



**TC04059**

**Appeal number: TC/2012/01869**

*VAT default surcharge - VAT not paid on time due - four defaults under appeal - Appellant's managing director suffered medical conditions which may have affected his ability to manage the business - whether reasonable excuse - on the facts no - whether surcharges disproportionate - no - for one default a direct debit set up by Appellant had not been applied by HMRC because it was set up after the return was submitted - this constituted a reasonable excuse - Appeal allowed in part*

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**BAYLEAF CLEANING LTD**

**Appellant**

**- and -**

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

**TRIBUNAL:    JUDGE MICHAEL S CONNELL  
                  MR TYM MARSH MA MBE**

**Sitting in public at 45 Bedford Square London WC1B 3DN on 25 July 2014**

**Mr Salah Djazia for the Appellant**

**Mrs Pateley Officer of HM Revenue and Customs, for the Respondents**

## DECISION

### The Appeal

1. Bayleaf Cleaning Limited LLP (“the Appellant”) appeals against the Respondent’s decisions to impose VAT default surcharges in respect of its failure to submit, for VAT periods ended 10/10, 01/11, 07/11 and 10/11 by the due date, payment of the VAT due.

2. The total late payment surcharges is £53,908.91, being:

10/10: 2%: £2,783.49;

01/11: 5%: £8,491.01;

07/11: 10%: £17,029.75;

10/11: 15%: £25,604.66.

3. The point at issue is whether or not the Appellant has a reasonable excuse for making the late payments.

### Background

4. The Appellant had previously defaulted on VAT payments in period 07/10 when a VAT surcharge liability notice was issued. The statutory due date in respect of that period was 31 August 2010. The payment was made by cheque on 5 October 2010 - being over a month late. The surcharge rate was 0%. Although 07/10 was the first default (in the current cycle), there had been a significant number of previous defaults surcharges.

5. Section 59 Value Added Tax Act 1994 (“VATA”) sets out the provisions in relation to the default surcharge regime. Section 59 of the VATA requires a VAT return and payment of VAT due on or before the end of the month following the relevant calendar quarter. [Reg 25(1) and Reg 40(1) VAT Regulations 1995].

6. The Appellant paid VAT on a quarterly basis and usually paid it’s VAT by cheque and sometimes electronically by CHAPS. When payment is made electronically, HMRC allows additional time for payment and pursuant to regulation 40(4) of the VAT Regulations 1995 allows an additional seven days after the end of the calendar month when payment would normally fall due (together with a further three days when the VAT is collected by direct debit). Limitations apply if the due date falls on a weekend or a bank holiday in which event, the due date defaults to the last previous working day.

7. Under s 59(1) a taxable person is regarded as being in default if he fails to make his return for a VAT quarterly period by the due date or if he makes his return by that due date but does not pay by that due date the amount of VAT shown on the return. The Commissioners may then serve a surcharge liability notice on the defaulting

taxable person, which brings him within the default surcharge regime so that any subsequent defaults within a specified period result in assessment to default surcharges at the prescribed percentage rates. The specified percentage rates are determined by reference to the number of periods in respect of which the taxable person is in default during the surcharge liability period. In relation to the first default the specified percentage is 2%. The percentage ascends to 5%, 10% and 15% for the second, third and fourth default.

8. In respect of the 10/10 period under appeal, the statutory due date was 31 November 2010. The VAT return and payment were received on the 10 January 2011. The payment of £139,174.59 was sent by cheque and therefore the statutory due date applied and the payment was over a month late. The applicable surcharge rate was 2% of the amount due. The surcharge was therefore £2,783.49.

9. In respect of the period 01/11 under appeal, the statutory due date was 28 February 2011. The VAT return and payment were received on the 23 March 2011. The payment of £169,820.22 was sent by cheque and therefore the statutory due date applied and the payment was over a month late. The applicable surcharge rate was 5% of the amount due. The surcharge was therefore £8,491.01.

10. In respect of the period 07/11 under appeal, the statutory due date was 31 August 2011. The VAT return was received on 2 September 2011 and payment of £170,297.54 was received by CHAPS on 9 September 2011. Because payment was made electronically the due date for payment was extended to 7 September 2011. Payment was therefore two days late and the applicable surcharge was 10% of the amount due. The surcharge was therefore £17,029.75.

11. In respect of the period 10/11 under appeal, the statutory due date was 30 November 2011. The VAT return was received on 29 November 2011. The payment was made by CHAPS and received on 8 December 2011. Because payment was made electronically the due date for payment was 7 December 2011. The payment was therefore received one day late. The amount due was £170,697.64. The applicable surcharge rate was 15% of the amount due and was calculated at £25,604.66.

12. HMRC say that the surcharges have been correctly issued in accordance with s59(4) of the VAT Act 1994, payment having been received by HMRC after the due dates.

13. HMRC contend that the Appellant should have been aware of the potential financial consequences of a default, having been in the default surcharge regime from 07/10 and having defaulted on previous occasions.

14. Section 21.3 of VAT Public Notice 700 - The VAT Guide (April 2012 onward) states;

*"Paying by an approved electronic method will give you up to seven extra calendar days to submit your return and pay your VAT.... The extended due date will be shown on your online VAT return and you must ensure that cleared funds reach HMRC's bank account by this date... If your due date falls on a*

*bank holiday or weekend, your payment must clear HMRC's bank account before then ...If your payment arrives late you may be liable to a surcharge for late payment. To make sure that your payment clears our account in time, you should check with your bank or building society to find out:*

- 5 *If there are any single or daily limits to how much you can transfer from your account is there a cut-off time for processing payments on the same day?*

*How long your payment will take to clear into HMRC's bank account?*

*Checking these details will help to ensure that you do not incur any unnecessary late payment surcharges.”*

- 10 The VAT acknowledgement form would have advised that payment was due electronically and would have given the dates by which it was due to be made. Again, it would have said:

- 15 *"...Before making an electronic payment please contact your bank or building society to check the services available to you, any daily value limits and the latest cut off times for making payment. For more information on making electronic payments see the 'How to pay' guide on the HMRC website.”*

Information when using the CHAPS Payment method is provided on the HMRC website.

- 20 Included within the notes on the reverse of the previous Surcharge Liability Notices is the following standard paragraph:

*"Please remember: Your VAT returns and any tax due must reach HMRC by the due date. If you expect to have any difficulties contact either your local VAT office, listed under HM Revenue & Customs in the phone book as soon as possible, or the National Advice Service on 0845 010 9000.”*

- 25 15. A taxable person who is otherwise liable to a default surcharge may nevertheless escape that liability if he can establish that he has a reasonable excuse for the late payment which gave rise to the default surcharge(s). Section 59 (7) VATA 1994 sets out the relevant provisions : -

- 30 *‘(7) If a person who apart from this sub-section would be liable to a surcharge under sub-section (4) above satisfies the Commissioners or, on appeal, a Tribunal that in the case of a default which is material to the surcharge –*

- 35 *(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 then 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 ..'*

16. The initial onus of proof rests with HMRC to show that a surcharge has been correctly imposed. If so established, the onus then rests with the Appellant to demonstrate that there was a reasonable excuse for late payment of the tax. The standard of proof is the ordinary civil standard on a balance of probabilities.

17. Section 59(7) must be applied subject to the limitation contained in s71(1) VATA 1994 which provides as follows : -

*'(1) For the purposes of any provision of section 59 which refers to a reasonable excuse for any conduct -*

*(a) any insufficiency of funds to pay any VAT due is not a reasonable excuse.'*

18. Although an insufficiency of funds to pay any VAT due is not a reasonable excuse, case law has established the principle that the underlying cause of any insufficiency of funds may constitute a reasonable excuse

#### Appellant's Case

19. The stated grounds of appeal in the Appellant's Notice of Appeal were:

i. Computer / system issues

The Appellant said that he had encountered difficulties with the online filing system. In spite of determined efforts the company proprietors were not able to handle the increased workload and technological change caused by the changeover to online filing. The assistance which they had requested from HMRC was not properly afforded. The Appellant asserts that this constitutes a reasonable excuse.

ii. Disruption of accountancy regime due to illness of Director

Mr Djazia suffers from severe back pains, claustrophobia and an anxiety disorder having been involved in an accident overseas. This intermittently results in him being unable to work or do anything physical due to a temporary inability to leave his home. He is under ongoing care of medical professionals for his anxiety and depression, for which he is prescribed medicine, and a chiropractor for his back problems. The illnesses have resulted in an inability to prepare returns and attend his bank to make payments. As a result the Director has appointed a Bookkeeper to assist and has set up a Direct Debit mandate.

iii. Defects in surcharge notices and failings of HMRC

The Appellant says that some of the surcharge liability notices were addressed to an incorrect address as the Appellant Company moved to its present address in May 2011 but HMRC persisted in writing to an old address. As a result the Appellant did not receive the surcharge liability notices in a timely manner and at best haphazardly. The Appellant contends that default surcharge assessment based upon incorrectly addressed notices must be invalid, whether levied in respect of the prescribed accounting period, during which the notice was served, or a later period. Further there are clear

inaccuracies on the face of some of the Notices and an inaccuracy in a surcharge liability notice ought to render it invalid. Subsequent surcharges depending on that notice ought to also be invalid. HMRC also failed to fully assist the trader with the change to online filing.

5 iv. Proportionality and ECHR

The application of the surcharge regime in this case is disproportionate and unfair and offends the European Convention on Human Rights.

10 The combination of the above resulted in exceptional pressure and the Appellant argues that collectively the circumstances set out above amount to a reasonable excuse for the late payments.

20. At the hearing Mr Djazia, the managing director of the Appellant Company, said that he wished to raise a further ground of appeal. He said that with regard to the last default period 10/11, he made every effort to make the payment on time and had set up a direct debit to ensure payment. However because at that stage the return had already been submitted, (the return was acknowledged as having been received in good time on 29 November 2011), the direct debit was not applied. It is the return that triggers the direct debit. Mr Djazia then set up a second direct debit for 6 November 2011. However the direct debit was again not applied, for the same reason, and he had to make payment by CHAPS on 8 November 2011. By then he was one day late. He checked with his bank who said that the direct debit had been properly set up and there appeared to be no reason why the monies had not been taken by HMRC.

21. Mr Djazia submitted medical evidence in respect of his illnesses. He provided a copy of a letter dated 23 May 2014 from Mr John Meenan, a consultant gastroenterologist, who reported that he had been treating Mr Djazia for irritable bowel syndrome which had been compounded by a debilitating anxiety disorder that he had suffered from for two decades. The condition had caused depression and severe anxiety attacks which despite treatment 'remained a considerable clinical issue'. Mr Meenan said that the Appellant's condition would have impacted markedly on his day to day functioning and in particular on his ability to manage the administration of his business.

22. A second letter dated 6 June 2014, provided by Mr Djazia, was from his GP Dr A Fenuyi who also said that Mr Djazia suffered from anxiety and depression, panic attacks, claustrophobia and recurring back pain.

23. Mr Djazia said that he had been suffering acute panic attacks for some time. On some days because of his claustrophobia, he did not go out. Often in the morning, he gets breathless and cannot concentrate. When this happens he is unable read anything and in particular finds it difficult to deal with online returns. He was having one of these attacks at the time the payment was due for period 07/11. He was eventually able to make the payment, but two days late on 9 September 2011.

40 HMRC's Case

24. Mrs Pateley for HMRC said that the Appellant does not dispute that payment was made late in each of the default periods.

25. With regard to the ground of Appeal that the "Director...was not able to readily handle the increased technological workload caused by the change to online filing," the director was issued with a paper return on two occasions, 4 October 2010 and 4 January 2011, after explaining the issues with online filing to Debt Management and Banking. He was also advised to contact the eVAT team for assistance. HMRC subsequently explained that the Appellant's business could not be given dispensation to submit paper returns due to the amount of its turnover. Online submission of returns is required once turnover exceeded £100,000. The Appellant, due to an annual turnover of over £3 million, had been mandated in a letter dated 10 January 2010, to submit returns electronically from period 07/10.

26. It is the director's responsibility ultimately to ensure that VAT returns and payments are made in time. The due date is given on electronic returns and the acknowledgement confirms when and how payment is to be made. It advises customers to check with their banks for any daily amount limits, bank cut-off times and services available. It also refers to the 'how to pay' guide on the HMRC website. The due date was also given on paper returns. HMRC say that the delays in submitting the returns, even allowing for problems with online submission, were excessive (being between 23 and 41 days late).

27. With regard to the director's illnesses, "resulting in an inability to prepare returns and attend his bank to make payments", no dates of the periods of illness or further detail was provided with the Notice of Appeal. HMRC notes that the director has appointed a bookkeeper, which was presumably an option he could have taken at an earlier stage in order to avoid the defaults. HMRC notes that in a telephone conversation of 9 April 2009 another director of the company contacted HMRC. HMRC state that it is reasonable to expect alternative arrangements to have been put in place to ensure the company's legal obligations were met in a timely fashion.

28. With regard to the Appellant's assertion that surcharge liability notices were addressed to the trader at an incorrect address, HMRC do not have any record of the Appellant notifying a change of address, other than an IDMS note dated 19 August 2011, in which Mr Djazia telephoned and although mentioning during security that the company's address had changed, he did not actually provide it.

29. HMRC records show that the following notices were issued to the principle place of business address, as notified to HMRC:

07/10 Surcharge Liability Notice ("SLN") issued on 17 September 2010;

10/10 SLN issued on 17 December 2010 & 18 January 2011;

01/11 SLN issued on 11 March 2011 & 6 July 2011;

07/11 SLN issued on 16 September 2011.

The SLN for 10/11 was issued on 16 December 2011 to the new address as notified by the Appellant.

30. In addition, the Appellant Company was informed during a call to the National Advice Service on 29 September 2011 that an authorised person had to contact  
5 HMRC Variations Unit, in writing regarding a change of address.

31. Under VAT Regulations 1995 (Regulation5(2):

‘Every registered person except one to whom paragraph 11, 12, 13(1), (2) or (3) of Schedule 1, paragraph 5 of Schedule2, or paragraph 5 of Schedule 3 to the Act applies shall, within 30 days of any changes being made in the name, constitution or ownership  
10 of the his business, or of any other event occurring which may necessitate the variation of the register or cancellation of his registration, notify the Commissioners in writing of such change or event and furnish them with full particulars thereof.’

32. Section 98 VATA 1994 states that: "Any notice, notification, requirement or demand to be served on, given to or made of any person for the purposes of this Act  
15 may be served, given or made by sending it by post in a letter addressed to that person or his VAT representative at the last or usual residence or place of business of that person or representative."

33. HMRC would issue Surcharge Liability notices to the last notified address held on file. There were no returned mail entries for the surcharge liability notices issued  
20 for the current default cycle. Therefore on the balance of probability there is nothing to suggest that they were not delivered to or received by the Appellant.

34. HMRC rely on the Upper Tribunal case of *Data Select Limited* [2012] UKUT 187 (TCC), where it was stated that "by section 98 of VATA, any notice ... may be served, given or made by sending it by post in a letter addressed to that person ... at  
25 the last or usual residence of place of business of that person" (paragraph 32). Further, at paragraph 33, that s.98 of VATA is supplemented by the general provisions contained in section 7 of the Interpretation Act 1978.

35. HMRC’s records of the Appellant company’s business address was amended following an online request, which was received on 8 December 2011.

30 36. Therefore, HMRC say that the surcharges were correctly issued in accordance with the VAT Act 1994 s 59(4).

37. With regard to the default in period 10/11, Mrs Pateley said that the second direct debit had not been applied possibly because the first one had already failed. She acknowledged that the return had been made on time and that the second direct debit  
35 would have effected payment by the due date, had it been applied.

38. In relation to the argument that the default surcharges for the periods 10/10, 01/11, 07/11 and 10/11 are disproportionate, HMRC refer to the decision in the case of *Total Technology (Engineering) Ltd* in the Upper Tribunal, which created a precedent binding on appeals before the First-tier Tribunal. The Tribunal said that:

i) There is nothing in the architecture of the VAT Default surcharge system which makes it fatally flawed.

ii) The Tribunal found that the default surcharge penalty does not breach EU law on the principle of proportionality.

5       iii) In order to determine whether or not a penalty is disproportionate, the Upper Tax Tribunal decision in the case of Total Technology addressed the following factors:

a. The number of days in default;

b. The absolute amount of the penalty;

10       c. The "inexact correlation of turnover and penalty";

d. The absence of any power to mitigate.

The Upper Tribunal, comprising the Chamber President, Mr Justice Warren, and Judge Colin Bishopp, concluded that none of these leads to the conclusion that the default surcharge regime infringes the principle of proportionality. In assessing  
15 whether the penalty in a particular case is disproportionate, the Tribunal said "the tribunal must be astute not to substitute its own view of what is fair for the penalty which Parliament has imposed". Also, "the regime viewed as a whole does not suffer from any flaw which renders it non-compliant with the principle of proportionality ..."

39. The decision in *Total Technology* concluded that since the overall aim of the VAT surcharge regime is to ensure that taxpayers pay their VAT by the due date, it is  
20 not disproportionate to the aim of the legislation, that penalties should arise when payment is made only a few days late.

40. HMRC contend that the above judgement supports HMRC's position that the default surcharge regime itself is proportionate and that HMRC was correct in  
25 charging default surcharges in respect of the late payment for the accounting periods 10/10, 01/11, 07/11 and 10/11.

41. HMRC also refer to the decision in the case of *Energys Holdings*, and submit that the decision of the Tribunal, that the surcharge was disproportionate, was reached on the particular facts of that case. However HMRC submit that this appeal can be  
30 differentiated to the *Energys* appeal in the following ways:

- *Energys* concerned a 5% surcharge. In this case there were four surcharges from 2% to 15%;

- *Energys* was served with a surcharge of £131,881; the Appellant was served with surcharges totalling £53,908.91;

- The late payment in Enersys was due to an employee mistake whereas the Appellant claims late payment was due to problems with online filing and illness.

42. HMRC cites the case of *Greengate Furniture Ltd* where it was found at paragraph 113, that the default surcharge system was not “devoid of reasonable foundation” and the surcharge itself was not found to be “plainly unfair”, although the Tribunal did say that there may be cases where this could be so. This was considered in *Total Technology*, where at paragraph 13 the Tribunal referred to *International Transport Roth GmbH* [2003] QB 728, and noted that this test set a high threshold.

43. The surcharge is a proportion of the outstanding VAT, so the charge is related to the size of the business and the amount of turnover declared in a particular quarter. The default surcharge regime is a penalty scheme. The penalty is for failure to file and pay by the due date and is intended to deter non-compliance with the obligation to pay on or by the due date. The Respondents say that the lateness of a return or payment is largely a question of fact and once it occurs a surcharge accrues.

44. HMRC submit that as the Appellant was aware it was in the Default Surcharge regime it should have known the consequences of failing to pay its VAT by the due date. Further, it is reasonable to expect a director of the business to check the Public Notices and the guidance referred to in them and on Returns, particularly regarding payment requirements.

45. The Appellant’s grounds of appeal do not include cash flow problems, but in any event it is specifically stated in s71(1) VATA 1994 that any insufficiency of funds to pay any VAT is not reasonable excuse. HMRC may allow additional time for payment if requested. The Appellant did not make any request for a time to pay arrangement in respect of the default periods in question.

### Conclusion

46. The Appellant was clearly aware of the due date for payments of its VAT and the potential consequences of late payment.

47. To decide whether a reasonable excuse exists, the Tribunal must take for comparison, a person in a similar situation to that of the tax-payer making the appeal and who is relying on the reasonable excuse defence. The Tribunal should then ask itself, with that comparable person in mind, whether notwithstanding that person’s exercise of reasonable foresight, due diligence and a proper regard for the fact that the tax would become payable on the particular dates, the Appellant would not have avoided the circumstances which led to the failures.

48. Although there is medical evidence that Mr Djazia suffers from conditions which may impact on his ability to manage his business, no specific evidence was offered as to how those conditions caused or contributed to the late VAT payments. He clearly manages his business from month to month and year to year without

difficulty in terms of maintaining the company's turnover and profitability. Although he has appointed a bookkeeper he runs his business without delegating any aspects of management. In evidence he said that there was 'too much money involved to trust anyone else'. He said that he did have a business partner, but that the individual was  
5 abroad during the 07/11 period. Given these circumstances, despite the Appellant's anxiety condition, he would have been fully aware that the condition could affect his ability to manage his business and there was no reason why he could not have delegated the responsibility for submission of returns and the making of payments to  
10 either his partner, bookkeeper or someone else. Eventually, he set up a direct debit arrangement which he should have done much earlier. The fact that the payments to HMRC 'involved a lot of money' is not a good reason for not doing so and being late with the payment.

49. The burden of proof is on the Appellant to show that the underlying cause of its failure to meet its VAT payment obligations was due to unforeseen circumstances or  
15 events beyond its control. In the Tribunal's view, for the above reasons and the reasons argued by HMRC, that burden has not been discharged in respect of the default periods 10/11, 01/11, and 07/11. However we find that the Appellant has shown a reasonable excuse for the late payment of VAT in respect of the 10/11 period.

20 50. Insofar as the Appellant argues that the surcharges are entirely excessive or disproportionate to the delays, we agree with HMRC's submissions, and for the same reasons argued do not conclude that any of the default surcharges were excessive or disproportionate.

25 51. The appeal is accordingly allowed in part. The Surcharges for periods ended 10/10, 01/11 and 07/11 are confirmed. The Surcharge for the period ending 10/11 is discharged.

30 52. 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.

35

**MICHAEL S CONNELL**

**TRIBUNAL JUDGE**

**RELEASE DATE: 8 October 2014**