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TC03724

Appeal Number: TC/2013/09545

Default surcharge – reasonable excuse – VATA 1994 s59 & s71 & – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

PARAGON PRECISION ENGINEERING LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE MALACHY CORNWEL-KELLY
MR DAVID EARLE

Sitting in public at 1 Shaftesbury Avenue, Cambridge, on 24 April 2014

Mr John Kent, Managing Director of the appellant company

Mr Martin Foster of HMRC, for the Crown

DECISION

Introduction

1 This is an appeal against a default surcharge of £9,594.32 assessed on Paragon Precision Engineering Limited ('Paragon') on 13 September 2013 in respect of the payment of tax for the 07/13 quarter being one working day late. Paragon had a history of defaults stretching back to the 10/10 quarter, but in the three quarters before that under appeal, 10/12, 01/13 and 04/13, the company had succeeded, despite a tight cashflow, in avoiding penalties. In addition to documentary evidence, we received oral evidence from Mr Kent, who we saw as a straightforward and honest witness.

2 The default in quarter 07/13 occurred as follows. Paragon's office manager, who dealt with much of the routine business with Barclays Bank, was going on holiday from 2 September for two weeks and the last date for payment of the quarter's VAT was – if the tax was paid electronically – 7 September, while the manager was due to be away. Paragon has live internet banking with Barclays and can see at any moment on screen the state of its bank account, but Mr Kent told us that while he authorised all financial transactions, he was not himself up to effecting a transfer of funds out of the company's account in payment of the tax.

3 In view of this, payment of the quarter's tax was set up in advance on 30 August with an 'execution date' of 5 September (a Thursday) and an 'available value' date of 9 September (the Monday following). Mr Kent explained to us that this would mean that a BACS transfer to HMRC would be effective as of 9 September, but not as of 5 September – even though on 5 September, or certainly on 6 September (the Friday), there were sufficient funds in the account for the payment to be made.

4 Since 7 September – which would normally have been the final day for payment – fell on a Saturday, Friday 6 September was the last working day on which the payment to HMRC could be made, as the official notices made quite clear. Mr Kent accepted that Paragon had received one such notice under cover of a letter from the Revenue dated 8 August 2012, and that he had been aware of it. The payment set up for 9 August was, in the circumstances, therefore an avoidable mishap and, although the office manager had set it up that way before going on holiday, Mr Kent said that it had been done on his own instructions.

5 As has been mentioned, cashflow was tight, and Paragon adopted a system similar to factoring, under which Barclays advanced to Paragon 85% of each invoice as soon as it was issued. In this context, Mr Kent was not initially confident of having the full amount in Paragon's account by 6 September. Mr Kent told us that the thinking behind the payment schedule he had set up was that he preferred to pay the whole of the tax due in one payment, rather than to make only a part payment of the amount that he could be sure of having by 5 or 6 September. We accept that Mr Kent had no intention to default on the company's tax obligations and that he did not at the time in question have in mind that he was, by this way of doing things, exposing Paragon to a 15% surcharge.

6 In the event, as we have seen, neither shortage of funds nor late payment by a customer was the reason for the lateness; it was that Mr Kent wanted to be absolutely sure that the total payable to HMRC was in the account before payment was made. The fact that there were sufficient funds in the account by 6 September leaves Mr Kent's personal inability to order the transfer that day as the operative factor in the delay.

7 Mr Kent made the point strongly that, while some penalty might be appropriate in the circumstances, the amount of the surcharge was disproportionate to the delay of a single

working day; had he not been so careful, the penalty would not have been incurred; had he indeed followed earlier advice from HMRC to give them a direct debit on his account, there would have been no penalty either. It is difficult not to be sympathetic to Mr Kent's point of view.

Legislation

8 The Value Added Tax Act 1994 provides:-

The default surcharge

59(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.

Construction of sections 59 to 70

71(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

9 In view of the prohibition in section 71(1)(a) on taking an insufficiency of funds into account, the mere apprehension that there might be insufficient funds in the account offers no basis for identifying a 'reasonable excuse' for the default, as defined by law. The problem that Mr Kent himself was unable to effect the necessary transfer by 6 September was entirely foreseeable, and it was indeed foreseen but then not dealt with – for example, by another member of staff being instructed how to operate the transfer, or by a special arrangement being made with the bank for that month.

10 Addressing next the proportionality issue, we note the decision of the Upper Tribunal in *Total Technology (Engineering) Limited v. RCC* [2012] UKUT 418 (TCC), which related to VAT surcharge penalties. While recognising that the First-tier Tribunal could strike down penalties which were clearly out of all proportion to a default, the Upper Tribunal expressed this stern warning at [99]:

> 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.

11 Unfortunately, such evidence as there is in the present appeal does not permit us to conclude that the penalty is so disproportionate that we are entitled "to substitute [our] own view of what is fair for the penalty which Parliament has imposed".

12 But, looked at in isolation, the surcharge in this case does seem very high in proportion to the extent of the default, which in terms of working days was the smallest possible default which could have occurred. In *Total Technology* the penalty amounted to 34% of the quarter's profits and it was still held not to be disproportionate as a matter of law. Paragon's return for 07/11 showed the total value of outputs excluding VAT to be £530,222; therefore, unless the gross profit margin was much lower than 5% (at which the surcharge would represent 36% of the profit), the penalty would not be out of line with that in *Total* Technology.

13 If gross profits for the quarter or the year were significantly lower than 5%, this just could be a case in which the level of penalty might be impugned on the ground of its lack of proportionality. In that event, all the factors would need to be taken into account, such as whether the figures for the quarter in question were in line with those for the year, Paragon's history of non-compliance, and that Paragon had clear knowledge of the effect of an intervening weekend on the due date. Since it seems unlikely that further evidence would disclose a realistic chance of a proportionality argument succeeding, we conclude that the right course is to dismiss the appeal.

14 Because however there is a possibility that further evidence may alter that conclusion, we give liberty to Paragon to submit accounts showing the company's gross profit covering the period in question (if available, for the whole of the year in question) within 21 days of the release of this Decision:-

(i) to HMRC; and,
(ii) to the tribunal, with an application that this Decision be reviewed.

15 The effect of this Decision is accordingly suspended pursuant to rule 5(3)(l) for 21 days from its release, but it becomes final if the application mentioned at 14(ii) above has not been made by the expiry of that period.

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16 Following the leave to submit further evidence and the suspension of this Decision provided for in the preceding paragraphs, the appellant submitted management accounts for Paragon for both the three month period ended 31 July 2013 and the year ended 30 April 2014. In summary these profit and loss accounts showed the following results:

	Quarter ended 31 July 2013	*Year ended 30 April 2014*
	£	*£*
Sales	*545,355*	*2,062,810*
Purchases	*(85,645)*	*(303,775)*
Direct expenses	*(57,464)*	*(213,181)*
Gross profit	*402,246*	*1,545,854*
Overheads:		
Salaries and wages	*(276,977)*	*(1,150,516)*
Other expenses	*(92,959)*	*(375,316)*
Net profit before taxation	*32,310*	*20,022*

17 We accepted these figures as submitted as evidence of the financial position of Paragon at the time of the default in relation to quarter 07/13, in particular the level of turnover, gross profit and net profit. We noted that sales for the quarter were above the average for the whole year and that this is reflected in both the gross and net profits for the quarter.

18 We have considered again whether the penalty is so disproportionate that we are entitled "to substitute [our] own view of what is fair for the penalty which Parliament has imposed". In order to do this we have to balance all the relevant factors in particular:

1. *Paragon's financial position, including sales and profitability*
2. *The seriousness of the default namely due date Saturday 7 September 2013, all paid on Monday 9 September 2013*
3. *The appellant's representative knowledge that the payment would be late when giving instructions for it to be made on 9 September 2013*
4. *The appellant's history of non-compliance and awareness of the default surcharge regime for late payment*

19 The question for us to decide is whether the actual penalty is disproportionate in all the circumstances, such that it is not merely harsh but plainly unfair. Our conclusion is that the penalty was not disproportionate and that the appeal must be dismissed. Since our conclusion is not adverse to HMRC, we have not invited further submissions from them.

Further appeal rights

20 This document contains the full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply in writing 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 the tribunal no later than 56 days after this decision is sent to that party.

21 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 CORNWEL-KELLY
TRIBUNAL JUDGE

RELEASE DATE: 9 June 2014