



TC03232

Appeal number: TC/2012/10251

VAT default surcharge - payment received by HMRC ten days late - whether a penalty of £6009.48 was unfair and disproportionate in not taking into account the Appellant's modest profitability - no - whether reasonable excuse - no - Appeal dismissed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

WEXO LIMITED

Appellant

- and -

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

**TRIBUNAL: JUDGE MICHAEL S CONNELL
 NICHOLAS DEE**

Sitting in public at 45 Bedford Square London on 11 October 2013

Mr Robin Kennedy for the Appellant

Ms Erika Carroll, Officer of HM Revenue and Customs, for the Respondents

DECISION

The Appeal

5 1. Wexo Limited (“the Appellant”) appeals against a default surcharge of £6,009.48, for its failure to submit, in respect of its VAT period ended 30 May 2012, by the due date, payment of the VAT due.

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

Background

10 3. The Appellant’s principle business activity is recruitment and matching of graduates and jobseekers with paid internships and other employment opportunities. The business was incorporated in the UK in 2007.

15 4. The Appellant had previously defaulted on VAT payments in period 05/10 when a VAT Surcharge Liability Notice was issued. There were further defaults in respect of periods 08/10, 02/11, 05/11 (default later removed), 11/11 and 02/12.

5. The Appellant paid VAT on a quarterly basis. Section 59 of the VAT Act 1994 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].

20 6. The due date for the Appellant’s 05/12 period was 30 June 2012. The Appellant’s return was received in time by HMRC on 13 June 2012. The amount due under the return was £40,063.25.

25 7. HMRC have discretion to allow extra time for both filing and payment when these are carried out by electronic means. [VAT Regulations 1995 SI 1995/2518 regs 25A (20), 40(2)]. Under that discretion, HMRC allow a further seven days for filing and payment. The due date for the 05/12 period, if payment was made electronically, was 6 July 2012. (7 July was a Saturday). Payment was made late by a CHAPS payment on 16 July 2012.

30 8. Section 59 Value Added Tax Act 1994 (“VATA”) sets out the provisions in relation to the default surcharge regime. Under s 59(1) a taxable person is regarded as being in default if he fails to make 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
35 surcharge regime, so that any subsequent defaults within a specified period result in assessment to default surcharges at the prescribed percentage rates.

9. 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 after the issue of a VAT Surcharge Liability Notice, the specified percentage is 2% and the percentage ascends to 5%, 10% and 15% for the second, third and fourth default.

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

10 ‘(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 –

15 (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

20 (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 ..’

11. 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 payment of the tax. The standard of proof is the ordinary civil standard on a balance of probabilities.

25 12. The Appellant’s stated grounds of appeal in its Notice of Appeal to the Tribunal were that:

30 (1) A direct debit arrangement was set up between the Appellant and HMRC in 2010 pursuant to a time to pay arrangement in relation to arrears of VAT and PAYE. The Appellant says that HMRC misallocated a payment which was intended as a payment for its VAT arrears to arrears of PAYE. This was subsequently resolved but caused the Appellant to assume that perhaps the mistake a happened at the Appellant’s end (which then led them to set up their VAT and PAYE bank payment system ‘the wrong way round’), when in fact this was not the case. When the mistake was realised payment was made manually but unfortunately late.

35 (2) The penalty is excessive and unfair, particularly because the Appellant’s turnover vastly exceeds its margins/profits with the result that its quarterly VAT liability is often greater than its annual profit. In such circumstances the penalty is disproportionate and unfair.

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13. The Appellant does not dispute that its VAT payment for the period 05/12, if made electronically, was due on 6 July 2012, nor that HMRC received the payment on 16 July 2012.

Appellant's Case

5 14. At the hearing, Mr Kennedy for the Appellant said that he did not wish to pursue the first ground of appeal referred to in the Notice of Appeal.

15 15. Mr Kennedy said that the Appellant company was a small internet start-up/social enterprise which is yet to turn a profit. The surcharge would cripple the company beyond measure and probably bankrupt the business. The company had not intentionally failed to pay its quarterly VAT, and the late payment was the result of a confusing mix up because of payments also being due under an old time to pay arrangement for VAT and PAYE. This was an innocent mistake and led to the late payment. It would be wrong to penalise the company so heavily when the VAT payment was only ten days late. Since the default the Appellant had paid its quarterly VAT on time.

20 16. With regard to the second ground of appeal, proportionality, Mr Kennedy accepted the conclusions reached in *Total Technology (Engineering) Limited* [2012] UKUT 418 heard by the Upper Tribunal, (where a penalty of £4,260.26 was held not to be disproportionate although the VAT payment had only been one day late.) He acknowledged that the case established the VAT default surcharge penalty regime was not “flawed legislation” and did not “amount to a breach of convention rights”, as had been argued in that case. He also accepted that the amount of the penalty had been arrived at by applying a scheme of calculation which did not involve a breach of the principle of proportionality.

25 17. Mr Kennedy's main argument was that the appeal must be looked at individually on the facts of each case. He submitted that a penalty of £6,009.48 imposed in respect of a delay in payment of VAT by ten days in circumstances where the company's turnover and VAT liability of the company vastly exceeded its revenue was clearly unfair and disproportionate.

30 18. Mr Kennedy referred to the Appellant company's 2012 accounts which show that sales of £484,089 resulted in gross profits of £112,631 and net profits of £27,446. In the year to 31 August 2013, the company had achieved a gross profit of £42,398 from revenues of £169,913, which resulted in a net loss of £36,978. At the 2013 year-end the company had net assets of -£77,784. Mr Kennedy argued that a company's profitability should be taken into account. The penalty imposed on the Appellant company was totally disproportionate to its modest profits and nominal capital adequacy.

40 19. The Appellant company was running a social enterprise that battled youth unemployment, and whilst accepting that the ethics of the Appellant's business purposes were not relevant to the appeal, the Appellant could potentially at some point contribute significantly to the UK GDP. If the penalty was confirmed the

Appellant would be put out of business. On the basis that HMRC's power to impose a penalty must not be disproportionate to the object to be achieved (*Total*), and on the assumption that the object to be achieved is not to render the Appellant company insolvent, its profitability and net capital position should be taken into account. Mr Kennedy said that he had been trying to build the business for six years and all this would be in vain if the company became insolvent.

HMRC's Case

20. Ms Carroll for HMRC said that the potential financial consequences attached to the risk of further defaults would have been known to the Appellant after issue of the Surcharge Liability Notice for period 05/10 and subsequent surcharge default notices. The information contained on the reverse of each Notice states:

15 '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.'

21. 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.
- 20 • On the actual website www.hmrc.gov.uk
- On the E-VAT return acknowledgement.

22. Ms Carroll said that this was the sixth default by the Appellant. There had been a pattern of defaults. 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).

23. HMRC may allow additional time for payment if requested. Any request must be made prior to the date on which the VAT falls due. No request for a time to pay arrangement was received by either the National Advice Scheme or the Business Payment Support Service from the Appellant prior to the due date.

30 24. Therefore the surcharge has been correctly issued in accordance with the VAT Act 1994 s 59(4).

Conclusion

35 25. As the Upper Tribunal said in *Total Technology*, there is nothing in the VAT default surcharge regime which leads to the conclusion that its architecture is fatally flawed or that it infringes the principle of proportionality. The Tribunal recognised that the VAT default surcharge legislation imposes a highly prescriptive regime with an inflexible table of surcharges laid down with no, or virtually no, discretion for HMRC to relieve a surcharge once imposed. It concluded however that there must be

some upper limit on the penalty for a default which was proportionate, although it did not suggest what that might be, given that all the circumstances of the default must be taken into account.

5 26. The Tribunal said that it is therefore open to Tax Tribunals to consider individual default surcharges without having first concluded that the default surcharge regime as a whole is disproportionate. However, in assessing whether a 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. The Tribunal should show the greatest deference to the will of Parliament when considering the application of the VAT default surcharge scheme.

27. By way of further background to the Tribunal's reasoning in *Total*, the Tribunal referred to what Simon Brown LJ had said in *International Transport Roth GmbH v Home Secretary* [2003] QB 728 at [26], setting out the test for assessing proportionality -

15 "... it seems to me that 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 achieving the social goal, it simply cannot be permitted? In addressing this question I for my part would recognise a wide discretion in the Secretary of State in his task of devising a suitable scheme, and a high degree of deference due by the court to Parliament when it comes to determining its legality. Our law is now replete with dicta at the very highest level commending the courts to show such deference."

25 The Tribunal observed that the "not merely harsh but plainly unfair" test set a high threshold which must be surmounted before a Tribunal could find that a penalty, correctly levied on the taxpayer by statutory provisions set by Parliament, should be struck down as disproportionate.

30 28. In the case of *Energys Holdings UK Limited*, due to a human error, the relevant return was submitted, and payment made, one day late. This resulted in a 5% penalty amounting to just over £130,000. Judge Colin Bishop held that the penalty was wholly disproportionate to the gravity of the offence. It was not merely harsh but plainly unfair and in the absence of any justification it could not be saved by the State's margin of appreciation. As he said, penalties must not go beyond what is strictly necessary for the objectives pursued and a penalty must not be so disproportionate to the gravity of the infringement that it becomes an obstacle to the underlying aims of the VAT Directive by imposing a disproportionate burden on a defaulting trader and distorting the VAT system as it applies to him. It is possible to envisage a penalty regime the architecture of which is unobjectionable, but which nevertheless leads occasionally to the imposition of a penalty so high as to be disproportionate.

29. Although the Appellant regards the penalty as unfair, a surcharge is only imposed on a second or subsequent default, and after the taxpayer has been sent a

5 surcharge liability notice warning him that he will be liable to surcharge if he defaults again within a year. The taxpayer therefore knows his position and should be able to conduct his affairs so as to avoid any default. The penalty is not a fixed sum but is geared to the amount of outstanding VAT. The percentage applicable to the calculation of the penalty increases with successive defaults if they occur within twelve months of each other. It is then open to the taxpayer to show whether a reasonable excuse exists for the late payment.

10 30. Is the penalty disproportionate? The penalty imposed on the company was £6,009.48. The delay was ten days, but the penalty would have been the same if the delay had only been one day or significantly longer. There must of course be a proportionate upper limit to a penalty. The penalty is certainly substantial but cannot be described as devoid of reasonable foundation. This was the seventh default since the 05/10 default. The penalty was imposed at 15% of the VAT due. It cannot be compared with the 5% penalty of £130,000 imposed in *Energys*. It does not approach the level which the Tribunal described in *Energys* as ‘unimaginable’. In our view it cannot be said to be within a range which would sensibly be regarded as entirely disproportionate.

20 31. Was there a reasonable excuse for the late payment? The Appellant was clearly aware of the due date for payments of its VAT and the potential consequences of late payment. Because there had been six earlier defaults the Appellant would have been aware of the financial consequences of a further late payment and should have ensured that the VAT payment was made on time.

25 32. 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, for the reasons given above, that burden has not been discharged and there was no reasonable excuse for the Appellant’s late payment of VAT for the 05/12 period.

33. The appeal is accordingly dismissed and the surcharge upheld.

30 34. 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.

MICHAEL S CONNELL

TRIBUNAL JUDGE

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RELEASE DATE: 13 January 2014