



TC06672

Appeal number: TC/2017/07333

VALUE ADDED TAX – default surcharge – can VAT credit under s 80 Value Added Tax Act 1994 be set against VAT for earlier periods which has already been paid – no – is a mistaken overpayment of VAT a reasonable excuse for late payment of VAT in respect of a subsequent VAT period – no – appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

K D MEDIA PUBLISHING LIMITED

Appellant

- and -

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

**TRIBUNAL: JUDGE ROBIN VOS
 HELEN MYERSCOUGH ACA**

Sitting in public at Colchester Magistrates Court on 8 June 2018

Mr Liban Ahmed of CTM Tax Litigation Limited for the Appellant

Miss Olivia Donovan, Presenting Officer of HM Revenue & Customs for the Respondents

DECISION

Background

5 1. The appellant, K D Media Publishing Limited (“K D Media”) is a magazine publishing company. It was set up in 2009 around the time of the global financial crisis. Partly as a result of this, it has always had cashflow problems and has consistently been late in paying its VAT, incurring VAT default surcharges for most VAT periods.

10 2. In February 2017, K D Media discovered that it had paid too much VAT for the 11/15 VAT period. HMRC accepted this, adjusted the VAT due for that period and also reduced the default surcharge for the 11/15 period as a result of the reduced VAT liability.

15 3. K D Media’s appeal is against the default surcharges which they have had to pay in respect of the late payment of VAT for the VAT periods after the 11/15 VAT period for which the overpayment occurred and the date when the error was spotted in February 2017. This is on the basis that HMRC effectively had an extra amount of VAT which had been paid by K D Media and that the amounts paid late for each of these intervening VAT periods should therefore be treated as reduced. If so, this would mean that the VAT default surcharges for each of those intervening periods should also be reduced as they should be calculated by reference to a lower amount of unpaid VAT.

20 4. The total amount of the default surcharges in dispute is just over £12,000.

25 5. With the consent of both parties, on 13 June 2018 the Tribunal issued a decision which did not include summary or full findings of fact and reasons for the decision. K D Media has now requested a decision containing full findings of fact and reasons for the decision.

The evidence and the facts

30 6. As well as the bundle of documents and correspondence produced by HMRC, the Tribunal heard oral evidence from K D Media’s Managing Director, Mr Robert Clark. The Tribunal has no hesitation in accepting Mr Clark’s evidence.

7. The relevant facts are relatively straightforward and are not in dispute.

35 8. K D Media submitted a VAT return for the 11/15 VAT period showing VAT due of £101,295.48. Due to an error by K D Media’s financial controller, this was actually the figure for the previous VAT period. The correct figure for the VAT due for the 11/15 VAT period was £87,320.48, a difference of £13,975.

9. K D Media was late paying all or part of its VAT for each of the subsequent VAT periods up to and including the 11/16 VAT period. However, in each case, the

VAT due for the relevant VAT period was all paid prior to the due date for the payment of VAT in respect of the subsequent VAT period.

10. In February 2017, K D Media discovered the error relating to the 11/15 VAT period. This was notified to HMRC by a letter dated 10 February 2017.

5 11. On 24 March 2017, HMRC acknowledged the error and applied a credit of £13,975 to K D Media's VAT account representing the overpaid VAT together with a further credit of £2,096.25 which represented the reduction in the surcharge for the 11/15 VAT period resulting from the reduced VAT liability for that period. HMRC applied these credits against the outstanding VAT due for the 11/16 VAT period
10 (£15,588.88) and the remainder against the 11/16 default surcharge, being the only amounts of VAT due to HMRC on 24 March 2017.

Did HMRC apply the VAT credit correctly

12. Mr Ahmed, on behalf of K D Media, submits that the credit totalling £16,071.25 relating to the 11/15 VAT period should be set against the VAT due for the
15 subsequent 02/16 VAT period. This would reduce the amount of VAT paid late for that period and would therefore reduce the VAT default surcharge for that period.

13. As K D Media had consistently been in default in respect of its VAT payments, the rate of the default surcharge was 15% for all VAT periods in accordance with s 59(5) Value Added Tax Act 1994 ("VATA"). The reduction in the default surcharge
20 for the 02/16 period would therefore be $£16,071.25 \times 15\% = £2,410.68$.

14. Mr Ahmed explained that this would then have a knock-on effect on the subsequent 05/16 VAT period since all of the VAT for the 02/16 period had been paid prior to the due date for the payment of the VAT for the 05/16 VAT period. On this basis, the amount available to credit against the VAT due for the 05/16 VAT period
25 was the total of the overpaid VAT plus the reduction in the default surcharge for the 11/15 period (£16,071.25) plus the amount of the reduced surcharge for the 02/16 period (£2,410.88) – i.e. £18,481.93 in total. This would reduce the default surcharge for the 05/16 period by $£18,481.93 \times 15\% = £2,772.28$.

15. Applying similar reasoning to the 08/16 and the 11/16 VAT periods, the
30 reduction in the default surcharges for those periods should, says Mr Ahmed, be $£21,254.21 \times 15\% = £3,188.13$ in respect of the 08/16 VAT period and $£24,442.35 \times 15\% = £3,666.35$ in respect of the 11/16 VAT period.

16. In total, Mr Ahmed argues that the default surcharges for the 02/16 – 11/16 VAT periods should be reduced by £12,037.44.

35 17. In support of his position, Mr Ahmed referred to the decision of the Upper Tribunal in *Swanfield Limited (and Others) v HMRC* [2017] UK UT 88 and in particular the finding at [52] that:

“In our view the taxpayer does have the right to appropriate a payment of VAT for VAT that is not yet due for payment and

that this extends both to the situation where the payment made reflects output tax which has already arisen, and to a case where (or the extent that) the payment exceeds the output tax that has already accrued.”

5 18. Mr Ahmed accepts that *Swanfield* is not on all fours with the situation in which
K D Media found itself but nonetheless submits that the Upper Tribunal’s decision
makes it clear that payment of VAT to HMRC, whether deliberate or not, can be
made in advance of a future debt. The overpayment in respect of the 11/15 VAT
10 period should therefore be available as a credit against the VAT which became due
for the subsequent VAT period. There is no reason, according to Mr Ahmed, why the
position should be any different because the credit arose as the result of a mistake
rather than a deliberate payment on account.

15 19. Miss Donovan, on the other hand, submits that HMRC were not bound to give a
credit until they were notified of the mistake by K D Media in February 2017. Once
that was done, she says that HMRC took prompt action and applied the credit against
the outstanding VAT/default surcharge at the relevant time which, in this case, was
the VAT and default surcharge which remained due in respect of the 11/16 VAT
20 period. The credit could not be applied against the VAT which had been due for any
earlier VAT periods as HMRC were not aware at the time this VAT became due that
there was any credit available.

20. Regulation 40 of the Value Added Tax Regulations 1995 (“VATR”) provides as follows:

“40(1) Any person making a return shall in respect of the period
to which the return relates account in that return for –

25 (a) all his output tax

...

30 (2) any person required to make a return shall pay to the
Controller such amount of VAT as is payable by him in
respect of the period to which the return relates not later
than the last day on which he is required to make that
return.”

21. It is clear from regulation 40 VATR that a taxpayer has a liability to pay any VAT which is shown as due in its VAT return.

35 22. Section 80 VATA deals with credits where VAT has been overpaid. The
relevant parts of s 80 VATA are as follows:

“80 Credit for, or repayment of, overstated or overpaid VAT

(1) Where a person –

40 (a) has accounted to the Commissioners for
VAT for a prescribed accounting period
(whenever ended), and

(b) in doing so, has brought into account as output tax an amount that was not output tax due,

the Commissioners shall be liable to credit the person with that amount.

5

...

(2) The Commissioners shall only be liable to credit or repay an amount under this section on a claim being made for the purpose.

10

...

(7) Except as provided by this section (and paragraph 16I of Schedule 3B and paragraph 29 of Schedule 3BA), the Commissioners shall not be liable to credit or repay any amount accounted for or paid to them by way of VAT that was not VAT due to them.”

15

23. Neither party referred to s 80 VATA in their submissions to the Tribunal. When this was drawn to Mr Ahmed’s attention, he submitted that the credit which is allowed as a result of a claim under s 80 VATA should still be backdated to the date of the overpayment in question and therefore available as a credit against any VAT which becomes due after that date.

20

24. Whilst, in principle, it may in some cases give a taxpayer a better result if the credit could be backdated in this way, in our view, s 80 cannot be interpreted in this way.

25. Section 80(2) VATA makes it clear that HMRC is only liable to give a credit when a claim is made. Section 80(7) VATA makes it equally clear that HMRC cannot give a credit except in accordance with s 80.

25

26. If the credit only arises at the date the claim is made (in this case on 10 February 2017), it can logically only be set against amounts of VAT which are due and outstanding at that date or which become due in the future. It cannot be set against amounts of VAT which have already been paid.

30

27. The decision of the Upper Tribunal in *Swanfield* does not provide any support for a contrary argument. As Mr Ahmed accepted, *Swanfield* was in any event dealing with a different situation which was whether a taxpayer had the right to decide which amounts of VAT any particular payment should be set against. The question was whether a payment could be set against VAT which would become due in the future, even though there may be VAT which was already due and payable and which remained outstanding. The Upper Tribunal accepted that if the taxpayer makes a specific allocation at the time the payment is made, this is binding on HMRC whether or not the VAT in question has become due by the date of that payment.

35

28. However, if the taxpayer makes no allocation, it is entirely up to HMRC how the payment is allocated (see paragraph [54]). The main issue in *Swanfield*, where

40

there had been no allocation by the taxpayer, was whether it was disproportionate to charge a penalty in circumstances where HMRC did not allocate a payment in the way which was most beneficial to the taxpayer. The question of proportionality is discussed further below.

5 29. The important difference in *Swanfield* however was that HMRC was able to allocate the payment either to historic VAT liabilities which remained outstanding or to liabilities which would arise in relation to the current VAT period. In this case, our view is that HMRC had no ability to allocate the credit against VAT liabilities which had already been paid as the credit was simply not available at the time those VAT
10 liabilities arose.

30. Our conclusion on this issue is therefore that HMRC correctly applied the credit against the VAT which was outstanding at the date the credit was claimed and that, even if they had wished to do so, they could not have applied it against the VAT liabilities for the prior VAT periods as suggested by Mr Ahmed. The default
15 surcharges for those earlier VAT periods (the 02/16 – 11/16 VAT periods) have therefore been correctly calculated in accordance with s 59 VATA.

Does the appellant have a reasonable excuse for the failure

31. Section 59(7) VATA provides that there is no liability to a surcharge if there is a reasonable excuse for the failure to pay the VAT on time.

20 32. Section 71(1)(a) VATA provides that an insufficiency of funds to pay any VAT due is not a reasonable excuse. The courts have however held that the reason why there is a shortage of funds may in certain circumstances provide a reasonable excuse (see, for example, the decision in *Commissioners of Customs & Excise v J B Steptoe* [1992] STC 757 and, in particular, the second paragraph of the judgment of the
25 Master of the Rolls).

33. It is common ground that the reason for the late payment of VAT giving rise to the surcharges which are the subject of this appeal was a shortage of funds. Mr Clark gave evidence that, in the course of 2015, K D Media was starting to get up to date with the payment of its VAT. A significant amount of the VAT (but not all of it) was
30 paid on time. Then, in June 2016 the decision in the Brexit Referendum provided a set-back as clients withdrew their advertising due to the uncertainty in the economic outlook.

34. Mr Clark also gave evidence that, if K D Media had received a repayment of the overpaid VAT (or had not made the overpayment in the first place), it would have
35 used the money to pay more VAT in relation to the later periods.

35. Miss Donovan took issue with this on the basis that Mr Clark also admitted that the company prioritised certain creditors such as the payment of salaries and paying the printers of the magazines, she suggested that there could therefore be no certainty that, even if K D Media had further funds available to it at the relevant time, it would
40 have used these funds to pay additional instalments of VAT.

36. It seems to us likely that, if it had funds available to it, the company would have used these funds to pay VAT. The history of VAT payments shows that the company made regular payments, presumably as and when it had funds available, and so there is no reason to suppose that it would not have done likewise if it had found itself with an extra £16,000 in its bank account.

37. Although Mr Clark gave evidence of the underlying reasons for the company's cashflow difficulties, Mr Ahmed did not suggest that these cashflow difficulties themselves constituted a reasonable excuse. Rather his point was that, as a result of the error, the company had £16,000 less available to it and, particularly bearing in mind that HMRC had the money, this constituted a reasonable excuse for the failure to pay the corresponding amount of VAT on time in respect of the later VAT periods.

38. Attractive though this argument is, we cannot accept it. The underlying cause of the overpayment was a mistake by the company itself. As the Tribunal observed in *Garnmoss Limited (T/A Parham Builders) v HMRC* [2012] UK FTT 315 at [12]:

“What is clear is that there was a muddle and a bona fide mistake was made. We all make mistakes. This was not a blameworthy one. But the Act does not provide shelter for mistakes, only for reasonable excuses.”

39. In this case, there is no evidence to show that the overpayment was anything more than a simple mistake and, like the Tribunal in *Garnmoss*, we take the view that a mistake will not normally constitute a reasonable excuse for the failure.

40. We also do not accept that K D Media had any reason for its shortage of funds which would constitute a reasonable excuse for its failure to pay its VAT on time. The only reason given which relates to the relevant periods is the withdrawal of advertising following the Brexit decision. However, this could only affect the 08/16 and 11/16 VAT periods and not the 02/16 and the 05/16 VAT periods and so could not provide a reasonable excuse for those earlier two periods. In addition, we note that K D Media paid all of its VAT late in respect of the 05/16 VAT period and so it is not at all apparent that the Brexit decision was the sole or main reason for the company's shortage of funds.

Proportionality

41. Mr Ahmed accepts that, in the context of K D Media's turnover and/or its regular VAT liabilities, the surcharges in question are not large amounts (approximately £2,000 - £3,000 for each VAT period where the VAT in question ranged from approximately £75,000 - £110,000).

42. Instead, he relies on the argument that it is disproportionate to impose a surcharge in circumstances where HMRC had the cash all along.

43. In support of this submission he relies on the decision of the Upper Tribunal in *HMRC v Trinity Mirror Plc* [2015] UKUT 421 and in particular the Upper Tribunal's comments at [63]:

5 “63 The correct approach is to determine whether the
penalty goes beyond what is strictly necessary for the objectives
pursued by the default surcharge regime, as discussed in detail in
Total Technology and whether the penalty is so disproportionate
to the gravity of the infringement that it becomes an obstacle to
the achievement of the underlying aim of the directive which, in
this context, we have identified as that of fiscal neutrality. To
those tests we would add that derived from *Roth* in the context of
10 a challenge under the Convention to certain penalties, namely ‘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?’”

44. Mr Ahmed makes the following points:

15 (1) The penalty regime is there to ensure compliance with a taxpayer’s VAT
accounting and payment obligations.

(2) K D Media is blameless in the sense that the default can be attributed to a
genuine error in overpaying VAT and so the penalty does interfere with the
principle of fiscal neutrality.

20 (3) There is no reason why a trader cannot make a payment on account of
future VAT liabilities (see *Swanfield*) and this should not be treated any
differently where the payment is made in error.

45. Miss Donovan also referred to the decision in *Trinity Mirror*, referring to
paragraph [69] in which the Upper Tribunal decided that:

25 “A financial penalty of this nature, based on a modest percentage
of the amount of VAT unpaid by the due date, cannot be
regarded as going beyond the objectives of the default surcharge
regime.”

46. As accepted by Mr Ahmed, the penalties in this case are of a relatively modest
amount and so should not, in Miss Donovan’s view, be considered disproportionate.

30 47. We do not need to delve into the concept of proportionality in detail. It is
common ground that the purpose of the default surcharge regime is to ensure that
VAT is accounted for, and paid, on a timely basis (as confirmed by the Upper
Tribunal in *Trinity Mirror* at [60]).

48. It is also common ground that, as the Upper Tribunal found in *Trinity Mirror*,
35 the VAT default surcharge regime is not itself disproportionate to those objectives.

49. The Upper Tribunal in *Trinity Mirror* went on to say at [66] that:

“Although the absence of a maximum penalty means that the
possibility of a proper challenge on the basis of proportionality
cannot be ruled out, we cannot ourselves readily identify

common characteristics of a case where such a challenge to a default surcharge would be likely to succeed.”

50. It therefore seems clear that the Upper Tribunal considered that proportionality was only likely to be an issue if the surcharge was, for some reason, particularly high.
5 As Miss Donovan has pointed out, that is not the case here.

51. In any event, the fact that HMRC held the cash representing the overpayment does not in our view lead to a conclusion that the penalty is disproportionate.

52. It has been accepted that the purpose of the default surcharge regime is to ensure that taxpayers pay their VAT on time. At the time the VAT which was paid late became due, the error was not known. This means that, although it was due to
10 cashflow problems, the late payment of VAT by K D Media was deliberate. It cannot on any view be said to be disproportionate to impose a surcharge where a taxpayer knowingly pays VAT late even though the late payment may indirectly have been as a result of an innocent mistake.

15 53. Although, as Mr Ahmed has mentioned, the facts in *Swanfield* were somewhat different to this case, we note that the Upper Tribunal concluded at [58]:

“that it is not disproportionate for a penalty to arise from the manner in which HMRC chooses to allocate a payment, in circumstances where the taxpayer could have but failed to make
20 an allocation at or before the time of payment.”

54. It follows from this that if, contrary to our decision, HMRC could have allocated the credit to the earlier VAT periods, but decided (as they did) to allocate it to the most recent VAT period where there was still VAT outstanding, the penalties charged in relation to the earlier VAT periods would still not be disproportionate. It
25 cannot therefore be said that the penalties are disproportionate where HMRC (as we have found) have no such power.

Decision

55. The surcharges have been properly imposed in accordance with s 59 VATA as the credit resulting from the overpayment cannot be allocated against VAT which has
30 already been paid prior to the date on which the credit arose.

56. K D Media does not have a reasonable excuse for the failure to pay its VAT on time for the relevant VAT periods.

57. The surcharges are not disproportionate given the purpose of the default surcharge regime.

35 58. This appeal is therefore dismissed and the default surcharges for each of the VAT periods 02/16 – 11/16 are upheld.

59. 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.

**ROBIN VOS
TRIBUNAL JUDGE**

10

RELEASE DATE: 22 AUGUST 2018