



TC06695

Appeal number: TC/2018/01597

VALUE ADDED TAX – default surcharge – delay in paying part of the tax due in respect of a prescribed accounting period allegedly caused by a fault in the Respondents’ system – whether or not a reasonable excuse – conclusion that, as this related to only part of the amount due, the issue of reasonable excuse was irrelevant – appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

LONDON NEEDS COOLING LIMITED

Appellant

- and -

**THE COMMISSIONERS FOR HER MAJESTY’S
REVENUE & CUSTOMS**

Respondents

**TRIBUNAL: JUDGE TONY BEARE
MR DAVID WILLIAMS**

Sitting in public at Taylor House, 88 Rosebery Avenue, London EC1R 4QU on 3 August 2018

Mr James Smith for the Appellant

Mr David Wilson, Officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

5 1. This decision relates to an appeal against a default surcharge of £5,883.39 which has been imposed on the Appellant in respect of its 08/17 value added tax (“VAT”) prescribed accounting period (a “VAT period”).

2. The Appellant accepts that it failed to make any payment of its VAT liability in respect of that VAT period by the due date of Saturday 7 October 2017. It was
10 required to pay £39,222.64 by that date and, in the event, it paid £30,000 on Monday 9 October 2017 and the balance of £9,222.64 on Monday 16 October 2017.

3. However, the Appellant alleges that the reason why it was late in making payment of the £30,000 that it paid on Monday 9 October 2017 is that, when it tried to pay the relevant amount on the preceding working day (Friday 6 October 2017), it
15 was prevented from doing so by a fault in the Respondents’ system. Thus, the Appellant alleges that it has a reasonable excuse for its failure to pay the £30,000 before the due date of Saturday 7 October 2017 and therefore that the default surcharge in respect of the VAT period 08/17 should be 15% of £9,222.64 (£1,383.39) instead of 15% of £39,222.64 (£5,883.39).

20 Background

4. The background to the appeal is that the Appellant has regularly experienced difficulties in meeting its VAT liabilities on time and has been in the default surcharge regime since the VAT period 05/13. In the interests of brevity, we will not rehearse in this decision the details of all of the Appellant’s prior defaults. Suffice it
25 to say that there is no dispute between the parties as to the fact that the Appellant was within the default surcharge regime on Saturday 7 October 2017, at the time when its payment in respect of the VAT period 08/17 became due, and that it was subject at that time to the default surcharge at the highest rate of 15% as a result of its earlier defaults.

30 The relevant law

5. The VAT default surcharge is imposed pursuant to Section 59 Value Added Tax Act 1994 (the “VATA 1994”). That section provides as follows:

35 “(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.

5 (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

10 (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.

15 (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.

20 (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,

25 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—

30 (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.

35 (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.

5 (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,

10 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—

15 (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.

20 (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.

25 (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."

30 Discussion

6. The debate between the parties which has led to this appeal is whether there actually was a failure in the Respondents' system on Friday 6 October 2017 which prevented the Appellant from paying the £30,000 which it said that it tried to pay on that date and, if so, whether that amounted to a reasonable excuse for its failure to pay
35 the £30,000, with the result that the default surcharge in respect of the VAT period 08/17 should be calculated only by reference to the balance of £9,222.64 which the Appellant eventually paid only on Monday 16 October 2017.

7. However, we believe that this debate is ultimately sterile as it is based on a misunderstanding of how Section 59 VATA 1994 operates and, in particular, how the concept of reasonable excuse fits within that section.

8. It can be seen from the legislation set out above that the way that Section 59 VATA 1994 operates is, first, to require the determination of whether there has been a default (ie a failure to discharge, by the due date, the amount of VAT which is shown in the VAT return in respect of the relevant VAT period) – see sub-section (1) - and then, secondly, to require the determination of the amount of the default surcharge by reference to:

- 10 (a) the amount of “outstanding VAT” in question - see sub-section (4); and
- (b) a percentage calculated by reference to the number of prior defaults that have occurred in the surcharge period in which the relevant default has occurred - see sub-section (5).

15 9. Sub-section (6) explains that, for the purposes of sub-section (4), the “outstanding VAT” is so much of the VAT for which the taxpayer is liable as has not been paid by the due date. In this case, it is common ground between the parties that that is £39,222.64 because none of the VAT which was due in respect of the VAT period 08/17 was paid on or before the due date of Saturday 7 October 2017.

20 10. The provisions within Section 59 VATA 1994 which provide relief in a case of reasonable excuse are sub-sections (7) and (8). They specify that, if a person who would otherwise be liable to a default surcharge has a reasonable excuse for its failure to pay its VAT liability in full by the due date, then that person will not be liable to a VAT surcharge in respect of the VAT period in question.

25 11. Turning then to the application of the section in this case, it can be seen that there is no dispute between the parties, and no suggestion by the Appellant, that the Appellant had a reasonable excuse for its failure to pay the balancing amount of £9,222.64 prior to Monday 16 October 2017, when it actually made payment of that amount. It follows that both parties necessarily accept that there was a default in
30 respect of the VAT period 08/17 because the Appellant failed to discharge its VAT liability in respect of the relevant VAT period in full by the due date and it had no reasonable excuse for that failure – at least so far as the balancing amount of £9,222.64 was concerned – with the result that the Appellant is liable to a default surcharge in respect of that VAT period. In addition, as noted at paragraph 9 above,
35 there is no dispute between the parties that the “outstanding VAT” in respect of the relevant VAT period was the full amount of £39,222.64.

12. The only debate between the parties centres on whether the default surcharge should be calculated solely by reference to the £9,222.64 that remained outstanding after Monday 9 October 2017, when the Appellant discharged £30,000 of the
40 outstanding VAT liability in respect of the VAT period 08/17, or on the full amount of £39,222.64 that had not been paid in respect of that VAT period by the due date of Saturday 7 October 2017.

13. It can be seen from the description of the manner in which Section 59 VATA 1994 operates as set out at paragraphs 8 to 10 above that that debate is in relation to the issue which falls to be determined at the second stage of the process – ie the point at which the quantum of the outstanding VAT by reference to which the default surcharge should be calculated falls to be determined – and not in relation to the first stage of the process – ie the point at which whether or not there has been a failure to pay in full the amount of VAT shown in the VAT return in respect of the relevant VAT period falls to be determined. Since the reasonable excuse defence is applicable only in relation to the first stage in the process, it follows that it is simply not relevant in this case because, by its own admission, the Appellant has conceded that it has no excuse for its failure to pay the £9,222.64 that remained outstanding until Monday 16 October 2017 and therefore that it was in default in respect of the relevant VAT period.

14. Putting this another way, the reasonable excuse defence applies in determining whether or not there has been a default and not in determining the amount of the surcharge once it is concluded that there has been a default. It is effectively an “all or nothing” defence.

15. Given the above, we do not think that it would be fruitful for us to consider whether or not the Appellant’s failure to pay the £30,000 in this case was attributable to the alleged failure in the Respondents’ system and, if so, whether or not that amounts to a reasonable excuse for the relevant failure.

16. For completeness, we should note that we have considered whether there might be any grounds for concluding that the default surcharge rate of 15% that has been applied in this case is too high because the Appellant had a reasonable excuse for one or more of its earlier defaults which is “material” to the present default surcharge, with the result that, in applying sub-section (5) to calculate the applicable rate in the case of the present default surcharge, that default should be treated as not having occurred. The definition of “material” in this context is set out in sub-section (8). It can be seen that a prior default is “material” to the present default surcharge if it is a default that was taken into account in the service of the surcharge liability notice upon which the present default surcharge depends and the taxpayer has not previously been liable to a default surcharge in respect of a VAT period ending within the surcharge period specified in or extended by that notice.

17. The language in sub-section (8) is not particularly clear but it has been the subject of some helpful exposition by Judge Poole in the case of *Workstation Farnham Limited v The Commissioners for Her Majesty’s Revenue and Customs* [2015] UKFTT 57 TC. According to Judge Poole in that case, a prior default is “material” for this purpose if its existence has contributed to the imposition of the default surcharge which is under consideration and it has not already given rise to a default surcharge in respect of a VAT period falling earlier than the VAT period which is the subject of the appeal. (We would question that formulation in one minor respect. It seems to us that a taxpayer’s first default – ie the default which leads to the issue of the initial surcharge liability notice but not to a default surcharge itself – would, on that formulation, remain a “material” prior default. However, we believe

5 that the existence of default surcharges which have arisen in respect of VAT periods falling after the issue of the initial surcharge liability notice means that, even though that initial default has contributed to the default surcharge which is under consideration, it is also precluded from being a “material” prior default by the language at the end of sub-section (8)).

10 18. In this case, all of the Appellant’s prior defaults from and including its default in respect of the VAT period 05/13 have contributed to the imposition of the present default surcharge because their existence has been taken into account in determining that the appropriate rate to be applied in calculating the present default surcharge is 15% and not some lower percentage. However, as each of the prior defaults which has occurred since the issue of the initial surcharge liability notice has already given rise to an earlier default surcharge, none of the prior defaults is “material” to the present default surcharge. In any event, the Appellant has not alleged that it had a reasonable excuse for its failure to pay in full by the relevant due date the amount of VAT which it was required to pay in respect of any earlier VAT period. So we do not think that there are any grounds for concluding that the applicable rate for the purposes of calculating the present default surcharge should be less than 15%.

20 19. For the reasons set out above, the appeal is dismissed. We sympathise with the predicament of the Appellant because the amount of the default surcharge in this case is significant for a business of the Appellant’s size and there is no doubt that the legislation would operate in a much fairer manner if the reasonable excuse defence could apply at both stages in the process described at paragraphs 8 to 10 above and not just at the point of determining whether or not there has been a default. However, for the reasons set out above, we are not permitted to apply the legislation in that way.

25 20. 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 30 “Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)” which accompanies and forms part of this decision notice.

35 **TONY BEARE**
TRIBUNAL JUDGE

RELEASE DATE: 29 August 2018

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