



TC03843

Appeal number: TC/2014/00337

VAT default surcharge - VAT payment one day late - limit imposed by Appellants bank caused temporary insufficiency of funds - whether reasonable excuse - no - whether surcharges disproportionate - no - appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

RICHARD HATHAWAY LIGHTING LTD

Appellant

- and -

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

Respondents

TRIBUNAL: JUDGE MICHAEL S CONNELL

The Tribunal determined the appeal on 17 April 2014 without a hearing under the provisions of Rule 26 of the Tribunal Procedure (First-tier Tribunal)(Tax Chamber) Rules 2009 (default paper cases) having first read the Appellant's Notice of Appeal dated 10 January 2014 and HMRC's Statement of Case dated 5 February 2014, the Appellant submitting no Reply.

DECISION

The Appeal

1. Richard Hathaway Lighting Limited ('the Appellant') appeals against a default surcharge of £726.12 imposed by HMRC on 11 October 2013, in respect of the VAT period ended 31 August 2013, for its failure to submit, by the due date, payment of VAT due. The surcharge was calculated at 2% of the outstanding VAT due of £36,306.12
2. The point at issue is whether or not the Appellant has a reasonable excuse for making late payment.

Background

3. The Appellant has been in the VAT default surcharge regime from period 05/13.
4. The Appellant paid VAT on a quarterly basis. Section 59 of the VAT Act 1994 requires VAT returns and payment of VAT to be made on or before the end of the month following each calendar quarter. [Reg. 25(1) and Reg 40(1) VAT Regulations 1995.]
5. In respect of the default period, as payment was made by BACS the due date for payment was 7 October 2013. The return was received on time on 7 October 2013 and the VAT payment was made one day late on 8 October 2013. A penalty was levied in respect of the late payment which the Appellant appeals.
6. Section 59 Value Added Tax Act 1994 ("VATA") sets out the provisions in relation to the default surcharge regime. Under s 59(1) a taxable person is regarded as being in default if he fails to make his return for a VAT quarterly period by the due date, or if he makes his return by that due date but does not pay by that due date the amount of VAT shown on the return. The Commissioners may then serve a surcharge liability notice on the defaulting taxable person, which brings him within the default surcharge regime, so that any subsequent defaults within a specified period result in assessment to default surcharges at the prescribed percentage rates.
7. The specified percentage rates are determined by reference to the number of periods in respect of which the taxable person is in default during the surcharge liability period. In relation to the first default after the issue of a VAT Surcharge Liability Notice, the specified percentage is 2% and the percentage ascends to 5%, 10% and 15% for the second, third and fourth default.
8. A taxable person who is otherwise liable to a default surcharge, may nevertheless escape that liability if he can establish that he has a reasonable excuse for the late payment which gave rise to the default surcharge. Section 59 (7) VATA 1994 sets out the relevant provisions : -

'(7) If a person who apart from this sub-section would be liable to a surcharge under sub-section (4) above satisfies the Commissioners or,

on appeal, a Tribunal that in the case of a default which is material to the surcharge –

(a)

5 (b) there is a reasonable excuse for the return or VAT not having been so despatched then 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.

10 9. The onus of proof rests with HMRC to show that the surcharge was correctly imposed. If so established, the onus then rests with the Appellant to demonstrate that there was reasonable excuse for late payment of the tax. The standard of proof is the ordinary civil standard of the balance of probabilities.

Appellant's contentions

15 10. The Appellant does not dispute that its VAT payment for the period 08/13 was late.

11. The Appellant's stated grounds of appeal are that:

i. 'The surcharge is harsh as the payment was received in full only one day late.

20 ii. The only reason for the delay in payment was because limits imposed by the Appellant's bank, Lloyds Bank, were exceeded in the default period following payment of the company's Corporation Tax of £57,154.20 which meant that the Appellant could not pay its VAT until the limit was free again.'

HMRC's contentions

25 12. The Appellant entered the Default Surcharge Regime following a default in period 05/13. The Company then defaulted in the default period.

13. HMRC maintain that the surcharge in respect of the period 08/13 has been correctly issued in accordance with VATA 1994 s.59 (4), payment having been received after the due date.

30 14. The period 08/13 had a due date of 7 October 2013 for electronic payments and electronic VAT submission. The return was received on 7 October 2013 and payment was received one day late on 8 October 2013.

35 15. The potential financial consequences attached to the risk of further default would have been known to the Appellant after the first default, given the information printed on the Surcharge Liability Notice.

16. Included within the notes on the reverse of the Surcharge Liability Notice, is the following, standard, paragraph:

"Please remember: Your VAT returns and any tax due must reach HMRC by the due date. If you expect to have any difficulties contact either your local VAT office, listed under HM Revenue & Customs in the phone book as soon as possible, or the National Advice Service on 0845 010 9000'.

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17. The reverse of each notice details how surcharges are calculated and the percentages used in determining any financial surcharge in accordance with the VAT Act 1994 s 59(5).

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18. The requirements for submitting timely payments can in any event be found-

- In notice 700 "the VAT guide" paragraph 21.3.1 which is issued to every trader upon registration.
- On the actual website www.hmrc.gov.uk
- On the E-VAT return acknowledgement.

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19. With effect from the period 02/13 the Surcharge Liability Notices advise the trader of the percentage used to calculate the current surcharge, if one has been issued, and/or the percentage which will be used in calculating the surcharge for any subsequent default.

20. The grounds of appeal make it clear that the Appellant company was aware of the payment limit imposed on its bank account and could have contacted HMRC to seek an extension in the payment date, as soon as they realised that payment could not be made by the due date. Had the Appellant done so and a deferment agreed, then, in accordance with the Finance Act 2009 s108, no surcharge would have been imposed. There is no record of any such call being received by HMRC.

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21. During a subsequent telephone conversation with the Appellant company's Director, Mr Hathaway on 22 January 2014, it became evident that the monetary limit of £85,000 on transfers out of the Appellant's account, had been present for some time and that if funds had been paid into the account, the bank would have extended the period end date thereby allowing payment of the VAT to be made. It can only be concluded that no additional funds were paid into the account.

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22. Mr Hathaway also stated that he did not recall receiving any previous Surcharge Notice. However the Notice for the period 05/13 was not returned undelivered by Royal Mail and was issued to the company's principle place of business, which has not changed.

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23. HMRC maintain that the VAT Default Surcharge Notice was correctly issued in accordance with the VAT Act 1994 (VATA 1994) s.98 and that in accordance with the Interpretation Act 1978 s.7 the Notice is deemed to have been delivered unless

the contrary is proved. HMRC contend that the onus of proof in relation to this aspect rests with the Appellant and HMRC further contend that this onus has not been met.

24. The rates of surcharge are laid down in law, and neither HMRC nor the Tribunal have the power to reduce the amount because of mitigating circumstance.

5 25. HMRC maintain that the surcharge in respect of the period 08/13 has been correctly issued in accordance with VATA 1994 s.59 (4), payment having been received after the due date.

26. The Appellant says that the surcharge is unreasonable and disproportionate. HMRC do not accept that the surcharge is unreasonable in comparison to the Appellant's turnover being less than 0.01% of its quoted turnover of £93,285. The case of *Total Technology (Engineering) Limited v HMRC*, heard in the Upper Tribunal held that:

- 1) There is nothing in the architecture of the Default Surcharge system which makes it fatally flawed.
- 15 2) The VAT default penalty regime does not breach EU law on the principle of proportionality.
- 3) In order to determine whether or not a penalty is disproportionate, the Upper Tier Tribunal addressed the following factors:
 - 20 (a) The number of days of the default
 - (b) The absolute amount of the penalty
 - (c) The 'inexact correlation of turnover and penalty'
 - (d) The 'absence of any power to mitigate'

25 27. The Upper Tribunal Chamber President, Mr. Justice Warren and Judge Colin Bishopp decided that none of these leads to the conclusion that the Default Surcharge regime infringes the principle of proportionality. HMRC contend that the judgement supports HMRC's position that the default surcharge is in accordance with legislation and proportionate.

30 28. HMRC say that the penalty is in any event determined by the number of defaults and amount paid late. The penalty imposed is therefore commensurate with the default and unless devoid of reasonable foundation cannot be held to be unfair.

Conclusion

35 29. The burden of proof is on the Appellant to show that they have a reasonable excuse for the late payment of VAT for the period 08/13. Was there a reasonable excuse for the late payment? The Appellant was clearly aware of the due date for payments of its VAT and the potential consequences of late payment.

40 30. There is no statutory definition of 'reasonable excuse', which is a matter to be considered in the light of all the circumstances of the particular case. A reasonable

excuse is normally an unexpected or unusual event that is either unforeseeable or beyond the taxpayer's control, and which prevents them from complying with their obligation to pay on time. A combination of unexpected and foreseeable events may, when viewed together, be a reasonable excuse

5 31. The temporary insufficiency of funds suffered by the Appellant was entirely foreseeable. As HMRC say, the Appellant was aware of the payment limits on its bank account. As soon as they realised that payment could not be made by the due date they could have contacted HMRC to seek an extension in the payment date.

10 32. Accordingly, the Tribunal finds that, for the reasons given above, the Appellant has not shown a reasonable excuse for the late payment of VAT in period 08/13

15 33. The Appellant's other ground of appeal is that the surcharge is unfair, given that it was only one day late in making payment. As the Upper Tribunal said in *Total Technology*, there is nothing in the VAT default surcharge regime which leads to the conclusion that its architecture is fatally flawed or that it infringes the principle of proportionality. The Tribunal recognised that the VAT default surcharge legislation imposes a highly prescriptive regime with an inflexible table of surcharges laid down with no, or virtually no, discretion for HMRC to relieve a surcharge once imposed. It concluded however that there must be some upper limit on the penalty for a default which was proportionate, although it did not suggest what that might be, given that all the circumstances of the default must be taken into account.

20 34. The Tribunal said in *Total Technology* that it is open to Tax Tribunals to consider individual default surcharges but in assessing whether a 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. The Tribunal should show the greatest deference to the will of Parliament when considering the application of the VAT default surcharge scheme.

25 35. By way of further background to the Tribunal's reasoning in *Total*, the Tribunal referred to what Simon Brown LJ had said in *International Transport Roth GmbH v Home Secretary* [2003] QB 728 at [26], setting out the test for assessing proportionality –

30 (1) "... 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."

35 40 36. The Tribunal observed that the "not merely harsh but plainly unfair" test set a high threshold which must be surmounted before a Tribunal could find that a penalty,

correctly levied on the taxpayer by statutory provisions set by Parliament, should be struck down as disproportionate.

5 37. Although the Appellant regards the penalty as unfair, a 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 surcharge if he defaults again within a year. The taxpayer therefore knows his position and should be able to conduct his affairs so as to avoid any default. The penalty is not a fixed sum but is geared to the amount of outstanding VAT. The percentage applicable to the calculation of the penalty increases with successive defaults if they occur within 10 twelve months of each other.

15 38. In the case of *Energys Holdings UK Limited*, [2010] UKFTT 20 (TC) due to a human error, the relevant return was submitted, and payment made, one day late. This resulted in a 5% penalty amounting to just over £130,000. Judge Colin Bishopp held that the penalty was wholly disproportionate to the gravity of the offence. It was ‘not merely harsh but plainly unfair’ and in the absence of any justification it could not be saved by the State’s margin of appreciation. As he said, penalties must not go beyond what is strictly necessary for the objectives pursued and a penalty must not be so disproportionate to the gravity of the infringement that it becomes an obstacle to the underlying aims of the VAT Directive by imposing a disproportionate burden on a 20 defaulting trader and distorting the VAT system as it applies to him.

25 39. Is the penalty unfair? The penalty imposed on the company was £726.12. The delay was only one day but the penalty would have been the same if the delay had been significantly longer. There must of course be a proportionate upper limit to a penalty. The penalty is certainly substantial given the modest delay. However it cannot be described as devoid of reasonable foundation. It is significantly below and cannot be compared with the penalty of £130,000 imposed in *Energys*. It does not approach the level which the Tribunal in that case described as ‘unimaginable’. In our view the surcharge imposed on the Appellant cannot be said to be within a range which would reasonably be regarded as entirely disproportionate.

30 40. For the above reasons the Tribunal finds that HMRC was correct in charging a default surcharge in accordance with the VAT Act 1994 s 59(4)

41. The appeal is accordingly dismissed and the surcharge upheld.

35 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.

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**MICHAEL S CONNELL
TRIBUNAL JUDGE**

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RELEASE DATE: 24 July 2014

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