



TC03594

Appeal number: TC/2013/05073

VAT default surcharge – VAT return late and VAT not paid on time – whether due to circumstances outside its control – yes – whether reasonable excuse – yes – appeal allowed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

THE GROUNDWORK SOUTH TRUST LTD **Appellant**

- and -

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

**TRIBUNAL: JUDGE MICHAEL S CONNELL
MR JOHN COLES**

Sitting in public at 45 Bedford Square, London WC1B 3DN on 20 February 2014

Mrs Ruth Holland, Financial Director of the Appellant company

Mr Bruce Robinson, Officer of HM Revenue and Customs, for the Respondents

DECISION

The Appeal

1. The Groundwork South Trust Limited (“the Appellant”) appeals against a VAT
5 default surcharge of £16,641.24, for its failure to submit, in respect of its VAT period
ended 03/13, by the due date, payment of the VAT due. The surcharge was calculated
at 15% of the amount due of £110,941.63.

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

10 Background

3. The Appellant is a registered charitable organisation formed approximately
thirty years ago which works with local authorities, schools, and businesses with the
stated objects of promoting sustainable, healthy and safe communities, by creating
jobs, reducing energy and waste, helping organisations to adapt to climate change,
15 maintaining green spaces in and around cities and improving neighbourhoods.

4. The Appellant had previously defaulted on VAT payments in period 06/11
when a VAT surcharge liability notice was issued. The Appellant defaulted in periods
09/11, 12/11, 06/12, 12/12 and again in the VAT period under appeal.

5. Section 59 Value Added Tax Act 1994 (“VATA”) sets out the provisions in
20 relation to the default surcharge regime. Section 59 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]. The return and
VAT payment were due by 30 April 2013.

6. The Appellant paid VAT on a quarterly basis and paid its VAT electronically.
25 HMRC may allow additional time for payment when made by electronic means and
pursuant to regulation 40(4) of the VAT Regulations 1995, allows an additional seven
days after the end of the calendar month when payment would normally fall due
(together with a further three days when the VAT is collected by direct debit).
Limitations apply if the due date falls on a weekend or a bank holiday in which event
30 the due date defaults to the last previous working day.

7. The Appellant submitted its 03/13 VAT return electronically on 9 May 2013
and was therefore late. Payment was made 14 May 2013 by direct debit. The VAT
payment was therefore also late.

8. Under s 59(1) a taxable person is regarded as being in default if he fails to make
35 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

5 surcharges at the prescribed percentage rates. 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 the specified percentage is 2%. The percentage ascends to 5%, 10% and 15% for the second, third and fourth default.

9. A surcharge liability notice was issued for £16,641.24 on 17 May 2013.

10. HMRC say that the Appellant should have been aware of the potential financial consequences of a default, having been in the default surcharge regime since 06/11 and having defaulted on five further occasions prior to the default under appeal.

10 11. 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 return or payment which gave rise to the default surcharge(s). Section 59 (7) VATA 1994 sets out the relevant provisions : -

15 ‘(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 –

20 (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

25 (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 ..’

30 12. 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 return or late payment of the tax. The standard of proof is the ordinary civil standard on a balance of probabilities.

Appellant’s Case

13. The stated grounds of appeal as set out by the Appellant’s finance director Mrs Ruth Holland, in the Appellant’s Notice of appeal were:

35 ‘We are appealing against the decision made by HMRC because we feel that the surcharge levied is disproportionate. HMRC have made no allowance for:

- The unusually large VAT payment due - this was 10 times our normal liability due to exceptional (and not repeatable) business activity. Hence the penalty is significantly higher than it would have been for any other quarter

- The difficulties that our charity has experienced during a period of rapid growth, and

- The fact that we were just two days late in submitting our return and had adequate funds to meet the liability.

5 During the year the charity has been going through a huge amount of change and growth to move from supporting 50 projects at the beginning of the year to over 150 projects at the end of March. In April 2012 we were based in Thames Valley with just 48 employees. Shortly afterwards one of the other companies in the Groundwork Federation, Groundwork South West went into receivership. As the nearest local Trust we offered support to enable worthwhile and successful projects to continue, initially in the Bristol area and then including Devon and Cornwall in August. In December we incorporated an additional 23 employees and their related transactions for a large project. In January, the Kent & Medway Trust agreed that because of financial difficulties they would transfer to our organisation, adding another 30 staff. In April, in addition to the year-end processing we added an additional 39 project staff transferred from Groundwork UK, and incorporated employees and projects of our subsidiary company Groundwork Solent. We now employ 170 monthly paid and 30 weekly paid staff, a clear indication of the scale of our expansion. The company's income has increased from £3,387,000 for the year ended 31.3.12 to a projected £8,947,000 for the year ending 31.3.14.

20 In their response to our appeal HMRC state that we should ensure that sufficient trained staff are available. However, many of the changes outlined above were unexpected and it has taken time to recruit and train additional staff. All these changes have put a great deal of strain on the finance team, which has to be a small team to keep our overheads low and enable our funds to be used in charitable work.

25 The March quarter coincides with our financial year end and we had difficulties with our project staff providing us with information on time to raise sales invoices to be included in the year's accounts. As described above, many of these staff were new to us and not familiar with our procedures. As a result of this, the volume of invoices raised meant that we were still recording March invoices throughout April. The backlog of invoices and the increase in the number of projects had a very clear effect on the value of VAT payable which is over five times greater than the same period last year (£110,941 compared to £19,424). The VAT return calculation itself was more time-consuming because of the volume of transactions to be considered (as a charity we perform partial exemption calculations).

35 This all meant that we submitted the return two days later than required, which has resulted in a substantial surcharge because the VAT return had such a high amount payable. Had the surcharge been levied on our previous returns the charge would have been in the order of £2-3,000. I understand that we are required to submit the VAT return by the due date, but the amount of the surcharge seems disproportionate. It is of a level that will affect our ability to deliver our projects as it will add significantly to our overhead costs (which we try to keep to a minimum). Our non-payment was not due to lack of funds to pay the amount due, and I attach a copy of our bank statement at the time.

45 I believe that the company has now reached a period of stability after all these changes during 2012/13. We have increased the number of staff in the finance team, reviewed and streamlined the procedures around producing the return and engaged a consultant to ensure that VAT returns are completed in a timely fashion in future. I am determined

to ensure that future Returns are submitted on time and that we can move, out of the surcharge period in March 2014’.

14. At the hearing of the appeal, Mrs Holland reiterated much of what she had said in the Notice of Appeal above. She said that the charity had sufficient funds to pay the VAT and it was only because of events entirely outside its control that the VAT return, and hence the payment of VAT, was late. The underlying cause of its failure to meet its VAT payment obligations was an accumulation of problems which were entirely unforeseen. Despite the organisation’s best efforts it was unable to overcome those problems in sufficient time to submit the VAT return and make payment on time.

HMRC’s Case

15. Mr Robinson for HMRC said that the Appellant Company had been issued with six previous default notices. He said that the potential financial consequences attached to the risk of a default would have been known to the Appellant after the issue of the Surcharge Liability Notice in 06/11 and the numerous subsequent surcharge default notices. 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.’

16. 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.

17. 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).

18. Mr Robinson argued that the Appellant could not rely on the upheaval it had suffered, because this had been going on for some time as evidenced by the number of previous defaults. HMRC may allow additional time for payment if requested. Any request must be made prior to the date on which the VAT falls due. Had the Appellant exercised more due diligence, it could have requested for a time to pay arrangement, but did not do so.

19. Therefore, HMRC say that the surcharge has been correctly issued in accordance with the VAT Act 1994 s 59(4).

Conclusion

20. The Appellant was clearly aware of the due date for payments of its VAT and the potential consequences of late payment. Indeed that is not in dispute.

21. The Appellant says that the surcharge is entirely disproportionate to the delay which has occurred. The case of *Total Technology (Engineering) Limited v HMRC* was heard in the Upper Tribunal when it was held that:

- 1) There is nothing in the architecture of the Default Surcharge system which makes it fatally flawed.
- 2) The Tribunal found that the DS penalty does not breach EU law on the principle of proportionality.
- 3) In order to determine whether or not a penalty is disproportionate, the Upper Tier Tribunal addressed the following factors:
 - (a) The number of days of the default
 - (b) The absolute amount of the penalty
 - (c) The ‘inexact correlation of turnover and penalty’
 - (d) The ‘absence of any power to mitigate’
- 4) The Upper Tribunal Chamber President, Mr. Justice Warren and Judge Colin Bishopp decided that none of these leads to the conclusion that the Default Surcharge.

The Surcharge is set down by statute and is a tax geared penalty which increases in line with the number of defaults. Unless entirely outside the realms of reasonableness, which the surcharge under appeal is not, it cannot be described as disproportionate.

22. Under s59 VATA (see above) a trader may have a reasonable excuse if the cause of default was an unforeseeable or inescapable event which, despite the exercise of reasonable forethought and due diligence, could not have been avoided. The Tribunal must take for comparison a person in a similar situation to that of the actual tax-payer who is relying on the reasonable excuse defence. The Tribunal should then ask itself, with that comparable person in mind, whether notwithstanding that the Appellant’s exercise of reasonable foresight, due diligence and a proper regard for the requirement to be compliant with VAT obligations, it would not have avoided the circumstances which led to the failures.

23. The Appellant could have requested a time to pay arrangement with HMRC but did not do so. However it is understandable that the charity organisers did not ask for time to pay because they were hoping to meet the deadline by which the return and VAT had to be paid. The backlog of invoices and the increase in the number of projects had a very clear effect, not only the value of VAT payable but the VAT return calculation itself.

24. 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, the default arose not because the Appellant was careless, dilatory or less than diligent; it occurred because of circumstances beyond its control. There was therefore a reasonable excuse for the Appellant's late payment of VAT for the 03/13 period.

5 25. The appeal is accordingly allowed and the surcharge discharged.

26. 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
10 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.

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**MICHAEL S CONNELL
TRIBUNAL JUDGE**

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RELEASE DATE: 13 May 2014