TC01300

Appeal number TC/2010/09318

VAT – Default Surcharge s 59 VATA – - reasonable excuse: no on the facts - proportionality

FIRST-TIER TRIBUNAL

TAX

BLUE FOREST (UK) LIMITED **Appellant**

- and -

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

TRIBUNAL: CHARLES HELLIER (TRIBUNAL JUDGE)
JOHN CHERRY, FCA (TRIBUNAL MEMBER)

Sitting in public at 185 Dyke Road, Brighton, BN3 1TL on 14 February 2011

Michael Ruddock, FCCA, director Blue Forest (UK) Limited for the Appellant

Gloria Orimoloye of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an Appeal by Blue Forest (UK) Limited ("Blue Forest") against the imposition of a Default Surcharge of £699.34 under s 59 VATA 1994 because of the late payment of VAT for the period 07/10. A surcharge of £1,748.35, at 5% of the tax in point, was notified to Blue Forest by HM Revenue and Customs ("HMRC") in a Notice of Assessment dated 17 September 2010. Blue Forest requested a review of the surcharge on 28 September 2010. The imposition of a surcharge was upheld on review, as notified by HMRC to Blue Forest on 16 November 2010. However, the amount of the surcharge was reduced to £699.34, being 2% of the tax in point. This was because an earlier Default, for the period 01/10, was removed by HMRC in the course of the review(the Appellant asserting that payment had in fact been made on time).

2. The Tribunal decided, as explained below, that the Appeal be dismissed as the surcharge was validly made, no reasonable excuse within the statutory meaning had been shown, and the surcharge was not disproportionate in the circumstances of the case.

The Relevant Law

3. The statutory provisions relevant to this Appeal are contained in s 59 VATA 1994 which are set out in Appendix 1 below.

4. The Appellant did not dispute that (1) the VAT for 7/10 had been due on 7 September 2010 if paid electronically, and had been paid late in four amounts: £10,000, £10,000, £10,000 and £4,967.10, paid on 8, 9, 13 and 15 September 2010 respectively; (2)that the VAT for the 4/10 period had been paid late; (3) that a valid surcharge liability notice had been served on it in respect of its default in the 4/10 period creating a surcharge period into which the late payment for 7/10 fell; and (4) the surcharge had been correctly computed at 2% of the relevant outstanding VAT.

The Evidence of Mr Ruddock

5. Mr Ruddock told us, and we accept, that:

(1) Blue Forest would never be able to make surcharges on its customers in such a manner;

(2) Blue Forest usually pays all of its taxes on time; the VAT due for the quarter 04/10 was paid late because Ruddock was very busy at that time;

(3) the VAT due for the quarter 07/10 was paid late because Mr Ruddock discovered that the daily amount he could pay by way of electronic banking was limited to £10,000. Accordingly he split the payment of VAT into four amounts: £10,000, £10,000, £10,000 and £4,967.10, paid on 8, 9, 13 and 15 September 2010 respectively;

(4) neither the quarterly amount due for VAT, nor any other payments he had tried to make electronically, had previously exceeded £10,000 on any one day, so he was not aware of the electronic bank payment daily limit, which he discovered sometime before 7 September 2010;

(5) he did not consider making payment of the VAT by other means (eg a CHAPS payment or a banker's draft) because he did not think of doing so. He agreed that he could have done so if he had thought of it.

(6) asked why he did not make any payment of the VAT before 8 September 2010, Ruddock said that he had to pay his suppliers first. He agreed that he had preferred them over the payment of VAT.

Mr Ruddock's submissions

6. Mr Ruddock argued that the surcharge was disproportionate. He said:

(1) it was an excessive penalty for only a few days delay;

(2) the Appellant's business operated on a low margin. A surcharge based on a percentage of turnover therefore bore more harshly (and in this case excessively) on the Appellant than it would on a business with higher margins;

(3) the 7/10 period had been a busy period. The Appellant's turnover was greater than in other quarters. The surcharge, computed by reference to that greater VAT was thus disproportionate;

(4) it would be impossible for the Appellant to impose a similar surcharge on any customer who paid late: it was not proportionate to the commercial world;

(5) the late payment had been an innocent oversight at the end of a busy period. This was not a grave default.

7. Mr Ruddock also relied on the decision of the ECJ in *Louloudakis* C-262/99. We shall return to that below.

Miss Orimoloye's submissions

8. Miss Orimoloye submitted (1) that the Appellant had no reasonable excuse for its default, and (2) that the surcharge of £690 was not out of proportion to the gravity of the default. She said that *Louloudakis* was concerned with surcharges which were different from the VAT default surcharge regime. She referred us to *Enersys Holdings UK Limited v HMRC* [2010]FTT 20 TC and said that whilst this surcharge might possibly be harsh it was part of a necessary regime: it was not unimaginably unfair in the context of a regime designed to promote timely compliance.

9. **Discussion**

(a)reasonable excuse

10. We find that the default surcharge of £699.34 was exigible under the terms of section 59 unless the Appellant had a reasonable excuse.

11. We find that Blue Forest had the means to pay its VAT on time, and could have used a payment method that would not have resulted in late payment, but did not do so.

12. In our view a reasonably diligent taxpayer would have considered other methods of making timely payment if the method it first contemplated was not available.

13. We find that the Appellant did not have a reasonable excuse for its default.

(b) Proportionality

14. In *Louloudakis* a penalty was imposed for the use of a vehicle which had been imported into Greece without payment of customs duties. One of the questions referred to the ECJ was whether the penalty which was imposed on the sole basis of the cubic capacity of the engine of the vehicle (and far exceeded the value of the vehicle) was compatible with the community principle of proportionality.

15. The Court observed ([67]) that under that principle such penalties must not go beyond what was strictly necessary for the objective pursued and that a penalty must not be so disproportionate to the gravity of the infringement that it became an obstacle to Treaty freedoms. It held that a penalty based on the sole criterion of cubic capacity could be compatible with the proportionality principle only if it was made necessary by the overriding requirement of enforcement where the gravity of the offence was taken into account. It later held that, in determining a penalty, the good faith of the offended should be taken into account.

16. Although this case was concerned with customs duty penalties rather than VAT penalties and Treaty freedoms are not in point in this appeal, it seems to us that its relevance is that it makes plain that the test to be applied is whether a particular penalty provision goes beyond what is necessary, and that in determining whether a particular penalty is necessary to achieve an objective the gravity of the default is a relevant consideration to be weighed against the object of the measure.

17. In *Enersys* the tribunal found that a VAT surcharge was disproportionate and allowed the appeal against it. In so doing it noted that (1) tribunals would not strike out penalties save in exceptional circumstances when the penalty was not merely harsh but plainly unfair, (2) the penalty imposed in that case was wholly disproportionate to the gravity of the offence – no judicial body unconstrained by statute would have imposed such a penalty for such an offence, (3) in the absence of any justification for the surcharge it could not be saved by the state's margin of appreciation. In addressing the question of the unfairness of the penalty it considered the gravity of the offence and how the size of the penalty bore on the taxpayer.

18. In this case we accept that the Appellant's default was not particularly grave. It was not deliberate or one of long series of defaults. Nevertheless it was not

completely blameless - the exercise of due care could have avoided the default; it was not a simple mistake.

19. Whilst the fact that a payment may have been only minutes or hours late could affect the gravity of the default, we do not regard the period for which the VAT was unpaid as otherwise relevant to the size of the penalty. The object of the regime is to encourage payment by a particular date, not to reduce the period for which payment remains outstanding. As the tribunal noted in *Enersys*, this is a penalty for failure, not compensation for interest foregone.

20. We regard the fact that the surcharge operates on the turnover rather than the profits or assets of the Appellant as relevant. The penalty regime bears comparatively more heavily on those with low margins. We consider that in some circumstances this could make a surcharge unfair. In this case it was clear that it bore harshly on the Appellant. Had it been at the 15% level we might have regarded it as being too harsh, but at the 2% level the penalty did not seem to us by reason of this criterion to be wholly unfair.

21. We regard the ability of the taxpayer to make similar surcharges on its late paying customers as irrelevant. There is a difference between contractual arrangements and the imposition of a penalty by the state. The compliance requirements of the state are not consensual arrangements.

22. We regard the fact that the surcharge was higher as a result of a larger VAT bill as equivocal in this case. Because the Appellant knew that it had a higher VAT bill it had more incentive to pay the VAT on time; but a particularly high VAT quarter could cause a surcharge to bear very harshly on a taxpayer. In this case we find it exacerbated the harshness of the charge created by the fact that it was based on turnover, but did not make the charge wholly unfair.

23. Putting these together we asked ourselves whether a penalty of some £700 for a taxpayer with a turnover of some £140K and relatively low profit margins was really unfair. We concluded that it was on the large side and bore heavily on the Appellant, but was not outrageous or wholly unfair. We therefore found that it was not disproportionate.

Conclusion

24. We dismiss the appeal.

Right to Appeal

25. 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.

CHARLES HELLIER

TRIBUNAL JUDGE
RELEASE DATE: 5 JULY 2011

Appendix 1

Value Added Tax Act 1994 s 59

59 The default surcharge

(1)Subject to subsction (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.