



TC03527

Appeal number: TC/2013/05146

VALUE ADDED TAX – default surcharge – section 59 Value Added Tax Act 1994 - whether deferral agreements excluded default surcharges - whether default in period 05/12– whether return sent in one day late so that surcharge liability period extended – whether result disproportionate - appeal dismissed-

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

CRESCENT OF CAMBRIDGE LIMITED

Appellant

- and -

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

Respondents

**TRIBUNAL: JUDGE GUY BRANNAN
MR MICHAEL SHARP FCA**

Sitting in public at Bedford Square, London WC1 on 14 April 2014

Alan Walker for the Appellant

Rita Paveley, Presenting Officer, for the Respondents

DECISION

Introduction

5 1. This is an appeal against VAT default surcharges for the VAT periods 12/03, 03/04, 09/04, 12/04, 06/06, 03/07, 09/07 and 06/08. These surcharges amount to £63,392.88.

2. No objection is taken by HMRC to the fact that these appeals are strictly out of time and, accordingly, we give permission for the appeals to be made out of time
10 under section 83G (4) Value Added Tax Act 1994 ("VATA").

3. Essentially, the issue in this appeal is whether the penalties are due as calculated by HMRC.

The facts

4. The appellant is a company manufacturing spiral, straight and helical staircases
15 for supply in the construction industry.

5. As noted above, HMRC have issued default surcharges against the appellant in the total amount of £63,392.88.

6. The period 09/03 had a due date for filing the return and payment of VAT of 31/10/03. We note that the due date for electronic payment and electronic VAT return
20 submission is in practice extended by HMRC by a further seven days. In respect of 09/03, the appellant settled its liability for the VAT quarter by a series of six cheques over the period 05/12/03 – 06/10/04. The return was received on 05/12/03. A surcharge liability notice was issued on 21/11/03. No surcharge was imposed because this was the first default in the surcharge liability period.

7. For the period 12/03, the due date for payment and for the return was 31/01/04. The return was received on 18/02/04 and payment was received by a series of cheques
25 over the period 06/10/04 – 02/12/05. The surcharge liability notice was issued on 25/02/04 in the amount of £859.71 (at the rate of 2%).

8. For the period 03/04 the due date was 30/04/04. The return was received by
30 HMRC on 30/04/04 (i.e. in time) but payment was received by cheque on 02/06/04. A surcharge liability notice was issued on 14/05/04. The amount of the surcharge was £3,859.35 (at the rate of 5%).

9. In respect of the period 09/04 the due date was 31/10/04 and payment was received by a series of cheques in the period 01/02/05 – 02/03/06. The return was
35 received on 01/02/05. The surcharge liability notice was issued on 09/02/05 in the amount of £8,510.33 (at the rate of 10%).

10. For the period 12/04 the due date was 31/01/05 and payment was made by a series of three cheques in the period 02/03/06 – 02/06/06. The surcharge liability notice was issued on 11/02/05 in the amount of £8661.81 (at the rate of 15%).

5 11. The period 12/05 is a critical period for the purposes of this appeal. The due date for the (non-electronic) payment of VAT and the return was 31/01/06. It is common ground that the VAT payment was received from the appellant by Chaps on 07/02/06. In other words, it was received in time because of the extended seven-day period for electronic payments. The real issue here does not relate to the time of payment of VAT, but rather to the date on which the return was received by HMRC.
10 HMRC say that the return was received on 08/02/06 and the appellant says of return was received well before that date. On HMRC's reckoning, therefore, the return was one day late. The reason why this was important is that if the return was, as HMRC contend, one day late the surcharge liability period, for the purposes of section 59 VATA, would be extended until 31 December 2006. If the appellant defaulted in
15 respect of an accounting period ending within this period the surcharge would be imposed at the 15% rate. A surcharge liability extension notice was issued on 27/02/06. The subsequent history of the appellant's defaults will make it clear why this point is important but, in short, there was a further default (06/06) in the period ending 31 December 2006. We shall return to the issue of when the return for 12/05
20 was received by HMRC shortly.

12. There were no further defaults by the appellant until the period 06/06. The due date for the period 06/06 (non-electronic payments) was 31/07/06. Payment was made by cheque received by HMRC on 07/08/06. The return was also received on 07/08/06.
25 The surcharge liability notice was issued on 25/08/06 in the amount of £10,488.62 (at the rate of 15%). It will be seen, therefore, that if the return for 12/05 had been submitted on time, as the appellant contends, the amount of the surcharge would have been nil since the earlier surcharge liability period would have expired and the default in the period 06/06 would have been a first default starting a new surcharge liability period. Also, any subsequent default surcharges would have been charged at lower
30 rates.

13. In the course of the hearing there was some debate about HMRC's records in respect of the date on which payment for 06/06 was received by HMRC. HMRC's computer records record the date as being 07/08/06. The payment was debited to the appellant's bank account on 09/09 2006. This is consistent with a cheque having been
35 received by HMRC on 07/08/06 and being presented for clearing on that day. The confusion was caused, we think, by the fact that HMRC's computer records indicate that the payment was entered into the computer on 17/08/2006.

14. The next default came in the period 03/07 in which the due date (for non-electronic payment and filing) was 30/04/07. Payment was received by cheque on
40 09/05/07 and the return was received on 01/05/07. The surcharge liability notice was issued on 18/05/07 in the amount of £14,082.89 (at the rate of 15%).

15. The penultimate default, for the purposes of this appeal, came in the period 09/07 for which the due date (non-electronic payment and filing) was 31/10/07.

Payment was received on 07/01/08 by BACS and the return was received (in time) on 29/10/07. The surcharge liability notice was issued on 16/11/07 in the amount of £11,277.38 (at the rate of 15%).

5 16. Finally, in the period 06/08 the due date (non-electronic payment and filing) was 31/07/08. Payment was received by BACS, which extended the due date to 07/08/08, on 08/08/08 (i.e. one day late) and the return was received on time on 29/07/08. The surcharge liability notice was issued on 15/08/08 in the amount of £5652.79 (at the rate of 15%).

10 17. The appellant did not dispute that its VAT payments were made late in respect of the periods 06/06, 03/07 and 09/07 and that it was, therefore, in default for those periods.

15 18. As noted above, because the payments for periods 09/03, 12/03, 03/04, 09/04, 12/04, 06/06 and 03/07 were all paid by cheque, the additional seven days for electronic payment and return submission was not applicable. Therefore, all payments in respect of those periods were due to be received by HMRC by the last day of the month following the last day of the VAT period.

19. The appellant did not dispute the arithmetical calculation of the default surcharges in respect of the periods 12/03, 03/04, 09/04 and 12/04 but did dispute its liability to those surcharges.

20 20. The challenge was based on the fact that there was an agreement between the appellant and HMRC to defer payment of the appellant's VAT liability for the period 09/03. However, the appellant only wrote to HMRC seeking deferral of payment on 2 December 2003 and HMRC's agreement was notified by letter dated 23 December 2003. The appellant in its letter referred to unspecified cash flow problems being experienced by the appellant due to a shortfall in cash collection from the period 25 October and November 2003, which the appellant did not expect to improve because of the impending Christmas period. In other words, the agreement was concluded after the due date for payment in respect of 09/03 – the first default which started the surcharge liability period running.

30 21. Moreover, HMRC's letter dated 23 December 2003 stated:

"Acceptance of this arrangement does not prevent or cancel the recording of defaults, liability to surcharge, and interest where applicable."

35 22. We agreed with Mrs Paveley's submission that this agreement could not prevent a default arising in respect of 09/03 and giving rise to the commencement of the surcharge liability period. Moreover, we do not consider either the agreement or the cash-flow difficulties as giving rise to a reasonable excuse for the purposes of section 59 VATA. In the first place, the default had already occurred by the time the agreement was made and, secondly, the reference to the cash flow problems of the 40 appellant was too unspecific to give rise to a reasonable excuse within the principles

established by the Court of Appeal in *Customs and Excise Commissioners v Steptoe* [1992] STC 757.

23. On 7 January 2004 the appellant's parent company wrote again to HMRC indicating that the appellant would be unable to adhere to the agreed payment schedule set out in HMRC's letter dated 23 December 2003. This letter cited liquidity problems of the appellant's group. The letter requested a moratorium for 90 days from 1 January 2004 to 31 March 2003.

24. It appears that no formal deferral agreement was reached between the appellant and HMRC with respect to the period 12/03. A letter from HMRC dated 23 June 2004 set out a proposed schedule of payments to be made by the appellant. HMRC's letter of 23 June stated:

"This arrangement **does not** prevent or cancel the recording of Defaults [sic] Surcharge liabilities or Further Interest charges, which must be paid as and when they are notified."

25. It is clear, therefore, that the letter of 23 June 2004 did not agree to waive any liability for default surcharges which had accrued.

26. A further deferment agreement was reached after a meeting in London between HMRC and representatives of the appellant's parent group on 7 July 2005. The agreement did not relate to a specific period but referred to various outstanding balances for three group companies, including the appellant. The outstanding balances referred but only to tax, and not to "any interest, surcharges etc." The letter stated that if the appellant wanted to have the default surcharges reconsidered the appellant should write to HMRC who would forward the request to the appropriate independent review team. It is clear from this letter that, under this deferment agreement, HMRC did not agree to waive any default surcharges that had already accrued.

27. By a letter dated 13 November 2006, the appellant's parent company noted that appeals would be made in respect of the various payments demanded from the group's subsidiaries and it was clear from the context that those appeals would include appeals in respect of the default surcharges.

28. In the papers before us, reference was made to section 108 Finance Act 2009. This provision introduced relief in respect of "Time to Pay" agreements entered into after 24 November 2008. The effect of section 108 was that if an agreement had been entered into prior to a default, no liability to surcharges would arise. However, it was common ground that section 108 did not apply to any of the deferral agreements relevant to this appeal.

29. As we have mentioned, there was considerable debate about the period 12/05. The issue here was whether the return for the period had been received by HMRC on time or whether, as HMRC argued, it was received one day late on 8 February 2006. As we have explained, if the return was one day late then the surcharge liability period was extended for another 12 months so that subsequent payment defaults would continue to be charged at 15% rate. If the return was not late, as the appellant

argued, the surcharge liability period would have expired prior to the next default so that, in effect, the default surcharges would be "reset", with the first default only serving to trigger a new surcharge liability period and the second default being charged with a default surcharge of 2% and so on.

5 30. It was common ground that the appellant paid its VAT for the period 12/06 on time on 7 February 2006. It was also common ground that, because the appellant had paid its VAT electronically, it had until 7 February 2006 to ensure that its return was received by HMRC.

10 31. The return for the period 12/05 was signed by Ms Jane Jakes, an employee of the appellant, and dated "31/1/06". On the upper right hand corner of the return was a box marked "For Official Use". In that box there was a stamp with the legend "BANK VALID 159" and a date "08 FEB 2006".

15 32. Mr Walker argued that because the return was dated 31/1/06, it was more likely than not that the return was posted the same day. He told us that the appellant always used first-class post. He also argued that the legend "BANK VALID 159" must be taken to refer to a date when the Chaps payment had gone through. Therefore, he submitted that it was more likely than not that the return would have been received well before the deadline of 7 February 2006.

20 33. In HMRC's computer records for the appellant the payment and receipt of the return were shown as follows:

LINE*	DATE	PERIOD	DESCRIPTION	S/CODE	REFERENCE	NOT POSTED	TRADER DEBITS	TRADER CREDITS
1	8/2/06	00/00	ELECTRONIC PAYMENT	374	00003805622			73,914.00 CR
2	8/2/06		DATE OF RECEIPT	000	7/2/06			
3	8/2/06		NON APPR CR (ACT) ACC	374	00003805622	73,914.00 CR		
4	14/2/06	12/05	TAX DUE	310	6020931587		73,914.00	
5	14/2/06		DATE OF RECEIPT	000	8/2/06			
6	14/2/06	12/05	AUTO APPROP - ACCTG	000	00003805622			
7	14/2/06		MATCHING PYMT TO RTN	374	8/2/06	73,914.00 CR		

*The column entitled "LINE" does not appear in the original document and is used here solely for ease of reference

25 34. It was explained to us that the column entitled "DATE" was the date on which the entries were keyed into the computer system by HMRC. From these records it seemed to us clear that the VAT payment in respect of 12/05 of £73,914 was been

received on 7 February 2006. However, the payment was not allocated to a return period until the return was received. The payment was allocated on 8 February 2006 which is recorded in line 5 as the date on which the return was received. Line 7 makes it clear that the payment was matched with the return on 8 February 2006. It seems to us, therefore, that it is more likely than not that the return for 12/05 was received on 8 February 2006 i.e. one day after the payment was made by Chaps.

35. In the bundle of papers for the hearing there were a number of the appellant's other paper (ie non-electronic) VAT returns. For the period 12/03, the return was signed by a Mr Mark Jakes and was dated 29 January 2004. In the same box on the upper right hand corner of the return, there was a stamp: "COLCHESTER (SOUTHEND LBO 099) 18 FEB 2004". Next to this was another stamp: "VCU (35) 214 24 FEB 2004." HMRC's computer records indicated that the return was received on 18 February 2004. Thus, it appeared to us that the return reached HMRC 20 days after it was signed by Mr Jakes.

36. The return for the period 03/04 was signed by Mr Jakes on 22 April 2004. The box on the upper right-hand side of the return was stamped: "VOPS (VCU) VALID 91 30 APR 2004." HMRC's computer records stated that the return was received on 30 April 2004 i.e. date a consistent with the date stamp on the upper right-hand box. On this basis, the return reached HMRC seven or eight days after it was signed by Mr Jakes.

37. The return for the period 09/04 was signed by Mr Jakes on 25 October 2004. The box on the upper right-hand side of the return was stamped: "VOPS (VCU) VALID 180 01 FEB 2005." HMRC's computer records indicated that the return was received on 1 February 2005 i.e. date a consistent with the date stamp on the upper right-hand box. On this basis, the return reached HMRC over three months after it was signed by Mr Jakes.

38. The return for the period 12/04 was signed by Mr Jakes on 26 January 2005. The box on the upper right-hand side of the return was stamped: "VOPS (VCU) VALID 180 01 FEB 2005." HMRC's computer records indicated that the return was received on 1 February 2005 i.e. date a consistent with the date stamp on the upper right-hand box. On this basis, the return reached HMRC over five days after it was signed by Mr Jakes. 26 January 2005 was a Wednesday and HMRC record it as having reached them on the following Monday. It does not, therefore, appear that the return was sent by first class post on the day it was signed.

39. The return for the period 06/06 was signed by Ms Jane Jakes on 31 July 2006. The box on the upper right-hand side of the return was stamped: "BANK VALID 173 07 AUG 2006." HMRC's computer records indicated that the return and the payment were received on 7 August 2006 i.e. date a consistent with the date stamp on the upper right-hand box. On this basis, the return reached HMRC at least seven days after it was signed by Mr Jakes.

40. It seemed to us, therefore, that there was a consistent pattern in which the appellant's VAT returns were signed some days before they were posted. In our view,

therefore, this pattern of behaviour was consistent with our conclusion that the return for 12/05 was received by HMRC 8 February 2006.

41. Moreover, HMRC's computer records indicated that the date on which the return was received was consistent with the date stamped in the box on the upper right-hand side of the return and this was so regardless of the wording used in the stamp.

42. We therefore find that the return for 12/05 was received by HMRC on 8 February 2006. In other words, it was received one day late. It follows, therefore, this constituted a default for the purposes of section 59 VATA and that the surcharge liability period was extended (a Surcharge Liability Extension Notice was issued on 17 February 2006) to 31 December 2006.

Discussion

43. Mr Walker drew attention to what he described as "a history of accidents and errors on the part of" HMRC. Nonetheless, notwithstanding that some errors did occur in the course of correspondence between the parties, we are confident that the figures and dates recorded above are accurate.

44. In his submissions, Mr Walker described the default surcharges imposed on the appellant as "brutal". He also submitted that the surcharges were disproportionate. Mr Walker also predicted that the appellant's parent might well, if the surcharges were upheld, choose to withdraw its financial support from the appellant with the result that the appellant would be forced to cease trading.

45. The default surcharge regime set out in section 59 VATA is the scheme laid down by Parliament to ensure that traders comply with their obligations to pay and return VAT – which, along with PAYE, is the major source of tax revenue – on a timely basis. It is essentially a regime without discretion. If a trader's conduct falls within the parameters of the legislation a surcharge is imposed. Neither HMRC nor this tribunal has discretion to wave a surcharge imposed by law. Moreover, if a trader is late in submitting a return, although no monetary default surcharge is imposed, the surcharge liability period is extended. It is only if a reasonable excuse for the default is established that the default can be ignored.

46. Is regime and its application in this case disproportionate? The issue was considered in great detail by the Upper Tribunal (Warren J and Judge Bishopp) in *HMRC v Total Technology (Engineering) Ltd* [2012] UKUT 418 (TCC). In that case the Upper Tribunal held that even though the scheme or architecture of the default surcharge regime was proportionate it was necessary to look at whether its application was proportionate in the facts of the particular case. In that case one argument put forward by the taxpayer was that its payment of VAT was only one day late. The Upper Tribunal held that this feature of the scheme was not disproportionate at [88]:

"This, as we see it, is a reflection of the aim of the legislation which, as we have explained, is to ensure compliance with the obligation to file and pay by the due date. The issue is not, in our view, whether the

5 absence of a different treatment depending on the extent of the delay in
filing the return undermines the system; the issue is whether the
amount of the penalty is proportionate to the breach of duty in being a
single day late. At the level of the scheme viewed as a whole, a penalty
10 which is incurred as the result of a particular failure is entirely
acceptable and compliant with the principle of proportionality provided
that the amount of the penalty for that failure (however innocent its
cause) is itself proportionate to the failure. At the level of the
individual taxpayer, the question is not whether it would be a more
coherent regime to have sequential penalties as time passes without the
15 default having been remedied. Rather it is whether the amount of the
penalty for the failure to file and pay by the due date is proportionate.
If it is of an appropriate amount, then there is no need for a power to
mitigate."

15 47. The Upper Tribunal also considered whether potential hardship to a trader was a
factor to be taken into account. In particular, the amount the surcharge was not related
to profitability. The Tribunal said at [90]:

20 "We do not consider that there is anything in this point at the level of
the regime viewed as a whole or at the level of the individual taxpayer.
The penalty is not related to profitability but it is related to the tax
unpaid. A penalty, if it is not a fixed-rate penalty, must vary according
to some objective criteria. It is not immediately apparent to us why a
penalty linked to profitability would be any fairer than one linked to
25 the outstanding tax although some penalty regimes do have that result.
It may be possible to design a system which brought into account many
factors—turnover, profitability, proportion of exempt or zero rated
supplies to name but three—so as to produce a more sophisticated
system which would produce a result that some people might perceive
as more fair. The fact that that might be done does not make the actual
30 regime non-compliant with the principle of proportionality."

48. At [99-100] the Upper Tribunal summarised its conclusions on the question of
the application of the principle of proportionality to the default surcharge regime as
follows:

35 "In our judgment, there is nothing in the VAT default surcharge which
leads us to the conclusion that its architecture is fatally flawed. There
are, however, some aspects of it which may lead to the conclusion that,
on the facts of a particular case, the penalty is disproportionate. But in
assessing whether the penalty in any particular case is disproportionate,
40 the tribunal must be astute not to substitute its own view of what is fair
for the penalty which Parliament has imposed. It is right that the
tribunal should show the greatest deference to the will of Parliament
when considering a penalty regime just as it does in relation to
legislation in the fields of social and economic policy which impact
upon an individual's convention rights. The freedom which Parliament
45 has in establishing the appropriate penalties is not, we think,
necessarily exactly the same as the freedom which it has in accordance
with its margin of appreciation in relation to convention rights (and

even there, as we have explained, the margin of appreciation will vary depending on the right engaged).

5 Our conclusion, therefore, is that with the possible omission of an upper limit on the penalty which may be imposed, the regime viewed as a whole does not suffer from any flaw which renders it non-compliant with the principle of proportionality in the sense that it, or some aspect of it, falls to be struck down."

49. In this case, as regards the default surcharges in respect of the periods 06/06, 03/07, 09/07 and 06/08, the appellant was subjected to default surcharges at the rate of 10 15%. This was because, in short, its return for the period 12/05 was received on 08/02/06 i.e. one day late. This had the effect of extending the surcharge liability period to cover the default in 06/06, with the subsequent defaults all falling within further extensions of the surcharge liability period. The consequent default surcharges for these four periods totalled £41,501.68 whereas, if the return had been filed on time 15 for the period 12/05, the surcharges would have been £5,636.84.

50. Does that mean that although the structure of the default surcharge regime is proportionate, its application in this particular case is disproportionate? In our view, it does not. The surcharges imposed in respect of the periods 06/06, 03/07, 09/07 and 06/08 were not imposed solely because the return in respect of the period 12/05 was 20 received one day late. They were imposed because of defaults in earlier periods which were then, so to speak, "linked" to the later defaults in those four periods by virtue of the late return in period 12/05. It was a combination of defaults in the earlier periods, the defaults in the later periods and the late return in period 12/05 that gave rise to surcharges of £41,501.68 – it was not just the late return that resulted in the penalties.

25 51. In our view, the imposition of surcharges in those amounts in these circumstances cannot be regarded as disproportionate. The fact that the surcharge liability period was extended by virtue of the late return in 12/05 seems to us entirely justified in terms of the policy of legislation i.e. to discourage defaults, both as regards payments but also as regards returns. The making of timely returns is essential 30 to enable HMRC to supervise the proper working of the VAT system. Had the surcharges been imposed solely by reason of the late return we would have had to consider whether that penalty would have been disproportionate. As we have explained, because the surcharges were imposed because of a combination of defaults taken together with the late return that point does not arise.

35 52. Accordingly, we consider that the default surcharges in respect of the periods 06/06, 03/07, 09/07 and 06/08 were not disproportionate. Also, on the basis of *Total Technology* it cannot, in our view, be argued that the surcharges for the earlier periods (12/03, 03/04, 09/04 and 12/04) were disproportionate.

40 53. In respect of the periods 12/03, 03/04, 09/04 and 12/04, Mr Walker did not dispute the amounts of the surcharges in question but did dispute liability. In fairness, Mr Walker did not focus his submissions on these periods but rather in respect of the period 12/05 and, consequently, on periods 06/06, 03/07 and 06/08.

54. In relation to the periods 12/03, 03/04, 09/04 and 12/04, we have found that the deferral arrangements described earlier in this decision did not absolve the appellant from any liability in respect of default surcharges. Accordingly, we confirm the default surcharges for those periods.

5 55. Secondly, we have found that in respect of the period 12/05 the appellant was one day late in submitting its return. The surcharge liability period was therefore extended to 31 December 2006 so that any default in respect of periods up to that date, which would include 06/06, would be charged at the rate of 15%. Accordingly, we confirm the surcharges in respect of periods 06/06, 03/07 and 06/08.

10 56. In the appellant's correspondence with HMRC and in its written submissions, the appellant argued that the default surcharges were time-barred. Mr Walker did not elaborate on this point in his oral submissions. It seemed to us that there was no basis for arguing that the default surcharges were time-barred, particularly since they were under appeal.

15 57. For the reasons given above, we dismiss this appeal.

58. 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
20 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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**GUY BRANNAN
TRIBUNAL JUDGE**

RELEASE DATE: 1 May 2014

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