TC03012

Appeal number: TC/2012/07542

VAT default surcharge - payment received by HMRC four days late - instructions for electronic transfer of funds not given to bank until shortly after 'cut off time'- extended date for electronic payment shortened due to bank holiday - whether in the circumstances a penalty of £9,341.45 was unfair and disproportionate - no - whether reasonable excuse - no - Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

POLTI (UK) LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE MICHAEL S CONNELL
RAYNA DEAN

Sitting in public at Alexandra House, The Parsonage Manchester on 17 May 2013

James Gorton of Gortons Chartered Accountants for the Appellant
Anne Sinclair, Officer of HM Revenue and Customs, for the Respondents

DECISION

The Appeal

1. Polti (UK) Limited ("the Appellant") appeals against a default surcharge of £9,341.45 for its failure to pay the VAT due, in respect of its VAT period ended 30 March 2012, by the due date.

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

Background

3. The Appellant's principle business activity is the distribution of commercial steam irons and presses. The business is a UK subsidiary of an Italian company and was incorporated in the UK in 2007.

4. The Appellant paid VAT on a quarterly basis. Section 59 of the VAT Act ("VATA") 1994 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].

5. The Appellant had previously defaulted on VAT payments in period 03/11 and 06/11. VAT Surcharge Liability Notices were issued in respect of these periods. Period 09/11 was a repayment return. A further default occurred in period 12/11.

6. The due date for the Appellant's 03/12 period was 30 April 2012. The Appellant's return was received late by HMRC on 4 May 2012. The amount due under the return was £113,537. Payment of the VAT due was received by HMRC by electronic transfer of funds on 8 May 2012.

7. The surcharge payable should have been calculated at 10% of the amount due, but was based on an incorrect allocation of payments by "Vision", HMRC's software allocation programme, and charged on the lesser sum of £93,414.50.

8. Section 59 Value Added Tax Act 1994 sets out the provisions in relation to the default surcharge regime. 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.

9. 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 after the issue of a VAT Surcharge

Liability Notice, the specified percentage is 2% and the percentage ascends to 5%, 10% and 15% for the second, third and fourth default.

10. 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 : -

> '(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 –
>
> (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 ..'

11. 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.

Appellant's Case

12. The Appellant does not dispute that its VAT payment for the period 12/11 was due on 04 May 2012, nor that HMRC received the payment on 08 May 2012.

13. Mr Gorton for the Appellant explained that the Appellant experienced a number of staff problems in early 2011, which resulted in its first VAT default. This led to the dismissal of an incompetent finance manager whose "book-keeping was inaccurate" and "administration incompetent". He was a senior member of staff who had been relied upon for the efficient running of the company's accounts department. Regrettably he had erroneously cancelled a direct debit arrangement with HMRC which caused delayed payments of VAT for March and June 2011. This in turn resulted in the imposition of a surcharge liability notice and a VAT default surcharge.

14. The directors of the Appellant appointed a replacement finance manager in October 2011, but unfortunately she had to leave the company in March 2012 due to ill-health after which it was discovered that although she had filed the company's VAT return for December 2011 on time, she had inexplicably overlooked payment of the liability. This led to a further surcharge in February 2012.

15. The Appellant then appointed its accountants to bring the company's affairs up-to-date. Its next VAT return was due at the end of April 2012 and was completed and filed in advance of the due date.

16. Payment of the VAT if made electronically is normally due seven days later. The Appellant says that e-mail instructions marked "urgent" were given to its bank to transmit £113,537.41 by CHAPS at 17.02pm on Friday 4 May 2012. The Appellant accepts that its instruction to the bank was given very late in the day, possibly after the banks "cut off time" (normally 16.45 with the majority of banks), and that it was unlikely the payment would have reached HMRC the same day. The Appellant also overlooked the fact the following Monday 7 May 2012 was a bank holiday so that payment would not actually reach HMRC until Tuesday 8 May 2012 which was four days late. The Appellant says that the monies were remitted on the due date and they were received only one working day late.

17. Mr Gorton referred to the case of *Total Technology (Engineering) Limited* [2012] UKUT 418 heard by the Upper Tribunal, (where a penalty of £4,260.26 was held not to be disproportionate although the VAT payment had only been one day late.) He acknowledged that the case established the VAT default surcharge penalty regime was not "flawed legislation" and did not "amount to a breach of convention rights", as had been argued in that case. He also accepted that the amount of the penalty had been arrived at by applying a scheme of calculation which did not involve a breach of the principle of proportionality. His main argument was that cases must be looked at individually as in *Enersys Holdings UK Ltd* [2010] UKFTT 20 (TC), and in certain circumstances a penalty could be regarded as "not merely harsh but plainly unfair" and therefore disproportionate. He submitted that a penalty of £9,341.45 imposed in respect of a delay in payment of VAT by one working day, in circumstances where there had been a clear attempt to pay on time, was clearly unfair and disproportionate.

HMRC's Case

18. Ms Sinclair for HMRC said that the Appellant's VAT Period 03/12 had a statutory due date of 30 April 2012. The due date is extended by seven days where payment is made electronically except where this falls on a bank holiday or weekend when the due date is deemed to be the last previous working day. The VAT should have been received by 4 May 2012 and was in fact four days late.

19. The potential financial consequences attached to the risk of further defaults would have been known to the Appellant after issue of the Surcharge Liability Notice for period 03/11 and further surcharge default notices for periods 06/11 and 12/11. The information contained on the reverse of each Notice states:

> '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.'

20. The requirements for submitting timely electronic payments can also be found -

- In notice 700 "the VAT guide" paragraph 21.3.1 which is issued to every trader upon registration.
- On the actual website www.hmrc.gov.uk
- On the E-VAT return acknowledgement.

21. Also the reverse of each default notice details how surcharges are calculated and the percentages used in determining any financial surcharge in accordance with the VAT Act 1994 s 59(5).

22. Therefore the surcharge has been correctly issued in accordance with the VAT Act 1994 s 59(4).

23. HMRC may allow additional time for payment if requested. Any request must be made prior to the date on which the VAT falls due. No request for a time to pay arrangement was received by HMRC from the Appellant prior to the default.

Conclusion

24. As the Upper Tribunal said in *Total Technology*, there is nothing in the VAT default surcharge regime which leads to the conclusion that its architecture is fatally flawed or that it infringes the principle of proportionality. The Tribunal recognised that the VAT default surcharge legislation imposes a highly prescriptive regime with an inflexible table of surcharges laid down with no, or virtually no, discretion for HMRC to relieve a surcharge once imposed. It concluded however that there must be some upper limit on the penalty which was proportionate, although it did not suggest what that might be, given that all the circumstances of the default must be taken into account.

25. The Upper Tribunal said that it is therefore open to Tax Tribunals to consider individual default surcharges without having first concluded that the default surcharge regime as a whole is disproportionate. However in assessing whether a penalty in any particular case is disproportionate, the Tribunal must be astute not to substitute its own view of what is fair for the penalty which Parliament has imposed. The Tribunal should show the greatest deference to the will of Parliament when considering the application of the VAT default surcharge scheme.

25. By way of further background to the Tribunal's reasoning in *Total,* the Tribunal referred to what Simon Brown LJ had said in *International Transport Roth GmbH v Home* Secretary [2003] QB 728 at [26], setting out the test for assessing proportionality -

> "…. it seems to me that ultimately one single question arises for determination by the court: 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? In addressing

> this question I for my part would recognise a wide discretion in the Secretary of State in his task of devising a suitable scheme, and a high degree of deference due by the court to Parliament when it comes to determining its legality. Our law is now replete with dicta at the very highest level commending the courts to show such deference."

The Tribunal observed that the "not merely harsh but plainly unfair" test set a high threshold which must be surmounted before a Tribunal could find that a penalty, correctly levied on the taxpayer by statutory provisions set by Parliament, should be struck down as disproportionate.

26. In the case of *Enersys Holdings UK Limited*, referred to by the Appellant, due to a human error, the relevant return was submitted, and payment made, one day late. This resulted in a 5% penalty amounting to just over £130,000. Judge Colin Bishop held that the penalty was wholly disproportionate to the gravity of the offence. It was not merely harsh but plainly unfair and in the absence of any justification it could not be saved by the State's margin of appreciation. As he said, penalties must not go beyond what is strictly necessary for the objectives pursued and a penalty must not be so disproportionate to the gravity of the infringement that it becomes an obstacle to the underlying aims of the VAT Directive by imposing a disproportionate burden on a defaulting trader and distorting the VAT system as it applies to him. It possible to envisage a penalty regime the architecture of which is unobjectionable, but which nevertheless leads occasionally to the imposition of a penalty so high as to be disproportionate.

27. Although the Appellant regards the penalty as unfair a surcharge is only imposed on a second or subsequent default, and after the taxpayer has been sent a surcharge liability notice warning him that he will be liable to surcharge if he defaults again within a year. The taxpayer therefore knows his position and should be able to conduct his affairs so as to avoid any default. The penalty is not a fixed sum but is geared to the amount of outstanding VAT. The percentage applicable to the calculation of the penalty increases with successive defaults if they occur within twelve months of each other. It is then open to the taxpayer to show whether a reasonable excuse exists for the late payment.

28. Is the penalty disproportionate? The penalty imposed on the company was £9,341.45. We find that the delay was four calendar days, not one as argued, but the penalty would have been the same if the delay had only been one day or significantly longer. There must of course be a proportionate upper limit to a penalty. The penalty is certainly substantial but cannot be described as "devoid of reasonable foundation". Even if the penalty is more than would possibly be imposed if it was a matter to be decided by the Tribunal, it is significantly below and cannot be compared with the penalty of £130,000 imposed in *Enersys.* It does not approach the level which the Tribunal described in *Enersys* as "unimaginable". In our view, it cannot be said to be within a range which would be sensibly regarded as entirely disproportionate.

29. Was there a reasonable excuse for the late payment? The Appellant was clearly aware of the due date for payments of its VAT and the potential consequences of late payment.

30. Instructions were given to the Appellant's bank to make a payment of £113,537.41 by electronic transfer of funds at 17.02 on Friday 4 May 2012. This was after the bank's cut off time for CHAPS payments and therefore no blame can be apportioned to the bank. Had the instructions been given perhaps an hour or so earlier the funds might have reached HMRC the same day. Because there had been several earlier defaults the Appellant would have been aware of the financial consequences of a further late payment and should have ensured that the VAT payment was made in good time to reach HMRC no later than close of banking on 4 May 2012. The Appellant may have overlooked the fact that the following Monday was a bank holiday, but is unfortunate for the Appellant that an oversight or a mistake, albeit honestly made, is not a reasonable excuse. The Appellant would or should have been aware that when payment is made electronically and the payment date falls on a bank holiday or weekend, the due date is deemed to be the last working day beforehand.

31. 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 events beyond its control. In the Tribunal's view, for the reasons given above, that burden has not been discharged and there was no reasonable excuse for the Appellant's late payment of VAT for the 12/11 period.

32. The appeal is accordingly dismissed and the surcharge upheld.

33. 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.

MICHAEL S CONNELL

TRIBUNAL JUDGE

RELEASE DATE: 25 October 2013