



TC06128

Appeal number: TC/2017/296

*VALUE ADDED TAX – default surcharge – whether there is was reasonable
excuse – yes – appeal ALLOWED*

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

RUX BURTON ASSOCIATES LTD

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE AMANDA BROWN
JULIAN SIMS**

**Sitting in public at Oxford Combined Court Centre, St Aldgates Oxford on 8
September 2017**

Mr Rux-Burton, director of the Appellant

**Ms Williams Presenting Officer for HM Revenue and Customs, for the
Respondents**

DECISION

1. This appeal concerns the imposition of a default surcharge issued to Rux Burton Associates Ltd (“the Appellant”) in respect of the late payment of the Appellant’s VAT return for the period 03/16. The rate of penalty chargeable is 5%. The total surcharge penalty assessed amounts to £1,540.00.

Background

2. The Appellant business has been registered for VAT since 1 February 2003 in respect of activities as fundraising consultants to the education sector.

3. The Appellant’s compliance record, prior to period 09/15 was not entirely unblemished as there had been some part payments for returns that had been made beyond the due date but, broadly speaking, they were a compliant taxpayer.

4. The Appellant employs a finance manager who is responsible to the directors and company for day to day financial management of the Appellant business. On 24 October 2015 the woman employed in that role commenced maternity leave. Cognisant of its obligations the Appellant sought and obtained, through an agency, maternity cover. The experience of obtaining agency staff was not a positive one for the Appellant business as the quality of staff was not as they had anticipated.

5. During the maternity leave period the periods 09/15, 12/15 and 03/16 returns were rendered on time but all or some of the VAT due on those returns was paid late.

6. The period 09/15 return triggered a default surcharge liability notice warning the Appellant that a further later return within a period of 12 months would attract a default surcharge penalty calculated at 2% of the net tax due on the return.

7. The period 12/15 return was again subject to late payment and whilst was liable to a 2% penalty but, in accordance with HMRC’s policy of not issuing default surcharge penalties where the amount to be assessed is less than £400, no penalty assessment was issued. The accompanying default surcharge liability extension notice would, however, have notified the Appellant that a further default within 12 months would trigger a 5% penalty.

8. The Appellant has accepted liability to these defaults.

9. By the due date for the submission and payment of the 03/16 return the Appellant was employing, on a temporary basis, an individual whom they considered appropriately qualified and competent in the role of finance manager.

10. Unbeknown to the Appellant director however the individual concerned suffered a substantial personal crisis. The mother of the individual had been diagnosed as terminally ill and the individual could not find adequate overnight care with the consequence that the individual was commuting from Oxfordshire to Birmingham daily.

11. On 4 May 2016 the individual filed the Appellant's VAT return online and before the 7 May 2016 due date. On Friday 6 May 2016 the payment of the return was due to be made. However, the finance manager simply did not attend the office, made no contact with the director and did not highlight that the payment due for the return had not been made. On Monday 9 May 2016 the Appellant director realised that no payment had been made and attempted to make two payments: one by bank transfer and one by credit card (though it is to be noted that the two payments would nevertheless have left £7810.85 outstanding on the return). The Bank payment was processed on 9th and the credit card payment on 10th. The final payment was made on 25 May 2016.

12. At some point in April the business had reached its factoring limit. Initially the Appellant director had investigated the position but considered that the response received from the finance manager was rational. Given the perceived competence of the finance manager it was not considered necessary to investigate further. However, when looking at making payment of the 03/16 VAT return it was identified that the finance manager had raised the invoices to customers but none of them had been sent to clients with an obvious impact on cash flow as the business reached its factoring capacity.

13. When the Appellant director discovered the issue with the invoices it was raised with the finance manager. It became quickly apparent that the individual was having a breakdown of sorts. She left the office to get a cup of coffee and never returned. The Appellant appointed a new finance manager on 9 June 2016. The maternity leave subsequently ended and the full time finance manager returned and the Appellant's compliance is again restored.

14. As a consequence of the late payment of the return the Appellant was subject to a 5% default surcharge penalty in the sum of £1540.

15. The Appellant requested a review of the imposition of the penalty for the 03/16 return on 8 November 2016. HMRC upheld the penalty by letter dated 29 November 2016.

30 **The default surcharge regime**

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

"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."

17. 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 –

- 10 (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,
- 15 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 –

- 20 (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.

30 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-

- 35 (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.

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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-

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(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;

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(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.

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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 –

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

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(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).

5 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

10 (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.

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15 18. 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 a reasonable excuse; and

20 (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.”

Appellant’s submissions

25 19. The Appellant contends that it has a reasonable excuse for the 03/16 default as a consequence of the crisis affecting the finance manager at that time. The Appellant contends in the alternative that the penalty is disproportionate.

Reasonable excuse

30 20. No case law was explicitly referred to by either party in relation to factors capable of constituting a reasonable excuse.

21. There is, however, 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.

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

5 “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?”

10 23. As indicated at paragraph 18 above there are two statutory conditions excluding reliance on a third party and insufficiency of funds from representing reasonable excuses. However, whilst it is not open to a taxpayer to rely on the fact of delegation to a third party to absolve itself of responsibility for its own statutory obligations, where circumstances arise in relation to the third party which would constitute a
15 reasonable excuse had they been experienced by the taxpayer it is appropriate to find a reasonable excuse provided always that the business has acted as a responsible taxpayer.

20 24. The facts of the present case are such that the Appellant had employed a competent and efficient finance manager who maintained an adequate compliance record. That individual went on maternity leave and as was prudent the Appellant appointed temporary maternity cover. That cover was inadequate and for two periods the Appellant fell into default but has accepted responsibility for that default as part of the consequences of business. However, by 03/16 the Appellant had ensured they had a competent finance manager to whom the management of submission and payment
25 of the VAT return had been delegated. However, as a consequence of the stress of a terminally ill mother and the associated obligations of caring for her, which she did not declare to the Appellant, the finance management of the business was catastrophically effected for a short period. Not only was the return not paid on time but more widely invoices were raised but not issued or chased leading directly to a
30 temporary insufficiency of funds.

35 25. The Tribunal takes the view that whilst on the margins the Appellant has established a reasonable excuse. The narration of facts as presented to the Tribunal was in greater detail and subject to questioning by the Tribunal and had not been available to HMRC prior to the hearing; no criticism can therefore be levelled at HMRC for not having considered the information prior to the hearing. The Appellant could not have predicted the events which led to the late payment of the 03/16 return. However, carefully managed events can sometimes take over and in those circumstances a reasonable excuse is established.

Proportionality

40 26. Whilst the question of proportionality is not material to the outcome of the appeal it was raised by the Appellant and addressed by HMRC. The Appellant referred to the case of *Energys* as support for a contention that as the majority of the

payment was only a day late the effective rate of interest was 640% which, it was argued was disproportionate.

27. 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.

28. 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. That Tribunal determined a number of principles/propositions on the application of proportionality of the default surcharge regime from the higher court and CJEU authorities. For present purposes suffice it to say that the courts and Tribunals have determined that the default surcharge regime is not inherently disproportionate. On an individual case by case basis it is appropriate to consider whether the imposition of the penalty goes beyond what is necessary in order for the penalty regime to achieve the objective of ensuring the timely payment of tax. By reference to the judgement in *The Commissioners for HMRC v Trinity Mirror plc [2015] UKUT 0421 (TCC)* a disproportionate surcharge would arise in a "wholly exceptional case, dependent upon its own particular circumstances". Had there been no reasonable excuse this would not have been such a situation.

20 **Decision**

29. The Appellant has established a reasonable excuse for period 03/16 and on that basis the appeal is allowed.

30. 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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**AMANDA BROWN
TRIBUNAL JUDGE**

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RELEASE DATE: 26 SEPTEMBER 2017