify HMRC that there is a problem. The penalty is based on the ‘potential lost revenue’, which is the difference between the assessed amount and the true liability for the period. In this situation, HMRC rightly treated the situation as a ‘prompted disclosure’ and issued a penalty for 15% of the potential lost revenue, which is the minimum penalty that can be applied:

$$£215,233 - £35,578 = £179,655 \times 15\% = £26,948.25.$$

Taxpayer argument

HMRC applied the law correctly, and the reason for the law is to act as a disincentive to a company that accepts a low assessment when it has a higher liability for a period. So it was always going to be difficult for the director to overturn the penalty. He highlighted the company’s general compliance to tax matters and the fact that the outstanding VAT liability was fully paid when the return was submitted. He agreed that the company was “struggling to cope with the growth in its business.”

The judge agreed that “a penalty of this magnitude for what is ultimately a fairly minor mistake does appear a little harsh” but the law had to be applied and the appeal was dismissed.

Annual accounting pitfall

The annual accounting scheme has never been widely popular with taxpayers, even though it can be used by any business that expects its annual taxable sales in the next 12 months to be less than £1.35m. excluding VAT. Accountants and clients often like the discipline of a client completing quarterly (or monthly) returns to ensure that record keeping is up to date, and it also means that cash flow is easier because the business is paying its actual dues on a regular basis.

I can see how the Curtises problem arose: the company's annual turnover increased from £700k in 2015 to £2.75m in 2016, so the final VAT liability on its 2016 annual VAT return was always likely to be higher than both the directors and HMRC were expecting. This is a major potential pitfall of the scheme, namely that the payments on account during the course of the year will often be too low for a growing business, leaving a big balancing payment when the return is submitted. The message is simple: Annual accounting scheme – beware!

Contributed by Neil Warren