TC01349

Appeal number: TC/2011/02067

VAT – default surcharge – payment after extended due date – trader's incorrect understanding that longer period allowed – levels of surcharge questioned as being an excessive interest charge – held, payments not despatched in sufficient time to reach HMRC's account – also held, no reasonable excuse for defaults – surcharges not interest and not in circumstances disproportionate – appeal dismissed

FIRST-TIER TRIBUNAL

TAX

INTABASE SOLUTIONS LIMITED **Appellant**

- and -

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

TRIBUNAL: JOHN CLARK (TRIBUNAL JUDGE)
SUSAN HEWETT

Sitting in public at Southampton on 8 June 2011

The Appellant did not appear and was not represented

David Lewis, Appeals Unit, HM Revenue and Customs, for the Respondents

DECISION

1. The Appellant ("Intabase") appeals against the imposition of six default surcharges for the periods ending 07/07, 01/08, 04/08, 07/08, 10/08 and 04/09.

2. When the appeal came on for hearing, the Appellant was not present. The Tribunal Clerk telephoned the director, Mr Jamie Thornton, to ask whether he was proposing to attend. (It appeared that he had not been aware of the hearing, despite letters both from the Tribunal and the Respondents.) His attendance at the hearing would not have been possible without it being postponed until later in the day, leaving insufficient time for the hearing. Mr Thornton decided not to attend. He indicated to the Clerk that he was happy for the hearing to go ahead without him being present; he had put in correspondence all the points which he wished to put before the Tribunal. He simply wished to have the matter decided.

3. In the light of Mr Thornton's comments and the correspondence specifying the hearing date, we decided pursuant to Rule 33 of the Tribunal Rules (SI 2009/273 (L.1)) that it was in the interests of justice to proceed with the hearing.

4. Mr Thornton had given Notice of Appeal on behalf of Intabase on 10 March 2011. The letter from the Respondents ("HMRC") setting out the decision relating to the default surcharges was dated 31 January 2011, and therefore notice should have been given by 28 February 2011. Mr Lewis stated that HMRC raised no objection to the late notice; in the light of this, we agreed that the appeal should proceed. Mr Thornton's reasons for the delay were that he did not realise that he had to complete the Notice of Appeal form to appeal; he had never appealed against what he described as unfair tax. However, HMRC's decision letter did specify that details of the appeals process and the forms to be completed can be found on the Tribunals website, and gave the website address. Any appellant wishing to use the appeals process should read the guidance available through the website; failure to carry out the necessary steps could result in a decision not to allow an appeal to be made out of time.

The facts

5. The evidence consisted of a bundle of documents containing the correspondence. From the evidence we find the following facts.

6. Intabase was registered for VAT with effect from 1 February 2001. It was in default for various earlier periods from 02/06 onwards, but these periods were not the subject of the present appeal.

7. From period 04/07 up to period 04/10 Intabase submitted manual returns. Payment was made electronically, varying between BACS and CHAPS as the method of payment. According to a note made by HMRC following telephone conversations with Mr Thornton on 5 and 7 April 2011, all payments made from 07/09 onwards have been made by BACS and have been on time. HMRC also noted that the payment for period 04/07 had been made on time but that the return had only been received recently following the issue of the demand notice relating to the default surcharges for

the periods under appeal and Mr Thornton's subsequent contact with HMRC's Debt Management Unit. (The scheduled default for period 04/07 is not subject to the present appeal; we consider this below.)

8. For period 07/07, the return and payment were received by HMRC on 11 September 2007, payment being by CHAPS. For period 01/08, the return and payment were received by HMRC on 10 March 2008, payment being by CHAPS. For period 04/08, the return was received by HMRC on 9 June 2008 and payment (made by CHAPS) on 11 June 2008. For period 07/08, the return was received by HMRC on 15 August 2008, before the due date, but the payment (made by BACS) was received on 18 September 2008. For period 10/08 the return was received on 5 December 2008, and payment (by CHAPS) on 10 December 2008. For period 04/09, the return was received on 9 June 2009 and the payment (by BACS) on 10 June 2009.

9. From June 2006 correspondence between Intabase and HMRC showed the address of Intabase as 46 RL Stevenson Avenue, Bournemouth. On 6 May 2008 Mr Thornton wrote to HMRC asking for the address to be changed to "77 Shatesbury Road Bournemouth" [the actual address, as shown on the Notice of Appeal, being 77 Shaftesbury Road]. A VAT return form to cover period 04/07, sent by HMRC to Intabase at its former address, was returned to HMRC on 27 April 2007 and stamped by HMRC "Returned Mail – Gone Away". No other correspondence was returned to HMRC.

10. The VAT return forms for period 04/08 and all earlier periods were sent to Intabase at the RL Stevenson Avenue address. For all later periods HMRC used the address as notified by Mr Thornton (ie using the misspelling "Shatesbury").

11. On 15 October 2010 HMRC wrote to Intabase with a Demand Notice indicating that £2,806.62 was now due. He responded on 3 November 2010 asking what this balance related to, as he had made ten or more calls to the debt management team and the central advice team and still did not have any answers. He said that he had been told various things and as a result had recently resubmitted his April 07 return; he attached a list of all his returns since then, all the tax on which had been paid.

12. A Complaints Manager at HMRC's Debt Management and Banking unit wrote to Mr Thornton on 16 December 2010. Despite recently received guidance that detailed written breakdowns should not be provided (because registered taxable persons were under the obligation to keep a record of their VAT details for six years), a colleague had obtained historical VAT account details which confirmed that the current debt (amounting to £3,472.20) was "legitimate". The Complaints Manager attached a breakdown of the amounts; the liability was made up of surcharges due to late receipt by HMRC of several VAT payments. If Mr Thornton wished the surcharges to be reconsidered, he could ask the relevant HMRC office to reconsider the matter, although due to the length of time that had passed since the surcharges had been incurred, such a request might now be out of time.

13. Mr Thornton wrote to the HMRC Default Surcharge Review Team on 29 December 2010. He attached a copy of the "Summary of debt due" supplied by the Complaints Manager. In his letter he stated:

> "Regarding the outstanding surcharges £3472.20 (List Attached) I consider these to be unfair in there [*sic*] scale of punishment for a total of 35 days late payments over a period of 2 years.
>
> This works out to be £99.21 a day interest on a few thousand pounds which is out of scale with the amount owed. As you will no doubt agree in recent years I have improved my payment cycle to ensure payments are received on time.
>
> Finally I understand these surcharges are a few years old however the first letter I received was earlier this year which [*sic*] I responded straight away (see attached letter). I do not know what happened to earlier correspondence on this matter.
>
> Please would you reconsider these charges of [*sic*] at least offer some sort of payment plan so I can pay the debt of [*sic*] in smaller amounts?"

14. On 31 January 2011 HMRC's Appeals and Reviews Unit wrote to Intabase (again using the incorrectly notified address "Shatesbury Road") responding to Mr Thornton's letter. HMRC's letter stated that the Unit was "unable to commence a reconsideration as you have not specified which periods you are appealing against". The letter stated that Intabase's Surcharge Liability Notice expiry date was 31 July 2011 and remained in force for 12 months following its last default. If Intabase defaulted again within this specified period, the expiry date would be extended by a further 12 months, and Intabase might become liable to a financial penalty.

Relevant legislation

15. Section 59 of the Value Added Tax Act 1994 ("VATA 1994") provides:

> "**59 The default surcharge**
>
> (1) . . . if, by the last day on which a taxable person is required in accordance with regulations under this Act to furnish a return for a prescribed accounting period—
>
> > (a) the Commissioners have not received that return, or
> >
> > (b) the Commissioners have received that return but have not received the amount of VAT shown on the return as payable by him in respect of that period,
>
> then that person shall be regarded for the purposes of this section as being in default in respect of that period.
>
> . . .
>
> (7) If a person who, apart from this subsection, would be liable to a surcharge under subsection (4) above satisfies the Commissioners or, on appeal, a tribunal that, in the case of a default which is material to the surcharge—

> (a) the return or, as the case may be, the VAT shown on the return was despatched at such a time and in such a manner that it was reasonable to expect that it would be received by the Commissioners within the appropriate time limit, or
>
> (b) there is a reasonable excuse for the return or VAT not having been so despatched,
>
> he shall not be liable to the surcharge and for the purposes of the preceding provisions of this section he shall be treated as not having been in default in respect of the prescribed accounting period in question (and, accordingly, any surcharge liability notice the service of which depended upon that default shall be deemed not to have been served)."

Arguments for Intabase

16. The grounds which Mr Thornton included in the Notice of Appeal were the following:

> (1) Several of the dates when the money was received by HMRC were different and later than Intabase's bank had confirmed that they were sent. For period 01/08, the payment had actually been made on 10 March 2008 using the bank's CHAPS payment system, so would have hit the VAT account that day. For period 07/08, he had sent the payment on 26 August 2008 within time. On the list which the Debt Management and Complaints Team had sent, it said that this amount was paid on 19 September 2008; how was this possible? For period 10/08, the payment had actually been made on 10 December 2008 [we have corrected this date, as that shown in Mr Thornton's letter to the First-tier Tribunal office dated 26 February 2011 is 10 August 2008, which is clearly an error] using the bank's CHAPS payment system, so would have hit the VAT account that day. For period 04/09, he had sent the payment on 8 June within time.
>
> (2) He had not received paper copies of the notices when they were sent by HMRC in 2008. The first notice which he had received was in June 2010.
>
> (3) He considered the interest charged extremely high and unfair. He calculated it at £99 a day.
>
> (4) Ultimately the amount surcharged would be affected if it was deemed that these payments had been made on time by Intabase. The issue with the CHAPS payments could be that HMRC's system registered them a day late and technically this was not Intabase's fault. Mr Thornton asked for the surcharges to be reconsidered; the amount [ie, of the debt including the surcharges] was likely to "take the company under" as it had just lost a major contract, and the debt would de-stabilise its business further if upheld.

17. The result which Mr Thornton requested was that either a reasonable amount should be applied or, if this was not possible, Intabase should be given a payment schedule over 12 months.

Arguments for HMRC

18. Mr Lewis emphasised that Intabase had been in the default surcharge regime from the period 05/06 onwards. Thus before the periods covered by the present appeal, a number of Surcharge Liability Notices had been issued. Mr Lewis referred to the standard paragraph included in such Notices:

> "Please Remember: Your VAT returns and any tax due **must** reach the VAT central unit by the due date. If you expect to have any difficulties let your local VAT office know as soon as possible. Any agreement with your local VAT office to defer payment or to pay by post dated cheques does not prevent the imposition of surcharge."

19. Intabase, having defaulted previously, therefore knew of the potential consequences attached to the risk of further defaults.

20. The underlying cause for late payment appeared to be that Intabase did not receive paper copies of the notices when they were sent by HMRC in 2008. Intabase also contended that the default surcharges which had been charged for late payment were extremely high and unfair, amounting to £99.21 a day on the VAT due.

21. Intabase argued that it had a reasonable excuse for the lateness of the payments for the periods covered by the appeal. Mr Lewis referred to s 59(7)(a) and s 71VATA 1994. HMRC argued that Intabase did not have a reasonable excuse for the late payment of the VAT for the periods under appeal. This was for the following reasons:

(1) Having defaulted in respect or earlier periods, Intabase would have been aware, from the guidance notes on the Surcharge Liability Notices issued, of the potential financial consequences of future defaults within the surcharge period. The details of the rising scale of surcharge were explained on the reverse of each such Notice, and this would have enabled Intabase to calculate the potential surcharge which would result in the event of a further default.

(2) In the Notice of Appeal Intabase had claimed that it had not received paper copies of the notices sent by HMRC in 2008. In addition, Mr Thornton's letter dated 29 December 2010 had stated that the first letter received had been earlier in 2010 (three months before his letter dated 3 November 2010). The business address had been changed following advice from Intabase on 6 May 2008 (see above). The only returned mail within the default cycle had been the VAT return form in April 2007. HMRC's records confirmed that the business address had not altered.

(3) Mr Thornton had stated in his letter dated 26 February 2011 that the January 2008 VAT payment had been paid on 10 March using the bank's CHAPS system. This payment had been received by HMRC on 10 March 2008. However, this was after the due date for electronic payments and would never have been received on time, despite the use of CHAPS.

(4) In the same letter, Mr Thornton had confirmed that the VAT payment for period 07/08 was sent on 26 August 2008. According to HMRC's records this had been received on 18 September 2008. During a later conversation with an

HMRC officer (Caroline Jones) on 5 and 7 April 2011, Mr Thornton had retracted this statement and confirmed that the payment was in fact forwarded in September. This tied in with a schedule which Mr Thornton had sent in with his letter dated 3 November 2010 to HMRC's Debt Management & Banking Complaints Unit. This showed the payment of VAT for period 07/08 as having been made on 16 September 2008.

(5) In the February 2011 letter Mr Thornton had also referred to the payment for 10/08 being made on 10 August [an error, as above, which should read December] 2008, and that for 04/09 being sent on 8 June 2009. Both these dates were after the due dates for the quarters in question. Mr Thornton had indicated in his telephone conversation with Caroline Jones that he believed that he had until the ninth day of the month to make payment. Mr Lewis submitted that the ninth day of the month was not the due date for the method of payment adopted by Intabase.

(6) He referred to the Special Commissioners case *Gladders v Prior* [2003] STC (SCD) 245, which contained a useful definition of reasonable excuse: "A reasonable excuse for not filing returns or paying tax on time is something outside the person's control that would prevent a reasonable man from complying, such as illness." HMRC contended that Intabase had not provided a reasonable excuse for not paying its tax on time.

22. Mr Thornton had contended in the grounds of appeal that the interest charge was extremely high and unfair. Mr Lewis referred to *Enersys Holdings UK Ltd* [2010] UKFTT 20 (TC), in which it had been held that the surcharge was disproportionate to the gravity of the offence. This decision had not been followed in more recent decisions. He submitted that the decision in *Enersys* could be distinguished as being specific to the circumstances of that particular case. There had been numerous recent appeals citing proportionality which had been dismissed; this demonstrated that the penalty had been found not to be disproportionate. He referred to *Crane Ltd* [2010] UKFTT 378 (TC), and *Scotpackaging Ltd* [2010] UKFTT 504 (TC).

23. For the periods under appeal the default surcharges incurred by Intabase were the sixth, seventh, eighth, ninth, tenth and eleventh in the cycle. Consequently they corresponded to 15 per cent of the outstanding VAT liability in each case. The present default system was provided by legislation, which set the level of any surcharge at various levels up to 15 per cent based on the number of previous defaults within the cycle.

24. At the issue of each Surcharge Liability Notice Intabase would have been made aware both of the consequences of continuing non-compliance and the rate at which the penalty increased. As early as 14 July 2006 Intabase had also been made aware of the consequences of failure to render payment and/or returns on time; it was therefore well aware of the financial increments.

25. HMRC contended that the rate at which the default surcharges for the periods under appeal had been imposed was not excessive, as there had been a number of defaults; from the earlier surcharge notices, Intabase was aware of the potential consequences of future defaults. Intabase had failed to provide a reasonable excuse

for not paying on time the VAT due in respect of the relevant periods. HMRC submitted that the appeal should be dismissed and the default surcharges confirmed.

Discussion and conclusions

26. As we have stated in relation to another appeal heard on the same day as this one (*Eyestar Consulting Ltd* – TC/2011/02441), two separate questions arise in appeals of this nature under s 59(7) VATA 1994 relating to payment of VAT liabilities. The first is whether the VAT shown on the return was despatched at such a time that it was reasonable to expect it to have been received by HMRC within the extended time limit of seven calendar days after the normal due date. If the answer to this first question is no, then was there a reasonable excuse for the VAT not having been despatched in time?

27. Mr Lewis' argument in the present case concentrated on the second of these questions (raised under s 59(7)(b) VATA 1994). In our view, the proper approach is to deal with the first question before addressing this second issue.

28. We consider the various payments made electronically through Intabase's bank for the periods under appeal. According to Mr Thornton's own schedule (attached to his letter dated 3 November 2010) the payment for 07/07 was made on 11 September 2007. As it was made by CHAPS, it was received by HMRC on the same date. In the same way, payment of the VAT for 01/08 was made on 10 March 2008 and received by HMRC on the same date. The position for 04/08 was similar; payment by CHAPS was both made and received on 11 June 2008. For 07/08, the position was not as Mr Thornton indicated in his letter dated 26 February 2011; his schedule shows payment being made by Intabase's bank on 16 September 2008. HMRC received this amount by BACS on 18 September 2008. The VAT payment for 10/08 was both made and received (by CHAPS) on 10 December 2008. According to Mr Thornton's schedule, the payment for 04/09 was made on 8 June 2009; as it was made by BACS, the date of receipt by HMRC was 10 June 2009.

29. In our decision in *Eyestar Consulting*, we have set out the basis for the time limits for making electronic payments. We do not repeat it here, but the effect of the relevant direction made by HMRC to extend the normal time limits is that payment must reach HMRC's account at the latest by the end of banking hours on the seventh calendar day after the normal time limit. The normal time limit itself is one calendar month from the end of the VAT period concerned. In general terms, this means that the payment must reach HMRC by the seventh day of the second month after the VAT return period. However, HMRC's Notice 700/50 – Default Surcharge at paragraph 3.1.1 also states: "If the due date falls on a weekend or bank holiday, you must ensure that cleared funds reach our bank account by the last bank working day beforehand."

30. In the note of the two telephone conversations between Mr Thornton and Caroline Jones of HMRC, Ms Jones stated:

> "With regard to the defaults for periods 07/07 to 04/09, payment for these periods was received marginally late on the 10th or the11th of the month (with the exception of period 07/08 received on the 18th). When I spoke to Mr Thornton, he advised that he had originally believed he had until the 9th of the month to make payment, he thought that he had seen this somewhere. He points out that he would not have made CHAPS payments if he had realised the payments were late anyway (this does not quite make sense as the 10th and 11th are after the 9th)."

31. We accept Ms Jones' note as evidence of Mr Thornton's statements relating to the VAT payments. We find that he misunderstood the statements made by HMRC relating to the extended time limit for making electronic payments. It may be that (as mentioned in *Eyestar Consulting*) the reference to collection of payments by direct debit three days after the extended time limit caused him to assume that payment could be made after that time limit had expired and still be regarded as being made on time. However, the VAT payments made by Intabase for the relevant periods did not fulfil the requirement in s 59(7)(a) VATA 1994 to satisfy us that the VAT was despatched at such a time and in such a manner that it was reasonable to expect that it would be received by HMRC within the appropriate time limit. Mr Thornton's misunderstanding prevented the VAT from being despatched in a timely manner. As HMRC have published ample materials setting out the details of the requirements for electronic payments, we hold that Intabase did not take the appropriate steps at the proper time to ensure that the payments could reasonably be expected to reach HMRC by the extended due date.

32. The second question is whether Intabase had a reasonable excuse for the late despatch of the VAT payments. As Intabase concentrated in its grounds of appeal and correspondence on the first question considered above, no specific pleading of reasonable excuse was put forward. Mr Thornton stated that he had not received paper copies of the notices sent by HMRC in 2008. He did not specify whether he had received the notices in any other form, and if so, when he had done so.

33. HMRC stated that only one item had been returned to them as undelivered mail, namely the VAT return form covering period 04/07. Although the absence of any other correspondence being returned to HMRC does not amount to conclusive proof that other items were delivered to Intabase, we find it more probable than not that they were so delivered. Even if, despite our conclusion, any items were undelivered and yet not returned to HMRC, we find that any delivery failures would probably have been due to the incorrect notification made by Mr Thornton to HMRC of Intabase's new address. We therefore find that Intabase did not have a reasonable excuse for the defaults in respect of any of the VAT periods 07/07, 01/08, 04/08, 07/08, 10/08 and 04/09.

34. In addition to defaults due to late payment, defaults can arise if a return is submitted late, whether or not the VAT is paid late. The return for VAT period 04/07 was not received by HMRC until 3 November 2010, the due date having been 31 May 2007 for a paper return and seven calendar days afterwards (or the previous business day) for electronic returns. Mr Thornton referred to "re-submitting" this return. As the default in respect of period 04/07 was not the subject of any appeal, we are not in a

position to make any findings relating to it. The default therefore stands, and can be taken into account by HMRC in assessing the percentage rate of surcharge applicable to Intabase's defaults, even though no financial penalty in the form of a surcharge was imposed on Intabase in respect of that period.

35. Mr Thornton raised other arguments challenging the surcharges; if these were successful, they would have the effect of overriding the effect of our conclusions at paragraphs 31 and 33 above.

36. He characterised the "interest charge" as being extremely high and unfair, calculating it at £99 per day. However, default surcharges in the form under appeal are not interest charges, but instead a form of penalty (not specified as such in the legislation) for failing to make the VAT payment (or to file the VAT return) on time. The level of the surcharges is fixed, whether the filing or payment is one day late or many weeks late. (The position under the replacement system is different, but we do not need to comment on this in the context of the present appeal.) Thus surcharges cannot be described as calculated by reference to the time for which the VAT has been outstanding. To constitute interest, an amount needs to come within what has been regarded as the definition for income tax purposes; in *Bennett v Ogston* (1930) 15 TC 374, Rowlatt J described interest as "payment by time for the use of money".

37. Although surcharges are not interest, the question remains whether they are open to challenge as being disproportionate, ie out of proportion to the amount owing. In *Enersys*, the Tribunal found that a 5 per cent surcharge of £131,881 in respect of one day's delay in payment was, in the circumstances of that case, disproportionate. In the light of those circumstances it discharged the penalty. However, those circumstances were exceptional. *Enersys* was due to be heard on appeal to the Upper Tribunal, but the appeal was discontinued, and the decision stands. Appeals to the First-tier Tribunal have been made in other cases on grounds including that of proportionality, and there have been no other decisions discharging VAT default surcharges on proportionality grounds. In both *Scotpackaging* and *Crane Limited* the surcharges were confirmed.

38. In *Crane Limited* at paragraph 12 the Tribunal commented:

> "12. In our view the 2% surcharge in this case is not disproportionate. A £5,000 penalty for a delay in making a £257,000 VAT payment does not seem to us to be wholly unfair even though it may be harsh. Judged against the purpose of a regime which is intended to encourage the timely submission of VAT returns and payment of VAT and to penalise late submission, rather than to compensate the State for the interest cost of the late payment or to recover the funding benefit of late payment of the taxpayer, a penalty of £5000, even for one days' delay, does not seem to us to be wholly outside the realms of what is necessary to achieve that object in this particular case."

We consider the position to be similar in the present case. Each of the various VAT payments, although much smaller, was outstanding for longer than one day beyond the relevant due date. The surcharges incurred for non-compliance, although harsh,

are not in our view disproportionate in the light of Intabase's failure to make the VAT payments by the extended due dates.

39. Mr Thornton also raised in his grounds of appeal the effect on Intabase's financial position if the surcharges were confirmed. As s 59(7) VATA 1994 limits the matters which can be considered by the Tribunal on appeal, and as the legislation provides no scope for any mitigation of surcharges, we cannot take the financial position into account in deciding whether the surcharges should stand.

40. For the above reasons we dismiss Intabase's appeal against the surcharges for the periods under appeal.

41. We wish to comment on HMRC's approach in the letter dated 31 January 2011 from the Local Compliance Appeals and Reviews unit. We regard it as far from helpful to have summarily refused to commence a reconsideration without giving Intabase an opportunity to specify the VAT periods which it was seeking to appeal against. We do not think that a decision should have been made in the absence of that information, other than for reasons of further delay if Intabase had not then provided it on a timely basis.

Right to apply for permission to appeal

42. 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.

JOHN CLARK

TRIBUNAL JUDGE
RELEASE DATE: 25 JULY 2011