TC03667

Appeal number TC/2014/01538

Value added tax – default surcharge – health concerns – proportionality of penalty – Total Technology decision – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

END-1 TRANS INDUSTRIES LIMITED

Appellant

- and -

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

TRIBUNAL: JUDGE MALACHY CORNWELL-KELLY
MR MICHAEL SHARP FCA

Sitting in public at Ashford House, County Shopping Centre, Ashford on 22 May 2014

Mr E Martinand, Managing Director, for the taxpayer company

Ms Rita Pavely of HM Revenue and Customs for the Crown

DECISION

Introduction

1 This appeal concerns a default surcharge of £1,697.34 for the period 11/13.

Facts

2 The surcharge history of the appellant shows that defaults occurred in periods 11/11, 11/12 and 05/13, as well as that under appeal in respect of 11/13. The first default occasioned simply the issue of a surcharge liability notice commencing the surcharge regime; the second and third defaults resulted in penalties at 2% and 5% respectively. The default under appeal is therefore at 10% of the tax paid late.

3 The due date for the payment in respect of the 11/13 quarter was 31 December 2013, extended in the case of electronic payments by seven days to 7 January 2014. Mr Martinand told us that he had thought that he had seven days beyond 7 January i.e. 14 days after the end of December, to settle the tax due, because he had misunderstood what his accountant had explained to him. In the event, Mr Martinand had occupied 7 January recalculating the amount due and had intended to submit the return electronically by midnight that day, but missed that deadline by over an hour submitting it at 1.16 am on 8 January; the tax payment itself did not get to HMRC until 13 January, when a direct debit was activated by the company's electronic return.

4 It emerged in evidence at the hearing that Mr Martinand considered that he was obliged to bring the tax payment calculations right up to date at the point of the return, rather than have them correct as at the end of the quarter in question, over a month prior to that date. It is not clear whether this applied only to the extent of the company's input tax claim or whether the final calculations also took output tax liabilities into account: if the latter, it follows that the company has been making advance payments of tax – and we were told that this had been the usual procedure adopted for some while.

5 Much more of concern was the question of Mr Martinand's health: he told us that he had been receiving medication for depression since July 2013 and that for some time he had been increasingly unable to cope with family and business pressures. For understandable reasons, Mr Martinand found it difficult to go into detail about his state of health, though we formed the clear impression that there was more to the matter than emerged at the hearing. Overall, the company's yearly turnover is in the region of £384,000 with a pre-tax profit of some £45,000.

6 On the issue of the proportionality of the penalty to the default, Ms Pavely relied on the decision of the Upper Tribunal in *Total Technology* as to the First-tier Tribunal's powers, which we cite below.

Legislation

7 The Value Added Tax Act 1994 provides:-

> 59 *The default surcharge*

(1) Subject to subsection (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.

71 *Construction of sections 59 to 70*

(1) For the purpose of any provision of sections 59 to 70 which refers to a reasonable excuse for any conduct—

(a) an insufficiency of funds to pay any VAT due is not a reasonable excuse; and

(b) where reliance is placed on any other person to perform any task, neither the fact of that reliance nor any dilatoriness or inaccuracy on the part of the person relied upon is a reasonable excuse.

> (2) In relation to a prescribed accounting period, any reference in sections 59 to 69 to credit for input tax includes a reference to any sum which, in a return for that period, is claimed as a deduction from VAT due.

Conclusions

8 It is well established that if a surcharge complies with the statutory requirements in the circumstances of the case, it must be upheld and any indulgence or mitigation is a matter for the commissioners alone or, in exceptional cases, for judicial review; parliament has given the tribunal no power to reduce or mitigate default surcharges. That said, the decision of the Upper Tribunal in *Total Technology (Engineering) Limited v. RCC* [2012] UKUT 418 (TCC) does acknowledge that the tribunal at this level may strike down penalties if they are clearly out of all proportion to a default,

9 The decision in *Total Technology* was an exhaustive review of the law on this subject, and a case in which the appeal failed. In the context of the approach to be taken to the principle of proportionality in connection with the default surcharge regime, the Upper Tribunal observed at [97] -

> At the individual level, however, the question is whether the actual penalty is disproportionate in all of the circumstances and not whether there is a power to mitigate. The relevance of a power to mitigate is that an unreasonable penalty can be reduced and the question of proportionality of the penalty then falls to be answered by reference to the penalty as mitigated. Accordingly, we do not consider that the absence of a power to mitigate a penalty renders the regime non-compliant with the principle of proportionality. It is the level of the penalty, if anything, which will bring about that result.

10 At [99] the parameters of the first-tier tribunal's discretion in the matter are set out –

> In our judgment, there is nothing in the VAT default surcharge which leads us to the conclusion that its architecture is fatally flawed. There are, however, some aspects of it which may lead to the conclusion that, on the facts of a particular case, the penalty is disproportionate. But in assessing whether the penalty in any particular case is disproportionate, the tribunal must be astute not to substitute its own view of what is fair for the penalty which Parliament has imposed. It is right that the tribunal should show the greatest deference to the will of Parliament when considering a penalty regime just as it does in relation to legislation in the fields of social and economic policy which impact upon an individual's Convention rights. The freedom which Parliament has in establishing the appropriate penalties is not, we think, necessarily exactly the same as the freedom which it has in accordance with its margin of appreciation in relation to Convention rights (and even there, as we have explained, the margin of appreciation will vary depending on the right engaged).

11 In regard to the circumstances of the case then under appeal, the Upper Tribunal noted at [101] and [102] –

> Nor, on the facts of the present case, do we consider that the penalty imposed on the Company is disproportionate in the sense that its imposition is a breach of EU law and in particular of the principle of proportionality.

> The Company's essential complaint is that the amount of the penalty is unfair. It is unfair because of the following factors:
> a. the payment was only one day late;
> b. the previous defaults had been due to errors which were innocent, even if the Company could not establish a reasonable excuse for them;
> c. the Company had an excellent compliance record prior to the first of the defaults leading to the penalty;
> d. the amount of the penalty represents an unreasonable proportion of the Company's profits.
>
> Each of those factors falls within one of the heads of complaint which we have addressed. None of those complaints results in the default surcharge being non-compliant with the principle of proportionality; nor, in our view, do they have that result even if taken collectively. At the level of the Company, the amount of the penalty has been arrived at by applying a rational scheme of calculation which involves no breach of the principle of proportionality. That amount cannot, even if looked at in isolation, be said to be disproportionate in the sense of giving rise to a breach of the principle of proportionality. And even if the penalty is more than would be imposed if it were a matter for the decision of a tribunal, the amount of the penalty does not approach the sort of level which Judge Bishopp described as unimaginable in *Enersys*.

12 In *Total Technology*, the penalty being appealed was £4,260.26; annual profits were "around £50,000", which suggests quarterly profits of £12,500 making the surcharge in that case 34% of the quarterly profit, contrasting with the 15% which is likely to be the highest which can be claimed in the present case. In regard to the claim of the lack of proportionality in the surcharge, therefore, it is clear that this case is a long way off the percentage which the penalty bore to the profits in *Total Technology* and in which the taxpayer was, even so, unsuccessful.

13 As far as Mr Martinand's misunderstandings of the system are concerned, they must either be attributable to incorrect advice from his accountant or, perhaps, to his state of health, since previously the company appears to have been able to operate the VAT payment requirements effectively. In so far as the accountant's advice is concerned, we are precluded by section 71 from taking it into account as a reasonable excuse. In regard to Mr Martinand's health, the evidence at present is insufficient for us to be able to find that it was the operative cause of the default that occurred.

14 In the outcome, no reasonable excuse within the meaning of the legislation has been established and, given the very limited powers which parliament has allowed to the tribunal, we regret that the appeal cannot succeed. We do however strongly urge HMRC to reconsider this penalty if, as we suspect, the health issue to which we have referred was more significant than we have been able to establish. The possibility that this taxpayer has repeatedly been making significant advance payments of tax for some time should also be investigated and – if that proves to be so – it is no doubt a factor the commissioners will wish to take into account in evaluating any loss or gain to the Treasury overall.

15 This document contains the full findings of fact and reasons for the decision.

16 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 no 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.

MALACHY CORNWELL-KELLY
TRIBUNAL JUDGE

RELEASE DATE: 30 May 2014