TC01591

Appeal number TC/2011/05295

VAT - default surcharge – appeal out of time – not opposed – appeal on the grounds of proportionality – whether Tribunal had jurisdiction to hear such appeals – yes – whether penalty disproportionate – no – appeal against surcharge dismissed

FIRST-TIER TRIBUNAL

TAX

ECO-HYGIENE LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE ROGER BERNER
JOHN WHITING CTA FCA (Member)

Sitting in public at 45 Bedford Square, London WC1 on 13 October 2011

Mrs Sarah Kay, Wise & Co for the Appellant

Miss S Whitley of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal by Eco-Hygiene Ltd ('Eco') against a penalty levied under the VAT default surcharge regime. The penalty falls into the 10% rate and was computed by HMRC at £1,712.52.

2. At the time the penalty was notified to Eco, it did not appeal under the usual 'reasonable excuse' route. Nor does it seek to do so now. Instead, Eco is challenging the penalty using the proportionality argument that has featured in a number of Tribunal cases of late. HMRC both resist the company's case and also say that this Tribunal does not have jurisdiction to hear such an appeal. Additionally, the company is in strictness too late to appeal against the penalty so as a preliminary point it is seeking leave to appeal out of time. There are thus three issues before the Tribunal:

(1) Can Eco appeal out of time?

(2) If so, does the Tribunal have jurisdiction to hear an appeal based on proportionality grounds?

(3) If so, is the penalty as levied disproportionate?

3. Eco's case was presented by Mrs Sarah Kay of Wise & Co, the company's advisers. Mr E G Harrap, the company's managing director, gave evidence. HMRC's case was presented by Miss S Whitley of HMRC's Appeals and Reviews Unit.

Preliminary point: appeal out of time

4. Eco did not appeal against the penalty within the requisite 30 days. We were told by Mrs Kay that a reasonable excuse case was considered but not pursued. However, the company later became aware of the proportionality argument that has been used before the Courts and now seeks leave to bring a late appeal with a view to taking that route.

5. Before us, Miss Whitley said that HMRC agreed to this late appeal. We therefore formally record that Eco is granted permission to bring its appeal outside the normal time limit.

Findings of fact

6. From the documentary and oral evidence we find the following facts.

7. Eco is a company specialising in conservation and hygiene services, in particular short-notice cleaning assignments for large businesses. It does a significant amount of work for Network Rail, among other major businesses.

8. Eco has been registered for VAT for some years. It normally paid its VAT liability electronically using the BACS system and so gained an extra seven days in

which to make its payment. The rules for this are set out in VAT Notice 700 at paragraph 21.3.1 (the emboldening is HMRC's):

> If you choose to pay the VAT shown as due on your return by Bankers Automated Clearing System (BACS), Bank Giro Credit Transfer or Clearing House Automated Payment System (CHAPS), you may receive up to 7 extra calendar days for the return and payment to reach us. Here are some important facts you need to know if you want to benefit from this concession:
>
> - The 7 day extension to the due date will be applied automatically every time you pay your VAT return using BACS Direct Credit or Bank Giro Credit Transfer. You may also pay by CHAPS but please note that this may be the most expensive payment method for you. Payment cannot be made via Girobank.
> - Payment must be in our bank account on or before the 7th calendar day. If the 7th day falls on a weekend, we must receive payment by the Friday. When the 7th day falls on a bank holiday, payment must be in our bank account by the last working day beforehand.
> - To make sure that your payment reaches us in time**, you should check with your bank how many days they need to complete the transaction.**

9. From a schedule provided by HMRC, which was accepted by the company, it was in default as follows:

(1) Period 06/09 (paid 10/09/09) – initial surcharge liability notice

(2) Period 12/09 (paid 15/02/10) – 2% surcharge

(3) Period 03/10 (paid 17/05/10) – 5% surcharge

(4) Period 09/10 (paid 09/11/10) – 10% surcharge

10. The default that has given rise to this appeal was in respect of the return period to 30 September 2010. There is no dispute about the earlier defaults and it was accepted that Eco was therefore well aware of the default surcharge system and its provisions.

11. The 09/10 return payment was £17,125.22 and was due to be paid on 7 November 2010. As this was a Sunday, the due date became Friday 5 November. Mr Harrap made the payment electronically using BACS. The evidence of his bank records, which we accept, is that the payment was made at 8.24am. However, the BACS system does not guarantee to deliver same day payments and it did not arrive into HMRC's bank account until after the due date. According to Mr Harrap's evidence, he spoke to HMRC on Monday 8 November and was told that the payment was in HMRC's bank account. HMRC only allocated the payment to Eco's account on Tuesday 9 November and so recorded this as the payment date. It is this date of 9 November that is used as the basis of the surcharge. We have no reason to doubt Mr Harrap's evidence but the exact date of receipt by HMRC of Eco's VAT payment does not matter: it is accepted by both parties that the payment was late.

12. HMRC wrote to Eco on 12 November 2010 to notify them of the surcharge. There is no dispute as to the validity of this notice and so we find that it was properly raised and served.

13. We were shown a copy of Eco's accounts to 31 July 2011. These show turnover for the year of £740,379, virtually the same as the previous year. Profit shown in the accounts was only £7,580, well down on the previous year's £43,471.

14. The company has suffered cash flow difficulties which meant that paying its VAT on time was difficult. The VAT cash accounting system had in the past been considered but the company's size mean it was on the margin of whether it would qualify (and reverting to the normal accounting system would have cash flow consequences) so it had not then been pursued (though it has now adopted the cash accounting system). She referred to regular late payments by National Rail. We asked how much of Eco's business this customer represented: Mr Harrap estimated that Eco billed National Rail £92,000 last year which we calculate as some 12.5% of their business.

15. As we have noted, Mr Harrap made Eco's VAT payment early on the due date. He had made a small payment from his own funds to ensure there were sufficient funds in the account to meet the VAT bill in full. This payment would have utilised most of Eco's agreed overdraft facility, which was £10,000 according to the bank statement. We note from the bank details that the balance in the account on 3 November 2010 was £5,293.56, sufficient, along with the overdraft facility, to meet most of the VAT liability. Mr Harrap commented, and we accept, that had he been aware that there would be a default because of the timing of the payment, he would have paid earlier.

Proportionality: does the Tribunal have jurisdiction?

16. Miss Whitley argued that the First Tier Tribunal does not have jurisdiction to hear cases on proportionality and thus Eco's appeal should be struck out.

17. In the context of a case concerning the VAT default surcharge regime, proportionality is a concept that originates in European Community law. The principle is contained in Article 5 of the EC Treaty where paragraph 3 provides that:

> "Any action by the Community shall not go beyond what is necessary to achieve the objectives of this Treaty."

18. The European Convention on Human Rights ("the Convention") also recognises the same principle implicitly in Article 1 of the first protocol:

> "Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of any possessions except in the public interest and subject to the conditions provided for by the law and by the general principles of international law.

> The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."

19. It is this second paragraph that introduces, for human rights purposes, the concept of proportionality. As Miss Whitley put it, this means that UK tax law may contravene European law if it does anything other than apply a "fair and reasonable system of taxation for the benefit of society as a whole".

20. Miss Whitley's contention was that the role of the Tribunal is to decide what the law says and to apply it to the facts of the case. A challenge on the grounds of proportionality relates to the administration of the law by HMRC and so should be challenged, on her submissions, only by judicial review. Her contention was thus that such an action should be before the Upper Tribunal: that the First Tier Tribunal does not have such a function.[1] Miss Whitley cited in support of her contention the wording in the Human Rights Act 1998 where section 4 allows a court to make a declaration of incompatibility. Section 7 allows a person to bring proceedings against a public authority before an 'appropriate court or tribunal'; Miss Whitley referred to HMRC's view being that the First-tier Tribunal is not an appropriate court or tribunal for these purposes.

21. Mrs Kay argued that the Tribunal did have jurisdiction to hear a case on proportionality grounds. She referred to the case of *Enersys Holdings UK Limited* [2010] UKFTT 20 (TC) (*"Enersys"*) in which it was held that the penalty levied on the company under the default surcharge regime was indeed disproportionate and was discharged.

22. We will need to consider the *Enersys* decision in some detail later in this judgment but at this stage we note that in that case Judge Bishopp clearly held that the Tribunal did have power to hear proportionality arguments. As he said at the end of [32]:

> "…if the remedy is disproportionate to the aim, the court or tribunal has a Community duty to intervene."

23. Judge Bishopp saw it as not only within the power of the Tribunal to determine such an issue but made it clear that he regarded it as part of the Tribunal's role to do so. We would respectfully agree with his reasoning, based as it was, not on any application of the Convention, but on Community law principles. In that context, cases such as *Garage Molenheide BVBA and others v Belgium* (joined cases C-286/94, C-340/95, C-401/95 and C-47/96) [1998] STC 126 indicate that the Tribunal has a duty to intervene if a penalty is disproportionate:

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[1] By way of footnote, we should note that, if HMRC's argument in this respect were correct, the Upper Tribunal would itself have jurisdiction only if the application for judicial review were made to the High Court in the first instance and the High Court were to transfer the application to the Upper Tribunal under s 31A(3) of the Supreme Court Act 1981 (as inserted by s 19 of the Tribunals, Courts and Enforcement Act 2007).

> "48 … the principle of proportionality is applicable to national measures which … are adopted by a member state in the exercise of its powers relating to VAT, since, if those measures go further than necessary in order to attain their objective, they would undermine the principles of the common system of VAT and in particular the rules governing deductions which constitute an essential component of that system.
>
> 49 As regards the specific application of that principle, it is for the national court to determine whether the national measures are compatible with Community law, the competence of the Court of Justice being limited to providing the national court with all the criteria for the interpretation of Community law which may enable it to make such a determination …."

24. Miss Whitley referred us to a series of cases that have considered the question of proportionality in a number of contexts: *St Gobain Building Distribution Ltd* [2011] UKFTT 461 (TC) (*"St Gobain"*), *Eastwell Manor Ltd* [2011] UKFTT 293 (TC) (*"Eastwell Manor"*), *HMRC v Facilities Maintenance Engineering Ltd* [2006] STC 1887 ("FAME") and *R King* [2010] UKFTT 79 (Ch). We were also given a copy of a schedule which appears as an appendix to the *St Gobain* case, setting out a total of seven cases which dealt with proportionality. The first of these was *Greengate Furniture Ltd v Customs & Excise Commissioners* [2003] VATTR 178, Decision 18280 (*"Greengate");* the others, including *Enersys,* were cases heard by the Tribunal which does seem to suggest that the Tribunal's power to hear arguments over proportionality is becoming well established.

25. We have considered carefully the cases that Miss Whitley cited. We would observe in relation to the four cases referred to in the previous paragraph:

(1) *St Gobain:* this was an appeal against a 2% VAT default surcharge, the penalty being £50,089 for a few days delay. Judge Poole had no difficulty in holding that the tribunal should consider proportionality: at [14] he commented that "....an individual surcharge may be struck down by the Tribunal as disproportionate if it is found to be 'not merely harsh but plainly unfair'."

(2) *Eastwell Manor:* this case was similar to *Enersys,* being concerned with a VAT default surcharge. The surcharge was significant - £18,453.66 – and imposed for a short delay in payment. The Tribunal considered carefully the principles behind proportionality and had no difficulty in continuing to hear the case. The tribunal noted at [38] the case of *Gasus Dosier-und Fordertechnik GmbH v Netherlands* (Application 15375/89) [1995] 20 EHRR 403 ("*Gasus*") which included the comment that the Human Rights Act requires "...a reasonable relationship of proportionality between the means employed and the aim pursued".

(3) *FAME:* this was an appeal against the cancellation of a CIS gross payment certificate, a penalty that the company argued was too severe. The General Commissioners had found the company's failure as 'minor and technical' and thus cancelled the penalty as disproportionate. Park J held (following cases such as *Shaw v Vicky Construction* [2002] STC 1544) that the company's failures could not be regarded as minor and technical and so reversed the Commissioners' decision. He commented at [33] that "...whether the rules are reasonable or

unreasonable, they are undoubtedly rules which Parliament has laid down, and neither the Commissioners nor the Courts on appeal have any power to dispense a company, with whose case they sympathise, from the consequence of them." Park J's comments are strictly *obiter* but we pay due regard to them. However, we think the learned judge was making a rather different point: that neither the Tribunal nor the Courts can vary the penalty that Parliament has laid down if the system does not give them the power to do so. We agree: but what we are considering here is the overriding power (and indeed duty) that European law gives us.

(4) *R King:* this was a CIS penalty case, with the taxpayer appealing against a penalty of £17,600 when all the tax due had eventually been paid. The case was a paper one so the Tribunal had no oral submissions to consider. Judge Coverdale noted that ...proportionality is not an issue that is relevant to the question of reasonable excuse...." We agree: it is a separate issue.

26. In *Greengate,* the VAT & Duties Tribunal held at paragraphs 75 & 76:

> **"75.** We start by observing that the issue of proportionality in this case is one of Community Law, as in *Customs and Excise Commissioners v P&O Steam Navigation* [1992] STC 809. If the Tribunal concludes that the surcharges imposed in the present case were incompatible with the principle of proportionality under Community Law, it is the duty of the Tribunal to disapply the domestic legislation in this case.
>
> **76.** This is wholly different from the power of the Courts to make a declaration of incompatibility under the Human Rights Act. The Tribunal has no such power. However, the responsibility of the Tribunal under Community Law, when relevant, is in effect wider."

We consider this to be important distinction. What it means is that, as in *Enersys,* the duty of the court or tribunal to intervene in cases where Community law is relevant is founded on Community law principles and any limitations on that jurisdiction that might apply under the Human Rights Act are not in point. There is accordingly no need for us to examine whether this tribunal is or is not an "appropriate court or tribunal" within s 4 of the 1998 Act; the jurisdiction is conferred, not by that Act, but by the Community law principles we have described.

27. Miss Whitley also referred us to the case of *Barnes v Hilton Main Construction* [2005] EWHC 1355 (Ch) (*"Hilton")*. In this case the Inland Revenue appealed against a decision by the General Commissioners that the Revenue's decision to withdraw Hilton's CIS (construction industry scheme) gross payment status was disproportionate. In his judgment, Lewison J said at paragraph 23 that:

> "In those circumstances I consider that the General Commissioners' application of a test of proportionality was not a test that the legislation allowed them to apply."

28. Miss Whitley argued that this was a clear statement to the effect that this Tribunal does not have jurisdiction over proportionality appeals. We do not agree.

29. The first point is that Lewison J was not considering a jurisdictional question. He was considering whether the General Commissioners had applied a test of proportionality, which, as a matter of law, they were not entitled to apply. That is not a question of jurisdiction; it is whether there has been an error of law in the exercise of a jurisdiction. Mr Justice Lewison concluded that, as the CIS scheme as a whole was not "devoid of reasonable foundation" (adopting the phraseology employed by the European Court of Human Rights in *Gasus* and in *National and Provincial Building Society v United Kingdom* [1997] STC 1466), no Convention right could have been infringed. There was accordingly no recourse to the Human Rights Act and the decision of the General Commissioners was thus legally flawed. It was not held to have been outside the scope of its jurisdiction.

30. Secondly, whilst *Hilton* is binding on the Tribunal on the question of the application of Convention rights, including the application of the principle of proportionality, in cases concerning the CIS gross payment status, it has no such binding effect in relation to cases concerning the VAT default surcharge. It is no doubt for that reason that no reference to it was made in *Enersys*.

31. In our view, the correct approach is that adopted in *Enersys*, and earlier in *Greengate*, namely that the Tribunal has not only jurisdiction, but a duty, to intervene if the Community principle of proportionality is infringed. We do not accept Miss Whitley's argument that a proportionality challenge is about the consequences of the proper application of the law and not about the validity of UK law of the decision itself, and that consequently this is a matter of administrative law and can only be considered by way of judicial review. We do not consider the distinction this attempts to draw is a valid one even under domestic law, as this is not a matter of an administrative or executive decision of HMRC, but the construction and application of UK law that has its origin in EC Directives and is subject to the principles of Community law. But in any event it is clearly contrary to what the Court of Justice said in *Garage Molenheide*, which formed the basis of the Tribunal decision in *Enersys*.

32. For all these reasons, we hold that we do have power to hear this appeal on proportionality, and we dismiss HMRC's application to strike it out.

Proportionality: the substantive issue

33. We now turn to the question of whether the penalty levied in this case is, in the circumstances, disproportionate.

34. The default surcharge regime is laid down in section 59 of the Value Added Tax Act 1994 ("VATA"). This prescribes, so far as is material to this appeal:

> **59 The default surcharge**
>
> (1) Subject to subsection (1A) below, 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.

(1A) A person shall not be regarded for the purposes of this section as being in default in respect of any prescribed accounting period if that period is one in respect of which he is required by virtue of any order under section 28 to make any payment on account of VAT.

(2) Subject to subsections (9) and (10) below, subsection (4) below applies in any case where—

(*a*) a taxable person is in default in respect of a prescribed accounting period; and

(*b*) the Commissioners serve notice on the taxable person (a "surcharge liability notice") specifying as a surcharge period for the purposes of this section a period ending on the first anniversary of the last day of the period referred to in paragraph (*a*) above and beginning, subject to subsection (3) below, on the date of the notice.

(3) If a surcharge liability notice is served by reason of a default in respect of a prescribed accounting period and that period ends at or before the expiry of an existing surcharge period already notified to the taxable person concerned, the surcharge period specified in that notice shall be expressed as a continuation of the existing surcharge period and, accordingly, for the purposes of this section, that existing period and its extension shall be regarded as a single surcharge period.

(4) Subject to subsections (7) to (10) below, if a taxable person on whom a surcharge liability notice has been served—

(*a*) is in default in respect of a prescribed accounting period ending within the surcharge period specified in (or extended by) that notice, and

(*b*) has outstanding VAT for that prescribed accounting period,

he shall be liable to a surcharge equal to whichever is the greater of the following, namely, the specified percentage of his outstanding VAT for that prescribed accounting period and £30.

(5) Subject to subsections (7) to (10) below, the specified percentage referred to in subsection (4) above shall be determined in relation to a prescribed accounting period by reference to the number of such periods in respect of which the taxable person is in default during the surcharge period and for which he has outstanding VAT, so that—

(*a*) in relation to the first such prescribed accounting period, the specified percentage is 2 per cent;

(*b*) in relation to the second such period, the specified percentage is 5 per cent;

(*c*) in relation to the third such period, the specified percentage is 10 per cent; and

(*d*) in relation to each such period after the third, the specified percentage is 15 per cent.

(6) For the purposes of subsections (4) and (5) above a person has outstanding VAT for a prescribed accounting period if some or all of the VAT for which he is liable in respect of that period has not been paid by the last day on which he is required (as mentioned in subsection (1) above) to make a return for that period; and the reference in subsection (4) above to a person's outstanding VAT for a prescribed accounting period is to so much of the VAT for which he is so liable as has not been paid by that day.

> (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—
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> (*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).

35. Both parties referred us to the *Enersys* case. This, and *Greengate*, give a full discussion of the legislative history and case law development around the default surcharge and we do not repeat it.

36. Miss Whitley's case was in essence that the *Enersys* decision was exceptional and dependent on its own facts and circumstances. The appendix from the *St Gobain* case, she argued, supported this contention.

37. Mrs Kay stressed that the cause of this late payment was a simple mistake, similar to *Enersys*. She distinguished *Eastwell Manor* as in that case the late payment was, as the tribunal put it at para 49, deliberate:

> "…the company paid its VAT late in full knowledge that it would be received late by HMRC…"

38. The reason that Eco paid its VAT so close to the due date was, according to Mrs Kay, that it was in difficulties over cash flow and was up to the limit on its overdraft.

39. To decide the current case, the Tribunal needs to consider, in the context of the principles that can be derived from the decided cases, whether the penalty levied on Eco was disproportionate to the gravity of its default. In *Enersys*, Judge Bishopp identified a number of features of the default surcharge system which have led to criticism. Those features were considered by the tribunal in *Eastwell Manor* in determining whether the penalty levied on the company in that case was disproportionate to the gravity of its offence. The tribunal in *Eastwell Manor* summarised those factors as follows:

(1) Whether the default was innocent or deliberate

(2) The number of days of the default

(3) The absolute amount of the penalty

(4) The "inexact correlation of turnover and penalty"

(5) The absence of any power to mitigate.

As well as these factors, in *Enersys* Judge Bishopp also made reference to the absence of any upper limit to the penalty.

40. It is clearly right to test the circumstances of any particular case by reference to elements of a penalty regime that might operate unfairly in certain cases. This summary of those perceived elements is helpful, but it should not be regarded as exhaustive, or in any way as a checklist. In the consideration of the issue of proportionality, each case must be considered by reference to its own facts and circumstances, and all of those circumstances must be taken into account.

41. In *Enersys*, the late payment resulted from a mistake: in essence, the person responsible for the VAT payment, relatively new to that role, confused two companies in the group which had differing VAT due dates. The VAT was paid over one day late. Here the situation is different. We accept that Mr Harrap waited until he was sure he had sufficient funds in Eco's bank account to cover the VAT payment in full, but he knew that a BACS payment was not guaranteed to give value to the recipient on the day of payment even though he made the payment commendably early in the day.

42. Mr Harrap's comment to the effect that had he realised that the payment would not go through on the day then he would have paid earlier does not assist Eco. BACS is well established and is the system that Eco has used for some time so he must have been familiar with its operation. Although therefore we accept that the late payment was not deliberate in the manner of the payment in *Eastwell Manor*, nor can it be described as a mistake of the type of that in *Enersys.*

43. The payment was late, but the number of days late was, as in *Enersys* and *Eastwell Manor,* minimal. As we have noted above, it is not established whether the payment was received one or two days late but that does not matter: the delay was minor. The criticism of the regime in this respect is that the penalty is the same no matter how long the delay. A minor delay of one or two days is therefore a factor to weigh in the balance.

44. The absolute amount of the penalty is undoubtedly high in relation to the minimal lateness involved. However, it could have been reduced significantly by paying over most of the VAT due earlier in the week. As we noted from the company's bank statement, funds were available to do so: some £15,000 could have been paid over in good time. The shortness of the period of delay must be seen in that context.

45. The correlation to turnover is rather influenced by the nature of the business. As Judge Bishopp said in *Enersys* at paragraph 24:

> "The correlation between the size of the trader and the size of the penalty is far from exact. For example, two manufacturers may have similar levels of turnover and profit, but if the major cost component of the products of one is attributable to standard-rated raw materials, he will have a smaller exposure than the other, whose product has a high labour content, since the former will, and the latter will not, have a large amount of input tax to set against his output tax, leaving a

> smaller net liability—the penalty being assessed by reference to the net liability. And a repayment trader (that is, one whose input tax consistently exceeds his output tax) is never exposed to a monetary penalty."

46. Here the penalty is barely 0.25% of Eco's turnover. (We assume, in the absence of evidence to the contrary, that all of Eco's sales were subject to VAT and so their turnover in the accounts is the same as their 'VATable' turnover.) Mrs Kay acknowledged that the penalty was tiny in relation to turnover but pointed to the very narrow margins that the company operates. Looking at the accounts for the year to 31 July 2011, these show a profit of only £7,580, meaning the penalty is nearly 23% of the year's profits. In these terms the penalty is clearly significant. However, proportionality is not something that can be considered by reference to any single measure. Where different measures give different results it will be for the Tribunal to determine what weight to give to each one. As regards a measure based on profits, this is unlikely to be as relevant as one based on turnover. Profits are apt to fluctuate (as indeed they did in this case) and may have little correlation to turnover and thus to the VAT liability (which is based on taxable turnover). We consider that in a case of this nature, the more reliable comparison is with turnover..

47. We take into account the absence of a power to mitigate. It was accepted by both parties that the system is an automatic one with no inbuilt mitigation power. The absence of such a power, whilst a factor, does not have any special impact in a particular case. It merely means the proportionality of the system must be considered in that context.

48. In assessing whether, taking account of all the circumstances, the penalty levied on Eco in respect of its default was disproportionate, , we do so against the test for proportionality as set out in *International Transport Roth GmbH v Home Secretary* (2003 QB 728). In that case, relied upon by Judge Bishopp in *Enersys,* Simon Brown LJ said at [26] & [27]:

> "[26] … it seems to me that ultimately one single question arises for determination by the court: is the scheme not merely harsh but plainly unfair so that, however effectively that unfairness may assist in achieving the social goal, it simply cannot be permitted? In addressing this question I for my part would recognise a wide discretion in the Secretary of State in his task of devising a suitable scheme, and a high degree of deference due by the court to Parliament when it comes to determining its legality. Our law is now replete with dicta at the very highest level commending the courts to show such deference. I take as a single example what Lord Bingham of Cornhill said in *Brown v Stott* [2003] 1 AC 681 at 703:
>
> > 'Judicial recognition and assertion of the human rights defined in the Convention is not a substitute for the processes of democratic government but a complement to them. While a national court does not accord the margin of appreciation recognised by the European Court as a supra-national court, it will give weight to the decisions of a representative legislature

> and a democratic government within the discretionary area of judgment accorded to those bodies …'
>
> [27] That said, the court's role under the 1998 Act is as the guardian of human rights. It cannot abdicate this responsibility. If ultimately it judges the scheme to be quite simply unfair, then the features that make it so must inevitably breach the Convention."

Although the observations of Simon Brown LJ and Lord Bingham were made in the context of the Convention rights, we take the view, as did Judge Bishopp in *Enersys*, that in their application in this respect Convention and Community rights are indistinguishable for practical purposes. Those observations are accordingly equally applicable to the application of the Community principle of proportionality in a default surcharge case such as this.

49. We also note the comments of Waller LJ in *R (Federation of Tour Operators) v HM Treasury* [2008] STC 2524 at [32], that to strike a provision down it must be "devoid of reasonable foundation", a phrase derived from observations made by the ECHR in *Gasus*.

50. The test of "not merely harsh but plainly unfair" does, as the tribunal put it in *Eastwell Manor* at paragraph 41 "…set[s] a high threshold before a court or tribunal can find that a penalty, correctly levied on the taxpayer by statutory provisions set by Parliament should be struck down as disproportionate." We agree with this observation.

51. In considering the proportionality of a penalty for an individual default, it is also important not to overlook the default history which, in the case of the default surcharge regime, increases the rate at which the penalty is levied. In principle, and subject of course to the detail of any particular regime, such an escalation of penalties for continuing defaults, especially where the clock can be reset if defaults cease for a 12-month period, would not of itself generally be considered disproportionate. In this case Eco's defaults in the surcharge liability period resulted in the penalty being levied at the 10% rate. This, together with the amount of VAT subject to the default, governs the amount of the penalty. That amount, as we have described was a very small fraction of Eco's turnover. The delay in payment may have only been for a few days, and not deliberate, but nor was it the product of a mere mistake of the nature of that in Enersys.

52. Accordingly, in the context of the wide margin of appreciation afforded to the state in these matters, and the high threshold and, as described in *Enersys*, exceptional circumstances that need to be present for a court or tribunal to strike down an individual penalty, we conclude that the surcharge in this case, whilst it may be considered harsh if viewed only in terms of the length of delay in HMRC receiving the funds, was not in all the circumstances "plainly unfair" or "devoid of reasonable foundation".

Conclusion

53. In summary, we find that:

(1) The default surcharge in question has been properly levied in relation to the late payment by Eco-Hygiene Ltd for the period to 30 September 2010.

(2) The Tribunal does have jurisdiction to consider proportionality in such cases.

(3) The resulting penalty was not, however, disproportionate.

54. We therefore dismiss the appeal and confirm the surcharge of £1,712.52.

Application for permission to appeal

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.

ROGER BERNER

TRIBUNAL JUDGE
RELEASE DATE: 21 NOVEMBER 2011