TC01954

Appeal number: TC/2011/4235

DEFAULT SURCHARGE- Proportionality – Electronic return stating due date for payment – Payment by cheque one day late – Held no reasonable excuse – Whether penalty over £8,000 disproportionate – Whether jurisdiction to consider particular case as opposed to system – Yes – Held particular surcharge not disproportionate – VATA 1994 s.25(1) – VAT Reg 25(1). 25A and 40 – Appeal dismissed.

FIRST-TIER TRIBUNAL
TAX

THE OXBRIDGE RESEARCH GROUP LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE THEODORE WALLACE
MRS S J LOUSADA

Sitting in public at Bedford on 26 September 2011 and in London on 16 February 2012

Nicholas Malaminatas for the Appellant company

Andrew MacNab, instructed by the Solicitor for HM Revenue and Customs, for the Respondents (Mrs Lynne Ratnett on 26 September 2011)

DECISION

1. This is an appeal against a default surcharge of £8,433.37 for the period to 31 December 2010 following a payment by cheque which was posted on 3 February 2011.

2. The surcharge was at the rate of 15%, following six previous defaults going back to period 06/08, the last two of which were also surcharged at 15%. This was the first appeal to the Tribunal although on 25 March 2010 the Appellant sought to "appeal" to HMRC against the surcharges imposed for periods 06/09 and 12/09. The Appellant had paid all the previous surcharges, amounting in total to over £20,000.

3. The Appellant produced substantial written submissions at the initial hearing including a submission that the penalty was disproportionate to the gravity of the offence.

4. Mrs Ratnett said that she had no prior notice of these extensive submissions and asked for time to make submissions on proportionality. The appeal was adjourned and skeleton arguments directed. We observe that the initial notice of appeal included the following, "The amount of the fine was disproportionate to the offence, and did not fit the 'crime'."

5. There was no real dispute as to the underlying facts.

6. The Appellant contracted academics from Oxford and Cambridge to produce research in various fields and was involved in academic tuition. The business started with a simple website and in four years expanded to a turnover of £1.5 million with an office in London and around 20 full-time staff.

7. Initially the accounting system was non-existent and the accounts, VAT and PAYE fell into substantial arrears giving rise to the surcharges already mentioned.

8. On 10 January 2010 the Appellant was issued with a "mandation" letter requiring returns to be submitted and payments to be made electronically. The VAT for period 03/10 was paid on time electronically. The VAT for period 06/10 was paid in eleven BACS payments, the last being on 7 June 2011.

9. Before the return for period 09/10 the Appellant set up a direct debit mandate and the VAT for that period was paid by direct debit, the payment being collected by HMRC on 10 November.

10. On 16 November 2010 HMRC agreed to a variation of a schedule of payments under which the arrears of £140,025.66 including surcharges would be paid off by June 2011.

11. The electronic return for period 12/10, the period under appeal was made on 31 January 2011 and showed £56,222.48 as payable. The electronic return form showed the due date as 7 February.

12. HMRC's contact centre at Glasgow recorded Eva Melin an employee of the Appellant as telephoning at 0832 hours on 2 February 2011 as follows, "Caller looking to cancel direct debit, advised to cancel with bank."

13. The Appellant paid by cheque which was debited to the Appellant's bank account on 9 February, the following Wednesday. At the time when the cheque was posted there were sufficient funds in the bank to meet it, as a result of an internal online transfer on 2 February. The Schedule of Defaults produced by HMRC showed the payment as received by cheque on 7 February.

14. The only witness was Farid Ahmed who was chief executive of the Appellant from September 2010 and a consultant from 2009.

15. He said that Eva Melin was employed as financial controller on his advice in August or September 2009. He said that the Appellant had major financial difficulties. In November 2010 he negotiated a time to pay agreement to pay off the arrears and PAYE in addition to the quarterly VAT.

16. Mr Ahmed said that towards the end of 2010 Eva Melin gave notice. Before leaving, she worked out the VAT for 12/10. Either she or Philip Malamatinas, a director, sent the return online.

17. Mr Ahmed said that he took a decision to stop all direct debits in order to understand and manage the cashflow; he did not know how many direct debits there were. He knew that the VAT for period 09/10 had been paid by direct debit. The arrears were being paid by BACS. Eva Melin made the call to HMRC on his instructions.

18. Mr Ahmed said that the Appellant used online banking with Barclays; there was a daily limit of £10,000 on payments by BACS but this did not apply to direct debits. Having cancelled the direct debit, the Appellant had to pay by cheque unless paying by CHAPS which involved a £25 charge. There were sufficient funds in the account to meet the VAT cheque. There was no intention to delay the payment of VAT. He said that it was his belief that the cheque had gone out on time on 31 January 2011. He did not discuss with the bank how the payment would be made. He did not know exactly what contacts Eva Melin had with HMRC. At the initial hearing, Mr Ahmed had said that the cheque was posted on 3 February.

19. Cross-examined, he said that Eva Melin cancelled the direct debit; he himself did not know when it was actually cancelled. He said that there were certain direct debits which could not be cancelled because the payee required payment by that method, such as Windsor Life Insurance. The funds required to meet the VAT cheque were transferred from another internal account at Barclays. He recalled having seen

the schedule of defaults sent by HMRC before the hearing, but he believed that he had not responded.

20. Re-examined, he said that he himself had not discussed payment with HMRC. Eva Melin had not told him that HMRC said that payment should be by cheque. Payment by CHAPS would have involved a signatory going to the bank in Tottenham Court Road where there were long queues.

21. He told the Tribunal that he had not known that HMRC had told the Appellant that it was required to make returns and payments electronically, although he knew that HMRC were encouraging electronic payment. He did not attempt to pay by BACS because he knew that there was a limit for payments by BACS.

The legislation

22. The legislation governing returns and payments is contained in section 25 of the Value Added Tax Act 1994 and regulations 25, 25A and 40 of the Value Added Tax Regulations 1995.

23. Section 25(1) provides that a taxable person shall account for and pay VAT by reference to prescribed accounting periods

> "at such time and in such manner as may be determined by or under regulations and regulations may make different provision for different circumstances."

24. Regulation 25(1) provides,

> "(1) Every person who is registered or was or is required to be registered shall …., not later than the last day of the month next following the end of the period to which it relates, make to the Controller a return in the manner prescribed in regulation 25A …"

25. Regulation 25A(3) requires specified persons to make returns after 1 April 2010 "using an electronic return system." The Appellant was a specified person. Regulation 25A(20) provides for additional time to make electronic returns "as the Commissioners may allow in a specific or general direction", and provides that the Commissioners need not give a direction.

26. Regulation 40 governs payments. The relevant parts are as follows:

> "(2) Any person required to make a return shall pay to the Controller such amount of VAT as is payable by him in respect of the period to which the return relates not later than the last day on which he is required to make that return.
> (2A) Where a return is made or is required to be made in accordance with regulations 25 and 25A above using an electronic return system,

> the relevant payment to the Controller … shall be made solely by means of electronic communications that are acceptable to the Commissioners for this purpose.
> (2B) With effect from 1 April 2010, where a person makes any payment to the Controller required by paragraph (2) above by cheque (whether or not in contravention of paragraph (2A) above) –
>
> > (a) the payment shall be treated as made on the day when the cheque clears to the account of the Controller, and
> > (b) …
>
> (2C) For the purposes of this regulation, the day on which a cheque clears to the account of the Controller is the second business day following but not including the date of its receipt."

Under (2D) "business day" excludes Saturdays and Sundays.

> "(3) The requirements of paragraphs (1) or (2) above shall not apply where the Commissioners allow or direct otherwise.
> (4) A direction under paragraph (3) may in particular allow additional time for a payment mentioned in paragraph (2) that is made by electronic communications. The direction may allow different times for different means of payment.
> (5) …"

Regulation 40(2B)-(2D) is authorised by sections 58B and 95 of the Act.

Notice 700 – The VAT Guide

27. Paragraph 2.4 states this under "VAT Law",

> "Generally speaking, this notice and the other VAT notices explain how HMRC interpret the VAT Law. However, sometimes the law says that the detailed rules on a particular matter will be set out in a notice or leaflet published by HMRC rather than in a Statutory Instrument. When this is done, that part of the notice or leaflet has legal force, and that fact will be clearly shown at the relevant point in the publication."

28. Paragraph 21 which is headed "VAT returns and payment of tax : submission of returns and payment" contains no statement to that effect. By contrast paragraph 7.7 covering values expressed in a foreign currency states that that paragraph has the force of law. Regulation 4 of the 1995 Regulations provides that any direction by the Commissioners under the regulations "may be made or given by notice in writing, or otherwise." Paragraph 21.1 of the Guide states,

"You must send in your return and any payment due, to arrive by the due date shown on the return."

29. Paragraph 21.3.1 headed "Paper VAT returns" contains the following:

"You can pay by cheque, postal order or by electronic means … if you choose to pay the VAT shown as due on your return by Bankers Automatic Clearing System (BACS), Bank Giro Credit Transfer or Clearing House Automated Payment System (CHAPS), you may receive up to 7 extra calendar days for the returns and payment to reach us.

Here are some important facts you need to know if you want to benefit from this concession:

- The 7 day extension to the due date will be applied automatically every time you pay your VAT return using BACS Direct Credit or Bank Giro Credit Transfer …"

30. Paragraph 21.3.2 headed "Electronic VAT returns" reads as follows:

"If you use Electronic VAT returns, you must pay by one of the electronic methods BACS, CHAPS or Bank Giro, as detailed above. You cannot pay by cheque. To make sure your payment reaches us in time, you should check with your bank how many days they need to complete the transaction."

Notice 700 makes no mention of payment by direct debit.

31. Non-statutory guidance is contained on HMRC's website, http://www.hmrc.gov.uk/payinghmrc/vat/htm. The web page "How to pay VAT" contains the following,

"HMRC recommends that you make all of your VAT payments electronically. If you submit your VAT Return online then you must make payment electronically.

… Paying electronically: …

- In most cases gives you up to seven extra calendar days in which to pay – or at least ten calendar days if paying by Direct Debit online."

…"

Under "Update : changes to cheque payments by post" it is stated that from 1 April 2010 all cheque payments by post are treated as received on the day when cleared funds reach HMRC's bank account and that a cheque takes three bank working days to clear. This reflected the insertion of subparagraphs (2B) and (2C) into regulation 40. Guidance under "Paying VAT by Direct Debit" contains,

"HMRC recommends that you pay by Direct Debit because your payments are collected automatically from your bank account on the third bank working day after the extra seven calendar days following your standard due date".

32. In addition to the written submissions by the Appellant for the initial hearing, referred to at paragraphs 3 and 4 above, the Respondents served a skeleton argument and the Appellant served written submissions for the adjourned hearing.

Submissions for the Appellant

33. In his written submissions Mr Malaminatas said that the VAT cheque was banked and cleared by HMRC before HMRC would have received it by direct debit. If this was late, it was deemed to be late because of a false construction or application of the legislation. HMRC relied on tertiary legislation which it had made up. The rules under which there were different times for those paying by cheque compared with those paying by direct debit were unfair, irrational and unreasonable and could not have been intended by Parliament; differential deadlines were ultra vires.

34. He said that regulation 40(2) required payment not later than the last day on which the return was required. The return form showed that as 7 February. Under section 59(7) of the VAT Act 1994 a person is not liable to a surcharge if the VAT is dispatched so that "it was reasonable to expect that it would be received by the Commissioners within the appropriate time limit". Parliament intended a test of reasonableness to be applied. The due dates for payment were confusing and difficult to calculate; they were incomprehensible to a layman and discriminated against those paying by cheque.

35. Mr Malaminatas said that HMRC had a discretion and did not have to surcharge the Appellant for paying earlier than if it had paid electronically. HMRC had unlawfully fettered its discretion, initially denying that a discretion exists. He referred to press reports of certain cases where a discretion had been exercised.

36. He said that no evidence had been produced that the earlier surcharges were valid or that valid penalty notices had previously been served.

37. Mr Malamatinas said that in any event the penalty in this case was disproportionate and should be discharged. It was not rational to penalise people who paid by cheque ahead of electronic payers. The penalty was not related to the extent of the crime. Imposing the penalty on a trader which had an existing agreement for paying arrears was not rational.

38. Continuing his written submission, Mr Malamatinas conceded that the circumstances of sending the cheque, an error by an employee, was not likely to be accepted as a reasonable excuse because of the "narrow view" of reasonable excuse in *Profile Security Services v Customs and Excise Commissioners* [1996] STC 808 and said that he did not invite the Tribunal to spend time on determining whether there was a reasonable excuse. He submitted, however, that *Enersys Holdings UK Ltd v Revenue and Customs Commissioners* [2010] Simon's FTD 387 was correctly decided

and that the penalty was unfair and disproportionate to the offence in this particular instance, where taxpayers paying by cheque were concerned. The discrimination by which cheque payers were more vulnerable to surcharges even if paying before electronic payers had never been considered by the Courts. The surcharge was alleged to relate to tax unpaid but in fact the tax was paid early. The alleged default was innocent. The penalty of £8,433.37 would have paid the salary of a full-time employee for a quarter; it represented 41 per cent of the gross profit for the period.

Submissions for HMRC

39. Mr McNab for HMRC said that there were only two cases where particular surcharges had been held to be disproportionate, *Enersys* and *Total Technology (Engineering) Ltd v Revenue and Customs Commissioners* [2011] UK FTT 473 (TC); he submitted said that both were wrongly decided, the latter case being now under appeal to the Upper Tribunal. He submitted that in any event the surcharge under appeal was not disproportionate on the facts.

40. Mr McNab said that section 25(1) provides for the time of payment to be determined by or under regulations with power to direct different times. Under regulation 25(1) the default date for returns is the end of the following month, here 31 January. Under regulation 25A(20) HMRC had power to allow additional time for electronic returns. Under regulation 40(2) payment was required not later than the last day on which the return was required. He said that here the additional time was irrelevant because the payment was not made electronically as required by regulation 40(2A). The Appellant had no option to pay by cheque. He said that here HMRC had treated the payment as received on 7 February, however that was immaterial because money paid by cheque was due by 31 January.

41. He said that the suggestion by Mr Malamatinas that regulation 40 was unlawful because of the different treatment of payments by cheque was hopeless because payment by cheque was contrary to regulation 40(2A). In *Lion and Loiret & Haentjens v FIRS* (Cases 292 and 293/81) [1982] ECR 3888 the Court of Justice held at [25] that the complaint of discrimination was misconceived because the difference in treatment was the consequence of the traders' choice between two systems. Here the Appellant could have had extra time by paying electronically.

42. Mr McNab said that paragraph 21.3.1 of Notice 700 was not relevant because electronic returns were required. If a cheque was used in contravention of regulation 40(2A), payment had to be by the basic due date.

43. He said that there was no reasonable excuse. The Appellant was aware of the need to pay on time, in particular because of the earlier surcharges. The direct debit had been cancelled after the last date for payment by cheque. Payment by cheque was a deliberate decision. The payment had not been despatched at such a time and in such a manner that it was reasonable to expect that it would be received in time within section 59(7) because payment by cheque was not permitted. There was nothing outside the Appellant's control which prevented compliance, see *Gladders v Prior*

[2003] STC (SCD) 245 at [7]. Reasonable excuse should be considered from the perspective of the prudent person exercising reasonable foresight and due diligence and having proper regard for his responsibilities under the tax legislation, see *Kellswater Reformed Presbyterian Church v Revenue and Customs Commissioners* [2011] UK FTT 430 (TC).

44. Turning to proportionality, Mr McNab said that HMRC accept that this Tribunal has jurisdiction to consider whether the default surcharge regime satisfies the requirement under EU law of proportionality.

45. He said that the Tribunal had held consistently that the default surcharge scheme as a whole satisfies the requirements of proportionality. He referred to *Greengate Furniture Ltd v Customs and Excise Commissioners* [2003] V&DR 178. He submitted that once it is concluded that the system as a whole is proportionate, there is no scope for holding that a particular penalty is disproportionate. The penalty arises under the scheme, it follows that if the scheme is proportionate, the individual penalty must itself be proportionate, being what Parliament has decreed. A high degree of deference is due by the courts to Parliament when determining the legality of legislation, see *International Transport Roth GmbH v Home Secretary* [2003] QB 728 per Simon Brown LJ at [26], where he said that the test was: "is the scheme not merely harsh but plainly unfair …". The Tribunal in *Eco-Hygiene Ltd v Revenue and Customs Commissioners* [2011] UK FTT 754 (UK) agreed with *Eastwell Manor Ltd v Revenue and Customs Commissioners* [2011] UK FTT 293 (TC) that the test set,

> "a high threshold before a court or tribunal can find that a penalty, correctly levied on the taxpayer by statutory provisions set by Parliament, should be struck down as disproportionate."

46. Mr McNab said that the history of previous defaults was relevant as giving rise to a 15 per cent penalty. As to the factors considered in *Enersys* and *Total*, he said that here although the default was not intentional, the decision to change to paying by cheque was deliberate; the default was not a single day but seven days; the surcharge was not excessive in absolute terms, its context was the need for compliance in paying on time, the VAT system including the payment of VAT was intended to be neutral between taxpayers. The amount of the surcharge arose from persistent defaults and everyone knew that there are progressively higher penalties. The Appellant's record made it all the more important to ensure that the payment was on time. The Appellant had brought the penalty on itself. He said that if, contrary to his primary submission, the Tribunal had power to consider the particular surcharge, the legislation should only be disapplied in exceptional circumstances; this was not such a case.

Reply for Appellant

47. Mr Malaminatas said that the purpose of the legislation was to encourage payment on time and it allowed a certain discretion, however no discretion had been

exercised. No distinction had been made by reason of the arrangements over the arrears. The approach of HMRC was all stick and no carrot.

48. He said that the Appellant was being surcharged over £8,000 for paying by cheque when HMRC were paid earlier than if payment had been by direct debit.

Conclusions

Was there a default?

49. We start by considering whether there was a default. Although Mr McNab said that the due date for payment when made by cheque was the last day of the month following the period covered by the return he did not identify the statutory provision on which he relied.

50. Under regulation 40(2) of the 1995 Regulations payment must be made "not later than the last day on which he is required to make that return." The Appellant was required to make an electronic return and did so. Under regulation 25A(20) additional time is allowed to make an electronic return as the Commissioners may allow in a specific or general direction. Under regulation 4 any direction may be made by notice in writing or otherwise. Under section 96(1) of the Act "document" includes anything in which information is recorded. In our judgment the electronic return issued by HMRC stating the date due as 7 February was a notice in writing. Notice 700 paragraph 21.1 states that a return is due by the date shown on the return; here that date was 7 February. Under regulation 40(2B) a payment by cheque made in contravention of the requirement to pay electronically is treated as made on the day when the cheque clears to the Controller's account, which under (2C) is the second business day following the date of its receipt.

51. We find on the balance of probabilities that the cheque was posted on 3 February, a Thursday, which was the day after Eva Melin's telephone call and the date given by the Mr Ahmed at the initial hearing; assuming that it was sent by first class post in a pre-paid envelope provided by HMRC and arrived on the next day, the second business day following receipt was Tuesday, 8 February. This was later than 7 February, the date shown on the electronic return form. Given that regulation 40(2C) is mandatory, the fact that HMRC recorded the payment as received on 7 February is irrelevant. We conclude that there was a default albeit by one day and not 7 days.

52. The legal status of the relevant paragraphs of Notice 700 is open to question since they are not in boxes showing that they have legal force, see paragraphs 27 and 28 above. The term "direction" is not defined either in the Act or in the 1995 Regulations; as a manner of normal usage, in the context of regulation 25A(20), the term "direction" would indicate an instruction or provision which has legal force. It was not suggested by either party that the return form and paragraph 21 of Notice 700 did not constitute directions either specific or general within regulation 25A(20). If it did not have legal effect it would not assist the Appellant since without such direction,

the due date for both payment and return was 31 January under regulations 25(1) and 40(2).

53. We do not accept the submission of Mr Malaminatas that the action of the Commissioners in setting different deadlines for payment depending on whether payment was by cheque or electronic means was ultra vires as being discriminatory. Section 25(1) expressly authorised different provision for different circumstances. We accept the submission of Mr McNab at paragraph 41 above that the different treatment was not contrary to EU law, see *Lion and Loiret & Haentjens*.

Was there a reasonable excuse?

54. The leading case on reasonable excuse is *Customs and Excise Commissioners v Steptoe* [1992] STC 757 in the Court of Appeal. At page 767g Nolan LJ quoted from his judgment in *Customs and Excise Commissioners v Salevon* [1989] STC 907 as follows,

> "… I think it is worth bearing in mind that the penalties imposed for a delay or deficiency in payment, however slight are fixed. Neither the Commissioners nor the tribunal have any power to mitigate them by reference to the facts of the particular case. In those circumstances the wide discretion conferred on the Commissioners and the tribunal by [section 59(1)] should not, in my view, be regarded as having been cut down by [section 71(1)] to any greater extent than the language of the latter subsection strictly requires."

Nolan LJ said at p.768d-e that his references in *Salevon* to "the wrongful act of another" and "unforeseeable and inescapable misfortune" were directed to the facts of that case. He continued,

> "They cannot be regarded as an all-purpose test of what constitutes a reasonable excuse. The test is to be found in the words of [section 59(7)(b) and section 71(1)(a)] read in the context of the statutory scheme for collection of value added tax."

Lord Donaldson MR agreeing with Nolan LJ said this at page 770d,

> "… if the exercise of reasonable foresight and of due diligence and a proper regard for the fact that the tax would become due on a particular date would not have avoided the insufficiency of funds which led to the default, then the taxpayer may well have a reasonable excuse for non-payment."

55. Although Mr Malaminatas referred (see paragraph 38 above) to a "narrow view" of reasonable excuse in *Profile Security Services*, that case simply decided that reliance "on any other person" includes an employee, we regard that as a matter of common sense. On the authority of *Salevon* and *Steptoe*, section 59(7) confers a wide discretion on the Tribunal. It is to be noted that in *Greengate Furniture* [2003]

V&DR 178, which concerned proportionality, counsel for Customs relied at [59] on the absence of reasonable excuse as removing cases where there was no gravity. At [67] the Advocate to the Tribunal said that the width of reasonable excuse was relevant. We consider that the concept of reasonable excuse is not to be narrowly applied and, adapting Lord Donaldson, apply the test as being whether the exercise of reasonable foresight and of due diligence and a proper regard for the fact that the tax was due on a particular date would have avoided the default.

56. On the basis that the non-statutory guidance as to "Paying VAT by Direct Debit" (see paragraph 31 above) was a direction within regulation 25A(20), the immediate cause of the default was the decision by Mr Ahmed to cancel the direct debit and to pay by cheque. Even if Mr Ahmed did not know that the Appellant company was required to pay by electronic means, the Appellant had been issued with a mandation letter (see paragraph 8 above) and had been paying electronically. Mr Ahmed's ignorance of this was not a reasonable excuse.

57. In other circumstances, the confusing legislation as to the due date for payment and the uncertainty as to the strict legal position might have given rise to a reasonable excuse. However there is nothing to suggest that this was considered at the relevant time or that the Appellant was misled in any way. Whether the due date was in law 31 January or 7 February, a cheque posted on 3 February could not have cleared to the Controller's account by 7 February as required with Regulation 40(2B)-(2D). The Appellant was not entitled to assume that the extra time allowed for payment by direct debit applied when the direct debit was cancelled.

58. We find that there was no reasonable excuse.

Discretion

59. It is clear that the Commissioners have a discretionary power not to impose a surcharge, see *Steptoe* per Scott LJ at p.760d and Nolan LJ at page 768d. However it is settled law that the Tribunal's jurisdiction does not cover the exercise of that power, see *Dollar Land (Feltham) Ltd and Others v Customs and Excise Commissioners* [1995] STC 414; the only remedy for an improper exercise of that discretion is an application to the High Court for judicial review, see per Judge J (as he then was) at page 421e.

Proportionality

60. As recorded above Mr McNab accepted that the Tribunal has jurisdiction to consider whether the default surcharge regime satisfies the requirement of proportionality. However he submitted that the regime as a whole is proportionate and that there is no scope for holding that a particular surcharge imposed under the scheme is disproportionate.

61. This approach would mean that in any appeal against a surcharge on grounds of proportionality, however extreme the facts, it would be necessary for the Tribunal

to consider the proportionality of the regime as a whole. It is to be remembered that in the great majority of default surcharge appeals, including this appeal, the Appellant is not professionally represented, still less legally represented.

62. The decision of the VAT Tribunal in *Greengate Furniture* although persuasive is not binding on the FTT nor indeed is any other FTT decision so binding.

63. Furthermore, the proportionality of the surcharge legislation is to be considered by reference to the circumstances when the surcharge under appeal was imposed as opposed to when the legislation was enacted or last amended. In *Wilson v First County Trust Ltd (No.2)* [2004] 1 AC 816, HL Lord Nicholls said this at [62],

> "it is the current effect and impact of the legislation which matter, not the position when the legislation was enacted or came into force."

Although *Wilson* concerned the proportionality of a provision of the Consumer Credit Act 1974 and its compatibility with Convention rights following the Human Rights Act 1998, we can see no difference in principle when considering proportionality under EU law of a penalty such as this.

64. In *Louloudakis v Greece* (Case C-262/99) [2001] ECR 1-5547, the Court of Justice said this at [71]:

> "… [N]ational legislation which provides, in the event of infringement of the temporary importation arrangements laid down by the Directive, for a series of penalties including, in particular:
>
> - fines set at a flat rate on the basis of the sole criterion of the vehicle's cubic capacity, without taking its age into account,
> - increased duty which can amount to up to ten times the taxes in question
>
> is compatible with the principle of proportionality only insofar as it is made necessary by overriding requirements of enforcement and prevention, when the gravity of the infringement is taken into account."

The underlining is ours. *Louloudakis* was cited and applied by the Court of Appeal in *Lindsay v Customs and Excise Commissioners* [2002] 1 WLR 1766 at page 1784E as being of general application. At paragraph [70] the Court of Justice referred to "the penalties actually imposed" and to "the gravity of the infringement." We do not see how the language used in paragraphs [70] and [71] is consistent with the submission by Mr McNab that there is no scope for consideration of the proportionality of the penalty in a particular case. The Court referred to the gravity of the infringement not once but twice and at [70] also referred to "the penalties actually imposed."

65. In *Roth* Simon Brown LJ said this at [26].

> "… 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 assisting the sonal goal, it simply cannot be permitted?"

The reference to "the scheme" was because that case *Roth* specifically involved a challenge to the intrinsic legality of the scheme under Part II of the Immigration and Asylum Act 1999 rather than to the liability of carriers in individual cases (see at [9]).

66. In our judgment it is open to the Tribunal to consider the proportionality of the surcharge of £8,433.37, independently of whether the surcharge regime as a whole complies with the principle of proportionality.

67. The Tribunal invited the Respondents to make any further written submissions on *Louloudakis* after the hearing, however the Respondents did not do so.

68. In *Ancklagemyndigheden v Hansen & Soen* 1/S (Case C-326/88) [1990] ECR I-2911 the Court of Justice said this at [17],

> "… [W]hilst the choice of penalties remains within [Member States'] discretion, they must ensure in particular that infringements of Community Law are penalised under conditions, both procedural and substantive, which are analogous to those applicable to infringement of national law of a similar nature and importance and which, in any event, make the penalty effective, proportionate and dissuasive."

69. In *Garage Molenheide BVBA and Others v Belgium* (Case C-286/94) [1998] STC 126 the Court said this at [47],

> "… [W]hilst it is legitimate for the measures adopted by the Member States to seek to preserve the rights of the Treasury as effectively as possible, they must go no further than is necessary for that purpose …"

70. It is clear from *Louloudakis* that, when considering whether the penalty in this case is compatible with the principle of proportionality, the Tribunal must take account both of the overriding requirements of enforcement and prevention and of the gravity of the infringement.

71. The starting point is the requirement of enforcement and prevention. Penalties are necessary to ensure that VAT is paid to HMRC on behalf of the Treasury when it is due and to ensure a level playing field between traders. In order to be effective a penalty must be a deterrent. Surcharges are proportionate arithmetically in that they are a percentage of the VAT paid late. The percentage increases with the number of defaults before a clear year without defaults. Once a payment is late, the penalty is

not related to the length of the default and is the same whether the payment is one day late or a month or more. If there is a reasonable excuse there is no default and no penalty; however there is no power to mitigate.

72. On initial impression the penalty in this case is very high in relation to the infringement. A penalty of over £8,000 for late payment of £56,000 would on any view be high even if the payment was a month late. A fine of that amount would exceed the jurisdiction of a Magistrates court. The maximum penalty on prosecution before the Finance Act 1985 was £100 plus ½ per cent of the tax due for each day the default continued, making 15 per cent for 30 days.

73. However the compatibility of the penalty with proportionality must be considered not as a matter of impression but by reference to an analysis of the facts of the case.

74. In *Eco-Hygiene* the Tribunal identified a number of factors which were considered in *Enersys* and *Total* as follows: (1) whether the default was innocent or deliberate; (2) the number of days of the default; (3) the absolute amount of the penalty; (4) the inexact correlation of turnover and penalty; (5) the absence of any power to mitigate; (6) the absence of an upper limit to the penalty. At [40] the Tribunal in *Eco-Hygiene* said this –

> "It is clearly right to test the circumstances of any particular case by reference to elements of a penalty regime that might operate unfairly in certain cases. This summary of those perceived elements is helpful, but it should not be regarded as exhaustive, or in any way as a checklist. In the consideration of the issue of proportionality, each case must be considered by reference to its own facts and circumstances, and all of those circumstances must be taken into account."

At [48] the Tribunal in *Eco-Hygiene* cited Simon Brown LJ in *Roth* at [26] (see paragraph 65 above), a passage on which Judge Bishopp relied in *Enersys*, which went on to refer to the deference due by the Court to Parliament.

75. In the present case although the default was not intended it resulted from the intentional act of cancelling the direct debit. Mr Ahmed was unaware of the requirement that the payment must be electronic or of the provisions of regulation 40(2B) regarding payment by cheque. Eva Melin who cancelled the direct debit should have known as should the directors at least one of whom presumably signed the cheque. The decision to cancel the direct debit was made at a very late stage. The default did not result from a mere mistake, slip or oversight but from a failure by the Appellant company through its servants and officers to exercise reasonable care as to the method and time of payment. It did not result from misunderstanding of the provisions regarding the time of payment which we find to be both confusing and unsatisfactory. The Appellant did not consider those provisions before the default

occurred. Furthermore some direct debits were not cancelled, see paragraph 19 above.

76. We have already concluded at paragraph 51 above on an analysis of the legislation and the documents issued by HMRC that the default was one day rather than seven days. However it was still a default and it resulted from a failure to exercise reasonable care.

77. The amount of the penalty was very high in absolute terms. This was because it was 15 per cent of the VAT due, the maximum percentage.

78. There was no evidence as to the annual turnover apart from the fact that in four years it expanded to £1.5 million. However we assume that the input tax was much lower in relation to turnover than for a trader for which services were a lower proportion of costs. If turnover was still only £1.5 million, the penalty was just over ½ per cent of turnover. It was however 41 per cent of the gross profit for the period; the margins were obviously narrow.

79. The absence of an upper limit is a basic feature of the system, and in this case adds nothing to the matters considered in paragraphs 77 and 78 above.

80. We do not accept that the imposing of the penalty when the Appellant had an existing agreement to pay off the arrears was either irrational or relevant to the issue of proportionality. The arrears which arose from previous defaults and surcharges gave rise to the 15 per cent rate of surcharge. The arrears show that the defaults in previous periods have not yet been remedied. In our judgment the gravity of an infringement includes of the fact that it is not only not isolated but that there have been repeated earlier infringements.

81. If the Tribunal had power to mitigate the penalty this is a case where we would have reduced the penalty. However that does not answer the question whether this is a case where the penalty was so unfair as to be incompatible with the principle of proportionality. An element of harshness is necessary to make a penalty dissuasive. *Enersys* was such a case; we observe that in addition to the matters referred to in the decision, it is apparent that the VAT due for the period of the default was sharply higher than the normal pattern because the previous return (which was one day late) was a repayment return.

82. *Total* was another exceptional case in that the two prior defaults involved underpayments of very small amounts due to problems with the Appellant's accounting system. Although the Tribunal held that there was no reasonable excuse for the actual default, it does not appear to have considered whether there was a reasonable excuse for the earlier defaults. Those earlier defaults resulted in the 5% surcharge under appeal notwithstanding "the Company's generally good compliance record."

83. In our judgment although the surcharge was heavy it was not so unfair that given the need for an effective penalty regime it was disproportionate.

84. **Summary of Conclusions**

(1) The return and payment were due on the date shown on the electronic return form, 7 February; the cheque was posted on 3 February; assuming it arrived on 4 February, payment was treated under Regulation 40(2B) and (2C) as made on 8 February; the Appellant was therefore in default by one day (paragraphs 50 and 51);

(2) The different deadline for payment by cheque was not ultra vires (paragraph 53);

(3) There was no reasonable excuse (paragraphs 54-58);

(4) The Tribunal has no jurisdiction with respect to the Commissioners' discretion as to whether to impose a surcharge (paragraph 59);

(5) The Tribunal does have jurisdiction to consider the proportionality of the surcharge in a particular case (paragraphs 64-66);

(6) The proportionality of the surcharge must be considered by reference to the requirement of enforcement and prevention and the quality of the infringement; this must be considered on the facts and circumstances of the case (paragraphs 70 and 74);

(7) Although the surcharge was heavy it was not so unfair that it was disproportionate (paragraph 83);

(8) The appeal is dismissed.

85. 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.

THEODORE WALLACE

TRIBUNAL JUDGE

RELEASE DATE: 12 April 2012