



TC04623

Appeal number: TC/2014/06148

VAT – default surcharge – late return and payment – direct debit method – tough trading conditions – whether reasonable excuse – no – payment one day late – whether penalty disproportionate – no – appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

AFFORDABLE CARS

Appellant

- and -

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

**TRIBUNAL: JUDGE DR HEIDI POON
NOEL BARRETT**

**Sitting in public at Tribunals Service, City Exchange, 11 Albion Street, Leeds on
14 May 2015**

The Appellant, no attendance or representation

**Mrs L Shepherd, presenting officer of HM Revenue and Customs, for the
Respondents**

DECISION

1. The appeal is against a default surcharge under the VAT regime in the amount of £5,042.68 at the rate of 15% for the VAT quarter ended 31 May 2014.

5 **Hearing in a party's absence**

2. On the day of the hearing, the tribunal clerk contacted the appellant at 10.30am (half an hour after the scheduled start of the hearing) and spoke to Mr T Dhasi to ask if he was aware of the hearing having been scheduled for the day. Mr Dhasi was a partner of the business and the signatory on the Notice of Appeal form, and he informed the clerk that he was aware of date of the hearing, but his understanding from reading the correspondence was that he did not have to attend.

3. The Tribunal then directed the clerk to make a further phone call to ascertain if Mr Dhasi would be willing to attend the hearing for the day, and if so, to give an estimated time of his arrival at the hearing venue. In reply, Mr Dhasi informed the Tribunal that he would not be able to attend due to work commitments, and offered his apologies for his non-attendance and misunderstanding. Mr Dhasi was informed that the hearing would proceed in his absence.

4. In allowing the hearing to proceed in the appellant's absence, the Tribunal had regard for Rule 33 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 ('the Tribunal Rules'). In terms of Rule 33(a), the Tribunal was satisfied that the party has been notified of the hearing; the appellant was evidently aware of the time and the date of the scheduled hearing.

5. As regards Rule 33(b), the Tribunal considered whether 'it is in the interests of justice' to proceed with the hearing in the appellant's absence. The Tribunal took into account the overriding objective of the Rules is 'to enable the Tribunal to deal with cases fairly and justly', and this includes 'avoiding delay, so far as compatible with proper consideration of the issues'. Since the facts in the instant case do not appear to be in dispute, the relevant law can be applied to the facts for a proper consideration of the issues. The appeal was therefore allowed to proceed in the appellant's absence.

6. The Tribunal is mindful that the appellant was not present during the hearing when the relevant points of law were raised. This decision seeks to give adequate coverage of these points with the view that it may facilitate the appellant in following how the Tribunal has reached its conclusion.

Grounds of Appeal

7. The appellant's grounds of appeal as stated in the Notice of Appeal are:

'This penalty surcharge relates to VAT quarter end 03/14 [*sic* 05/14]. Due to the amount being so large [£33,000] and also cashflow difficulties, this payment by direct debit was paid **1 day** late.'

Due to our financial predicament as a result of very tough trading conditions, we [hope you] are able to sympathise and understand we are not in a position to pay this penalty charge.’ (emphasis original)

8. To summarise, the appellant has put forward two grounds of appeal:

- 5 (1) Cash flow difficulties caused by tough trading conditions to meet a large payment on time;
 (2) A surcharge of £5,042.68 is disproportionate to the VAT payment being one day late.

The Facts

10 9. From HMRC’s Schedule of Defaults, a summary of the history of defaults that culminated in the default under appeal for period 05/14 is as follows:

VAT qtr	Return late	Payment late	Method	VAT due	Rate	Surcharge
05/12	2 days late	188 days late	Direct Debit	£30	0%	0.00
11/12	11 days late	11 days late	Direct Debit	£13,370	2%	0.00
11/12	11 days late	52 days late	<i>Time to Pay</i>	£8,391	n/a	
11/13	on time	30 days late	Cheque	£13,639	5%	£681.98
02/14	on time	8 days late	Faster Payment	£26,504	10%	£2,650.38
05/14	1 day late	4 days late	Direct Debit	£33,618	15%	£5,042.68

10. A ‘Time to Pay’ agreement takes a VAT payment out of the default regime; any VAT payments made after the due date under such an agreement are not treated as a default, and will not extend the 12-month rolling period, or increase the rate for surcharge calculation.
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11. For the period 11/12, part of the VAT payable (in the sum of £8,391) was under a ‘Time to Pay’ agreement. The payment was received 52 days late but did not count as a default. The VAT paid of £13,370 was not under a ‘Time to Pay’ agreement; the surcharge related thereto at 2% was £267.40; it was not collected owing to HMRC’s concessionary practice not to impose a surcharge falling below £400. If the ‘Time to Pay’ agreement had not been in place to take £8,391 out of the default regime, the rate at 2% when applied to £21,761 (being the sum of £13,370 and £8,391) would have given rise to a surcharge of £435.22, and would have been imposed as it would have exceeded the concessionary threshold of £400.
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12. For the period 05/13, the normal due date was 7 July 2013. The appellant entered into another ‘Time to Pay’ agreement to settle the VAT payable of £19,215 in three instalments: paying £9,215 on 10 July, £5,000 on 31 July, and £5,000 on 22 August of 2013 without going into default.
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13. For the period 08/13, the appellant again tried to negotiate a payment plan for the VAT liability of £21,750.86. According to HMRC's log of communications, Mr Dhesi phoned on 3 October 2013 (at 10.10) to request '4x pyts' (4 payments over 4 weeks), noting that the overdraft limit was at its maximum of £200,000, and that the bank had refused to increase the overdraft on six occasions weeks ago. The officer refused the request, making the following pertinent notes for his reasons:

- '(1) TP is pif [Taxpayer is paid in full] by clients at point of sale;
- (2) TP stated used funds to buy stock and pay other debts.'

14. Mr Dhesi phoned again on the same morning (at 11.52) and spoke to a different officer, who advised that his request could not be agreed to as it had been refused by the previous officer. It would appear that Mr Dhesi then made a different proposal, and the notes continue as follows:

'I agreed to pyt promise. 6750.56 will be collected 09/10/12, 5000.00 14/10/13, 5000.00 21/10/13 & 5000.00 24/10/13. Pyts will be collected by DD. TP will cancel DD at bank. Future pyts will be PIF on time.'

15. These two consecutive periods 05/13 and 08/13 would have come in after the second default (period 11/12) if there had not been the 'Time to Pay' agreements in place. In consequence to the agreement made with the second officer on 3 October 2013, that future payments would be 'paid in full (PIF) on time', no further 'Time to Pay' agreements seemed to be in force after the one for 08/13. Immediately after the period 08/13, the appellant went into its third default, in relation to the period 11/13.

16. A default is triggered either by a return being submitted late, or by a payment being made late. For the period 05/14 under appeal, the return was submitted one day late, and the late submission, of itself, was enough to trigger a default.

17. As regards payment due date recognition, it is the practice of HMRC to give 'concessionary' days according to the payment method used:

- (a) Where payment is made electronically, the due date for payment is extended to 7 days after the statutory due date;
- (b) An electronic payment must clear into HMRC's account before such an extended due date that falls on a bank holiday or weekend;
- (c) An exception to (b) applies if an electronic payment is by Faster Payment Service which can be received on bank holidays and weekends;
- (d) If a payment is made by Direct Debit, the sum is collected 3 bank working days after the extended due date.

18. For two practical reasons, HMRC can *only* request a payment to be made by Direct Debit on the submission of a VAT return. First, by virtue of the taxpayer's express choice to pay by Direct Debit on the return, it gives HMRC the authority to apply for the payment. Secondly, the return provides the exact figure for the Direct Debit payment to be applied.

19. By choosing the Direct Debit payment method, the taxpayer is *automatically allowed three more bank working days* for the payment to be collected, based on a return filing date of 7th following the month of the return period. A payment due date recognition concerning Direct Debit is predicated on the return having been filed on time. With other payment methods, for example, by cheque or Faster Payment, the *submission of return* and the *payment of tax* remain two disparate processes. With Direct Debit, the submission and payment processes become conjoined – the taxpayer only needs to ensure that the return is submitted on time, and the Direct Debit payment will ensue as being made on time. (This is, of course, on the assumption that the necessary funds are in place for the payment to be collected.)

20. For the period 05/14 under appeal, the appellant opted to pay the VAT due by Direct Debit. Since the return was filed one day late on 8 July 2014, the payment could not be applied for until 8 July and was not collected until 11 July 2014.

The Law

15 *Reasonable Excuse*

21. The default surcharge regime is set out under section 59 of Value Added Tax Act 1994 ('VATA 1994'). Under section 59(7)(b), it is provided that if *there is a reasonable excuse for the return or VAT not having been so despatched* (that is submitted or paid on time), then the taxpayer *shall not be liable to the surcharge ... and shall be treated as not having been in default in respect of the prescribed accounting period in question.*

22. 'Reasonable excuse' cannot be considered at large, and is circumscribed by statute and precedent. The relevant statutory exclusion for this case comes under section 71(1)(a) of VATA 1994, which provides that for the purpose of any provision of sections 59 to 70 which refers to a reasonable excuse or any conduct, *an insufficiency of funds to pay any VAT due is not a reasonable excuse.*

23. For case law precedent, a well-known authority is *Customs and Excise Commissioners v Steptoe* [1992] STC 757 ('*Steptoe*') in which the *direct or proximate* cause is distinguished from the *underlying* cause for the shortage of funds. The Court of Appeal decided in *Steptoe* (though only by a majority) that the statutory exclusion of *an insufficiency of funds* as an excuse did not preclude the court from considering the *underlying* cause of the insufficiency. The insufficiency of funds was the immediate cause of the trader's default in *Steptoe*, but if the underlying cause for the shortage of funds was some *unforeseeable and inescapable* event outside the influence and control of the taxpayer, then that can amount to a reasonable excuse. The normal hazards of trade, however, would not warrant exceptional discretion.

24. In another Court of Appeal decision, *Dollar Land (Feltham) Ltd & Another v CEC* [1995] STC 414 (CA) ('*Dollar*'), the question whether an economic recession can constitute a reasonable excuse was considered. The tribunal of first instance, after considering *Steptoe*, expressed the following view:

‘We see no reason in principle why the length and depth of the recession should be incapable of giving rise to a reasonable excuse provided it is clearly shown that the recession is the real cause of the shortage of funds and that the resultant lack of funds is unavoidable.’

5 25. This view expressed in *Dollar* was considered in *Scrimsign v HMRC* [2014] UKFTT 866 (TC) (*‘Scrimsign’*), in which the particular facts of the case led Judge Reid to conclude:

10 [27]... the Appellant’s temporary lack of funds which prevented it from meeting its VAT obligations timeously *was caused not through any imprudence of Mr Scrimshire*, who controlled the company, but by the underlying economic recession the effects of which so far as the Appellant was concerned were difficult to predict and could not be reasonably avoided.’ (emphasis added)

15 26. Notwithstanding the view expressed on reasonable excuse and the recession, the critical question the judges in *Dollar* (Gibson LJ, Sir Roger Parker) focused on for the purpose of establishing whether there was a reasonable excuse was to ask – *whether, given the exercise of reasonable foresight, due diligence and a proper regard for the fact that the tax is due, the lack of funds is reasonably avoidable*. On asking this question, the court found there was no reasonable excuse, as the appellant
20 had committed funds to capital investment at a time when it was already in difficulty with its VAT payments. A close examination of the appellant’s financial report at the material time led the court to conclude that ‘[i]n the face of that report it could hardly be said that the earlier defaults could not reasonably have been avoided’; the appellant was expending on capital acquisitions in order ‘to take advantage of exceptional
25 opportunities’ – even when cash might have been tight by then.

27. It is important to distinguish the facts between *Dollar* and *Scrimsign* in respect of the conduct of the respective appellants. In *Scrimsign*, the conscientious efforts of the managing director in meeting the company’s VAT liability on time, using personal funds at times and in the face of its customers taking in excess of 60 days to pay, contrast starkly with the speculative investment endeavours of the appellant in
30 *Dollar*, which were made at the expense of the company meeting its obligations to pay its VAT liabilities on time.

28. The court in *Dollar* makes two pertinent remarks regarding the reality of the default surcharge regime – that ‘in the absence of a surcharge a trader can obtain free credit in respect of the tax liability’; and that ‘the level of the surcharges makes this an
35 expensive form of credit’.

29. The fact that the VAT receipt by a registered trader should become his VAT ‘liability’ in due course is an ultimate reminder that the trader is ‘the temporary custodian’ of the ‘money destined for the Exchequer’ (Nolan LJ in *Customs and*
40 *Excise Comrs v Salevon Ltd* [1989] STC 907 at 911).

Proportionality

30. The questions of proportionality as applied to the default surcharge regime have been considered thoroughly in *Commissioners for HMRC v Total Technology (Engineering) Ltd* [2012] UKUT 418 (TCC) (*Total Technology*), see in particular
5 paragraphs [85] to [105]. The Upper Tribunal decision examines the various features of the default surcharge regime which might be said to result in unfairness in different circumstances from the perspective of both the EU law and the European Convention on Human Rights, and none of these features ‘leads to the conclusion that the default surcharge regime infringes the principle of proportionality’ (at [105]).

10 31. It is clearly stated in *Total Technology* that the ‘questions of proportionality can only be judged against the aim of the legislation’ (at [79]). One aim of the default surcharge regime, as manifest from the legislation, is to penalise *only the failure to deliver a return and to make payment of the tax owed by the due date* (at [89]). Unlike other penalties, the default surcharge regime does not penalise the failure further after
15 the due date, or progressively by reference to the delay in remedying the failure.

32. In *Commissioners for HMRC v Trinity Mirror plc* [2015] UKUT 0421 (TCC) (*Trinity Mirror*), the approach formulated in *Total Technology* for determining when an individual penalty is to be judged as disproportionate is stated as follows:

20 [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 *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 ...’

25 33. In *Trinity Mirror* the context for the purpose of judging on the questions of proportionality is extended, beyond ‘the aim of legislation’ as defined in *Total Technology* to the underlying aim of the EU directive, which is ‘to ensure the neutrality of taxation of economic activities’ (at [56]). The underlying aim of the directive is stated at [59] as ‘the principle of fiscal neutrality, in its sense of ensuring a
30 neutral tax burden which protects the taxable person, since the common system of VAT is intended to tax only the final consumer’. To achieve the aim, ‘a necessary concomitant of a system that provides for a system of deduction and collection of tax at each stage in the process, that tax should be accounted for, and paid on a timely basis’ (at [60]), and hence, a failure to comply with the obligations by individual
35 traders undermines the fiscal neutrality of the system as a whole.

Discussion

Reasonable excuse

34. The appellant’s first ground of appeal is ‘cash flow difficulties’, which is specifically excluded under section 71(1)(a) of VATA 1994 from being a reasonable
40 excuse – *an insufficiency of funds to pay any VAT due is not a reasonable excuse*.

35. If a shortage of funds is the proximate cause, there is no further or particular evidence to establish an *underlying* cause, whether as a single event or a combination of factors of varying importance, for the shortage of funds in line with *Steptoe*. The ‘tough trading conditions’ referred to in the grounds of appeal cannot be adduced to
5 be any more than the ‘normal hazards of trade’; these are the concomitant risks for being in business that every trader has to contend with and cannot constitute a reasonable excuse.

36. In *Dollar*, the court asked the question *whether, given the exercise of reasonable foresight, due diligence and a proper regard for the fact that the tax is due, the lack of funds is reasonably avoidable*. The Tribunal did not have the benefit of the appellant giving evidence to ask the same question. However, it is not unreasonable to adduce that if the funds were in place for the Direct Debit payment to be collected on 11 July, the funds were probably already in place a day earlier on 10 July. As related earlier, the Direct Debit payment method means the payment
10 mechanism is only triggered by the submission of the return. It was quite probable that the payment was late in consequence of the *filing of the return being one day late*, rather than necessarily due to the funds being unavailable by one day.

37. Furthermore, the Tribunal notes that the appellant had been given ‘Time to Pay’ agreements on three occasions within the default rolling periods concerned, and had
20 agreed to make future payments *on time and in full* during the negotiation for the agreement made on 3 October 2013. The Tribunal considers that the ‘Time to Pay’ facility has functioned as a safeguard in the default surcharge regime; and in the appellant’s case, has already mitigated on more than one occasion, the effect of penalty charges that could have been caused by temporary shortages of funds.

38. The existence of the ‘Time to Pay’ facility means that the statutory exclusion of *an insufficiency of funds* being an excuse can be justly and reasonably enforced as the default position. It requires exceptional circumstances, such as those in *Steptoe* or *Scrimsign*, for the Tribunal to depart from this statutory position, and only on being
25 satisfied in evidence that:

- 30 (1) the underlying cause for the insufficiency of funds amounts to a reasonable excuse in line with *Steptoe*; and
- (2) the taxpayer has exercised reasonable foresight and due diligence to avoid the shortage of funds.

39. Based on the evidence available, the Tribunal has no reasons to depart from the
35 statutory exclusion of an insufficiency of funds being a reasonable excuse. In particular, we note the reasons for the first officer’s refusal of a ‘Time to Pay’ request on 3 October 2013 – (a) that the appellant was paid in full at the point of sale, and (b) funds deployed *to buy stock and pay other debts*. The conduct of the appellant in this regard was similar to that being criticised in *Dollar*, and could form no basis for any
40 consideration that a reasonable excuse could have existed for the shortages of funds in the relevant 12-month surcharge rolling period in which periods 08/13 and 05/14 fell.

40. Finally, the late submission of the return of itself would have triggered the default, regardless of when the payment was made. In other words, it would not have been sufficient for a reasonable excuse to exist for the late payment, the late filing of the return would also have required a reasonable excuse for the default surcharge under appeal to be vacated. We have no evidence, nor has the appellant advanced it as a ground of appeal, that there was a reasonable excuse for the default in respect of the late submission of return for period 05/14.

41. For the reasons stated above, the ground of appeal concerning whether there was a reasonable excuse for the default has to fail.

10 *Proportionality*

42. In terms of proportionality, the regime has certain features which render the penalty being calculated proportionately to the magnitude of the default: (a) the penalty is tax-g geared, calculated with reference to the VAT liability; (b) the rate of penalty escalates from 0%, 2%, 5%, 10% to 15% as a reflection of the persistence of the trader's defaults.

43. The magnitude of the surcharge at £5,042.68 at the maximum rate of 15% is the culmination of previous defaults, not an isolated event without forewarning. It is a feature of the default surcharge regime that *a trader who is late is subject to a penalty which cannot be reduced even though his payment is only a single day late*. In line with the conclusion drawn in *Total Technology*, the penalty in this case has been arrived at by applying a rational scheme of calculation which involves no breach of proportionality.

44. The appellant emphasised the fact that the payment was only *one day* late. The Tribunal has regard that for the purpose of determining when a payment is overdue, HMRC have given seven extra days as a concession for payment made electronically, and a further three bank working days where Direct Debit payment method is chosen. Altogether, the appellant was given an extra ten days to make the payment without going into default. In assessing whether the surcharge is disproportionate to the delay, the appellant's reckoning that it was only 'one day late' has to be set against the context of the ten concessionary days already given before the payment was reckoned as overdue.

45. In *Total Technology*, the feature that *the regime does not distinguish between traders who are a day late, a week late or even a month late* is highlighted, and the feature is judged not disproportionate against the aim of the legislation, which is to penalise only the failure to deliver a return and to make the tax payment *by the due date*. The essential aim of the default surcharge regime is to encourage compliance by the due date; it is proportionate to its aim that the regime should determine when a default is triggered with the due date as the sole reference, and with no regard for how long or short the delay in remedying the original default is.

46. The appellant in this case is always paid in full at the point of sale; it has a cash flow advantage over other traders in this respect. Viewed from the context of the EU directive, the essential purpose of the default surcharge regime is to ensure that the

underlying aim of the directive, which is fiscal neutrality, is not undermined. As analysed in *Trinity Mirror*, the common system of VAT is intended to tax only the final consumer, and to protect the taxable trader by ensuring that his tax burden is *neutral* to his activities through the mechanism of input tax offset against output tax payable. Timeliness – compliance by the due date – is imperative for the safeguard of fiscal neutrality, and the design of the default surcharge regime to penalise non-compliance by the due date is proportionate to the aim of achieving timeliness.

47. As a trader paid in full at the point of sale, the appellant could be holding money destined for the Exchequer for as long as four months in some instances before being obliged to return it. The appellant is to be reminded of the fact that every taxable trader is *the temporary custodian of the money destined for the Exchequer*. The trader takes the VAT paid by the ultimate taxpayer (the final consumer) on behalf of the Exchequer, and is under a statutory obligation to return it timeously to the Exchequer. As stated in *Dollar*, in the absence of a surcharge, a trader can obtain free credit in respect of the tax liability. In the light of this analysis, to impose a penalty for a failure to return the VAT due to the Exchequer by the statutory due date cannot be considered to be disproportionate, even when making good the sum due to the Exchequer is late only by one day.

Decision

48. For the reasons stated above, the appeal is dismissed. The default surcharge of £5,042.68 for the period 05/14 is confirmed.

49. 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.

DR HEIDI POON
TRIBUNAL JUDGE

RELEASE DATE: 3 SEPTEMBER 2015