



TC03688

Appeal number TC/2014/02162

Value added tax – default surcharge – nine days’ late payment – proportionality of penalty – Total Technology decision – appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

ESSEX ELECTRICAL WHOLESALERS (BRAINTREE) LTD

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE MALACHY CORNWELL-KELLY
MRS SONIA GABLE ATII**

Sitting in public at Portal House, 27 Southway, Colchester, Essex on 2 June 2014

Mr Barry Magowan, Managing Director, for the taxpayer company

Mr Philip Rowe of HM Revenue and Customs for the Crown

DECISION

Introduction

1 This appeal concerns a default surcharge of £2,675.81 for the period 10/13, at 5% of
5 the tax paid late.

Facts

2 The surcharge history of the appellant shows that defaults occurred in periods 10/12
and 07/13, as well as that under appeal in respect of 10/13. The first default
occasioned simply the issue of a surcharge liability notice commencing the surcharge
10 regime; the second default resulted in no monetary impact, because the amount of the
surcharge was less than £400 and was not therefore collected. The surcharge for
period 10/13 is thus the first to impact financially on the company, but in each of the
first two cases the company would have been notified of the defaults and their
significance in the surcharge system, namely that the progressive increase in the
15 penalties from 2% to 5% to 10% was in principle operating.

3 The due date for the payment in respect of the 10/13 quarter was 30 November
2013, extended in the case of electronic payments by seven days to 7 December. The
payment was actually made by the Faster Payments System on 16 December. This
was the company's best quarter of the year in financial terms, so the tax-related nature
20 of the penalty meant that it was particularly painful. There were two grounds of
appeal: reasonable excuse based on an employee's indisposition, and proportionality.

4 In relation to the first ground, the unhappy circumstance which occurred was that an
employee, Mrs Lizzie Burrell, who was the accounts manager, had suffered a
miscarriage of twins to whom she was expecting to give birth. Mrs Burrell was
25 assisted by two junior clerks who in her absence could not manage on their own, and
Mr Magowan stepped in himself to make up for it and to keep Mrs Burrell's place
open for her if she wanted to return to work. Mr Magowan accepted however that the
connection between Mrs Burrell's absence and miscarriage, and the late payment, was
"loose" and he was unable to give precise dates relating to it; the problem had
30 essentially been one of human error in that he had overlooked the matter himself,
while if Mrs Burrell had been in the office the mistake would not have occurred.

5 Mr Magowan said that the company faced stiff competition in its sphere and that he
worked seven days a week to survive; in the sector in which he traded, he allowed
customers between 30 and 60 days' credit terms, which often meant that at the end of
35 a quarter he was to some extent paying the tax against money which he had not yet
received – though in this instance there had not in fact been a cashflow problem. Mr
Magowan added that he had found officials to whom he had explained his position
after the surcharge had been assessed unhelpful, and unable to exercise any discretion.
This was Mr Magowan's principal complaint, that the penalty was out of proportion
40 to the default, and that he was left with a feeling of injustice: if he had paid the tax
three months late, the penalty would have been the same; as it was, it equated to an
APR of 202.77% which Mr Magowan said was extortionate.

6 The turnover of the appellant company at this period Mr Magowan estimated at between £4,000,000 and £5,000,000 per annum, with a net profit rate of about 3-4% - giving at lowest about £120,000 per annum, or £30,000 per quarter.

5 7 In relation to the issue of proportionality, Mr Rowe drew our attention to the decision of the Upper Tribunal in *Total Technology* as to the First-tier Tribunal's powers, which we cite below. For the rest, Mr Rowe submitted that the evidence disclosed no 'reasonable excuse' within the meaning of the legislation and that the circumstances of Mrs Burrell's absence were such that the directors could, and did, make alternative provision for the discharge of her duties, but that in the event the
10 lateness was down to pure human error.

Legislation

8 The Value Added Tax Act 1994 provides:-

59 The default surcharge

15 (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
20 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
25 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;
30 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)
35 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
40 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—

45 (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 (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—

10 (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

15 (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.

20 (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—

25 (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

30 (b) there is a reasonable excuse for the return or VAT not having been so despatched,

35 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).

(8) For the purposes of subsection (7) above, a default is material to a surcharge if—

40 (a) it is the default which, by virtue of subsection (4) above, gives rise to the surcharge; or

45 (b) it is a default which was taken into account in the service of the surcharge liability notice upon which the surcharge depends and the person concerned has not previously been liable to a surcharge in respect of a prescribed accounting period ending within the surcharge period specified in or extended by that notice.

(9) In any case where—

50 (a) the conduct by virtue of which a person is in default in respect of a prescribed accounting period is also conduct falling within section 69(1), and

(b) by reason of that conduct, the person concerned is assessed to a penalty under that section,

the default shall be left out of account for the purposes of subsections (2) to (5) above.

5 (10) If the Commissioners, after consultation with the Treasury, so direct, a default in respect of a prescribed accounting period specified in the direction shall be left out of account for the purposes of subsections (2) to (5) above.

(11) For the purposes of this section references to a thing's being done by any day include references to its being done on that day.

71 *Construction of sections 59 to 70*

10 (1) For the purpose of any provision of sections 59 to 70 which refers to a reasonable excuse for any conduct—

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

15 (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.

(2) In relation to a prescribed accounting period, any reference in sections 59 to 69 to credit for input tax includes a reference to any sum which, in a return for that period, is claimed as a deduction from VAT due.

Conclusions

20 9 It is well established that if a surcharge complies with the statutory requirements in the circumstances of the case, it must be upheld and any indulgence or mitigation is a matter for the commissioners alone or, in exceptional cases, for judicial review; parliament has given the tribunal no power to reduce or mitigate default surcharges. That said, the decision of the Upper Tribunal in *Total Technology (Engineering)*
25 *Limited v. RCC* [2012] UKUT 418 (TCC) does acknowledge that the tribunal at this level may strike down penalties if they are clearly out of all proportion to a default,

10 The decision in *Total Technology* was an exhaustive review of the law on this subject, and a case in which the appeal failed. In the context of the approach to be taken to the principle of proportionality in connection with the default surcharge
30 regime, the Upper Tribunal observed at [97] -

At the individual level, however, the question is whether the actual penalty is disproportionate in all of the circumstances and not whether there is a power to mitigate. The relevance of a power to mitigate is that an unreasonable
35 penalty can be reduced and the question of proportionality of the penalty then falls to be answered by reference to the penalty as mitigated. Accordingly, we do not consider that the absence of a power to mitigate a penalty renders the regime non-compliant with the principle of proportionality. It is the level of the penalty, if anything, which will bring about that result.

40 11 At [99] the parameters of the first-tier tribunal's discretion in the matter are set out —

45 In our judgment, there is nothing in the VAT default surcharge which leads us to the conclusion that its architecture is fatally flawed. There are, however, some aspects of it which may lead to the conclusion that, on the facts of a particular case, the penalty is disproportionate. But in assessing

5 whether the penalty in any particular case is disproportionate, the tribunal
must be astute not to substitute its own view of what is fair for the penalty
which Parliament has imposed. It is right that the tribunal should show the
greatest deference to the will of Parliament when considering a penalty
10 regime just as it does in relation to legislation in the fields of social and
economic policy which impact upon an individual's Convention rights. The
freedom which Parliament has in establishing the appropriate penalties is
not, we think, necessarily exactly the same as the freedom which it has in
accordance with its margin of appreciation in relation to Convention rights
(and even there, as we have explained, the margin of appreciation will vary
depending on the right engaged).

12 In regard to the circumstances of the case then under appeal, the Upper Tribunal
noted at [101] and [102] –

15 Nor, on the facts of the present case, do we consider that the penalty imposed
on the Company is disproportionate in the sense that its imposition is a breach
of EU law and in particular of the principle of proportionality. The Company's
essential complaint is that the amount of the penalty is unfair. It is unfair
because of the following factors:
20 a. the payment was only one day late;
b. the previous defaults had been due to errors which were innocent, even if
the Company could not establish a reasonable excuse for them;
c. the Company had an excellent compliance record prior to the first of the
defaults leading to the penalty;
25 d. the amount of the penalty represents an unreasonable proportion of the
Company's profits.

Each of those factors falls within one of the heads of complaint which we have
addressed. None of those complaints results in the default surcharge being
non-compliant with the principle of proportionality; nor, in our view, do they
30 have that result even if taken collectively. At the level of the Company, the
amount of the penalty has been arrived at by applying a rational scheme of
calculation which involves no breach of the principle of proportionality. That
amount cannot, even if looked at in isolation, be said to be disproportionate in
the sense of giving rise to a breach of the principle of proportionality. And
35 even if the penalty is more than would be imposed if it were a matter for the
decision of a tribunal, the amount of the penalty does not approach the sort of
level which Judge Bishopp described as unimaginable in *Energysys*.

13 In *Total Technology*, the penalty being appealed was £4,260.26; annual profits
40 were "around £50,000", which suggests quarterly profits of £12,500 making the
surcharge in that case 34% of the quarterly profit, contrasting with the 9% which is
likely to be the highest which can be claimed in the present case. In regard to the
claim of the lack of proportionality in the surcharge, therefore, it is clear that this case
is a long way off the percentage which the penalty bore to the profits in *Total*
45 *Technology* and where the taxpayer was, even so, unsuccessful.

14 In the outcome, no reasonable excuse within the meaning of the legislation has
been established and, given the very limited powers which parliament has allowed to
the tribunal, we regret that the appeal cannot succeed.

15 This document contains the 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 no later
5 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.

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**MALACHY CORNWELL-KELLY
TRIBUNAL JUDGE**

RELEASE DATE: 5 June 2014