[2016] UKFTT 0557 (TC)

TC05306

Appeal number: TC/2015/7320

VALUE ADDED TAX – default surcharge – return 5 days late – single large land transaction on the return – very significant financial penalty imposed – whether there is a reasonable excuse – no – whether penalty "plainly unfair" in all the circumstances – no – appeal dismissed.

FIRST-TIER TRIBUNAL
TAX CHAMBER

SUSANNA CLAIRE POSNETT **Appellant**

- and -

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

TRIBUNAL: JUDGE AMANDA BROWN

Sitting in public at Royal Courts of Justice, The Strand, London on 18 July 2016

Michael Conlan QC, Counsel, instructed by Olsawng, for the Appellant

Farah Chaumoo, Officer of HM Revenue and Customs, for the Respondents

DECISION

1. This appeal concerns a default surcharge issued to Susanna Claire Posnett ("the Appellant") in respect of the late submission and payment of the Appellant's VAT return for the period 08/15. The penalty was calculated at 15% of the net VAT payable on the return in the sum of £217,701.52.

Background

2. The Appellant is a sole trader, who was registered with effect from 25 April 2011. The Appellant is a freelance television producer working principally on documentaries. Following the death of her father in 2005 she inherited a number of properties: Tiresford Farm ("the Farm"), a working farm in Cheshire which was tenanted, Tiresford Cottages ("the Cottages") which were residential rental properties and Cwm Farm a holiday let on Anglesey ("the Holiday Let").

3. She is required to make quarterly returns for the periods ending on the last days of February, May, August and November each year. She submits her returns electronically with the consequence that the due date for submission of the return and payment is one month and seven days following the end of the period. A direct debit mandate applies. Submitting the return triggers payment automatically.

4. The due date for submission and payment of the 08/15 VAT return was 7 October 2015 but the return was submitted on 12 October 2015 and payment was made on 15 October 2015.

5. The Appellant's compliance record in the period prior to 08/15 was poor:

Period	Default	Action
08/13	Return and payment late	As turnover less than £150,000 help letter issued offering advice and support
02/14	Return and payment late (44 and 50 days respectively)	Surcharge liability notice issued
05/14	Return and payment late (15 and 18 days respectively)	Surcharge liability notice extension issued. Penalty calculated at 2% however, as the penalty value did not exceed £400 no financial penalty issued
08/14	Return and payment late (44 and 49 days respectively)	Surcharge liability notice extension issued.

		Penalty calculated at 5% however, as the penalty value did not exceed £400 no financial penalty issued
11/14	Return and payment late (19 and 22 days respectively)	Surcharge liability notice extension issued. Penalty calculated at 10% sum assessed £139.16 (collected despite being lower than £400)
02/15	Return 41 days late (repayment return no payment due)	Surcharge liability notice extension issued. No net tax due therefore no financial penalty
05/15	Return and payment late (97 and 100 days respectively)	Surcharge liability notice extension issued. Penalty calculated at 10% sum assessed £158.61 (collected despite being lower than £400)

6. The Appellant, acting by her representatives, initially sought a request for a review of the surcharge by letter dated 12 November 2015. By a response dated 23 November 2015 the penalty was upheld.

7. On 21 December 2015 the Appellant appealed on the grounds that the penalty was disproportionate or, in the alternative, the Appellant has a reasonable excuse.

The default surcharge regime

8. The default surcharge regime is described by Judge Bishopp in *Enersys Holdings* [2010] UKFTT 20 TC0335 ("*Enersys*"):

> "The first default gives rise to no penalty, but brings the trader within the regime; he is sent a surcharge liability notice which informs him that he has defaulted and warns him that a further default will lead to the imposition of a penalty. A second default within a year of the first leads to the imposition of a penalty of 2% of the net tax due. A further default within the following year results in a 5% penalty; the next, again if it occurs within the following year, to a 10% penalty, and any further default within a year of the last to a 15% penalty. A trader who does not default for a full year escapes the regime; if he defaults again after a year has gone by the process starts again. The fact that he has defaulted before is of no consequence."

9. The legislation for the default surcharge regime is found primarily in Section 59 Value Added Taxes Act 1994 ("VATA") those parts relevant in this appeal are set out below:

59 – The default surcharge

59(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.

59(1A) [not relevant]

59(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.

59(3) If a surcharge liability notice is served by reason of a default in respect of a prescribed account 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.

59(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.

59(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.

59(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.

59(7) If a person who, apart from this subsection, would be liable to a surcharge under subsection (4) above satisfies the Commissioners or, on appeal, a tribunal that, in the case of a default which is material to the surcharge –

(a) the return or, as the case may be, the VAT shown on the return was despatched at such a time and in such a manner that it was reasonable to expect that it would be received by the Commissioners within the appropriate time limit, or

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

he shall not be liable to the surcharge and for the purposes of the preceding provisions of this section he shall be treated as not having been in default in respect of the prescribed accounting period in question (and, accordingly, any surcharge liability notice the service of which depended upon that default shall be deemed not to have been served).

59(8) For the purposes of subsection (7) above, a default is material to a surcharge if –

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

(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.

…

10. Section 71(1) VATA provides:

"For the purposes of any provision of section 59 … which refers to a reasonable excuse for any conduct:

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

(b) where reliance is placed on any other person to perform a task, neither the fact of that reliance nor any deleteriousness or inaccuracy on the part of the person relied upon is a reasonable excuse."

Evidence regarding period 08/15

11. The Tribunal was provided with a bundle of documents. The Appellant had prepared a witness statement together with attachments and gave oral sworn evidence to the Tribunal. The Appellant was a credible witness.

12. The Appellant retains a property agent for the collection of rents in relation to the Farm, Cottages and Holiday Let but does not employ a property manager, she is thus responsible for the management and maintenance of the properties she owns. She employs an accountant who issues VAT invoices on her behalf and completes the VAT returns but on the basis of the paperwork provided by the Appellant.

13. Prior to the present surcharge penalty the Appellant had understood that the late filing regime for VAT was similar to that for self-assessment income tax i.e. the penalties were broadly £100. The Tribunal finds that this was the Appellant's belief and, in view of the size of the surcharge penalties that had been levied on her previously, her belief was not contradicted by her experience. The Appellant claimed that she was unaware of the cumulative nature for the surcharge regime. She accepted that all correspondence from HM Revenue and Customs ("HMRC") including the surcharge liability notice and extensions had been sent to her at her residential address but that she had simply passed the correspondence to her accountant.

14. The Appellant's income for VAT purposes consists of that associated with her activities as a freelance television producer and the rental income from the holiday let.

The Appellant appreciated that income from the Farm and the Cottages were exempt from VAT as letting of residential accommodation. The net tax declared on the VAT return over the period from registration per quarter did not exceed £4,000.

15. The period 08/15 return was different.

16. The property inheritance from the Appellant's father had included some undeveloped land. On 10 August 2015 the Appellant sold the land to BDW Trading Ltd a company associated with David Wilson Homes. The sale price of the land was £10,360,000. At some point (though the Tribunal was not provided with a copy) the Appellant had, acting on the advice of her accountant, opted to tax the land with the consequence that the sale proceeds were subject to VAT. The Appellant provided the Tribunal with a copy of the completion statement which evidenced that part of the sales proceeds were subject to deferred payment terms. The completion statement also particularises the payments made from the sale proceeds to: solicitors, site designers, land agents, promotors etc. The Appellant was clear that she had sought to ensure that the development on the site would be a quality development and that she had invested considerable time and emotion over a number of years in ensuring that was the case.

17. In the period leading up to the due date for the 08/15 the Appellant had been experiencing significant pressure both in connection with the management of the properties and in connection with two particular TV documentaries on which she was working.

18. The TV documentaries on which she was working at the time were "Modern Times: the Last Dukes" and "The Prince's Trust". The Appellant explained to the Tribunal that both documentaries had been extremely challenging requiring her to work exceptionally long hours in order to deliver the productions on time and within budget. Working with the Prince of Wales and his family and Ant and Dec (presenters of the programme) required exceptional time management and flexibility. The tribunal accepts the Appellant's evidence that she was working exceptionally long hours on the productions which were challenging to deliver.

19. At the same time there were issues with the tenanted properties. It is not necessary for the Tribunal to detail the nature of the issues save to say that it was apparent that they were time consuming to resolve and they required the Appellant to make frequent visits up to Cheshire which she had to fit around her demanding TV production schedule.

20. The Appellant's witness statement set out in some considerable detail the daily movements and commitments of the Appellant from 1 September 2015 through to 12 October 2015 when both the 05/15 and 08/15 returns were rendered. These indicate, and the Tribunal finds that the Appellant was exceptionally over stretched in that period. By the end of the period she had become so run down that she became unwell. She was unwell on the day that the VAT return was due.

21. The Appellant asserted that the pressures on her were what prevented her from giving appropriate attention to sending the paperwork necessary to complete the return to her accountant in time to ensure it was filed by 7 October 2015.

22. The Appellant expressed the view that she had been completely unaware of the severity of the default surcharge regime. She had relied upon her accountant to advise her on what needed to be done and when as regards all accounting and tax matters. Her accountant had explained to her how her liability to capital gains tax would arise but had not explained the consequences of failing to render and pay the VAT return on time.

Reasonable excuse

23. It is reasonable to consider first whether the Appellant has a reasonable excuse for the late submission and payment of the 08/15 return.

24. As set out above the provisions of s71(1)(b) expressly excludes reliance on a third party as the basis for a reasonable excuse. The Appellant's stated reliance on her accountant to advise regarding the potential severity of the default surcharge in the event of not rendering any paying the return on time is, therefore, not something that can be considered when determining whether she has a reasonable excuse.

25. The Appellant's submissions on reasonable excuse were essentially that her professional life as a TV producer was "stressful, inexorable and unremitting", on top of that she needed to manage the property portfolio which, at the relevant time was also time consuming and stressful. As set out in his skeleton Mr Conlan QC submitted "The cumulative effect of all of this was such that the Appellant was unable to begin collecting paperwork for her return … the pressures escalated, resulting in the Appellant becoming ill. Unsurprisingly, her accountant (a small firm in Chester) was unable to complete the return by 7 October."

26. HMRC's submissions on reasonable excuse were that the liability to account for VAT is a statutory obligation placed on the Appellant which should, by any reasonably diligent taxpayer, be given the appropriate priority.

27. Reliant on the judgments in *Rowland v Revenue and Customs Commissioners [2006] STC 536*, and *Anthony Wood, t/a Propave v Revenue and Customs Commissioners [2011] UKFTT 136* HMRC contended that when determining whether a reasonable excuse is made out the actions of the taxpayer should be considered from the perspective of a prudent person, exercising reasonable foresight and due diligence, having proper regard for its responsibilities in accordance with the relevant legislation.

28. HMRC in their submission referred to the provisions of Notice 700/50/13 "Default Surcharge". They referred to paragraph 6.3 which provides:

> " What factors will you take into account when considering reasonable excuse?"

We will consider all the circumstances of your individual case so it's important that you provide us with as much information as you can to support your case. We will take into account whether you:

- Could have foreseen the circumstances that led to the delay in submitting your return and/or payment, and if so what steps you took to make alternative arrangements;

- Contacted us to seek help or advice about your VAT return and/or payment before the date it was due

- Gave sufficient priority to completing your VAT return; and

- Paid a reasonable estimate of the VAT by the due date

Genuine mistakes, honesty and acting in good faith are not reasonable excuses …"

29. By reference to these criteria HMRC contended that no reasonable excuse could be made out on the basis that:

(1) The Appellant was or should have been aware that she was in the default surcharge regime as she was in receipt of the surcharge liability notice extensions which clearly set out that she had reached the highest rate

(2) The Appellant failed to give sufficient priority to completing her return on time

(3) She took no steps to make alternative arrangements or seek help

(4) As a TV producer the Appellant's pattern of working was unpredictable but that unpredictability of itself was entirely predictable and any reasonable taxpayer would have made arrangements to accommodate the demands put upon her

(5) The sale of the land was not unforeseen, it was something that had been planned over a significant period

Discussion and conclusion on reasonable excuse

30. There is significant case law on reasonable excuse. From which it is clear that the Tribunal must consider all of the relevant facts and determine whether the taxpayer acted as a reasonably conscientious business person would have done.

31. As Judge Medd articulated in *The Clean Car Company Ltd v CEC [1991] VTTR 234*:

"the test of whether there is a reasonable excuse is an objective one. In my judgment it is an objective test in this sense. One must ask oneself: was what the taxpayer did a reasonable thing for a responsible trader conscious of and intending to comply with his obligations regarding tax, but having the

experience and other relevant attributes of the taxpayer and placed in the situation that the taxpayer found himself in at the relevant time, a reasonable thing to do?"

32. There are cases which have come before the tribunal in connection with reasonable excuse concerning exceptional transactions and errors made in connection with them (see *Appropriate Technology Ltd v CEC [1991] VATTR 226*). However, the Tribunal does not consider them relevant in the context of the present case. The Appellant did not make an error in her return as a consequence of having failed to understand the VAT implications of the land sale. Her return when rendered was accurate.

33. Similarly, the line of cases including and following *Jo Ann Neal [1988] STC 131* make it clear that basic ignorance of the law does not represent a reasonable excuse. The Appellant was aware of the requirement to render and pay returns, she accepts that she received the surcharge liability notice extensions but says that she was ignorant as to the legal implications of the default surcharge regime. The Tribunal considers that such a claim is akin to one that she was ignorant of the basic law on the administration of VAT and, in line with the cases, does not represent a reasonable excuse.

34. The Tribunal finds that the Appellant was over stretched but, by her own admission, she thought that the late filing and payment of her VAT return would give rise to a penalty but a small one similar to that payable for self-assessment tax, i.e. a penalty in the low hundreds of pounds. It is apparent to the Tribunal that given the extensive list of all her conflicting demands at the time, the rendering of her VAT return and its payment were low down her list, no doubt because she perceived the negative consequences of letting other matters slip were far greater than those for her VAT return. Unfortunately, as she now knows that was not the case. The consequences were significant.

35. The Appellant did not, in the Tribunal's view, and by reference to all of the circumstances (rather than only to those on which HMRC seemed to place reliance by reference to their non-binding guidance) act as would be expected of "responsible trader conscious of and intending to comply with his obligations regarding tax". The Tribunal rejects the Appellant's appeal that she has a reasonable excuse.

Proportionality

36. The Appellant's case was very much more focused on a challenge that the penalty imposed in the present case was disproportionate.

37. The question of the proportionality of the system of default surcharges vexed the tribunal for a number of years. However, the case law is now, in the Tribunal's view, reasonably settled.

38. The judgment of the recently decided matter of *Kingsdale Group Ltd and another v HMRC [2016] UKFTT 236* undertook a thorough review of the case law on proportionality in the context of the default surcharge regime. This Tribunal was not

referred to that judgment but was taken to a number of the judgments reviewed. The Tribunal adopts that tribunal's review with gratitude:

> "42. The doctrine of proportionality is central to our discussions later in this decision. In relation to it and its application to the issues in this case, we have reviewed the following cases (all of which, save *Enersys*, are binding on us):
>
> *Dyrektor Izby Skarbowej w Biaymstoku v Profaktor Kulesza, Frankowski, Jowiak, Orowski* (Case C-188/09) [2010] ECR I-7639 *("Profaktor")*
>
> *Paraskevas Louloudakis v Elliniko Dimosio* (Case C-262/99) [2001] ECR I-5547 ("*Louloudakis*")
>
> *The Commissioners for HMRC v Total Technology (Engineering) Ltd* [2012] UKUT 418 (TCC), [2013] STC 681 ("*Total Technology*")
>
> *The Commissioners for HMRC v Trinity Mirror plc* [2015] UKUT 0421 (TCC) ("*Trinity Mirror*")
>
> *International Transport Roth GmbH v Secretary of State for the Home Dept* [2003] QB 728 ("*Roth*")
>
> *James v UK* (Application 8793/79) (1986) 8 EHRR 123 ("*James*")
>
> *Wilson v SoS for Trade and Industry* [2003] UKHL 40 [2004] 1AC816 ("*Wilson*")
>
> *Molenheide and others* [1997] ECR I-72181 ("*Molenheide*")
>
> *R(on the application of Lumsden and others) (Appellants) v Legal Services Board (Respondent)* [2015] UKSC 41 ("*Lumsden"*)
>
> *Enersys*
>
> 43. From them we have derived the following principles:
>
> (1) Member States are obliged to take all legislative and administrative measures to ensure collection of VAT (*Profaktor* at [21]). This is required to ensure that the tax is collected accurately thus ensuring the normal functioning of the VAT system by, in turn, ensuring tax neutrality (*Profaktor* at [21]).
>
> (2) The measures may not, however, go further than is necessary to achieve the objective of levying and collecting the correct amount of tax (*Profaktor* at [26]).
>
> (3) In the absence of harmonisation of European Union Legislation relating to sanctions which may be applied for non-compliance with such legislative measures, Member States are empowered to choose sanctions which seem to them to be appropriate (*Profaktor* at [29]).

(4) But they must exercise that power in accordance with the principle of proportionality (*Profaktor* at [29]).

(5) Proportionality is a general principle of EU law which is enshrined in article 5 (4) of the Treaty on European Union. Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties (*Lumsden* at [24].

(6) The principle of proportionality is therefore applicable to national measures which are adopted by a Member State in exercise of its powers relating to VAT (*Molenheide* at [48]).

(7) It is for the national court to determine whether such national measures are compatible with the principle of proportionality (*Molenheide* at [49]).

(8) In deciding whether the measures or their application is appropriate and not disproportionate, the court must exercise a value judgment by reference to the circumstances prevailing when the issue is to be decided. It is the current effect and impact of the legislation which matters, not the position when the legislation was enacted or came into force (*Wilson* at [62]).

(9) Proportionality as a general principle of EU law involves a consideration of two questions: first, whether the measure in question is suitable or appropriate to achieve the objective pursued; and secondly, whether the measure is necessary to achieve that objective, or whether it could be attained by a less onerous method (*Lumsden* at [33])

(10) As is the case for other principles of public law, the way in which the principle of proportionality is applied in EU law depends to a significant extent upon the context (*Lumsden* at [23].

(11) In the context of its application to penalties, the principle of proportionality is that:

> (A) penalties may not go beyond what is strictly necessary for the objective pursued; and
>
> (B) a penalty must not be so disproportionate to the gravity of the infringement that it becomes an obstacle to the freedoms enshrined in the Treaty (*Louloudakis* at [67]).

(12) In the field of VAT, the freedoms enshrined in the Treaty means the underlying aims of the EU Directives which govern VAT (the "Directive") (*Trinity Mirror* at [14]).

(13) The objective of the default surcharge penalty (the "penalty") in

enforcing the collection of tax is itself a natural consequence of the essential aim of the Directive to ensure the neutrality of taxation of economic activities (*Trinity Mirror* at [56]).

(14) The underlying aim of the Directive for this purpose is the fiscal neutrality which protects taxable persons since VAT is intended to tax only the final consumer (*Trinity Mirror* at [59]).

(15) And given that this is achieved by the collection and deduction at each stage of the supply chain, ensuring the timely payment at each stage is a necessary consequence of that aim (*Trinity Mirror* at [60]).

(16) The correct approach, therefore, is to determine whether the penalty goes beyond what is strictly necessary for the objectives pursued by the default surcharge regime (*Trinity Mirror* at [63]).

(17) But a penalty must not become an obstacle to the underlying aims of the Directive (*Total* at [72]).

(18) An excessive penalty will impose a disproportionate burden on a defaulting trader and distort the VAT system as it applies to him (*Total* at [72]).

(19) For example, the imposition of a flat rate penalty might be proportionate as far as a penalty regime is concerned; but disproportionate in respect of its application to a specific small trader. It might go beyond what is necessary in relation to such trader and would distort the VAT system as far as that trader is concerned. The burden would bear more heavily on him than on a larger trader (*Total* at [76]).

(20) The application of the doctrine of proportionality can be at a high level (is the penalty regime as a whole disproportionate?), or at an individual level (does the penalty regime that applies in a particular case, disproportionate?) (*Total* at [74]).

(21) The margin of appreciation given to law makers in implementing social and economic policy should be a wide one and the courts will respect the law makers judgment as to what is in the public interest unless that judgment is manifestly "without reasonable foundation" (*James* at [46]) or "not merely harsh but plainly unfair" (*Roth* at [26]).

(22) The principles of "devoid of reasonable foundation" or "not merely harsh but plainly unfair" can be applied to a case relating to a particular taxpayer just as much as it can be applied to the regime as a whole (*Total* at [93], *Trinity Mirror* at [72]).

(23) A UK court should be cautious in the extreme in saying that national legislation has overstepped the mark in setting the level of penalty (*Total* at [73]).

(24) But a national measure will not be proportionate if it is clear that the desired level of protection could be obtained equally well by measures which were less restrictive of a fundamental freedom (*Lumsden* at [66]).

(25) The default surcharge regime viewed as a whole is a rational scheme (*Trinity Mirror* at [65]).

(26) A penalty (if it is not a fixed rate penalty) must vary according to some objective criteria. The use of the amount unpaid as an objective criterion is an appropriate if not the most appropriate criterion (*Trinity Mirror* at [65]), (*Total* at [90]).

(27) But this is only so if the amount of the penalty for a failure to file or pay is itself proportionate to that failure (*Total* at [88]).

(28) Since the penalty is for failing to pay and file by the due date, and not for delay in paying after that date, the fact that a trader is only one day late in paying does not, per se, render an otherwise proportionate penalty, disproportionate (*Total* at [88]).

(29) The absence of any financial limit does not render the regime disproportionate; but may, in a wholly exceptional case, (dependent on its own circumstances), render its application to a particular case, disproportionate (*Trinity Mirror* at [66]).”

39. On behalf of the Appellant reliant upon para 66 in *Trinity Mirror* and para 135 of *Louloudakis* it was submitted that the principle of fiscal neutrality is one concerned with fairness and that any penalty which becomes an obstacle to the aim of fairness is one that is disproportionate. The Tribunal was invited to consier the individual circumstances of the Appellant’s case and determine whether those circumstances give rise to a conclusion that the penalty impedes or obstructs fiscal neutrality.

40. The Appellant contended that its case was a wholly exceptional one for the following reasons:

(1) She was not a sophisticated property company with fully resourced infrastructure

(2) Her property interests were ones that by and large gave rise to income exempt from VAT

(3) The inherited property had not been subject to VAT on its acquisition and there had therefore been no VAT recovery on it (though it was acknowledged that VAT had been deducted on significant costs associated with the sale)

(4) The land sale was to a property developer who would use it for the purposes of making zero rated transactions and thus it was of no concern to it whether the land sale had been taxable or exempt

(5) This was not a case of collecting VAT from final consumers where HMRC would have been in a ‘net gain position’

(6) To have a penalty on the full land value was disproportionate to the gravity of the infringement

(7) The penalty was undeniably harsh and was not "strictly necessary" to achieve its object

(8) The penalty was "plainly unfair" by reference to the sheer magnitude of the penalty, the fact that it arose from a significant large and one-off transaction

41. In response HMRC contended that the Appellant's position was not exceptional. In substance HMRC relied on precisely the same factors as are set out at paragraph 30 above to evidence that the situation was not exceptional.

42. HMRC further relied on the conscious act of the Appellant to exercise the option to tax in relation to the land sold which had facilitated input tax recovery on costs totalling in excess of £3m.

43. It was further contended that in assessing the gravity of the penalty the amount of VAT which was unpaid as at the return due date was a factor to be taken into account. The Appellant had failed to render and pay on a timely basis a return declaring substantial sums in net tax due to HMRC.

Discussion and conclusion on proportionality

44. As set out in the analysis of case law provided in paragraph 38 above and *Trinity Mirror* in particular the focus of the tribunal should be the imposition of the penalty in the individual circumstances of the Appellant for period 08/15.

45. The Tribunal is unable to accept the submissions of HMRC that precisely the same factors as those that prevent the Appellant establishing a reasonable excuse defence, by equal measure, evidence that the penalty is proportionate. If the Appellant were able to establish the defence proportionality would be irrelevant and thus failing to establish a reasonable excuse cannot, ipso facto, mean that the penalty is disproportionate. It certainly did not appear to be HMRC's case that the existence of the possibility of a reasonable excuse defence made the whole regime, in every circumstance, proportionate. Such a submission would, in the Tribunal's view, also have been contrary to the judgment of the Upper Tribunal in *Trinity Mirror* which clearly envisaged that there might be situations in which the imposition of a default surcharge might be disproportionate.

46. The Upper Tribunal in *Trinity Mirror* envisaged that a disproportionate surcharge would arise in a "wholly exceptional case, dependent upon its own particular circumstances". Perfectly understandably the Upper Tribunal made no attempt to indicate what an exceptional case might be though they rejected HMRC's submission in that case that an *Ernysis* type 'spike' in profits would not necessarily be such a case. The focus of the Upper Tribunal was by reference to the functioning of the VAT system.

47. VAT is a system intended to tax consumption. For taxable persons engaging in taxable transactions the tax is intended to be neutral, the output tax of party A

becomes the input tax of party B and so on down the chain of supply until the point of final consumption when the output tax of the supplier is not recoverable. That neutrality and the effective operation of the tax depends on that fact that, in the above example party A on a timely basis accounts for and pays to HMRC the output tax which will become recoverable by party B as input tax. There is an inherent timing consequence which arises from the possibility that party A and party B may account for VAT by reference to different VAT quarters. Thus if party A were on Jan/April/July/Oct quarters and party B were on Mar/June/Sept/Dec output tax which became chargeable in March would be recovered by party B before it was declared and paid by party A. But that is a natural consequence of an eminently proportionate administrative measure which facilitates the even collection of VAT though the annual cycle with taxpayers having the ability to determine, as appropriate, which stagger by reference to which their VAT is accounted for.

48. This Tribunal considers that the Upper Tribunal was entirely clear in *Trinity Mirror* at paragraph 60 of its judgment that the default surcharge regime is focused on the contribution of the timely collection of VAT to the overall neutrality of the tax. Only where a surcharge is "so disproportionate as to constitute an obstacle" to fiscal neutrality in this sense should it be unenforceable on the grounds of disproportionality.

49. Contrary to the submission of the Appellant the Tribunal considers that the fact that the output tax which was due from the Appellant in connection with the land sale was input tax in respect of which David Wilson Homes was entitled to recovery is a significant factor. Had David Wilson Homes been on a 31 August or 30 September period end the tax would have been reclaimed before it was paid to HMRC by the Appellant. Repayment before collection as a consequence of an August period end would have been inherent in the scheme of VAT, repayment before collection in relation to a September period end would have been as a consequence of the Appellant's failure to render and pay her return on a timely basis.

50. Further, in the context of fiscal neutrality in the more conventional sense, the Appellant had chosen to opt to tax. The submissions made on her behalf were that it would not have mattered whether she had opted to tax or not: for David Wilson Homes it did not matter whether the land was opted. With respect to that submission the Tribunal considers that to be highly unlikely. Had the Appellant not opted to tax the land the £3m or so fees that were payable in connection with the transaction would have borne irrecoverable VAT thereby increasing the cost base of the transaction for the Appellant. Naturally the Appellant would have wanted to recover that additional cost. Unopted, the land may well have had a market price that would not have permitted recovery of the additional cost. The very neutrality of the tax which lies at the heart of the proportionality question however enabled the Appellant to remove the cost of VAT on professional and design fees thereby potentially releasing greater value for the Appellant from the transaction.

51. Essentially the Appellant's case on proportionality is that the land transaction was an exceptional transaction. It didn't result in a spike of profits because it was not within the normal pattern of business, it was a one off. As a combination of an

exceptional transaction when combined with a poor compliance history the Appellant suffered a very significant penalty.

52. For the reasons set out in paragraph 47 – 50 the Tribunal does not consider that the stated exceptional nature of the transaction can impact the proportionality of the penalty. The poor compliance history was a matter of which the Appellant, had she acted with proper regard to her statutory VAT compliance requirements, should have been aware. She had been required to pay two previous penalties albeit in relatively small sums.

53. The return and payment were 5 days late, because the return included a single land transaction with a value of £10m the penalty was very very large and may appear harsh. But this Tribunal cannot conclude that it was so unduly harsh that it amounted to a disproportionate penalty. The bar is extremely high. The facts of this case are undoubtedly ones which required careful consideration, facts which were considerably closer to meeting the test than many. However, for the reasons stated the Tribunal does not consider that, in all the circumstances, the penalty was plainly unfair.

Decision

54. The Tribunal dismisses the appeal on the basis that the penalty was proportionate and the Appellant failed to make out a defence of reasonable excuse.

55. 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.

Amanda Brown
TRIBUNAL JUDGE

RELEASE DATE: 8 August 2016