TC03490

Appeal number: TC/2011/03837

VAT – default surcharge – whether penalty proportionate – appeal allowed

FIRST-TIER TRIBUNAL
TAX CHAMBER

TRINITY MIRROR PLC **Appellant**

- and -

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

TRIBUNAL: JUDGE DR KAMEEL KHAN
MR CHRISTOPHER JENKINS

Sitting in Bedford Square, London on 27 February 2014

Zizhen Yang, Counsel, appeared for the Appellant

Phillip Rowe, presenting Officer, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. The Appellant, Trinity Mirror Plc ("Trinity Mirror") appeals against a default surcharge ("the Surcharge") arising by reason of a one day delay in filing its VAT return and paying the VAT due. The Surcharge was initially assessed in the amount of £95,900 but reduced to £70,909.44 following a voluntary disclosure by Trinity Mirror of an overpayment of VAT in the relevant VAT period.

2. The issue for the Tribunal is whether the Surcharge is proportionate having regard to the relevant domestic and European law and all circumstances giving rise to the defaults and if the Surcharge is not proportionate, whether it should be discharged.

Backgrounds facts

3. The facts in this matter are not in dispute and have been agreed by the parties and set out in an agreed statement of facts and issue. The agreed facts are provided below:

(1) The appellant ("Trinity Mirror") is a major publisher of newspapers and magazines.

(2) On 31/01/2007, HM Customs and Excise, a predecessor body to the respondents ("HMRC"), served a notice of direction under s.28 (2A) of the Value Added Tax Act 1994 ("VATA 1994") on Trinity Mirror. Pursuant to the notice of direction, Trinity Mirror was brought within the payments on account regime for value added tax ("VAT") in respect of the VAT period 02/04/2007 to 01/07/2007 ("the 06/07 VAT Period") and subsequent prescribed accounting periods.

(3) In respect of the 06/07 VAT Period, Trinity Mirror was required to (1) make 2 payments on account of £1,546,965.00 each by, respectively, 31/05/2007 and 29/06/2007, and (2) file its VAT return and make a balancing payment of £5,467,130.92 by 01/08/2007. Trinity Mirror made the 2 payments on account, and filed its VAT return, on time. It made the balancing payment in full on 02/08/2007, that is, 1 day late.

(4) As a result of the late balancing payment for the 06/07 VAT Period, on 31/08/2007 HMRC served a surcharge liability notice on Trinity Mirror ("the First Notice"), pursuant to ss.59A(1)(b) and (2) VATA 1994. The surcharge period was expressed to begin on 31/08/2007 and run until 01/07/2008.

(5) In respect of the VAT Period 01/10/2007 to 30/12/2007 ("the 12/07 VAT Period"), Trinity Mirror was required to (1) make 2 payments on account of £1,546,965.00 each by, respectively, 30/11/2007 and 31/12/2007, and

(2) file its VAT return and make a balancing payment of £4,795,005.45 by 30/01/2008. Trinity Mirror made the 2 payments on account on time. It filed its VAT return and made the balancing payment in full on 31/01/2008, that is, 1 day late.

(6) The above 2 events of default were the first events of default since the effective date of the VAT registration (number 440 3567 67) held by Trinity mirror, which is 10/03/1986.

(7) As a result of the late filing for the 12/07 VAT Period, on 19/02/2008 HMRC served a surcharge liability notice extension on Trinity Mirror, pursuant to ss.59A(1)(b) and (2) VATA 1994. Pursuant to s.59A (3) VATA 1994, the surcharge period previously notified to Trinity Mirror was extended until 30/12/2008.

(8) The 12/07 VAT Period ended within the surcharge period specified in the First Notice, and was the first such prescribed accounting period in respect of which Trinity Mirror was in default. The default was to a value of more than nil (see ss.59A (6) (d), (e) (ii) and (7) VATA 1994). In the event, ss.59A(4) and (5)(a) VATA 1994 provided for Trinity Mirror to be liable to a surcharge equal to 2 percent of the aggregate value of its defaults in respect of the 12/07 VAT Period ("the Surcharge").

(9) Pursuant to ss.76 (1) (a) and (3) (a) VATA 1994, HMRC assessed Trinity Mirror to the Surcharge of £95,900 ("the Assessment"), and notified the Assessment to Trinity mirror by way of a notice of assessment of surcharge dated 19/02/2008.

(10) By way of a letter dated 19/03/2008, Trinity Mirror requested a local reconsideration of the Assessment, on the basis that (amongst other things) the Surcharge was disproportionate in view of Trinity Mirror's history as a compliant taxpayer and the short lengths of delays giving rise to the defaults.

(11) On 16/04/2008. HMRC wrote to Trinity Mirror, confirming the imposition and extension of the surcharge period and the Assessment.

(12) On 04/06/2008, Trinity Mirror paid £95,900 to HMRC pursuant to the Assessment.

(13) By letter dated 21/08/2008, Trinity Mirror made a number of voluntary disclosures to HMRC in respect of VAT overpaid between December 2007 and June 2008, including an overpayment of £1,249.681.20 in respect of the 12/07 VAT Period.

(14) On 09/02/2010, Trinity mirror wrote to HMRC following the First-tier Tribunal's decision in favour of the taxpayer in *Enersys Holdings UK Ltd v. Revenue and Customs Commissioners* [2010] UKFTT 20 (TC). In that letter, Trinity Mirror repeated its position that the Surcharge was

disproportionate, invited HMRC to discharge the Assessment and claimed repayment of the £95,900. Thereafter, at the invitation of HMRC, Trinity Mirror agreed to stay resolution of the dispute until after the Upper Tribunal has decided HMRC's appeal in the *Enersys* case.

(15) On 25/01/2011, following HMRC's withdrawal of their appeal in the *Enersys* case and repayment of the default surcharge in full to the taxpayer in that case, Trinity Mirror wrote to HMRC, again inviting HMRC to discharge the Assessment on the basis that the Surcharge was disproportionate and claiming repayment of the £95,900.

(16) Following further correspondence between the parties, HMRC wrote to Trinity Mirror on 18/04/2011, stating that the original case had been reviewed and a decision made to uphold the Assessment. In the same letter, HMRC noted the overpayment in respect of the 12/07 VAT Period voluntarily disclosed by Trinity Mirror in its letter of 21/08/2008, and as a result reduced the Surcharge from £95,900 to £70,906.44.

(17) Trinity Mirror appealed to the Tribunal by way of a notice of appeal dated 17/05/2011. The appeal was allocated by the Tribunal on 27/05/2011 to the "standard" category.

Submissions by Appellant

4. The Appellant says that the Surcharge is disproportionate and ought to be discharged by the Tribunal. They make the following core submissions:

(1) The default surcharge regime must comply with the Community Law principle of proportionality. This requires that both the regime as a whole, and the Surcharge imposed in this particular case, comply with the principle of proportionality.

(2) The regime as a whole is flawed because there is no maximum penalty. Moreover, taking into account the circumstances of the default and the relevant characteristics of Trinity Mirror in this particular case, the Surcharge is not a proportionate response to the gravity of the default which it seeks to penalise; and

(3) In the absence of any power to mitigate or otherwise reduce a disproportionate surcharge, the only possible course of action open to the Tribunal is to set aside the Surcharge.

Submissions by the Respondents

5. The Respondents make the following points:

(1) When taken as a whole the default surcharge regime is proportionate, consistent with European Law and compatible with the European Convention on Human Rights.

(2) The regime is within the "margin of appreciation" allowed to the United Kingdom to maintain a default surcharge system without an upper limit, or fixed cap on the amount of default surcharge that can be imposed in a particular case. The absence of an upper limit or fixed cap does not make the default system disproportionate.

(3) Even if the penalty is more than would be imposed by a Tribunal, the amount in this case does not approach the level to be considered disproportionate.

(4) If an upper limit on the penalty was imposed by the regime this can create unfairness on smaller businesses and create a disproportionate penalty.

(5) The Respondents agree that the default surcharge regime should comply with community law and the principle of proportionality and agreed with the Upper Tribunal. In the case of *Revenue of Customs Commissioners v Total Technology Engineering) Limited* [2012] UKUT 418 (TCC) ("*Total Technology*") the Upper Tribunal "found the regime as a whole does not suffer from any flaw which renders it non-compliant with the principle in the sense that it, or some aspect of it, falls to be struck down". The Respondents disagreed with the Upper Tribunal decision that a system that is found to be proportionate could produce a penalty that is said to be disproportionate.

(6) The Respondents submit that it would be wrong to compare the circumstances leading to the imposition of a surcharge of £131,881 in the case *Enersys Holdings UK Limited v Revenue and Customs Commissioners* [2010] UKFTT 20 (TC) ("*Enersys*") with a surcharge of £70,906 in this case. In the *Enersys* decision there was an unexpected spike in trading which resulted in an unusually large VAT liability. In this case, there was no spike in trading and the Appellant were warned of the consequences of the late payment and cannot claim to be surprised at the amount of surcharge imposed on them. To set aside the surcharge in this case would make the surcharge system itself disproportionate. In effect, the Tribunal would be saying the surcharge imposed on a smaller company is proportionate but a larger surcharge on a larger company is not.

(7) The Respondents submit that if the Tribunal set aside the surcharge in this case they would in effect be making the surcharge system disproportionate by saying that there are some businesses that are just too big to be surcharged.

The Law

6. Reference was made to the following legislation and case law which are outlined below:

(1) VATA 1994, ss.59, 59A, 76, 77, 80 and 83

(2) Council Directive 2006/112/EC, Art 273

(3) *Customs and Excise Comrs. v Peninsular and Oriental Steam Navigation Co* [1992] STC 809

(4) *Garage Molenheide BVBA & ors v Belgium* (joined cases C-286/94, C-340/95, C-401/95 and C-47/96) [1998] STC 126 ("*Garage Molenheide*")

(5) *Paraskevas Louloudakis v Elliniko Dimosio* (case C-262/99) [2001] ECR I-5547

(6) *Lindsay v Customs and Excise Comrs* [2002] EWCA Civ 267; [2002] STC 588 (*"Lindsay")*

(7) *International Transport Roth GmbH & ors v Secretary of State for the Home Department* [2002] EWCA Civ 158; [2003] QB 728 (*"International Transport")*

(8) *Greengate Furniture Ltd v Customs and Excise Comrs* [2003] V&DR 178 (VAT Decision 18280) (*Greengate Furniture")*

(9) *EC Commission v Greece* (case C-156/04) [2007] ECR I-4129("Greek Case")

(10) *Sony Ericsson Mobile Communications AB v HMRC* (2007) VAT Decision 20513 ("*Sony Ericsson*")

(11) *Dyrektor Izby Skarbowej w Bialymstoku v Profaktor Kulesza, Frankowski, Jóźwiak, Orlowski sp. J.* (case C-188/09) [2010] ECR I-7643

(12) *Enersys Holdings Uk Ltd v Revenue and Customs Commissioners* [2010] UKFTT 20 (TC); [2010] SFTD 387 *("Enersys")*

(13) *Márton Urbán v Vám-és Pénzügyörség Észak-alföldi Regionális Parancsnoksága* (case C-210/10)

(14) *Revenue and Customs Commissioners v Total Technology (Engineering) Ltd* [2012] UKUT 418 (TCC); [2013] STC 681 ("*Total Technology*")

(15) *Frontier Environmental Ltd v HMRC* [2014] UKFTT 101 (TC)

(16) HMRC Notice 700/50 (July 2013) ("*Notice 700/50*")

Materials presented to the Tribunal

(1) 2 ring binders, one containing a bundle of authorities and the other Respondents forms and other documents relevant to the appeal;

(2) Skeleton arguments were presented before the hearing for the Tribunal to review. These were comprehensive in nature; and

(3) The Appellant provided a chart showing the First-tier Tribunal's decisions in relation to VAT default surcharges against the Upper Tribunal decision in *Total Technology*. This was 2 pages long.

Discussion and Conclusion

7. Let us start by looking at the first issue raised by the Appellant.

Must the default surcharge regime as a whole and the Surcharge itself comply with the Community law principle of proportionality?

(1) As set out in the case of *Total Technology*, the default surcharge regime, being part of the UK implementation of the Sixth VAT Directive imposes obligations on traders to pay VAT and to make returns, is subject to compliance with the Community law principle of proportionality. In implementing such measures, the Member State must not go further than is suitable and necessary to attain the objects of ensuring the correct levying and collection of the tax. An obligation is placed on the national court to determine whether national measures are compatible with Community law.

(2) In the case of *Total Technology*, the Upper Tribunal stated that proportionality must be assessed at the level of the default surcharge regime as a whole and at the individual level by asking whether the penalty imposed on a particular taxpayer based on the facts of the case are proportionate. The Tribunal explained it as follows:

> "[74] We turn then to the question whether proportionality is to be assessed at a high level, that is to say whether it is correct to view the default surcharge regime as a whole, recognising the possibility of its producing, in some cases, a disproportionate and possibly entirely unfair result; or whether proportionality is to be assessed at an individual level by asking whether the penalty imposed on a particular taxpayer on the particular facts of its case is disproportionate."

The tribunal went on to say at paragraph 76, that:

> "Even if the structure of the surcharge regime is a rational response to the late filing of returns and the late payment of VAT, it is, nonetheless necessary to consider the effect of the regime on the particular case in hand. It is necessary to do so not least because … a penalty must not be disproportionate to the gravity of the infringement …"

(3) This approach being suggested, as a point of law and consistent with other ECJ decisions, is binding on this Tribunal. In looking at the Surcharge, the Tribunal must therefore examine whether the measure in question and the manner in which it is applied by the taxing authority is proportionate. The Tribunal must therefore set aside the Surcharge if it decides that it is not proportionate. There is no power to vary the Surcharge. The Tribunal must also look to the particular taxpayer and determine whether the Surcharge is proportionate. This is borne out in the *Greek* case, where the Court explained that "the question whether the penalties applied are proportionate or disproportionate has to be assessed on the basis of the level of the penalties actually applied in the individual case" The penalty must not become an obstacle to the underlying aim of the directive since an excessive penalty "would impose a disproportionate burden on a defaulting trader and distort the VAT system as it applies to him."

Is the particular Surcharge disproportionate?

(4) The Upper Tribunal in *Total Technology* examined the authorities in both Community law and Human Rights law and recognised that there are important differences. The Court recognised a "tension" between Convention rights (where the State was afforded a "margin of appreciation" which allowed most things to be done in furtherance of a legitimate objective provided it is not unfair) and cases concerned with the principle of proportionality in Community law (which precludes any furtherance of a legitimate objective other than by the imposition of measures which are "strictly necessary" for the objective pursued), but stated that there is no inconsistency between the two. Thus, whatever the "wide margin of appreciation" afforded to the UK by the human rights jurisprudence, the Surcharge must comply with the principle of proportionality in Community law. It must not go beyond what is "strictly necessary" for the objectives pursued.

(5) The Tribunal went on to say that the purpose of the default surcharge legislation is to realise "the failure to deliver a return and to make payment of tax owed by the due date … the penalty is for a failure to do something by a due date, not a penalty for continuing failure to put right the original default".

(6) The penalty regime looks at successive defaults during the Surcharge period and its aim is to impose higher penalties on a taxable person who defaults repeatedly than those who default less frequently. This suggests

that the regime identifies the gravity of the particular infringement by reference to the number of times in the relevant Surcharge period that the taxable person has previously been in default and penalises that person according to the gravity so identified. There is, as it were, a hierarchy of seriousness of breaches.

(7) Let us look at the Surcharge in question. A Surcharge of £95,900 later reduced to £70,906.44 was imposed on an otherwise compliant trader to penalise a one day default is plainly unfair. The regime recognises the level of penalty in this case (one default) as being at the low end of the hierarchy of penalties. If compared to *Enersys*, where the Appellant had a 5% Surcharge based on a fifth default over a two year period resulting in a £131,881 penalty, the Surcharge here at 2% (or two and a half times less than the one levied in *Enersys)* would suggest a penalty level of £52,752.40 (being 40% of the £131,881 in *Enersys)* as being proportionate. The penalty imposed is disproportionate by comparison. This view finds support in the view of the Upper Tribunal in *Total Technology*, who gave a benchmark figure which they thought would be disproportionate. They suggested that a £50,000 penalty would be disproportionate in respect of a third default (at para.76).By this standard, the penalty imposed on the Appellant is harsh. There is a strong underlying intention in the legislation that different breaches warrant different penalties and the gravity of the infringement is relevant. The gravity here is low but the penalty is high. The Tribunal does not agree with the counter argument of the Respondents, who say that to set aside the Surcharge in this case "would make the Surcharge system itself disproportionate." There is no evidence that this would be the case.

(8) There are two further points made by the Respondents which need to be addressed. The first is that HMRC say that they waive penalties which are less than £400 at 2% and 5% Surcharge rates (para.4.5 Notice 700/50). This is presented by the Respondents as evidence that they do look at individual surcharge cases in deciding whether the penalty imposed is proportionate and it is not correct to say that this issue was not considered when the penalty was imposed. However, this waiving of penalties across the board appears to be a decision based on administrative convenience rather than an informed look at the issue of proportionality in individual cases. The Upper Tribunal in *Total Technology* (at paragraph 76) explained that several characteristics needed to be examined in making a determination on proportionality. This included the gravity of the offence, the penalty and the system itself. The legislation does allow a minimum surcharge to be included without penalty and the waiver by HMRC of a minimum Surcharge at the lower level shows that they are administering the law rather than considering issues of proportionality in individual cases. The Tribunal can see no evidence that HMRC considered the issue of proportionality in this case before issuing the Surcharge.

(9) The second point made by the Respondents is that to set aside the Surcharge would make the "Surcharge system itself disproportionate" since "Trinity Mirror and other large companies could pay their VAT late with immunity". This may be true since there are flaws with the penalty regime but the Tribunal does not look at the size of the business and its profitability as the Upper Tribunal recognised (at paragraph 90) in *Total Technology*. The Upper Tribunal conceded that a system could be designed to take account of factors such as turnover, profitability, proportion of exempt or zero rated supplies but that had not been done. It was their view that it is "not immediately apparent to us why a penalty linked to profitability would be any fairer than one linked to the outstanding tax …" The system as presently designed can produce unfair results. However, it is recognised that the fundamental "architecture" of the penalty regime is fair. It is not the task of the Tribunal to create a perfect system but simply to look at the particular penalty to see if it is disproportionate.

8. In conclusion, the Tribunal finds that the penalty is disproportionate. There is no provision which allows the Tribunal to mitigate or otherwise reduce the amount of the Surcharge and in the circumstances can only set aside the Surcharge. The Tribunal agrees with the observations of the Upper Tribunal that in the absence of any power to mitigate or otherwise reduce the penalty, discharge is the only possible course open to the Tribunal which concludes that the penalty is disproportionate.

9. For these reasons, the Surcharge is considered to be disproportionate and goes beyond what is strictly necessary for the objectives pursued and is excessive in view of the gravity of the infringement that it imposes a disproportionate burden on Trinity Mirror.

10. The appeal is allowed.

11. 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.

DR KAMEEL KHAN
TRIBUNAL JUDGE

RELEASE DATE: 15 April 2014