[2016] UKFTT 173 (TC)

TC04949

Appeal number: TC/2015/04878

Value Added Tax – default surcharge – whether or not appellant had a reasonable excuse for the late payment – held not – whether or not penalty disproportionate – held not – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

COLLEGIATE ACCOMMODATION CONSULTING LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE PHILIP GILLETT
NIGEL COLLARD

Sitting in public at Oxford on 2 March 2016

Heriberto Cuanalo, Managing Director, for the Appellant

Simon Bates, Officer of HMRC, for the Respondents

DECISION

1. This was an appeal against a VAT default surcharge of £10,073.59, levied at a rate of 15%, in respect of the VAT accounting period ending 31 December 2014.

2. The Appellant's business is that of managing student accommodation on behalf of the owners of the properties. The company started trading in 2011 and took on its first employee in 2012. The company had expanded rapidly and now had 152 employees.

Late Appeal

3. The appeal in question, which was dated 10 August 2015, was technically made outside the normal time limit for an appeal. The initial decision to impose the surcharge was subject to a review and the letter confirming the outcome of that review was dated 23 April 2015. However, the Appellant had supplied further information and HMRC had therefore, exceptionally, carried out a second review. The letter confirming the outcome of this second review had been sent on 16 July 2015 and therefore, although the appeal was made within 30 days of the date of the second letter, it was not made within 30 days of the date of the first letter. Nevertheless, in the circumstances, HMRC did not object to the late submission of the appeal. The Tribunal therefore decided to accept the late appeal and to hear the substantive case.

Evidence

4. We heard oral evidence from Mr Cuanalo, Managing Director, and Ms Nicola Cahill, Accounts Manager for Collegiate Accommodation Consulting Ltd ("Collegiate").

5. Mr Cuanalo explained that Collegiate had needed loan capital in order to finance its expansion but had been unable to secure finance through the normal routes. Mr Cuanalo had therefore spoken to his local MP who had advised him to talk to HMRC and arrange to pay the company's VAT liability in instalments in order to provide the necessary finance.

6. It was agreed that there had been previous defaults such that Collegiate was now within the 15% surcharge band. It was also agreed that, although the VAT return for the period to December 2014 had been submitted on time, allowing for the additional seven days where payment is made electronically, on 6 February 2015, the payment of the tax due, £67,157.29, had not been made until 12 February 2015, which was five days late.

7. Mr Cuanalo explained that Ms Cahill had joined the company in July 2012 and had taken some time to get the company's VAT accounting in order. However things were generally up to date by July 2014, when Ms Cahill went on maternity leave. During Ms Cahill's absence the company employed the services of an external accountant, Sadler Talbot, of Witney, to carry out the monthly accounting which had

normally been done by Ms Cahill, together with responsibility for preparing the quarterly VAT returns. Sadler Talbot already prepared the company's annual accounts.

8. For some of the earlier accounting periods Collegiate had made arrangements with HMRC to pay the VAT in instalments. However it was agreed that the company did not have a formal time to pay agreement in respect of those payments, which might otherwise have displaced the corresponding default surcharges.

9. There was no written contract between Collegiate and Sadler Talbot but Mr Cuanalo said that the understanding was that Sadler Talbot would prepare the VAT returns and once they had filed the return they would inform the company of the amount of the payment which should be made. At that time only Mr Cuanalo and his wife had authority to make payments on behalf of the company.

10. This process had not worked well in respect of the VAT period to June 2014. The return had not been filed until 23 August 2014 and the payment, of £23,873.74 was not made until 1 December 2014. A default surcharge in the amount of £3,581.06, at the 15% rate, had therefore been levied.

11. For the period to 30 September 2014 the process had worked much better. Both the return and the payment had been lodged within the time limit.

12. For the VAT accounting period ending 31 December 2014 Sadler Talbot had filed the return on time, on 6 February 2015, showing tax due of £67,157.29. However, Mr Cuanalo said that Sadler Talbot had not informed the company of this amount or that the payment was due. Mr Cuanalo acknowledged that he was not really aware of the normal VAT payment dates as he was too stretched running and developing the business.

13. Ms Cahill returned from maternity leave on Monday 9 February 2015 and a handover meeting was arranged with Sadler Talbot on Wednesday 11 February 2015. At that meeting Ms Cahill realised that the VAT payment was overdue and arranged for the payment to be made on 12 February 2015, but this was unfortunately five days late.

14. The Tribunal noted that the VAT payment for this period was significantly larger than payments made in previous periods but Mr Cuanalo explained that this was because the business was expanding rapidly and that when they took on a new contract they often received up-front fees, which accounted for the substantial increase in VAT payable.

The Law

15. Liability to a VAT surcharge is governed by s 59 VATA 1994 and the percentage rates to be used in calculating any surcharge are set out in s 59(5). In relation to each default after the third default within a surcharge period the rate of surcharge is given as 15%.

16. S 59(7) VATA 1994 provides that a taxpayer will not be liable to a surcharge if:

> "(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."

17. The expression "reasonable excuse" for these purposes is not defined as such but s 71(2) VATA 1994 provides that:

> "(a) an insufficiency of funds to pay any VAT due is not a reasonable excuse; and
>
> (b) where reliance is placed on any other person to perform any task, neither the fact of that reliance nor any dilatoriness or inaccuracy on the part of the person relied upon is a reasonable excuse"

Discussion

18. In this case it is clear that the delay in the payment being made was due to the fact that the external accountants, Sadler Talbot, did not inform Mr or Mrs Cuanalo that the VAT payment should be made on or before 7 February 2015. This seems to us to be a simple case of error on the part of the accountants, since they had apparently performed this task correctly for the previous payment, in respect of the VAT accounting period ending 30 September 2014.

19. Unfortunately genuine mistakes, even when made honestly and by people acting in good faith are not in our view acceptable as reasonable excuses for purposes of the surcharge legislation. This was stated clearly by Judge Hellier in the case of *Garnmoss Ltd v HM Revenue & Customs* [2012] UKFTT 315 (TC):

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

20. We can only agree with Judge Hellier's comments.

21. In its Notice of Appeal, Collegiate had also asked for the rate of surcharge to be reduced from 15% to 2%. Unfortunately, as stated above, the rate of surcharge is prescribed by statute and it is a feature of the default surcharge regime that the Tribunal does not have the power to reduce the rate in the way requested.

22. In addition, in his submissions, Mr Cuanalo said that he believed that the penalty was disproportionate in that it amounted to £10,073.59 even though the payment was only a few days late. It is important to remember in this context

however that the surcharge is not designed to be equivalent to interest on the late payment. It is a penalty which is designed to encourage compliance.

23. The question of proportionality has been considered by both the First Tier and the Upper Tribunal in a number of cases concerning the VAT default surcharge regime, in particular by the First Tier Tribunal in the case of *Enersys Holdings UK Ltd v Revenue and Customs Commissioners* [2010] UKFTT 20 (TC), [2010] SFTD 387 ('*Enersys*') and by the Upper Tribunal in *Revenue and Customs Commissioners v Total Technology (Engineering) Ltd* [2012] UKUT 418 (TCC), [2013] STC 681 ('*Total*'). *Enersys* was decided in favour of the taxpayer. It is not binding on us but it a very important decision which we should not disregard. *Total* was decided in favour of HMRC and is of course binding on us.

24. In *Enersys* the Tribunal Judge examined the default surcharge regime in some detail. He concluded that there were three features of the regime which might render it disproportionate: the absence of a power to mitigate, the fact that the penalty is the same no matter what the period of delay, and the absence of any upper limit. In examining these factors the judge concluded that the absence of a power to mitigate and the lack of any relationship with the period of delay arguably went further than was strictly necessary in order to attain the objective of encouraging compliance.

25. As regards the absence of an upper limit the judge thought that this might be justifiable in the context of a tax-geared penalty, but that there must come a time, even in a large company, when this justification would break down.

26. The judge then asked himself the question whether a court or tribunal, if it had the power to set any penalty it chose, without statutory constraint, would exercise its ordinary judicial discretion to impose a penalty of as much as £130,000 for an error of the kind that had arisen in the case of *Enersys*. He came to what he described as the 'inescapable' conclusion that, even taking into account the public interest in the prompt payment of taxes, the surcharge imposed on Enersys was disproportionate.

27. In *Total* the Upper Tribunal undertook a thorough examination of the jurisprudence on the principle of proportionality. It concluded that firstly, penalties must not go beyond what is strictly necessary for the objectives pursued, and secondly, a penalty must not be so disproportionate that it becomes an obstacle to the underlying aims of the VAT directive.

28. The Upper Tribunal went on to examine a number of the features of the default surcharge regime which it considered might be raised as criticisms of the regime as a whole. It concluded, at [99], that in relation to the regime itself "there is nothing in the VAT default surcharge which leads us to the conclusion that its architecture is fatally flawed". However there were some aspects of the regime which the Upper Tribunal considered might mean that on the facts of a particular case, as in *Enersys*, the penalty might be disproportionate. It said:

> "… 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."

29. The Upper Tribunal summarised their conclusions as follows (at [100]):

"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."

30. The Upper Tribunal also set out its thinking on the lack of a maximum penalty under the regime:

"There is no maximum penalty. This, we think, is a real flaw at both the level of the regime viewed as a whole and potentially at the level of a taxpayer with a very large payment obligation. In *Enersys* Judge Bishopp considered it unimaginable that a tribunal imposing a penalty would do so in an amount as much as £130,000 for the sort of error in that case. We have adopted a slightly different analysis of the purpose of the legislation from that set out in *Enersys*, and have taken a slightly different view of the requirements of the principle of proportionality, as a reflection of the changed focus of the arguments presented to us. But any approach to the analysis must pay due regard to the principle that the absolute amount of the penalty must be proportionate in the context of the objectives of the directive. We agree therefore that there must be some upper limit, although it is not sensible for us in the present case to suggest where that might be. That is because the penalty imposed on the company here, of £4,260, is clearly of a wholly different character from the £130,000 in issue in *Enersys*. If one accepts, as our conclusions above show must be the case, that a substantial, rather than purely nominal, penalty may legitimately be imposed, it is in our judgement plain that the penalty imposed on the company [in the case of *Total*] cannot properly be described as "devoid of reasonable foundation" (an expression used in *Gasus Dosier-und Fordertechnik GmbH v Netherlands* (1995) 20 EHRR 403, [1995] ECHR 15375/89, ECt HR, at [60], or "not merely harsh but plainly unfair" (an expression used by Simon Brown LJ in *International Transport Roth GmbH v Secretary of State for the Home Department* [2003] QB 728 at [26]) and that it correspondingly falls and, we would say, comfortably so, below any possible upper limit."

31. Applying this analysis to the current case it is clear that the overall default surcharge regime should not be considered fatally flawed per se but that there may be an upper limit to the penalty which should be imposed if the penalty is not to be considered to be disproportionate.

32. There is no doubt that this is a substantial penalty in the context of a company of this size. In addition it is clear that the amount of VAT payable for the period in question was more than double the amounts payable in previous periods. However, Mr Cuanalo did not say that this was an exceptional period in the overall scheme of

things but explained it by saying that the business was growing very rapidly and that when they took on a new contract the company would receive up-front fees. We therefore gained the impression that future VAT payments would have been at a similar level and that this was not an exceptional payment.

33. We also note that for the VAT accounting period to 30 June 2014, the company had suffered a default surcharge of £3,581.06, also at the 15% rate, but this had not apparently achieved the stated objective of encouraging the company to pay more attention to its VAT affairs. In this context we particularly noted Mr Cuanalo's statement under questioning that he was not really aware of his VAT responsibilities and the likely need to pay VAT at the beginning of February 2015, because of his focus on developing the business. We cannot therefore in all conscience conclude that this penalty was disproportionate in the circumstances.

Decision

34. Having considered the evidence and the legal analysis set out above the Tribunal decided that Collegiate did not have a reasonable excuse for its failure to pay the VAT when it was due and that the penalty imposed was not disproportionate. The Tribunal therefore decided that Collegiate's appeal should be dismissed.

35. 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.

PHILIP GILLETT
TRIBUNAL JUDGE

RELEASE DATE: 7 MARCH 2016