[2015] UKUT 421 (TCC)

Appeal number: FTC/95/2014

VAT – default surcharge – taxable person required to make payments on account – s 59A VATA 1994 – proportionality – Enersys, Total Technology considered

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Appellants**

- and -

TRINITY MIRROR PLC **Respondent**

TRIBUNAL: MRS JUSTICE ROSE (PRESIDENT)
JUDGE ROGER BERNER

Sitting in public at The Royal Courts of Justice, The Rolls Building, London EC4 on 17-18 June 2015

Peter Mantle, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants

Zizhen Yang, instructed by Mr Stephen Field of Trinity Mirror Plc, for the Respondent

DECISION

1. The Appellants, HMRC, appeal against the decision of the First-tier Tribunal (Judge Khan and Mr Jenkins) ("FTT"), released on 15 April 2014, whereby the FTT allowed the appeal of the Respondent, Trinity Mirror Plc ("Trinity Mirror"), against a default surcharge of £70,906.44 for the failure, by one day, to file a VAT return and pay the VAT due in respect of a balancing payment for the VAT quarterly period ended 30 December 2007 ("the 12/07 VAT period").

2. The FTT decided that the surcharge which had been levied at the rate of 2% on a net under-payment of VAT of £3,545,324 was disproportionate and in consequence discharged the surcharge.

Background

3. There was no dispute on the facts before the FTT. The FTT recorded, at [3], the facts that had been agreed by the parties.

4. Trinity Mirror is the well-known publisher of newspapers and magazines. Its publications include the Daily Mirror, Sunday Mirror, People and Daily Record as well as regional newspapers and magazines.

5. At all material times, Trinity Mirror had approximately three-month long prescribed VAT accounting periods. It had been directed by HMRC, pursuant to s 28(2A) of the Value Added Tax Act 1994 ("VATA"), to make payments on account of VAT. For relevant VAT periods, Trinity Mirror was required to make two monthly payments on account and a third balancing payment on a specified date (which had been notified to Trinity Mirror in advance) approximately one month after the end of the VAT period.

6. Trinity Mirror failed to make the balancing payment for its 06/07 VAT period by the due date. It paid in full one day late. As a result HMRC served, pursuant to s 59A(2) VATA, a surcharge liability notice on Trinity Mirror. It specified a surcharge period from 31 August 2007 to 1 July 2008, and expressly notified Trinity Mirror that it may be liable to a surcharge if it defaulted in respect of a VAT period ending within that period.

7. Trinity Mirror failed to make the balancing payment for its 12/07 VAT period by the due date of 30 January 2008. It did pay one day late. The surcharge for that default was assessed at the rate of 2%, initially on the amount of a late balancing payment of £4,795,005 giving a surcharge liability of £95,900, which amount was paid by Trinity Mirror to HMRC on 4 June 2008.

8. Subsequently, on 21 August 2008, Trinity Mirror made a voluntary disclosure of an overpayment of VAT for the 12/07 VAT period of £1,249,681.20. The surcharge amount was consequently reduced to £70,906.44, being 2% of the amount actually due and not paid by the due date.

The law

9. For traders such as Trinity Mirror that are subject to the "payments on account" regime, the relevant default surcharge provisions are set out in s 59A VATA. As the detail of those provisions is not material to this appeal, we set out s 59A in the appendix to this decision. A brief summary here material to the facts of this case will suffice.

10. A first default, which may be a default in the making of a VAT return or in making a payment of VAT by the due date, does not give rise to any liability to a surcharge but triggers the issue of a surcharge liability notice. That notice creates a "surcharge period", which begins on the date the notice is issued and ends on the first anniversary of the VAT period for which the default arose (s 59A(2)).

11. The significance of the surcharge period is that if there is a second default in respect of a VAT period which ends within that surcharge period, and the aggregate value of the defaults in respect of that VAT period (taking both defaults in respect of payments on account and a default in respect of the balancing payment) is more than nil, the defaulting trader is liable to a surcharge calculated at a specified percentage of the aggregate value of the defaults in respect of that VAT period (s 59A(4)). For a first default within a surcharge period, the specified percentage is 2% (s 59A(5)).

12. There is no surcharge if the taxable person demonstrates a reasonable excuse for non-payment (s 59A(8)). However, neither HMRC nor the FTT has power to mitigate a surcharge.

13. Where a default occurs within a surcharge period, that surcharge period is extended (s 59A(3)). On subsequent defaults within that extended period (as further extended by any such subsequent defaults), the specified percentage applied to the aggregate value of the defaults for the relevant VAT period increases with successive VAT accounting periods of default to 5%, then 10%, and finally to a maximum of 15% (s 59A(5)).

14. VAT is of course a tax derived from EU Directives which stipulate in detail the persons on whom and the activities for which the tax is to be imposed by the Member States. This ensures that the application of the tax is the same in all EU Member States. The EU Directives require Member States to take all legislative and administrative measures appropriate for ensuring collection of all the VAT due in their respective territories (see *Dyrektor Izby Skarbowej w Biaymstoku v Profaktor Kulesza, Frankowski, Jówiak, Orowski* (Case C-188/09) [2010] ECR I-7639 ("*Profaktor*")), at [21]. There is, however, no harmonisation of enforcement provisions. Member States are thus empowered to choose the penalties which seem appropriate to them, but that power must be exercised in accordance with the principle of proportionality. According to the Court of Justice's decision in *Paraskevas Louloudakis v Elliniko Dimosio* (Case C-262/99) [2001] ECR I-5547 ("*Louloudakis*") (at [67]), this means (i) that penalties must not go beyond what is strictly necessary for the objectives pursued, and (ii) that a penalty must not be so disproportionate to the gravity of the infringement that it becomes an obstacle to, in the case of VAT, the underlying aims of the directive.

15. A wide discretion is conferred on the Government and Parliament in devising a suitable scheme for penalties, and a high degree of deference is due by courts and tribunals when determining its legality. The state has a wide margin of appreciation, so wide as to allow the imposition of taxes, contributions and penalties unless the legislature's assessment of what is necessary is devoid of reasonable foundation: see *Gasus Dosier-und Fördertechnik GmbH v Netherlands* (1995) 20 EHRR 403, [1995] ECHR 15375/89, ECt HR, at [60]. A court or tribunal must be astute not to substitute its own view of what is fair for the penalty which Parliament has imposed.

16. There are two tribunal decisions that were referred to extensively by the FTT in its decision and which are key to our approach to this appeal; the decision of the First-tier Tribunal in *Enersys Holdings UK Ltd v Revenue and Customs Commissioners* [2010] UKFTT 20 (TC), [2010] SFTD 387 ('*Enersys*') and the decision of the Upper Tribunal (Warren J (P) and Judge Bishopp) in *Revenue and Customs Commissioners v Total Technology (Engineering) Ltd* [2012] UKUT 418 (TCC), [2013] STC 681 ("*Total Technology*"). It is convenient to describe them here.

Enersys

17. *Enersys* was referred to by the Upper Tribunal in *Total Technology* as "the most significant of the first instance decisions in the Tax Chamber". In *Enersys*, the taxpayer company was the representative member of its VAT group. It was, like Trinity Mirror, within the payments on account regime. Its return and payment, due on 30 January 2008, were submitted one day late. As the default was the third default (or, strictly, the third VAT period of default) within the surcharge period, a 10% surcharge was applied to the amount of VAT paid late. That surcharge amounted to £263,763. However, subsequently it was accepted that Enersys had a reasonable excuse for an earlier default, and as a result the surcharge for the January 2008 default was reduced to 5%, or £131,881.

18. The tribunal judge (Judge Bishopp) held, first of all, that there was no reasonable excuse for Enersys' relevant default. He then turned to the question of proportionality. He considered first the competing arguments whether the focus should be on whether the default surcharge regime as a whole is disproportionate, or whether proportionality could be considered by reference to the individual penalty. On that point the judge concluded, at [55], that it was open to him to consider the individual penalty without first having concluded that the system as a whole was disproportionate.

19. Judge Bishopp then examined the default surcharge regime. He concluded, at [60], that there were three features of it which had the potential to undermine its proportionality: the absence of a power to mitigate, the fact that the penalty is the same whatever the period of delay, and the absence of any upper limit. In relation to these features, the judge concluded, at [70], agreeing in this respect with the VAT & Duties Tribunal in *Greengate Furniture Ltd v Customs and Excise Commissioners* [2003] V&DR 178, that the absence of a power to mitigate arguably meant that the regime went further than was necessary in order to attain its objective, adopting the phrase used by the ECJ in *Garage Molenheide BVBA v Belgium* (Joined cases C-286/94, C-340/95, C-401/95 and C-47/96) [1998] STC 126, at [48]. The judge made

a similar observation in relation to the lack of any relation between the period of delay and the magnitude of the penalty.

20. As regards the absence of an upper limit on the amount of a surcharge, Judge Bishopp expressed the view that this might be justifiable on the basis that it is a necessary consequence of a tax-geared penalty, but that there must come a time, even in the case of a large company, when this justification would break down.

21. At [61], Judge Bishopp described as a pertinent question to be asked, whether a court or tribunal, if it had the power to set any monetary penalty it chose without statutory constraint, would exercise its ordinary judicial discretion to impose a penalty of as much as £130,000 for an error of the kind that had arisen in *Enersys*. He regarded it as unimaginable that it would. He arrived at the "inescapable" conclusion that, even taking into account the public interest in the prompt payment of taxes, the surcharge imposed on Enersys was disproportionate.

22. The judge cited in support, at [62], the 2007 judgment of the European Court of Human Rights in *Mamidakis v Greece* (Application 35533/04), in which a penalty of up to 10 times the tax sought to be evaded was found to be disproportionate to the legitimate objective of preventing tax evasion. The judge referred to the Court's observation in that case, at para 71, that an essentially fixed (but high) penalty "is compatible with the principle of proportionality only in so far as it is made necessary by overriding requirements of enforcement and prevention, when the gravity of the offence is taken into account".

Total Technology

23. In *Total Technology* the surcharge in question was of a different order of magnitude from that in *Enersys*. The relevant default was the second in the surcharge period and the surcharge at the rate of 5% amounted to £4,260.26. The First-tier Tribunal in that case had decided that the penalty was disproportionate as it was "not merely harsh but plainly unfair", applying the judgment of Simon Brown LJ in *International Transport Roth GmbH v Secretary of State for the Home Dept* [2003] QB 728 ('*Roth*') at [26].

24. The Upper Tribunal overturned this decision, holding that the surcharge was not disproportionate. It described at [104] the factors relied upon by the First-tier Tribunal, namely (a) the number of days of the default; (b) the absolute amount of the penalty; (c) the inexact correlation of turnover and penalty; and (d) the absence of any power to mitigate. The tribunal concluded at [105] that none of those factors led to the conclusion that the default surcharge regime as a whole infringes the principle of proportionality or to the conclusion that the actual penalty imposed on the company did so.

25. The tribunal in *Total Technology* undertook a thorough examination of the jurisprudence on the principle of proportionality, both from the perspective of EU law and of the European Convention on Human Rights ("the Convention"). It concluded at [72], relying in particular on the judgments of the ECJ in *Louloudakis* and in

Márton Urbán v Vám-és Pénzügyőrség Észak-alföldi Regionális Parancsnoksága (Case C-210/10) (9 February 2012, unreported), first, that penalties must not go beyond what is strictly necessary for the objectives pursued, and secondly, that 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. In that regard, and in connection with the issue whether proportionality is to be tested by reference to the scheme as a whole or in an individual case, the tribunal stated that an excessive penalty would impose a disproportionate burden on a defaulting trader and distort the VAT system as it applies to him.

26. The tribunal went on to conclude, at [78], in common with what Judge Bishopp had decided in *Enersys*, that it is open to a tribunal both to find that a penalty system as a whole is disproportionate, in which case a flaw which offends against the principle of proportionality may be relied upon by any affected person, and as well to consider an individual penalty without having first concluded that the system as a whole is disproportionate.

27. The tribunal noted that the aim of the default surcharge regime was twofold - from a general perspective it aimed to ensure compliance with a taxpayer's obligations to file returns and to pay tax, and more specifically it aimed to ensure submission of returns and the payment of tax on the due date. The tribunal went on to examine possible areas of criticism about the general architecture of the statutory scheme at issue here. At [83], the tribunal identified the main such areas as follows:

> "(a) The regime does not distinguish between a trader who has made a trivial slip and a trader who deliberately fails to file a return and to pay on the due date. Nor does it cater for degrees of culpability between those two extremes.
>
> (b) A trader who is late but has a reasonable excuse is not subject to a penalty. Nor, however long he then delays in payment, is he subjected to a penalty.
>
> (c) In contrast, a trader who is late is subject to a penalty which cannot be reduced even though his payment is only a single day late.
>
> (d) The regime does not distinguish between traders who are a day late, a week late or even a month late, in contrast with some other regimes to be found in the United Kingdom tax system.
>
> (e) The potential hardship to a trader is not a factor to be taken into account. In particular, the amount of the penalty is not related to profitability.
>
> (f) The previous compliance record of the trader is not taken into account save in the negative sense that previous defaults within the preceding 12 months affect the amount of the penalty (as a percentage of the tax overdue).
>
> (g) The correlation between the turnover of the trader and the size of the penalty is far from exact even where there is a failure to pay any of the tax due.
>
> (h) There is no maximum penalty.

> (i) There is no discretion to reduce or waive a penalty once imposed. Although the 'reasonable excuse' exception provides some relief from the harshness of the regime, there are meritorious cases where a penalty, it is suggested, should not be paid that cannot be brought within that exception."

28. For the reasons explained by the tribunal at [86] – [98], the tribunal concluded, at [99], in relation to the default surcharge regime itself that "there is nothing in the VAT default surcharge which leads us to its conclusion that its architecture is fatally flawed". However, there were some aspects of it which might lead to the conclusion that on the facts of a particular case the penalty is disproportionate. But the tribunal urged caution in the assessment of whether an individual penalty is disproportionate, saying:

> "… 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)."

29. The tribunal summarised the position as follows (at [100]):

> "Our conclusion, therefore, is that with the possible omission of an upper limit on the penalty which may be imposed, the regime viewed as a whole does not suffer from any flaw which renders it non-compliant with the principle of proportionality in the sense that it, or some aspect of it, falls to be struck down."

30. As it is central to this case, we should also set out in full the tribunal's discussion, at [93], of the lack of a maximum penalty under the regime:

> "*There is no maximum penalty*. This, we think, is a real flaw at both the level of the regime viewed as a whole and potentially at the individual level of a taxpayer with a very large payment obligation. In *Enersys*, Judge Bishopp considered it unimaginable that a tribunal imposing a penalty would do so in an amount as much as £130,000 for the sort of error in that case. We have adopted a slightly different analysis of the purpose of the legislation from that set out in *Enersys*, and have taken a slightly different view of the requirements of the principle of proportionality, as a reflection of the changed focus of the arguments presented to us. But any approach to the analysis must pay due regard to the principle that the absolute amount of the penalty must be proportionate in the context of the aim pursued and in the context of the objectives of the directive. We agree therefore that there must be some upper limit, although it is not sensible for us in the present case to suggest where that might be. That is because the penalty imposed on the Company here, of £4,260, is clearly of a

> wholly different character from the £130,000 in issue in *Enersys*. If one accepts, as our conclusions above show must be the case, that a substantial, rather than purely nominal, penalty may legitimately be imposed it is in our judgment plain that the penalty imposed on the Company cannot properly be described as 'devoid of reasonable foundation' (*Gasus Dosier*) or 'not merely harsh but plainly unfair' (*Roth*) and that it correspondingly falls and, we would say, comfortably so, below any possible upper limit."

31. Having reached its conclusion as regards the regime as a whole, the tribunal turned to the factors put forward in support of the company's complaint of unfairness on its particular facts. Those factors, described by the tribunal at [101], were: (a) the payment was only one day late; (b) previous defaults had been innocent, even if no reasonable excuse could be established; (c) the company's excellent compliance record; and (d) the amount of the penalty represented an unreasonable proportion of the company's profits.

32. The tribunal held that at the individual level of the company, the amount of the penalty, even if looked at in isolation, could not be regarded as disproportionate. Furthermore, at [103], the tribunal held that the company's Convention rights had not been infringed, as although the surcharge might be considered harsh, it could not be regarded as plainly unfair.

The FTT decision in this case

33. The FTT set out its conclusions at paragraph [7], which is divided into nine sub-paragraphs, to [9] of its decision. It began by considering *Total Technology*, which, as the FTT correctly observed, was binding on it. It referred to the conclusion reached by the Upper Tribunal, at [76], that even if the structure of the default surcharge regime is a rational response to the late filing of returns and late payment of VAT, it is nonetheless necessary to consider the effect of the regime on the individual case in hand.

34. Drawing further support from *EC Commission v Greece* (Case C-156/04) [2007] ECR I-4129, the FTT determined that the question whether a penalty was proportionate or disproportionate was to be assessed on the basis of the level of the penalties actually applied in the individual case. The FTT also quoted from what the Upper Tribunal had said in *Total Technology*, at [72], when discussing the ECJ's judgment in *Louloudakis* namely that "an excessive penalty would impose a disproportionate burden on a defaulting trader and distort the VAT system as it applies to him …".

35. The FTT went on to consider whether the particular surcharge in this case was disproportionate. It referred further to *Total Technology*, at [72], when the tribunal, citing from *Louloudakis* at [67], referred to the requirement under EU law that penalties must not go beyond what is strictly necessary for the objectives pursued. The FTT discussed what the tribunal in *Total Technology* had said, at [79] and [80], concerning the purpose and effect of the default surcharge regime, referring in particular to the feature noted by the Upper Tribunal that the penalty is for a failure to

do something by a due date and not for a continuing failure to put right the original default.

36. The FTT itself noted at [7](6) that the default surcharge regime looks at successive defaults during the surcharge period and that "its aim is to impose higher penalties on a taxable person who defaults repeatedly than those who default less frequently". It found that this suggested that "the regime identifies the gravity of the particular infringement by reference to the number of times in the relevant Surcharge period that the taxable person has previously been in default and penalises that person according to the gravity so identified. There is, as it were, a hierarchy of seriousness of breaches."

37. In relation to the surcharge in this case, the FTT referred in particular to the decision of the First-tier Tribunal in *Enersys Holdings UK Ltd v Revenue and Customs Commissioners* [2010] SFTD 387, and said this (at [7](7));

> "Let us look at the Surcharge in question. A Surcharge of £95,900 later reduced to £70,906.44 [that] was imposed on an otherwise compliant trader to penalise a one day default is plainly unfair. The regime recognises the level of penalty in this case (one default) as being at the low end of the hierarchy of penalties. If compared to *Enersys*, where the Appellant had a 5% Surcharge based on a fifth default over a two year period resulting in a £131,881 penalty, the Surcharge here at 2% (or two and a half times less than the one levied in *Enersys*) would suggest a penalty level of £52,752.40 (being 40% of the £131,881 in *Enersys*) as being proportionate. The penalty imposed is disproportionate by comparison. This view finds support in the view of the Upper Tribunal in *Total Technology*, who gave a benchmark figure which they thought would be disproportionate. They suggested that a £50,000 penalty would be disproportionate in respect of a third default (at para.76). By this standard, the penalty imposed on the Appellant is harsh. There is a strong underlying intention in the legislation that different breaches warrant different penalties and the gravity of the infringement is relevant. The gravity here is low but the penalty is high. The Tribunal does not agree with the counter argument of the Respondents, who say that to set aside the Surcharge in this case "would make the Surcharge system itself disproportionate." There is no evidence that this would be the case."

38. The FTT also rejected arguments of HMRC based on waivers of certain small penalties, holding that this did not amount to evidence that HMRC considered the real question of proportionality.

39. The FTT concluded at [8] and [9] that the surcharge in the case of Trinity Mirror's default went beyond what was strictly necessary for the objectives pursued and was excessive in view of the gravity of the infringement such that it imposed a disproportionate burden on Trinity Mirror. The surcharge was, accordingly, disproportionate, and as a consequence was to be discharged.

Discussion

40. HMRC's case is that the FTT made a number of errors of law and that its decision is therefore flawed. They submit that this tribunal should set aside the FTT's decision and re-make it, by determining for itself whether the surcharge imposed in this case was disproportionate.

41. That general ground of appeal is supported by six further grounds. Two of those grounds attack the findings of the FTT as regards the comparative exercise it undertook at [7](7) of the FTT decision to conclude that the surcharge in this case was disproportionate, and the reasoning of the FTT in finding support for that approach from *Total Technology*. The other grounds argue either that the FTT took into account certain irrelevant considerations, or that it failed to have proper regard to certain other factors which were submitted to be relevant.

This tribunal's jurisdiction

42. The jurisdiction of this tribunal on an appeal from the FTT is limited to questions of law (s 11 of the Tribunals, Courts and Enforcement Act 2007).

43. Ms Yang appearing for Trinity Mirror sought to persuade us that certain findings of the FTT should be regarded as findings of fact and thus not open to challenge otherwise than on the basis that the findings were perverse or "such that no person acting judicially and properly instructed as to the relevant law could have come to …" (*Edwards v Bairstow and another* [1956] AC 14, per Lord Radcliffe at p 36). She referred us to *London Clubs Management Ltd v Revenue and Customs Commissioners* [2012] STC 388, in the Court of Appeal, where Etherton LJ, at [73], had referred to the finding of the First-tier Tribunal in that case that a particular activity was a potential source of profit as "a specific finding of primary fact on the evidence" and that any challenge on the basis of perversity had to be raised as a distinct ground of appeal. That course, argued Ms Yang, had not been adopted by HMRC in this case.

44. Ms Yang also referred us, by way of summary of the relevant principles, to a recent case in this tribunal, *Revenue and Customs Commissioners v Lok'nStore Group plc* [2015] STC 112, at [50] – [53], where Henderson J referred to the well-known authorities of *Proctor & Gamble UK v Revenue and Customs Commissioners* [2009] STC 1990, *Edwards v Bairstow* and *Georgiou (trading as Marios Chippery) v Customs and Excise Commissioners* [1996] STC 463.

45. We can deal with this issue quite shortly. In our view the challenge in this case is not to the findings of the FTT as to primary facts, nor as to any inferences drawn from primary facts. It is a challenge to the legal test applied by the FTT in assessing, first, the seriousness of Trinity Mirror's default, and secondly whether the surcharge in this case was disproportionate. Those are questions of law. We do not accept that there is any constraint, either by reference to the grounds of appeal as raised by HMRC, or as regards the jurisdiction of this tribunal in this regard.

The FTT's comparative exercise

46. We set out above the FTT's reasoning as expressed at [7](7) of its decision. It took as its benchmark the amount of the 5% penalty in *Enersys*, namely £131,881, which had been determined by the First-tier Tribunal, in the circumstances of that case, to be disproportionate. It reasoned that the gravity of the default was to be assessed solely by reference to the number of defaults in the surcharge period, and appears therefore to have concluded that relative gravity could thus be determined by the different rates of surcharge applied to each such default. On that basis it considered that the application of the same ratio of 2 to 5, reflecting a comparison of a 2% surcharge (that in Trinity Mirror's case) with a 5% surcharge (that in *Enersys*), should be applied to the respective surcharges to generate an appropriate benchmark figure for assessing the proportionality of a surcharge at 2%.

47. In our judgment, there is no basis for an arithmetical approach of this nature. The conclusion as to whether the surcharge was disproportionate or not was not one that could be arrived at as a matter of law by the reasoning adopted by the FTT. The FTT's reliance on *Enersys* here was misguided. Irrespective of whether the conclusion in *Enersys* was correct on its own facts, it could never be right in principle for a tribunal in a different case to extrapolate from it a conclusion based on an arithmetical calculation. Paradoxically, in employing the figure for the surcharge in *Enersys* as its principal benchmark, and in calculating its own benchmark from that base, the FTT was not only failing to have regard to the amount of VAT unpaid by Trinity Mirror in assessing the gravity of its own default, but was basing its calculation, at least in part, on the VAT that had been unpaid by Enersys, and by reference to which the surcharge amount in *Enersys* had been determined. Such an approach has no regard to the individual circumstances of Trinity Mirror's case, and provides no foundation for determining the proportionality of the surcharge on an individual basis. It is a flawed approach and an error of law on the part of the FTT.

48. The FTT's reasoning starts from the false premise that the gravity of the offence is exclusively dictated by the number of times the taxable person is in default. The FTT reached that conclusion by reference to the escalating scale of penalties depending on the number of defaults in a surcharge period. Such an analysis might be feasible in a case of increasing fixed penalties of absolute amounts. However, the FTT failed to recognise that a penalty based on a percentage of the amount unpaid at the due date escalates not only by reference to the percentage, but by reference to the amount unpaid. In assessing the gravity of the default, the amount of VAT that the taxable person has not paid is an essential element of this statutory scheme.

49. Ms Yang argued that the amount of VAT paid late should not be a factor in determining the gravity of the default. If it were, she submitted, a penalty based on a percentage of such VAT could never be disproportionate. We do not agree. In a given case, where the circumstances are such as to lead to such a conclusion, the fact that the gravity of the default has been determined, in part, by reference to the unpaid VAT will not preclude a finding that a surcharge is disproportionate.

50. We agree in this respect with Mr Mantle, appearing for HMRC. Ignoring the amount of VAT unpaid in determining the gravity of the default leaves out of account

a material element of the individual circumstances of the trader and is also contrary to authority. As the tribunal in *Total Technology* noted, at [40], in *Louloudakis*, at [70], the ECJ observed that:

> "it is for the national court to assess whether, in view of the overriding requirements of enforcement and prevention, as well as the amount of the taxes in question and the level of the penalties actually imposed, those penalties do not appear so disproportionate to the gravity of the infringement that they become an obstacle to the freedoms enshrined in the Treaty."

It is thus clear on authority, as well as according with common sense, that it is legitimate to adopt a scheme which takes into account the amount of tax related to the penalty in assessing the gravity of a default in payment of that tax.

51. We do not consider that the FTT's approach was supported by *Total Technology*. The FTT was wrong to say that the Upper Tribunal had provided a benchmark figure of £50,000 for a "third" default (by which it meant a second default within the surcharge period). The FTT referred in particular to what the Upper Tribunal had said at [76]:

> "… Even if the structure of the surcharge regime is a rational response to the late filing of returns and late payment of VAT, it is, nonetheless, necessary to consider the effect of the regime on the individual case in hand. It is necessary to do so not least because *Louloudakis* and *Urbán* show that a penalty must not be disproportionate to the gravity of the infringement in the sense described in those decisions, that is to say the penalty must not become an obstacle to, as we identify it, the underlying aims of the directive. If the penalty is simply too great, at least in a large number of cases—imagine a flat rate penalty of £50,000 for a third default which no one could possibly say was a permissible penalty for ordinary small traders—there would be an illegitimate distortion of the VAT system and it might then be said that the regime viewed as a whole, is a disproportionate to the legitimate aim pursued. But if a smaller flat-rate penalty were put in place—sufficiently small as to be seen as not unfair to large or medium sized traders but still large enough to be manifestly unfair to small traders generally—it could not be said that the regime, viewed as a whole, was disproportionate. But it could properly be said that it was disproportionate so far as concerns the small traders. Viewed in the context of the directive, the penalty would go beyond what was necessary in relation to such traders and would distort the VAT system so far as they are concerned: the burden on a smaller trader of a penalty for failure to pay his VAT on time would bear more heavily than the same penalty imposed on a large trader."

52. Reliance on this passage in support of an arithmetical calculation of a "benchmark" figure for a "second" default of £52,752.40 was misplaced and based on a misunderstanding of what the Upper Tribunal had said. At [76], the tribunal in *Total Technology* was considering the question whether proportionality had to be tested by reference to the system as a whole or by reference to its application in an individual case. Its example was merely designed to illustrate that a system could

give rise to disproportionality at the level of the regime itself, but could equally be disproportionate only for a particular section of those affected. Thus, the question of proportionality fell to be addressed both at a scheme and individual level. The scheme postulated by the tribunal, and the figures it chose to use, were each illustrative only. The figure of £50,000 was no doubt chosen because it could be readily appreciated that a system that provided for such a flat-rate penalty in the case of a default, even a third default, would bear disproportionately on those, described by the tribunal as ordinary small traders, whose liability to account for tax would be relatively modest. A £50,000 flat-rate penalty could be regarded as too great in a large number of cases, and thus render the scheme as a whole disproportionate. A lower flat-rate penalty might only affect a smaller section of the relevant traders and could be disproportionate not because the system as a whole was disproportionate but as regards the individual penalty. The figure of £50,000 chosen to illustrate this point was not a benchmark for the default surcharge, which is of an entirely different order than the Upper Tribunal's notional fixed penalty; nor could it provide any support for the benchmark figure arrived at by the FTT.

53. That, in our view, is sufficient for us to conclude that the FTT erred in law, and that its decision should be set aside. Neither party invited us to remit the case to the FTT. We consider that it is appropriate for us to re-make the decision.

54. We are conscious that we have not addressed a number of the further grounds of appeal, by which HMRC submitted that the FTT made additional errors of law in either taking into account irrelevant matters or in failing to take account of certain factors that were relevant. Except in one respect, we propose to say nothing about those matters, as they add nothing to our decision that the FTT was wrong in law.

55. The one issue we should remark on is the submission by Mr Mantle that the FTT should have considered that Trinity Mirror did not have any reasonable excuse for its default. We do not agree that this would have been a relevant factor. For proportionality to be in issue it is axiomatic that there will have been no reasonable excuse for the default; if there had been, the effect of s 59A(8) VATA (or, in a normal case, s 59(7)) is that the trader would not be liable to a surcharge at all, and will not be treated as having been in default in respect of the relevant VAT period. Accordingly, the mere fact that there is no reasonable excuse will be a factor universally applicable, and can have no bearing on the question of proportionality. Contrary to Mr Mantle's submissions, the absence of reasonable excuse goes to the fact of the default, and not to the gravity of it.

Our decision on proportionality

56. In respect of penalties the principle of proportionality, according to EU law, is concerned with two objectives. One is the objective of the penalty itself; the other the underlying aims of the directive. But more broadly, the objective of the penalty in enforcing collection of tax is itself a natural consequence of the essential aim of the directive to ensure the neutrality of taxation of economic activities.

57. In *Total Technology* the Upper Tribunal rightly focused not only on the general aim of the default surcharge regime to ensure compliance with a taxpayer's obligations to file returns and to pay tax, but on the specifics of that regime. It did so because questions of proportionality can only be judged against the aim of the legislation (*Total Technology*, at [79]). But the tribunal did not examine in detail the other relevant objective, namely the underlying aim of the directive, which we consider to be the more fundamental question.

58. That question is in our view fundamental because the way the principle of proportionality has been expressed in the case law is not confined to an examination of the penalty simply by reference to the gravity of the infringement. It is not enough for a penalty simply to be found to be disproportionate to the gravity of the default; it must be "so disproportionate to the gravity of the infringement that it becomes an obstacle to [the underlying aims of the directive"] (*Louloudakis*, at [70], referred to above).

59. The underlying aim of the directive that is relevant for this purpose was considered in *Profaktor*. It is the principle of fiscal neutrality in its sense of ensuring a neutral tax burden which protects the taxable person, since the common system of VAT is intended to tax only the final consumer. This is reflected, for example, in the system of deductions, in the UK of input tax, designed to ensure that the taxable person is not improperly charged to VAT. This analysis is derived from *Elida Gibbs Ltd v Customs and Excise Commissioners* (Case C-317/94) [1996] ECR I-5339, [1996] STC 1387, in which the ECJ also said (at [22]):

> "It is not, in fact, the taxable persons who themselves bear the burden of VAT. The sole requirement imposed on them, when they take part in the production and distribution process prior to the stage of final taxation, regardless of the number of transactions involved, is that, at each stage of the process, they collect the tax on behalf of the tax authorities and account for it to them."

60. It is a necessary concomitant of a system that provides for a system of deduction and collection of tax at each stage in the process, that tax should be accounted for, and paid, on a timely basis. That essential neutrality can itself be undermined by a failure of a taxable person to comply with its obligations. It is in that context that the legislative measures adopted by member states to ensure collection and to deter default, and the question whether those penalties, either generally or in an individual case, are so disproportionate as to constitute an obstacle to fiscal neutrality, must be viewed.

61. The Upper Tribunal in *Total Technology* determined, at [99], that the default surcharge system was not fatally flawed so as to give rise to disproportionate penalties generally, although at [100] it entertained some residual doubt about the absence from the regime of an upper limit on the penalty which might be imposed. It regarded certain aspects of the regime, however, as capable of leading to the conclusion, in an individual case, that the penalty is disproportionate. Chief amongst these was the question of the absence of a maximum penalty which the tribunal addressed at [93] in a passage we have set out above.

62. In our judgment, it is not appropriate for the courts or tribunals to seek to set any maximum penalty, or range of maximum penalties. That would in effect be to legislate. The task of the tribunal is to consider the relevant tests in the context of the individual case before it. It must not seek to establish a maximum and then compare the actual penalty to that benchmark. That was what the FTT attempted to do in this case, and it was wrong in law to have done so.

63. The correct approach is to determine whether the penalty goes beyond what is strictly necessary for the objectives pursued by the default surcharge regime, as discussed in detail in *Total Technology* and whether the penalty is so disproportionate to the gravity of the infringement that it becomes an obstacle to the achievement of the underlying aim of the directive which, in this context, we have identified as that of fiscal neutrality. To those tests we would add that derived from *Roth* in the context of a challenge under the Convention to certain penalties, namely "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?"

64. In *Total Technology* the Upper Tribunal identified, at [84], features of the regime which supported an argument that the scheme was fair. The tribunal said:

> "However, from HMRC's point of view, the regime has a lot to commend it. It is mechanistic and therefore comparatively easy to administer. There is no need for hard-pressed officers of HMRC to spend scarce time and resources in dealing with a vague and amorphous power to mitigate a penalty. The following factors can be prayed in aid in response to the unfairness alleged by the Company:
>
> (a) The simplicity of the system makes it easily understood, as well as being relatively easy to operate.
>
> (b) The surcharge is only imposed on a second or subsequent default, and after the taxpayer has been sent a surcharge liability notice warning him that he will be liable to surcharge if defaults again within a year. Taxpayers thus know their positions and should be able conduct their affairs so as to avoid any default.
>
> (c) The penalty is not a fixed sum but is geared to the amount of outstanding VAT. Although a somewhat blunt instrument, it does bring about a broad correlation between the size of the business and the amount of the penalty. It does not suffer from the objections which could be made to the fixed penalty in *Urbán.*
>
> (d) The percentage applicable to the calculation of the penalty increases with successive defaults if they occur within 12 months of each other. This is a rational and reasonable response to successive defaults by a taxpayer.
>
> (e) The 'reasonable excuse' exception strikes a fair balance. The gravity of the infringement is reflected in the absence of 'reasonable excuse' and the amount of the penalty reflects the extent of the default, that is to say the amount of tax not paid by the due date."

65. We agree with the tribunal in *Total Technology* that the default surcharge regime, viewed as a whole, is a rational scheme. The penalties are financial penalties, calculated by reference to the amount of tax unpaid at the due date. Although penalties may vary with the liability of the taxable person for the relevant VAT period, and increase commensurately with an increase in such liability (and, consequently, such default), the penalties are not entirely open-ended. The maximum liability for a fifth or subsequent period of default is 15% of the amount unpaid. In common with the Upper Tribunal in *Total Technology*, we consider that the use of the amount unpaid as the objective factor by which the amount of the surcharge varies is not a flaw in the system; to the contrary, the achievement of the aim of fiscal neutrality depends on the timely payment of the amount due, and that criterion is therefore an appropriate, if not the most appropriate, factor.

66. However, we accept that, applying the tests we have described, the absence of any financial limit on the level of surcharge may result in an individual case in a penalty that might be considered disproportionate. In our judgment, given the structure of the default surcharge regime, including those features described in *Total Technology*, this is likely to occur only in a wholly exceptional case, dependent upon its own particular circumstances. Although the absence of a maximum penalty means that the possibility of a proper challenge on the basis of proportionality cannot be ruled out, we cannot ourselves readily identify common characteristics of a case where such a challenge to a default surcharge would be likely to succeed.

67. We should, in particular, not be taken to have endorsed the suggestion put forward by Mr Mantle that the exceptional circumstances that might give rise to a disproportionate penalty could include cases, such as *Enersys*, where there had been what was described as a "spike" in profits, such that for a particular VAT period the liability to account for and pay VAT was of a different order of magnitude that was normal for the trader concerned. Attempting to identify particular categories of case in this way is not, in our view, helpful. Whilst it might be tempting to seek to isolate, and thus confine, cases by reference to particular criteria, such cases, by reason of their exceptional nature, are likely to defy such characterisation.

68. With these observations in mind, we turn to the particular facts of Trinity Mirror's case. Viewed simply in absolute terms, the surcharge of £70,906.44 is large. Its size was dictated by the substantial sum of VAT, £3,545,324, that Trinity Mirror paid late, the surcharge being levied at the rate of 2% for a first default within the surcharge period. Although payment was delayed by only one day, we accept that the scheme of the default surcharge regime is to impose a penalty for failing to pay VAT on time, and not to penalise further for any subsequent delay in payment. That, as we have described, is entirely consistent with the fiscal neutrality aim of the directive. It would not be possible, therefore, in our view, for the fact that the payment was only one day late to render an otherwise proportionate penalty disproportionate.

69. In our judgment, there are no exceptional circumstances in Trinity Mirror's case that could render this surcharge disproportionate. A financial penalty of this nature, based on a modest percentage of the amount of VAT unpaid by the due date, cannot be regarded as going beyond the objectives of the default surcharge regime.

70. The gravity of the default must be assessed by reference to the relevant factors, first that it was a second default, in respect of which Trinity Mirror had been notified by the surcharge liability notice issued following the first default that further default within the surcharge period could result in a surcharge, and secondly that it was in a substantial sum.

71. Having regard to the need, in order to preserve the fiscal neutrality of the VAT system, to enforce prompt payment of VAT collected by a taxable person, a penalty of 2% cannot be regarded as so disproportionate to the gravity of the infringement as to constitute an obstacle to the underlying aim of the directive.

72. Nor can the surcharge be regarded as disproportionate by reference to the Convention. It has been arrived at by the application of a rational scheme that cannot be characterised as devoid of all reasonable foundation. The penalty might be considered harsh, but in our view it cannot be regarded as plainly unfair.

Decision

73. For the reasons we have given:

(1) we allow HMRC's appeal; and

(2) we re-make the decision of the FTT by upholding the surcharge liability of £70,906.44.

Costs

74. Any application for costs should be made not later than 14 days after the date of release of this decision. As any order will be for detailed assessment, if costs are not agreed, it will not be necessary for the application to be accompanied by a schedule of costs.

MRS JUSTICE ROSE

UPPER TRIBUNAL JUDGE ROGER BERNER

RELEASE DATE: 3 August 2015

APPENDIX

Section 59A, Value Added Tax Act 1994 – Default surcharge: payments on account

(1) For the purposes of this section a taxable person shall be regarded as in default in respect of any prescribed accounting period if the period is one in respect of which he is required, by virtue of an order under section 28, to make any payment on account of VAT and either—

(a) a payment which he is so required to make in respect of that period has not been received in full by the Commissioners by the day on which it became due; or

(b) he would, but for section 59(1A), be in default in respect of that period for the purposes of section 59.

(2) Subject to subsections (10) and (11) 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 which—

(i) begins, subject to subsection (3) below, on the date of the notice; and

(ii) ends on the first anniversary of the last day of the period referred to in paragraph (a) above.

(3) If—

(a) a surcharge liability notice is served by reason of a default in respect of a prescribed accounting period, and

(b) 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, the existing period and its extension shall be regarded as a single surcharge period.

(4) Subject to subsections (7) to (11) below, if—

(a) a taxable person on whom a surcharge liability notice has been served is in default in respect of a prescribed accounting period,

(b) that prescribed accounting period is one ending within the surcharge period specified in (or extended by) that notice, and

(c) the aggregate value of his defaults in respect of that prescribed accounting period is more than nil,

that person shall be liable to a surcharge equal to whichever is the greater of £30 and the specified percentage of the aggregate value of his defaults in respect of that prescribed accounting period.

(5) Subject to subsections (7) to (11) 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 during the surcharge period which are periods in respect of which the taxable person is in default and in respect of which the value of his defaults is more than nil, 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 this section the aggregate value of a person's defaults in respect of a prescribed accounting period shall be calculated as follows—

(a) where the whole or any part of a payment in respect of that period on account of VAT was not received by the Commissioners by the day on which it became due, an amount equal to that payment or, as the case may be, to that part of it shall be taken to be the value of the default relating to that payment;

(b) if there is more than one default with a value given by paragraph (a) above, those values shall be aggregated;

(c) the total given by paragraph (b) above, or (where there is only one default) the value of the default under paragraph (a) above, shall be taken to be the value for that period of that person's defaults on payments on account;

(d) the value of any default by that person which is a default falling within subsection (1)(b) above shall be taken to be equal to the amount of any outstanding VAT less the amount of unpaid payments on account; and

(e) the aggregate value of a person's defaults in respect of that period shall be taken to be the aggregate of—

(i) the value for that period of that person's defaults (if any) on payments on account; and

(ii) the value of any default of his in respect of that period that falls within subsection (1)(b) above.

(7) In the application of subsection (6) above for the calculation of the aggregate value of a person's defaults in respect of a prescribed accounting period—

(a) the amount of outstanding VAT referred to in paragraph (d) of that subsection is the amount (if any) which would be the amount of that person's outstanding VAT for that period for the purposes of section 59(4); and

(b) the amount of unpaid payments on account referred to in that paragraph is the amount (if any) equal to so much of any payments on account of VAT (being payments in respect of that period) as has not been received by the Commissioners by the last day on which that person is required (as mentioned in section 59(1)) to make a return for that period.

(8) 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—

(a) in the case of a default that is material for the purposes of the surcharge and falls within subsection (1)(a) above—

(i) that the payment on account of VAT 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 by the day on which it became due, or

(ii) that there is a reasonable excuse for the payment not having been so despatched,

or

(b) in the case of a default that is material for the purposes of the surcharge and falls within subsection (1)(b) above, that the condition specified in section 59(7)(a) or (b) is satisfied as respects the default,

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).

(9) For the purposes of subsection (8) 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.

(10) 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 section 69,

the default shall be left out of account for the purposes of subsections (2) to (5) above.

(11) 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.

(12) For the purposes of this section the Commissioners shall be taken not to receive a payment by the day on which it becomes due unless it is made in such a manner as secures (in a case where the payment is made otherwise than in cash) that, by the last day for the payment of that amount, all the transactions can be completed that need to be completed before the whole amount of the payment becomes available to the Commissioners.

(13) In determining for the purposes of this section whether any person would, but for section 59(1A), be in default in respect of any period for the purposes of section 59, subsection (12) above shall be deemed to apply for the purposes of section 59 as it applies for the purposes of this section.

(14) 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.