TC03739

Appeal number: TC/2013/04486

VAT – Default surcharge – Payment on Account Regime - VATA 1994 Section 59A - whether penalty of £33,453 proportionate for failure to pay £1.67 million less than one day late where company profits in excess of £6 million - yes – Appeal refused.

FIRST-TIER TRIBUNAL
TAX CHAMBER

EDGEN MURRAY EUROPE LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE W RUTHVEN GEMMELL,WS
MR IAN M P CONDIE, CA

Sitting in public at George House, 126 George Street, Edinburgh on 6 May 2014

Jonathan McGarrity and Andrew Ramage for the Appellant

Elizabeth McIntyre, Officer of HMRC, for the Respondents

DECISION

1. This is an appeal against a decision by the Commissioners for HM Revenue & Customs ("HMRC") who applied a 2% default surcharge amounting to £33,453 against Egden Murray Europe Limited ("EME") in respect of a payment due on 31 January 2013 for a total of £1,672,658 but which was received on 1 February 2013.

Legislation

VATA 1994, ss59, 59A, 76, 77, 80 and 83

Council Directive 2006/112/EC, Art 273

Case References

Greengate Furniture Ltd v *Customs and Excise Comrs* [2003] V&DR 178 (VAT Decision 18280) (*"Greengate Furniture")*

Sony Ericsson Mobile Communications AB v *HMRC* (2007) VAT Decision 20513 (*"Sony Ericsson")*

Enersys Holdings UK Ltd v *Revenue and Customs Commissioners* [2010] UKFTT 20 (TC); [2010] SFTD 387 (*"Enersys Holdings"*)

Revenue and Customs Commissioners v *Total Technology (Engineering) Ltd* [2012] UKUT 418 (TCC); [2013] STC 681 (*"Total Technology")Trinity Mirror Plc v Commissioners of H M Revenue and Customs* [2014] UKFIT 355 (TC)

Evidence and Finding of Facts

2. EME is a global supplier of steel and other products and carries on business at Newbridge Industrial Estate, Newbridge, Midlothian. In its financial year which ended in 2012, it had a turnover of approximately £120 million and profits, after tax, of between approximately £6 million and £7 million.

3. EME had been in the Default Surcharge Regime from the period of 06/12 onwards and had received a Surcharge Liability Notice on 21 August 2012. The reason for this was because a payment due on 31 July 2012 made by CHAPS did not reach HMRC until 1 August 2012 because the payment had been authorised late by EME on 31 July 2012, after their bank's 1530 cut off time for same day payments.

4. EME is in the Payment on Account Scheme as it has an annual VAT liability of more than £2.3 million. This involves making interim payments at the end of the second and third month of each quarter and a balancing payment at the end of the quarter along with submitting the VAT return. Payments on account and balancing payments must be made electronically. For surcharge purposes, all late payments are added together and the surcharge based on the total amount paid late.

5. The payment under appeal for the period 12/12 was due on 31 January 2013, and was received on 1 February 2013 via the CHAPS payment system. The CHAPS payment was fully authorised at 1811 on 31 January 2013, after EME's bank's deadline for same day CHAPS payments of 1530, which the bank processed at 0446 on 1 February 2013 so HMRC received the payment approximately 4 hours and 46 minutes after the deadline.

6. The 12/12 VAT return was submitted on time as were the previous payments on account on 30 November and 31 December 2012. According to the evidence of EME's Tax Manager, Mr Ramage, these payments were made by direct debit but the Schedule of Defaults submitted to the Tribunal stated these were paid by CHAPS. A consequence of this was that any default within the Default Surcharge period, that is until 30 June 2013, would attract a penalty of 2% of the unpaid tax.

7. Liability to default surcharges in this case arise under the provisions of Section 59A of the VAT Act 1994. HMRC regarded the payment as having been received after the due date.

8. By letter dated 11 March 2013, EME wrote to HMRC advising that EME had set up the payment to HMRC to be transferred on 31 January 2013, "but unfortunately our finance director second authorised the payment after the banking deadline meaning that you did not receive the funds until 1 February. In the past we have always paid our VAT return payments and payments on account on time".

9. HMRC replied on 15 April 2013, stating that EME did not have a reasonable excuse for the default stating that "Whilst your comments are noted we must advise that, as a limited company registered for VAT, it is ultimately the directors responsibility to be (*sic*) ensure that all payments are made on time as per the "'Payment on Account' Schedule issued to the business".

10. EME wrote on 23 April 2013 to HMRC stating that the payment was processed at 0446 on 1 February 2013 and that they felt the penalty of £33,453 was disproportionate to the infringement, "given that the delay in HMRC receiving the funds was only 4 hours and 46 minutes and the fact that we have got an excellent compliance history".

11. The statement from HSBC evidencing the timing of payments, as noted above, was submitted to the Tribunal.

12. On 19 June 2013, HMRC wrote to EME stating that they would not carry out a further review as "only one review for each decision under dispute is permitted and this has already occurred as communicated to you in my colleague's letter dated 15 April 2013 (Copy enclosed)".

13. As a result of the delay in HMRC replying and some dubiety about whether a further review could take place, EME's appeal to the Tribunal was late. HMRC had no objections to the late appeal which was accepted by the Tribunal as being made on time.

HMRC's Submissions

14. HMRC say that it is a matter of fact whether a VAT return or payment is submitted after the due date.

15. VAT return forms for the period 12/12 were received on 31 January 2013 and payments on accounts for November and December 2012 were made on time but the balancing payment in respect of the VAT return for the period 12/12 was received on 1 February 2013 after the due date of 31 January 2013.

16. HMRC say that it is EME's responsibility to confirm with their bank what time or monetary limits are in place for making payments on the same day, either by Faster Payment Service or by the Clearing House Automated Payments System, respectively "FPS" and "CHAPS". EME made the CHAPS payment after the bank's published cut off time of 1530.

17. HMRC say that it does not matter whether a payment is made 365 days or hours after the due date, it is still late.

18. HMRC have no discretion to vary the level of surcharge and can only consider whether EME has a reasonable excuse for default. It is for EME to demonstrate that there is a reasonable excuse for the failure to submit or pay the VAT return by the due date and EME have failed to demonstrate that there is a reasonable excuse.

19. HMRC say that the onus of proof is on the Appellant once the Respondents have demonstrated that the payment of the VAT was after the due date and refer to the case of *Total Technology* in which the Upper Tier Tribunal deals with the proportionality of default surcharges.

20. HMRC say that the case of *Enersys Holdings* is a First-tier Tribunal Decision which is persuasive rather than binding. HMRC do not consider that the views expressed in that case, that a surcharge in individual cases could be disproportionate or that the absence of an upper limit is a flaw in the system is correct and believe that the Default Surcharge Regime is proportionate. Similarly, HMRC say that the case of *Trinity Mirror PLC* is also a First-tier Tribunal Decision and that it is persuasive rather than binding.

EME's Submissions

21. Mr McGarrity for EME set out the basis of the Default Surcharge Regime; its method of application by reference to HMRC Notice 700/50 and the consequences of the issuance of a Surcharge Liability Notice and a Surcharge Liability Notice Extension.

22. EME say that as there is no existing mechanism in UK legislation to authorise HMRC to reduce a default surcharge penalty and request that the penalty imposed on 20 February 2013 is extinguished.

23. EME say that the Appeals in *Total Technology* and *Enersys Holdings* were made with reference to the principle of proportionality and that their case is predicated on the same principle and requires to be considered on its own facts.

24. EME are not making a claim for reasonable excuse or reasonable expectation.

25. EME disagree with HMRC's view that there is "nothing fatally flawed" regarding the architecture of the Default Surcharge Scheme but, in any event, contend that the absence of "fatally flawed" does not inhibit the ability of a Tribunal to examine whether or not a penalty in question is proportionate.

26. EME also noted that Section 70(1) of VATA which allows HMRC to reduce penalties as they think proper, does not apply to Section 59A and, furthermore, that the value of the penalty is linked solely to the amount of VAT not paid; that there is no sliding scale; that there is an absence of flexibility and there is no upper limit.

27. EME highlighted a number of what they believed were significant issues in each of the cases of *Total Technology* and *Enersys Holdings* and, in relation to the latter, highlighted that the size of the penalty is not weighted to the specific infringement.

28. EME say the *Total Technology* Upper Tribunal Decision does not wholly override the First-tier Tribunal case in *Enersys Holdings* and, in particular, drew attention to Mr Justice Warren's assessment of the Default Surcharge Regime as regards possible areas of complaint for the taxpayer at paragraph 83 and possible advantages to HMRC and taxpayers at paragraph 84.

29. EME then highlighted Mr Justice Warren's assessment of each criticism of the regime and his statement:-

> "when considering a trader who is late and subject to a penalty which cannot be reduced even although his payment is only a single day late; the issue is whether the amount of the penalty is proportionate to the breach of the duty in being a single day late. At the level of the scheme, viewed as a whole, a penalty which is incurred as a result of a particular failure is entirely acceptable and compliant with the principle of proportionality provided the amount of the penalty for that failure (however innocent its cause) is itself proportionate to failure.
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> The Judgement continued:-
>
> "there is a real flaw at both the level of the regime viewed as a whole and potentially at the individual level of a taxpayer with a very large payment obligation because there is no maximum penalty".

30. This flaw is, EME say, established in both *Total Technology* and *Enersys Holdings* whilst acknowledging at the same time that the Tribunal must tread carefully when ruling on Parliamentary statute.

31. EME say that the decisions in *Total Technology* and *Enersys Holdings* by the Upper and First-tier Tribunals, respectively, recognise the importance of affording

Member States discretion as to how they implement their penal system, subject to any such system being applied within the parameters of proportionality and that, consequently, it is up to the Courts to make a value judgement as to whether the policy objectives sought by legislation are proportionate.

32. EME refer to the importance placed on the concept of fairness and examination of whether a penalty has gone further than is strictly necessary and say that in *Enersys Holdings*, Judge Bishopp cites a number of UK and community cases to support this position. EME believe, in this case, that HMRC has invoked a penalty that goes further than is necessary.

33. EME concede that the Upper Tribunal in *Total Technology* were less concerned with fairness *per se* but did endorse the approach of identifying whether a penalty had gone further than was necessary to prevent it being disproportionate to the gravity of the infringement notwithstanding that in implementation of a Penalty Regime, a wide margin of appreciation should be afforded to the State.

34. The Tribunal in *Total Technology* further crystallised the approach to proportionality by adopting, in their analysis of what is and is not proportionate, the concepts evinced by the Court of Justice of the European Union that a penalty should be neither excessive nor inadequate to achieve the prescribed quality objective and should not go beyond what is strictly necessary or further than is necessary and, where similar appropriate measures are available, the least onerous should be adopted.

35. EME contend that the penalty is excessive, has gone beyond what is necessary and, other measures being equal, does not represent the least onerous approach.

36. EME refer to Mr Justice Warren's comments in *Total Technology* that the absence of an upper limit does represent a flaw in the Default Surcharge Regime and say that the penalty under appeal would exceed any upper limit where that limit aims to reflect proportionality in line with the gravity of the infringement.

37. EME contend that they have no reasonable excuse and that the Default Surcharge Regime as a whole does not offend the proportionality principle but that that does not necessarily apply to all cases under the regime.

38. EME say that the Court can look at specific cases, mindful always of the margin of appreciation afforded to the State, in the implementation of a Penalty Regime and the intention of Parliament.

39. EME say that when judging proportionality, the penalty must be appropriate and necessary, not excessive nor inadequate; not go further than necessary; nor be more than strictly necessary and that, consequently, a lower penalty with a maximum amount would be effective without being inadequate.

40. EME say that "HMRC cannot hide behind the shield of material appreciation and effectiveness of the deterrent whilst watching the doctrine of proportionality being put to the sword".

41. EME also made reference to the case of *Trinity Mirror* whilst accepting that the case was still within the period in which it might be appealed. This case concerned a Default Surcharge Penalty of 2%, amounting to £70,906, which was held to be disproportionate to the infringement being paid one day late.

42. EME accept that this decision is persuasive but not binding on the Tribunal but is further recognition that there is a disconnection between penalties and offences. EME also noted that in *Trinity Mirror*, the VAT return was late as well as the payment.

43. EME say individual cases can be disproportionate and that the absence of an upper penalty limit is a flaw and that HMRC are cherry picking aspects from *Total Technology* and *Enersys Holdings* and ignoring certain aspects.

44. EME say that both the Upper Tribunal and the First-tier Tribunal in *Total* Technology and *Enersys Holdings* were clear that individual penalties could be disproportionate but that the scheme as a whole was good and that whilst no upper limit was a major flaw could lead to cases of disproportionality of which theirs is one such case.

Decision

45. The Tribunal considered whether the Default Surcharge Regime as a whole and the surcharge itself complied with community law and the principle of proportionality and whether the Penalty Surcharge Regime as a whole was proportionate.

46. The Tribunal felt a correct summary of this was succinctly set out by the Tribunal in the case of *Trinity Mirror* as follows –

> *Must the default surcharge regime as a whole and the Surcharge itself comply with the Community law principle of proportionality?*
>
> (1) As set out in the case of *Total Technology*, the default surcharge regime, being part of the UK implementation of the Sixth VAT Directive imposes obligations on traders to pay VAT and to make returns, is subject to compliance with the Community law principle of proportionality. In implementing such measures, the Member State must not go further than is suitable and necessary to attain the objects of ensuring the correct levying and collection of the tax. An obligation is placed on the national court to determine whether national measures are compatible with Community law.
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> (2) In the case of *Total Technology*, the Upper Tribunal stated that proportionality must be assessed at the level of the default surcharge regime as a whole and at the individual level by asking whether the penalty imposed on a particular taxpayer based on the facts of the case are proportionate.
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> The Upper Tribunal (in *Total Technology*) explained it as follows:

"[74] We turn then to the question whether proportionality is to be assessed at a high level, that is to say whether it is correct to view the default surcharge regime as a whole, recognising the possibility of its producing, in some cases, a disproportionate and possibly entirely unfair result; or whether proportionality is to be assessed at an individual level by asking whether the penalty imposed on a particular taxpayer on the particular facts of its case is disproportionate."

The Tribunal went on to say at paragraph 76, that:

"Even if the structure of the surcharge regime is a rational response to the late filing of returns and the late payment of VAT, it is, nonetheless necessary to consider the effect of the regime on the particular case in hand. It is necessary to do so not least because …a penalty must not be disproportionate to the gravity of the infringement …".

(3) This approach being suggested, as a point of law and consistent with other ECJ decisions, is binding on this Tribunal. In looking at the Surcharge, the Tribunal must therefore examine whether the measure in question and the manner in which it is applied by the taxing authority is proportionate. The Tribunal must therefore set aside the Surcharge if it decides that it is not proportionate. There is no power to vary the Surcharge. The Tribunal must also look to the particular taxpayer and determine whether the Surcharge is proportionate. This is borne out in the *Greek* case, where the Court explained that "the question whether the penalties applied are proportionate or disproportionate has to be assessed on the basis of the level of the penalties actually applied in the individual case". The penalty must not become an obstacle to the underlying aim of the directive since an excessive penalty "would impose a disproportionate burden on a defaulting trader and distort the VAT system as it applies to him."

47. The Tribunal (in *Trinity Mirror*) then considered: -

Is the particular Surcharge disproportionate?

(4) The Upper Tribunal in *Total Technology* examined the authorities in both Community law and Human Rights law and recognised that there are important differences. The Court recognised a "tension" between Convention rights (where the State was afforded a "margin of appreciation" which allowed most things to be done in furtherance of a legitimate objective provided it is not unfair) and cases concerned with the principle of proportionality in Community law (which precludes any furtherance of a legitimate objective other than by the imposition of measures which are "strictly necessary" for the objective pursued), but stated that there is no inconsistency between the two. Thus, whatever the "wide margin of appreciation" afforded to the UK by the human rights *jurisprudence*, the Surcharge must comply with the principle of proportionality in Community law. It must not go beyond what is "strictly necessary" for the objectives pursued.

(5) The Tribunal went on to say that the purpose of the default surcharge legislation is to realise "the failure to deliver a return and to make payment of tax owed by the due date … the penalty is for a failure to do something by a due date, not a penalty for continuing failure to put right the original default".

(6) The penalty regime looks at successive defaults during the Surcharge period and its aim is to impose higher penalties on a taxable person who defaults repeatedly than those who default less frequently. This suggests that the regime identifies the gravity of the particular infringement by reference to the number of times in the relevant Surcharge period that the taxable person has previously been in default and penalises that person according to the gravity so identified. There is, as it were, a hierarchy of seriousness of breaches.

48. The penalty in this case was £33,453. The penalty in *Enersys Holdings* was £131,881 and the penalty of £70,906.44 in the *Trinity Mirror* case both of which were declared to be disproportionate. The penalty in *Total Technology* was £4,260.26 and was found to be proportionate.

49. In terms of the case law put forward by EME, which the Tribunal accepted, the Tribunal is required to make a value judgement and consider what is proportionate. In doing so, the Tribunal should consider whether the penalty is (a) excessive, (b) adequate, (c) suitable (d) goes as far as necessary and no more and (e) whether it is at a level that is strictly necessary and no more.

50. The Oxford English Dictionary defines "proportionate" as being "appropriate in respect of quantity, extent, degree, etc"; and "appropriate" as "specially fitted or suitable, proper".

Period of time

51. The Tribunal considered the period of time over which an infringement takes place and concluded that this is clearly of some relevance in general terms but noted that Section 59A VATA provides a penalty regime that is not concerned with the length of the period of the default but merely with the fact that there is a default.

52. As Mr Justice Warren stated in *Total Technology*, when considering a penalty which could not be reduced even although it was a single day late, "the question is not whether it would be a more coherent regime (for the individual taxpayer) to have sequential penalties as time passes without the default being remedied. Rather it is whether the amount of the penalty for failure to file and pay by the due date is proportionate. If it is of an appropriate amount, then there is no need for a power to mitigate".

Business Turnover or Profitability

53. The Tribunal also considered whether the assessment of whether a penalty is proportionate or appropriate in respect of quantity, extent, degree etc, should be made by reference to the size of a business or its turnover or profitability.

54. In *Total Technology*, Mr Justice Warren, when considering HMRC's likely view of the Default Surcharge Regime, stated "the penalty is not a fixed sum but is geared to the amount of outstanding VAT. Although a somewhat blunt instrument it does bring about a broad correlation between the size of the business and the amount of the penalty" and "the surcharge is only imposed on a second or subsequent default and after the taxpayer has been sent a Surcharge Liability Notice warning him that he will be liable to a surcharge if he defaults again within a year. Taxpayers thus know their positions and should be able to conduct their affairs so as to avoid any default".

55. In *Total Technology*, it was also suggested that an imaginary flat rate penalty of £50,000, for a third default, would not be a permissible penalty for ordinarily small traders because there would be an illegitimate distortion of the VAT system and "it might then be said that the regime, viewed as a whole, is disproportionate to the legitimate aim pursued. But if a smaller flat target penalty were put in place – sufficiently small to be seen as not unfair to large or medium sized traders but still large enough to be manifestly unfair to smaller traders generally – it could not be said that the regime, viewed as whole, was disproportionate but it could probably be said that it was disproportionate so far as concerns the smaller traders".

56. The Tribunal in *Total Technology* concluded "the burden on a small trader for a penalty for failure to pay his VAT on time would bear more heavily than the same penalty imposed on a larger trader".

57. In this case, the Tribunal believe that the assessment of the proportionality of the amount of the penalty should take account of the profitability or assessment as to whether EME is a large, medium or small sized trader.

58. EME were aware or should have been aware, as a consequence of having received the Penalty Surcharge Liability Notice, that they were in a default period and, accordingly, that if they repeated the errors which led to the late payment of the 06/12 VAT liability due on 31 July 2012, they would suffer a 2% penalty. EME, however, repeated the very same error at the 12/12 payment date.

59. Mr Ramage stated at the Tribunal hearing, that he was unaware that the Assistant Finance Manager had failed to pay the 06/12 payment on time and, consequently, was also unaware, not only that the company had received a Surcharge Liability Notice, but also of the reasons why it had been issued, until after the Assistant Finance Manger had tried to reduce or remove the repeated default 2% penalty for the 12/12 late payment, some six months later.

60. The Company should have had in place procedures and policies whereby they were aware not only of late payments but receipt of any documentation or findings from HMRC. The Default Surcharge Regime is primarily there as a deterrent to stop the late payment of VAT. The infringement is the late payment of VAT (or the submission of late VAT returns although that is not applicable here).

61. EME is a large company and in the year ended 2012 made substantial profits and the first step of the Default Liability Surcharge Regime quite clearly failed to have any effect on its ability to make its subsequent VAT payments on time.

62. The Tribunal considered that late payment means late payment and that the company had no reasonable excuse.

63. EME in their submissions accepted that they should pay some penalty for late payment but, in reality, this means a nil penalty as the alternative is the penalty of £33,000 which they do not accept.

64. In *Trinity Mirror* the Tribunal referred to the Upper Tribunal's suggestion in *Total Technology* that a £50,000 penalty would be disproportionate in respect of a third default option but is qualified by saying "at least in a large number of cases".

65. In *Trinity Mirror*, the Tribunal referred to the issue of profitability in relation to "fairness" and referred again to the *Total Technology* decision (at paragraph 90) where the Upper Tribunal conceded that a system could be designed to take account of factors such as turnover, profitability, proportion of exempt or zero rated supplies but that had not been done. It stated "it is not immediately apparent to us why a penalty linked to profitability would be any fairer than a link to outstanding tax although some penalty regimes do have that result. It may be possible to design a system which brought into account many factors – turnover, profitability, proportion of exempt or zero rated supplies to name but three so as to produce a more sophisticated system which would produce a result that some people might perceive as more fair. The fact that that might be done, does not make the actual regime non compliant with the principle of proportionality".

66. Whether or not a penalty was linked to profitability, the Tribunal considered in this case on the facts, that a penalty of £33,453 for a company with profits in its financial year ended 2012 in excess of £6 million for late payments of £1.62 million for a second default, of which its senior management were unaware (as they were also unaware of being in a Surcharge Default Period at all), albeit less than one day late was (a) suitable, (b) adequate, (c) was not excessive and (d) was at a level that was necessary and no more than strictly necessary.

67. Consequently, the Tribunal considered that the penalty was proportionate and appropriate to the infringement and the appeal is refused.

68. 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.

W RUTHVEN GEMMELL
TRIBUNAL JUDGE

RELEASE DATE: 16 June 2014

Amended pursuant to Rule 37 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 on 18 June 2014.