TC06950

Appeal number: TC/2018/03172

VALUE ADDED TAX – default surcharge – whether failure to pay VAT on time as a result of being unaware of a same day transfer limit applied by the Appellant's bank amounts to a reasonable excuse - no – whether penalty disproportionate – no - appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

CONTENTISKING LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE TONY BEARE

Sitting in public at Taylor House, 88 Rosebery Avenue, London EC1R 4QU on 24 January 2019

Mr Stephen Liddle for the Appellant

Ms Sophie Rhind, Officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This decision relates to an appeal against a default surcharge of £4,670.11 which has been imposed on the Appellant in respect of its 12/17 value added tax ("VAT") prescribed accounting period (a "VAT period").

2. The Appellant accepts that it failed to discharge its VAT liability in respect of that VAT period of £31,134.08 by the due date of 7 February 2018. Instead, payment of that amount was received by the Respondents only on the following day – 8 February 2018. The reason for this was that, although the Appellant instructed its bank (the Bank of Scotland) to transfer the relevant amount at 09.47:46 on 7 February 2018, the Appellant was unaware of the fact that, under the terms and conditions of its agreement with the bank, the bank was not required to give effect to an instruction to make a transfer of more than £25,000 until the business day next succeeding the day that the instruction was given. Thus, the payment in this case was made only on 8 February 2018 – that is to say, one day late.

Background

3. The background to the appeal is that the Appellant has regularly experienced difficulties in meeting its VAT liabilities on time and has been in the default surcharge regime from the VAT period 12/15 onwards. In the interests of brevity, I will not rehearse in this decision the details of all of the Appellant's prior defaults. Suffice it to say that there is no dispute between the parties as to the fact that the Appellant was within the default surcharge regime at the time when its payment in respect of the VAT period 12/17 became due, and that, in respect of any default in respect of that VAT period, it was subject to the default surcharge at the highest rate of 15% as a result of its earlier defaults. Indeed, the Appellant's two most recent defaults prior to the VAT period in question had both led to a default surcharge at the 15% rate.

The relevant law

4. The VAT default surcharge is imposed pursuant to Section 59 Value Added Tax Act 1994 (the "VATA 1994"). That section provides as follows:

"(1) Subject to subsection (1A) below, if, by the last day on which a taxable person is required in accordance with regulations under this Act to furnish a return for a prescribed accounting period—

(a) the Commissioners have not received that return, or

(b) the Commissioners have received that return but have not received the amount of VAT shown on the return as payable by him in respect of that period,

then that person shall be regarded for the purposes of this section as being in default in respect of that period.

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

(2) Subject to subsections (9) and (10) below, subsection (4) below applies in any case where—

(a) a taxable person is in default in respect of a prescribed accounting period; and

(b) the Commissioners serve notice on the taxable person (a "surcharge liability notice") specifying as a surcharge period for the purposes of this section a period ending on the first anniversary of the last day of the period referred to in paragraph (a) above and beginning, subject to subsection (3) below, on the date of the notice.

(3) If a surcharge liability notice is served by reason of a default in respect of a prescribed accounting period and that period ends at or before the expiry of an existing surcharge period already notified to the taxable person concerned, the surcharge period specified in that notice shall be expressed as a continuation of the existing surcharge period and, accordingly, for the purposes of this section, that existing period and its extension shall be regarded as a single surcharge period.

(4) Subject to subsections (7) to (10) below, if a taxable person on whom a surcharge liability notice has been served—

(a) is in default in respect of a prescribed accounting period ending within the surcharge period specified in (or extended by) that notice, and

(b) has outstanding VAT for that prescribed accounting period,

he shall be liable to a surcharge equal to whichever is the greater of the following, namely, the specified percentage of his outstanding VAT for that prescribed accounting period and £30.

(5) Subject to subsections (7) to (10) below, the specified percentage referred to in subsection (4) above shall be determined in relation to a prescribed accounting period by reference to the number of such periods in respect of which the taxable person is in default during the surcharge period and for which he has outstanding VAT, so that—

(a) in relation to the first such prescribed accounting period, the specified percentage is 2 per cent;

(b) in relation to the second such period, the specified percentage is 5 per cent;

(c) in relation to the third such period, the specified percentage is 10 per cent; and

(d) in relation to each such period after the third, the specified percentage is 15 per cent.

(6) For the purposes of subsections (4) and (5) above a person has outstanding VAT for a prescribed accounting period if some or all of the VAT for which he is liable in respect of that period has not been paid by the last day on which he is required (as mentioned in subsection (1) above) to make a return for that period; and the reference in subsection (4) above to a person's outstanding VAT for a prescribed accounting period is to so much of the VAT for which he is so liable as has not been paid by that day.

(7) If a person who, apart from this subsection, would be liable to a surcharge under subsection (4) above satisfies the Commissioners or, on appeal, a tribunal that, in the case of a default which is material to the surcharge—

(a) the return or, as the case may be, the VAT shown on the return was despatched at such a time and in such a manner that it was reasonable to expect that it would be received by the Commissioners within the appropriate time limit, or

(b) there is a reasonable excuse for the return or VAT not having been so despatched,

he shall not be liable to the surcharge and for the purposes of the preceding provisions of this section he shall be treated as not having been in default in respect of the prescribed accounting period in question (and, accordingly, any surcharge liability notice the service of which depended upon that default shall be deemed not to have been served).

(8) For the purposes of subsection (7) above, a default is material to a surcharge if—

(a) it is the default which, by virtue of subsection (4) above, gives rise to the surcharge; or

(b) it is a default which was taken into account in the service of the surcharge liability notice upon which the surcharge depends and the person concerned has not previously been liable to a surcharge in respect of a prescribed accounting period ending within the surcharge period specified in or extended by that notice.

(9) In any case where—

(a) the conduct by virtue of which a person is in default in respect of a prescribed accounting period is also conduct falling within section 69(1), and

(b) by reason of that conduct, the person concerned is assessed to a penalty under that section,

the default shall be left out of account for the purposes of subsections (2) to (5) above.

(10) If the Commissioners, after consultation with the Treasury, so direct, a default in respect of a prescribed accounting period specified in the direction shall be left out of account for the purposes of subsections (2) to (5) above.

(11) For the purposes of this section references to a thing's being done by any day include references to its being done on that day."

5. It can be seen from Section 59A(7) VATA 1994 above that there is no surcharge if the taxable person demonstrates that there is a reasonable excuse for the default in question. However, although HMRC has discretion as to whether or not to assess a default surcharge (see Section 76 VATA 1994 and the case of *Dollar Land (Feltham) Ltd and others v Customs and Excise Commissioners* [1995] STC 414) neither HMRC nor the First-tier Tribunal has power to mitigate a default surcharge.

6. VAT is of course a tax derived from EU Directives which stipulate in detail the persons on whom and the activities for which the tax is to be imposed by the Member States. This ensures that the application of the tax is the same in all EU Member States. The EU Directives require Member States to take all legislative and administrative measures appropriate for ensuring collection of all the VAT due in their respective territories (see *Dyrektor Izby Skarbowej w Biaymstoku* v *Profaktor*

Kulesza, Frankowski, Jówiak, Orowski (Case C-188/09) [2010] ECR I-7639, at paragraph [21]). There is, however, no harmonisation of enforcement provisions. Member States are thus empowered to choose the penalties which seem appropriate to them, but that power must be exercised in accordance with the principle of proportionality. According to the European Court of Justice's decision in *Paraskevas Louloudakis* v *Elliniko Dimosio* (Case C-262/99) [2001] ECR I-5547 ("*Louloudakis*") (at paragraph [67]), this means that (i) penalties must not go beyond what is strictly necessary for the objectives pursued, and (ii) a penalty must not be so disproportionate to the gravity of the infringement that it becomes an obstacle to the underlying aims of the applicable directive.

7. The principle of proportionality also plays an important role in the jurisprudence of the European Court of Human Rights although there are no material differences between the meaning of proportionality in that context and the meaning of proportionality in the context of the EU Directives.

The arguments of the parties

8. Whilst the Appellant does not dispute the fact that its payment in respect of the VAT period 12/17 was one day late, it contends that:

> (a) it had a reasonable excuse for the late payment because it made an honest mistake in failing to be aware of the £25,000 limit for same day transfers which formed part of its agreement with its bank; and
>
> (b) the amount of the default surcharge resulting from the one day delay in making its payment - £4,670.11 – is disproportionate to the gravity of its offence.

9. In response to the Appellant's first ground of appeal, the Respondents submit that whether or not an excuse is a reasonable excuse turns on whether the taxpayer in question has acted in the manner to be expected of a prudent person exercising reasonable foresight and due diligence and having proper regard to his or her responsibilities under the tax legislation. They add that the fact that a taxpayer has made an honest error does not, in and of itself, mean that it has a reasonable excuse. In this case, the Appellant ought to have been aware of the payment terms which were applied by its bank. Moreover, it had already defaulted on a number of previous occasions in relation to its VAT liabilities. It both knew that it was within the VAT default surcharge regime and had already had to pay a default surcharge at the rate of 15% in respect of its VAT periods 06/17 and 09/17. As such, the Respondents say, a reasonable person in the position of the taxpayer should have been assiduous in ensuring that its VAT liability in respect of the VAT period 12/17 was met.

10. In response to the Appellant's second ground of appeal, the Respondents submit that, following the Upper Tribunal decisions in *The Commissioners for HMRC v. Total Technology (Engineering) Ltd* [2012] UKUT 418 (TCC), [2013] STC 681 ("*Total Technology*") and *The Commissioners for HMRC v. Trinity Mirror plc* [2015] UKUT 0421 (TCC) ("*Trinity Mirror*"), it is clear that the default surcharge regime is a rational system that would lead to a disproportionate result only in a wholly exceptional case. They add that there is nothing in these circumstances which makes

them exceptional, given that the Upper Tribunal has already held in those cases that the regime is intended to penalise a taxpayer for a failure to meet its liabilities on time and without regard to the extent of the delay in making payment.

Discussion

Reasonable Excuse

11. The first issue before me is whether the Company had a reasonable excuse for its late payment in respect of the period 12/17.

12. In that regard, I agree with the Respondents' exposition of the law as to when a mistake can amount to a reasonable excuse. That is to say that the mere fact that a mistake is honestly and genuinely made is not sufficient in and of itself for the mistake to amount to a reasonable excuse. As outlined by Judge Brannan in *Stuart Coales v The Commissioners for Her Majesty's Revenue and Customs* [2012] UKFTT (477) (TC) at paragraph [32] of his decision:

> "The test contained in the statute is not whether the taxpayer has an honest and genuine belief but whether there is a reasonable excuse. It is true that the absence of a genuine and honest belief would usually indicate that the excuse [is] not reasonable, but its presence does not mean that the excuse is necessarily reasonable".

13. A similar point was made by Judge Medd in *The Clean Car Company Limited v The Commissioners of Customs & Excise* [1991] VATTR 234, when he said that the relevant test is to ask oneself whether "what the taxpayer did [was] a reasonable thing for a responsible trader conscious of and intending to comply with his obligations regarding tax, but having the experience and other relevant attributes of the taxpayer and placed in the situation that the taxpayer found himself at the relevant time", to do.

14. Similar sentiments were expressed by the First-tier Tribunal in *Garnmoss Limited T/A Parham Builders v The Commissioners for Her Majesty's Customs and Excise* [2012] UKFTT 315 (TC) ("*Garnmoss*") and *County Inns Limited v The Commissioners for Her Majesty's Revenue and Customs* [2015] UKFTT 204 (TC).

15. Mr Liddle submits that a mistake of the nature made by the Appellant in respect of the period 12/17 satisfies the test outlined above, given that it tried in good faith to discharge its liability in respect of the VAT period in question in full on the due date and that the failure on the part of the Appellant to be aware of the £25,000 limit for same day transfers was a reasonable mistake to make.

16. In response, Ms Rhind contends that the Appellant is carrying on a business and that "a responsible trader conscious of and intending to comply with his obligations regarding tax, but having the experience and other relevant attributes of the taxpayer and placed in the situation that the taxpayer found himself at the relevant time", would have taken care to be aware of any limits applicable to same day transfers, both as regards its tax liabilities and as regards its other business liabilities. Moreover, if the Appellant had not deferred payment until the due date itself, its failure to be aware of the limit would not have given rise to a default and, as the Appellant knew, at the time of its default, that it was already in the default surcharge regime, it should have been taking particular

care to ensure that it complied with its VAT obligations. As such, the Appellant did not have a reasonable excuse for its failure to pay the VAT on time.

17. I have found this question to be quite a difficult one to answer.

18. I should say at the outset that I accept entirely that the mistake which was made by the Appellant in this instance was made in good faith and that the Appellant fully intended to discharge the relevant VAT liability in full on the due date. Accordingly, in reaching my decision on the question, I do not intend to cast any aspersions on the character or motives of the officers and employees of the Appellant.

19. However, whilst I accept that the mistake which was made in respect of the VAT period 12/17 was genuinely and honestly made, I do not think that it amounts to a reasonable excuse. In that respect, I agree with Ms Rhind that the failure to be aware of the same day transfer limit which the Appellant had agreed with its bank falls below the standard required for a mistake to qualify as a reasonable excuse as outlined in the cases listed above and that a responsible trader, conscious of and intending to comply with its obligations in relation to VAT and having the experience and other relevant attributes of the Appellant, would not have made this mistake. Moreover, I think that this would be the case even if the Appellant was not already within the default surcharge regime. The fact that the Appellant was already within the default surcharge regime means that it knew, or should have known, that a payment default could have serious ramifications and I would therefore expect a responsible taxpayer in that position to have shown a higher degree of diligence then was displayed by the Appellant.

20. I am reinforced in this view by the conclusion reached by the First-tier Tribunal in *Garnmoss*, where a clerical error – a mis-posting which led the taxpayer to conclude that it had paid more VAT than it should have done so that it erroneously reduced its VAT payment – was considered not to amount to a reasonable excuse (see paragraphs [9] to [12] of that decision).

21. For the above reasons, I have concluded that there is no reasonable excuse for the late payment of £31,134.08 which was made in respect of the VAT period 12/17.

Proportionality

22. The second issue before me is whether the surcharge which is the subject of this appeal should be struck down on the basis that it is not proportionate to the gravity of the infringement.

23. In relation to this question, I am bound by the decisions of the Upper Tribunal in *Total Technology* and *Trinity Mirror*.

24. The principles which I derive from those cases may be summarised as follows:-

(a) a wide discretion is conferred on the Government and Parliament in devising a suitable scheme for penalties and therefore a high degree of deference is due by courts and tribunals when determining the legality of penalties. The state has a wide margin of appreciation and a court or tribunal

must be astute not to substitute its own view of what is fair for the penalty which Parliament has imposed;

(b) a penalty under the default surcharge regime could be disproportionate either if the regime as a whole is disproportionate or if the way in which the regime applies to an individual taxpayer operates in a disproportionate manner;

(c) there is nothing in the default surcharge regime as whole which leads to the conclusion that its architecture is fatally flawed;

(d) having said that, the regime could operate in a disproportionate manner in an individual case. In this context, the absence of a maximum penalty is a real flaw in the regime;

(e) in respect of penalties, the principle of proportionality is concerned with two objectives - the objective of the penalty itself and the underlying aims of the relevant directive. Of the two, the latter is the more fundamental because it is not enough for a penalty simply to be found to be disproportionate to the gravity of the default. Instead, it must be "so disproportionate to the gravity of the infringement that it becomes an obstacle to [the underlying aims of the directive]" (see *Louloudakis* at paragraph [70]);

(f) the underlying aim of the relevant directive in this case is the principle of fiscal neutrality since the common system of VAT is intended to tax only the final consumer and it is a necessary concomitant of a system that provides for the deduction and collection of tax at each stage in the process that tax should be accounted for and paid on a timely basis;

(g) the correct approach is to determine whether the penalty goes beyond what is strictly necessary for the objective pursued by the default surcharge regime 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 (i.e. fiscal neutrality);

(h) to those tests should be added the question derived from *International Transport Roth GmbH v Secretary of State for the Home Dept* [2003] QB 728 at [26], which is "is the scheme not merely harsh but plainly unfair, so that, however effectively that unfairness may assist in achieving the social goal, it simply cannot be permitted?";

(i) the use of the amount unpaid as the objective factor by which the amount of the surcharge varies is not a flaw in the system; on the contrary, as the achievement of the aim of fiscal neutrality depends on the timely payment of the amount due, that criterion is an appropriate, if not the most appropriate, factor;

(j) in addition, as the objective of the default surcharge regime is to penalise a failure to pay VAT on time and not to penalise for a further delay in payment, the fact that a late payment is made only one day after its due date is not sufficient to render an otherwise proportionate penalty disproportionate;

(k) whilst the absence of any financial limit on the level of the default surcharge may result in an individual case in a penalty that might be considered disproportionate, this is likely to occur only in a "wholly exceptional case" and be dependent upon its own particular circumstances;

(l) it is not possible to identify common characteristics of a case where such a challenge to a default surcharge would be likely to succeed. In particular:

(i) it is not appropriate for a court or tribunal to seek to set any maximum penalty or range of maximum penalties because that would in effect be to legislate;

(ii) the question of whether the taxpayer had a reasonable excuse for its default is not a relevant factor in considering the proportionality of a penalty because it is axiomatic that, in any case where a default surcharge has arisen, the taxpayer will not have a reasonable excuse for its default; and

(iii) the Upper Tribunal in *Trinity Mirror* expressly stated that it should not be taken to have endorsed the suggestion that the exceptional circumstances giving rise to a disproportionate penalty could include cases where there has been a "spike" in profits;

and

(m) more generally, the Upper Tribunal in *Trinity Mirror* noted that:-

> "Attempting to identify particular categories of case in this way is not, in our view, helpful. Whilst it might be tempting to seek to isolate, and thus confine, cases by reference to particular criteria, such cases, by reason of their exceptional nature, are likely to defy such characterisation".

25. Just pausing there, it is unfortunate that, having identified the use of the amount unpaid as the objective factor by which the surcharge is calculated to be the most appropriate factor in the calculation of the surcharge but also stated that the absence of any financial limit on the level of the surcharge may result in a disproportionate penalty in certain circumstances, the Upper Tribunal did not provide guidance as to what those circumstances might be. If the principle is that it is entirely appropriate to calculate a surcharge by applying the specified percentage to the amount of tax unpaid even in a case where there has been a "spike" in profits, then it is hard to see what circumstances could lead a surcharge so calculated to be regarded as disproportionate. The Upper Tribunal in *Trinity Mirror* recognised this when it noted at paragraph [66] that, "[although] the absence of a maximum penalty means that the possibility of a proper challenge on the basis of proportionality cannot be ruled out, we cannot ourselves readily identify common characteristics of a case where such a challenge to a default surcharge would be likely to succeed".

26. It follows that, in my view, the present facts do not qualify as a "wholly exceptional case" of the kind to which reference was made in *Trinity Mirror* and that the penalty in this case cannot be regarded as disproportionate.

27. I therefore uphold the default surcharge liability of £4,670.11.

28. For completeness, I have considered whether the Appellant might have had a reasonable excuse for any prior default in the default surcharge period which is "material" to the present default. It can be seen that a prior default is "material" to the present default surcharge if it is a default that was taken into account in the service of the surcharge liability notice upon which the present default surcharge depends and the taxpayer has not previously been liable to a default surcharge in respect of a VAT period ending within the surcharge period specified in or extended by that notice.

29. The language in Section 59(8) VATA 1994 is not particularly clear but it has been the subject of some helpful exposition by Judge Poole in the case of *Workstation Farnham Limited v The Commissioners for Her Majesty's Revenue and Customs* [2015] UKFTT 57 TC. According to Judge Poole in that case, a prior default is "material" for this purpose if its existence has contributed to the imposition of the default surcharge which is under consideration and it has not already given rise to a default surcharge in respect of a VAT period falling earlier than the VAT period which is the subject of the appeal. (I would question that formulation in one minor respect. It seems to me that a taxpayer's first default – ie the default which leads to the issue of the initial surcharge liability notice but not to a default surcharge itself – would, on that formulation, remain a "material" prior default. However, I believe that the existence of default surcharges which have arisen in respect of VAT periods falling after the issue of the initial surcharge liability notice means that, even though that initial default has contributed to the default surcharge which is under consideration, it is also precluded from being a "material" prior default by the language at the end of Section 59(8)).

30. In this case, all of the Appellant's prior defaults from and including its default in respect of the VAT period 12/15 have contributed to the imposition of the present default surcharge because their existence has been taken into account in determining that the appropriate rate to be applied in calculating the present default surcharge is 15% and not some lower percentage. However, as each of the prior defaults which has occurred since the issue of the initial surcharge liability notice has already given rise to an earlier default surcharge, none of the prior defaults is "material" to the present default surcharge. In any event, the Appellant has not alleged that it had a reasonable excuse for its failure to pay in full by the relevant due date the amount of VAT which it was required to pay in respect of any earlier VAT period. So I do not think that there are any grounds for concluding that the applicable rate for the purposes of calculating the present default surcharge should be less than 15%.

31. For the reasons set out above, the appeal is dismissed. I sympathise with the predicament of the Appellant because, in addition to the fact that its mistake in this case was genuine and honest, the amount of the default surcharge is significant for a business of the Appellant's size and there is no doubt that the legislation would operate in a much fairer manner if the amount of the penalty reflected not only the number of earlier defaults and the amount of the VAT which is due in respect of the VAT period in question but also the length of time for which the relevant amount is outstanding. However, that very issue has been addressed by the Upper Tribunal and, for the reasons set out in paragraph 24(j) above, I am not permitted to take that factor into account in determining whether or not the default surcharge in any particular case is disproportionate.

32. 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.

TONY BEARE
TRIBUNAL JUDGE

RELEASE DATE: 28 JANUARY 2019