TC01705

Appeal number: TC/2011/07670

VAT default surcharge – reasonable excuse – proportionality – appeal dismissed

FIRST-TIER TRIBUNAL

TAX

FRENCH & CO. SOLICITORS **Appellant**

- and -

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

TRIBUNAL: J. BLEWITT (JUDGE)

Sitting in public at Birmingham on 7 December 2011

Mr Hale, of French & Co Solicitors for the Appellant

Ms Taylor, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal by French & Co Solicitors against a penalty levied under the VAT default surcharge regime. The penalty falls into the 5% rate and was computed by HMRC at £1, 467.33.

Legislation

2. The default surcharge regime is found in section 59 of the Value Added Tax Act 1994 ("VATA"). This prescribes:

59 The default surcharge

(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.

[(1A) A person shall not be regarded for the purposes of this section as being in default in respect of any prescribed accounting period if that period is one in respect of which he is required by virtue of any order under section 28 to make any payment on account of VAT.]

(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.

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

(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.

(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.

(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.

(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).

3. Mr Hale, on behalf of the Appellant referred me to the case of ***Enersys Holdings UK Limited v HMRC*** *[2010] UKFTT 20 (TC)*, more about which I will say later. The case involves a detailed discussion of the legislative history and case law development around the default surcharge and I do not repeat the same here.

Background

4. From a schedule provided by HMRC, which was accepted by the Appellant, it was in default as follows: the 02/10 return payment was £23,780.53 and was due to be paid on 31 March 2010 or 7 April 2010 (the latter allowing for the 7 additional calendar days afforded to those paying electronically). The payment was made by cheque on 9 April 2010. Two further defaults occurred in the periods 05/10 and 08/10, however it was subsequently accepted by HMRC that a reasonable excuse existed for both periods on the basis that the Appellant was unaware that its bank delayed payments over £10,000, as confirmed in an email from Barclays dated 26 October 2010, and as a consequence the payment took 3 days. A further default occurred in the period 02/11 when payment due on 7 April 2011 was received by BACS in 3 payments on 13 April 2011. The default which is the subject of this appeal occurred during the 05/11 period, when payments made in 3 tranches and due by 7 July 2011 were received by HMRC on 8 July 2011. It was accepted on behalf of the Appellant that the payment was late.

5. The Appellant requested a review of the surcharge relating to the 02/11 period by letter dated 12 May 2011. The letter stated that there had been a delay in payment due to *"an innocent misreading of the online guidance in which HMRC provides 3 separate dates as to when payment is due: Cheque...electronic method other than VAT direct debit, VAT direct debit...the correct date...was read by our Practise Manager from the VAT direct debit line which happens to be 5 days later than the normal electronic method line in this instance."*

6. By letter dated 6 June 2011 from HMRC to the Appellant, HMRC upheld the surcharge imposed for the 02/11 period following a review and informed the Appellant that:

"HMRC is currently unable to receive or make payments using the faster payment service which is offered by some banks. BACS payments take up to three working days to reach our account...according to our records you have previously paid electronically and therefore should be aware of the regulations..."

7. The letter dated 6 June was accompanied by an HMRC leaflet "Advice to help you avoid a Default Surcharge" which stated:

"BACS Direct Credit...BACS Direct Debit, CHAPS or Bank Giro Credit...Check with your bank to see how long it will take them to process payments...Please note: HMRC is currently unable to receive Faster Payments."

8. As regards the default subject of this appeal, the Appellant wrote to HMRC on 30 July 2011, stating:

"We do know that we sent the payment to HMRC in 3 almost identical tranches by online banking from our Barclays account...the payments left our account on 6th July 2011. Payment was due on 7th July 2011. We have previously been told by Barclays than online payments for sums less than £10,000 would be paid the same day or the next day...Whatever delay has occurred must be minimal...the surcharge represents a monstrous penalty out of all proportion to any "loss" that might have been sustained by HMRC...We would be grateful if you could confirm whether we can pay our VAT by Telegraphic Transfer...Your letter of 6th June 2011 seems to suggest that we could not..."

9. It is clear from the reference to HMRC's letter of 6 June 2011 that the letter was received and read by the Appellant.

10. By letter dated 2 September 2011 HMRC upheld the surcharge for the period 05/11 on the basis that no reasonable excuse existed as the Appellant had previously been informed that HMRC do not operate the faster payment service.

Appeal

11. By Notice of Appeal dated 29 September 2011 the Appellant appealed to the Tribunal Service. The grounds relied upon can be summarised as follows:

(a) the Appellant understands that payment would not have taken longer than 2 days to reach HMRC and it would seem likely therefore that payment was received one day late;

(b) HMRC have a bank account to which payments typically take one day longer than for most UK clearing banks;

(c) The Appellant frequently makes CHAPS (same day) payments. The Appellant now understands that HMRC can receive same day payments which would be the Appellant's preferred method of payment of VAT;

(d) Information about electronic payments appears almost deliberately obscure on HMRC's website;

(e) The implication, as was understood by the Appellant, is that HMRC do not accept same day payments and that the payee has to take extreme care to ensure that payment is made in sufficient time;

(f) There may be good commercial reasons why businesses might not agree a direct debit payment; the Appellant is reliant to a large part on payments from the LSC which are often delayed;

(g) If HMRC were to sue in a County Court for the tax due as a debt it would be allowed to claim interest at 8% per annum;

(h) Discretion should be exercised taking into account the mischief that has occurred.

12. Mr Hale, on behalf of the Appellant, succinctly summarised the Appellant's arguments as falling into two categories:

(a) Reasonable excuse; and

(b) Proportionality.

Reasonable Excuse

13. On behalf of the Appellant, Mr Hale accepted that the Company had been informed that BACS payments take up to 3 working days to clear, but submitted that the senior partner at the Appellant Company, who was not present to give evidence, had not understood that an online transfer also takes up to 3 days as in the normal course of business such a transfer would occur the same or following day.

14. The Appellant understood that the delay in the 3 payments being received was a result of HMRC's bank account and although the Appellant had been informed that the faster system of payment was not available, the senior partner had understood this to relate to a telegraphic transfer.

15. The Appellant had made payments in 3 tranches on 6 July 2011, as evidenced by a bank statement, in order to avoid the delay by their own bank account for sums in excess of £10,000 as had occurred in the periods 05/10 and 08/10. It was submitted that the Appellant had a reasonable expectation that it would take no longer than 1 day for HMJRC to receive the payments and that there was a clear intention on the part of the Appellant to provide the payments by the due date.

16. Ms Taylor for HMRC submitted that HMRC had accepted that the Appellant Company had a reasonable excuse in respect of past defaults, however the default subject of this appeal post dated HMRC's letter to the Appellant dated 6 June 2011 in which the Appellant was informed that HMRC did not operate a faster payment system.

17. It was submitted that there could be no reasonable expectation that HMRC would receive payment on time and no reasonable excuse for the late payment.

Proportionality

18. Mr Hale argued that the Tribunal could consider the issue of proportionality. He relied on the case of *Enersys* in which it was held that the penalty levied on the company under the default surcharge regime was disproportionate and was discharged.

19. Mr Hale submitted that the objective of the default surcharge regime is to ensure that those liable to pay tax pay promptly; in this case the Appellant had paid by the due date, but the payment had not been received. The quantum of the surcharge imposed, in such circumstances, was disproportionate to the gravity of the offence.

20. I was referred to Judge Bishopp's comments at paragraph 61 of *Enersys*:

"...it seems to me that a pertinent question to ask is whether, if the penalty were not determined mechanically but by a court or tribunal with the power to set any monetary penalty it chose without statutory constraint, that court or tribunal, exercising ordinary judicial discretion, would impose a penalty of as much as £130,000 for an error of this kind."

21. Mr Hale, having accepted that the quantum of the penalty imposed in *Enersys* was significantly greater than that in the present case, invited me to apply the same principle and conclude that no court or tribunal would impose a penalty in the sum of £1,467.33 on the facts of this case.

22. Mr Hale submitted that his arguments on proportionality were supported by the fact that the Appellant was in the final period of the surcharge regime.

23. Ms Taylor for HMRC contended that neither HMRC nor the Tribunal have discretion to mitigate the penalty which is set by statute. Ms Taylor submitted that the surcharge was correctly imposed in accordance with legislation and should be confirmed by the Tribunal. I was invited, should the Appellant succeed on the issue of proportionality, to adjourn the case in order to await the outcome of the case currently under appeal to the Upper Tier of ***Total Technology (Engineering) Ltd***.

Decision

Reasonable Excuse

24. I will deal first with the issue of reasonable excuse.

25. Section 59A(8) of the 1994 Act provides that a taxable person will not be liable to a surcharge if he satisfies the Commissioners or, on appeal, this tribunal that he has a reasonable excuse for the default. The legislation specifically excludes insufficiency of funds and an error made by another relied upon; neither of which are relevant in this case.

26. I noted Judge Bishopp's comments at paragraph 14 of *Enersys*:

"...the courts and this tribunal...have consistently taken a narrow view of the circumstances which may constitute a reasonable excuse."

27. I found as a fact that, at the time of cancelling the default surcharges for the periods 05/10 and 08/10, HMRC had informed the Appellant of the various methods of making payment and timescales involved. The letter from HMRC to the Appellant dated 6 June 2011 specifically stated that HMRC did not operate a faster payment service and that BACS payments take up to three days to reach HMRC's account. The Appellant was also provided with an advice sheet for further clarification.

28. There was no evidence before me that the Appellant had sought any further clarification as to the various methods of paying electronically and the length of time that such methods required. I found as a fact that the senior partner's lack of understanding as to the type of transaction he had conducted or length of time

involved for payment to be received does not constitute a reasonable excuse. I rejected the contention set out in the Appellant's grounds of appeal that the information provided by HMRC is deliberately obscure and queried why, if the Appellant had found the information to be so, no action had been taken to seek clarification from HMRC, particularly bearing in mind the difficulties experienced previously in relation to payments and delays.

29. Precedents have made clear that ignorance cannot amount to a reasonable excuse and I found as a fact that the error on the part of the senior partner as a result of his ignorance or lack of understanding in respect of HMRC's bank system was not a reasonable excuse, bearing in mind the assistance available from HMRC and the contents of HMRC's letter dated 6 June 2011 and advice sheet attached to it.

30. I accepted that the Appellant had made payments in 3 tranches in order to avoid delay by their own bank for sums exceeding £10,000; however I found as a fact that this did not provide the Appellant with a reasonable excuse.

31. I did not accept that, having made payment on 6 July 2011, there could be any reasonable expectation that HMRC would receive the payment by the due date of 7 July 2011 given the fact that the Appellant had been informed that such payments can take up to 3 days to clear. I therefore did not find that the Appellant fell within s 59(7)(*a*) VAT Act 1994.

32. I accepted that there was no intention on the part of the Appellant to avoid making payment, however I found as a fact that this did not provide the Appellant with a reasonable excuse for the fact that payment was made late.

33. I accepted that there may be businesses which might not wish to agree a direct debit payment; however I found that this general observation did not assist me in determining whether the Appellant had a reasonable excuse on the facts of this case.

34. I accepted that the Appellant is reliant to a large part on payments from the LSC which are often delayed; however this was not put forward as the reason for late payment being made and in the absence of any evidence to support the assertion that this had been the cause of the late payment, I did not accept that this provided the Appellant with a reasonable excuse.

35. I found that the fact that the Appellant frequently makes CHAPS (same day) payments does not, in my view, provide it with a reasonable excuse for the late payment of VAT. I found as a fact that the Appellant's understanding that HMRC can receive same day payments does not assist in determining whether a reasonable excuse existed for its late payment of VAT in the period with which this appeal is concerned. Case law has made clear that the onus to comply with its tax obligations rests firmly with the Appellant and its ignorance as to the methods available for payment does not amount to a reasonable excuse. The Appellant accepted in its grounds of appeal that a payee must take "extreme" care to ensure that payment is made in sufficient time. I found as a fact that the Appellant had not taken "extreme"

care, or even the care to be expected of a diligent and prudent taxpayer seeking to comply with his obligations.

36. The legislation is designed to penalise lateness, irrespective of length, and is to be applied strictly. I therefore reject the first ground of appeal.

Proportionality

37. In a case concerning the VAT default surcharge regime, proportionality is a concept that originates in European Community law. The principle is contained in Article 5 of the EC Treaty where paragraph 3 provides that:

"Any action by the Community shall not go beyond what is necessary to achieve the objectives of this Treaty."

38. Judge Bishopp in *Enersys* clearly held that the Tribunal did have power to hear proportionality arguments [32]:

"…if the remedy is disproportionate to the aim, the court or tribunal has a Community duty to intervene."

39. I agreed with his comments based, not on the application of the Convention, but on Community law principles. In that context, cases such as ***Garage Molenheide BVBA and others v Belgium*** *(C- 286/94, C-340/95, C-401/95 and C-47/96) [1998] STC 126* indicate that the Tribunal has a duty to intervene if a penalty is disproportionate [48] and [49]:

"… the principle of proportionality is applicable to national measures which… are adopted by a member state in the exercise of its powers relating to VAT, since, if those measures go further than necessary in order to attain their objective, they would undermine the principles of the common system of VAT and in particular the rules governing deductions which constitute an essential component of that system.

49 As regards the specific application of that principle, it is for the national court to determine whether the national measures are compatible with Community law, the competence of the Court of Justice being limited to providing the national court with all the criteria for the interpretation of Community law which may enable it to make such a determination …."

40. I therefore accepted that the Tribunal did have jurisdiction to consider proportionality.

41. I then turned to the question of whether the penalty levied in this case is, in the circumstances, disproportionate and I bore in mind that each case must be decided on its own merits.

42. I was invited to consider the principles that can be derived from case law precedents. Mr. Hale submitted that the question posed by Judge Bishopp as to

whether any court or tribunal would impose such a penalty, if it were not constrained by legislation, should be applied in this case.

43. In considering this issue, I found the following points relevant:

(a) Whether the default was innocent or deliberate

(b) The number of days of the default

(c) The absolute amount of the penalty

(d) The "inexact correlation of turnover and penalty"

(e) The absence of any power to mitigate

44. In *Enersys*, the late payment resulted from a mistake as the person responsible for the VAT payment, new to his role, confused two companies in the group which had differing VAT due dates. The VAT was paid one day late.

45. I found as a fact that the situation in the appeal before me is different; I accept that the late payment was not deliberate but in my view it cannot be described as a mistake of the type in *Enersys* as the Appellant had received information prior to the due date for payment relating to payment methods and the time taken for receipt of payments.

46. I accepted that the number of days the payment was late was, as in *Enersys*, minimal. I also found that the amount of the penalty is clearly high in relation to the period of lateness involved.

47. There was no evidence before me as to the Appellant's turnover. Mr Hale submitted that the period in question involved a higher amount of VAT (in the region of 50%) than normal for the Appellant. The only evidence before me was that shown on the unchallenged schedule of defaults prepared by HMRC, which showed tax assessed in 02/10 as £23,780.53, 05/10 as £16,836.76, 08/10 as £19,217.66, 02/11 as £24,771.26 and 05/11 as £29,346.61. On the basis of this document I was prepared to accept that 05/11 involved a higher VAT payment than previous periods. That said, I did not accept that this provides sufficient reason to interfere with the penalty on grounds of proportionality.

48. I also took into account the absence of a power to mitigate and I considered the issue of the proportionality of the system in that context.

49. The test for proportionality, as relied upon by Judge Bishopp in *Enersys*, is set out in *International Transport Roth GmbH v Home Secretary* (2003 QB 728) as per Simon Brown LJ at [26]:

"… 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?"

50. I agreed with and followed Judge Bishopp's comments in *Enersys* that the default surcharge regime is not of itself disproportionate [59]:

"As I have pointed out, the law allows a taxable person a calendar month from the end of each of his prescribed periods to prepare his return and arrange for the payment of the net amount due, a period which, as I have said, is of reasonable length. It also seems to me impossible, in principle, to criticise a penalty system which is designed to deter delay, even of as little as one day, beyond that month, and to punish delay when it occurs. It is necessary also to bear in mind that the tax due from many traders amounts to a very large sum; the imposition of a small fixed penalty, such as the £100 imposed in many of the cases to which Mr Conlon referred me, would constitute in such circumstances neither deterrent nor punishment. For that reason I see nothing offensive in principle in a tax-geared penalty nor, self-evidently, in a system which increases the rate of the penalty for repeated offences."

51. In following such guidance, I rejected Mr Hale's submission that his arguments on proportionality were strengthened by the fact that the Appellant was in the final period of the surcharge regime or that any analogy could be drawn with interest claimed in a County Court; the timescale of the regime and amount of the penalty imposed acts as a deterrence.

52. I considered the principles derived from case law and noted that *Enersys,* with reference to ***Customs and Excise Commissioners v Peninsular and Oriental Steam Navigation Co*** *[1992] STC 809* makes clear that exceptional circumstances must be present for a court or tribunal strike down a penalty; Simon Brown J said:

"My inclination, therefore, for the purposes of this appeal is to assume without finally deciding that in circumstances such as arise here the court could indeed strike down national penal legislation simply on the ground that it offends the principle of proportionality. That said, however, it seems to me that only most exceptionally could the court properly do so."

53. I concluded that the surcharge in this case, whilst it may be considered harsh given the minimal length of delay in HMRC receiving the funds, was not in all the circumstances "plainly unfair" or "devoid of reasonable foundation".

54. My findings were as follows:

(a) There was no reasonable excuse for the late payment of VAT in the 05/11 period;

(b) The default surcharge has been properly levied in relation to the late payment;

(c) The tribunal does have jurisdiction to consider proportionality in such cases;

(d) The resulting penalty was not disproportionate

55. I therefore dismiss the appeal and confirm the surcharge.

56. 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.

TRIBUNAL JUDGE
RELEASE DATE: