



[2020] UKFTT 0084 (TC)

TC07578

VAT – imposition of default surcharge - sections 59 and 59A Value Added Tax Act 1992 - final payment of VAT due was lower than the amount stated in a return, reasonable excuse, impact on default surcharge period, whether penalty imposed by virtue of a later delayed instalment payment proportionate in the circumstances – appeal allowed.

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

Appeal number: TC/2018/04992

BETWEEN

MEDIVET GROUP LIMITED

Appellant

-and-

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

Respondents

**TRIBUNAL: JUDGE GETHING
Member Maryvonne Hands**

Sitting in public at Taylor House, London on 10 January 2020 at 10.30 until 12 noon

Mr Michael Firth, counsel, for the Appellant

Miss Laura Castle, presenting officer, for the Respondents

DECISION

INTRODUCTION

1. The issues in this case arise out of a default surcharge imposed by HMRC on the Appellant for late payment of VAT in the period 10/17 (i.e. the period ended 31 October 2017). I refer to this period below as “10/17” and use that notation in relation to all other VAT quarter periods) in the sum of £269,239. The specified percentage by reference to which the surcharge was calculated was 10% of the VAT paid late in respect of 10/17 and was dependent on the surcharge period having begun in 10/15 as a result of (a) an overstatement of liability to pay VAT in that period by reason of the failure to take into account in put tax credit of £399.92 and (b) the VAT surcharge period having been extended by alleged defaults in 04/16 and 10/16 (the first alleged default and the second alleged default) concerning the over statement in 10/15 which alleged defaults are described in paragraphs 2(f) and 2(i) below.

We heard evidence from Tracy Gates (“**Ms Gates**”) the head of finance for the Appellant, who was cross examined by Miss Castle.

THE FACTS

2. We find the following facts from the evidence given by Ms Gates, the witness statements and documents in the bundles (named Bundle1 and Bundle 2):

(a) In the periods in question the Appellant was required to make monthly payments on account of VAT under section 28A VAT Act 1994 (“**the VAT Act**”).

(b) The VAT Group returns for the periods in question were prepared by a finance manager employed by the Appellant and subject to review by Ms Gates. If any amendments were required by Ms Gates, adjustments were to be made and the finance manager was to proceed to file the return and arrange for the balancing payment of VAT to be made to HMRC, taking into account payments already made to HMRC in the quarter.

10/15

(c) For the VAT period 10/15, during her review of the Group VAT return, Ms Gates identified that £399.92 input tax had been omitted from the return. The finance manager adjusted the payment amount but omitted to make the adjustment to the return. This produced a mismatch in amounts. It is common ground that the correct amount of VAT had been paid. There had been an error in a supporting spreadsheet.

(d) HMRC was made aware of the error on a call on 14 December 2015. Ms Gates planned to correct the error in the following quarter's return and the officer of HMRC warned that there may be a default surcharge.

(e) A default surcharge notice was issued by HMRC on 21 December 2015. It records that there was no default in the timing of the monthly instalment payments or the balancing final payment for the quarter but the value of the alleged default on the balancing payment was £400 (£399.92 rounded up) and advised that the Appellant may be liable to a surcharge if in the 12 month period ending on 31 October 2016 the Appellant was in default. Queries concerning the notice were to be sent to an address in Liverpool. The notice was not capable of being appealed.

04/16

(f) The next alleged default occurred when the first monthly payment on account for 04/16 was made 22 days late. HMRC's ledger showed that when the monthly payment was made, an additional £399.92 was due and was paid alongside the first instalment

payment. When the balancing payment was made for the quarter 04/16 the £399.92 overpayment in the first instalment was mistakenly deducted from the balancing payment made. The correct amount of VAT had been paid but the original return had not been amended to reflect the claim to input tax of £399.92 in respect of the period 10/15. The Appellant had intended to correct the amount shown as due by deducting the £399.92 in the return but had been busy dealing with other issues and had failed to do so.

(g) On 16th June HMRC imposed a 2% penalty of £4,230 and notified the Appellant that the surcharge period was extended to 30 April 2017. HMRC also contacted Ms Gates by phone insisting that the Appellant pay the £399.92.

(h) The Appellant did not exercise the right of appeal and agreed to pay the £399.92 and the penalty because the sum concerned was modest having regard to the scale of the business and she was keen to draw a line under the matter. A total payment of £4,628.29 was made on 16 August 2016.

10/16

(i) The VAT return for 10/16 was submitted on time but when the balancing payment was calculated the finance manager deducted from the amount due the sums paid to HMRC in the quarter. The £4,629.29 paid in tax and penalty for the period 04/16 was inadvertently deducted from the balancing payment resulting in an alleged underpayment of that amount (“**the second alleged default**”).

(j) Ms Gates rang HMRC on 16 January 2017 to explain and arranged payment the same day of £4,629.29. A further default surcharge notice was issued. No penalty was assessed but the default surcharge period was extended by 12 months to 31 October 2017 under section 59A(3) VAT Act.

10/17

(k) The balancing payment for 10/17 of £2,692,392 was paid one day late. Taking into account defaults in 04/16 and 10/16 HMRC imposed a penalty at the prescribed percentage of 10% giving rise to the surcharge penalty of £269,239.00.

(l) During cross examination Ms Gates rejected the suggestion that the Appellant had failed to take reasonable care in preparing returns and paying VAT in the periods 10/15 and 04/16.

(m) Ms Gates accepted that there was no reasonable excuse for the delay in making the first instalment late in 04/16 and balancing payment for 10/17 under section 59A(8)(a)(ii) VAT Act.

THE LEGISLATION

3. The relevant statutory provisions of the VAT Act are set out below.

S59 - The Default surcharge

(1) Subject to subsection (1A) below, if, by the last day on which a taxable person is required in accordance with regulations under this Act to furnish a return for a prescribed accounting period-

(a) The Commissioners have not received that return, or

(b) The Commissioners have received that return but have not received the amount of VAT shown on the return as payable by him for that period,

then that person shall be regarded for the purpose 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 other 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 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 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, the 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,

that person shall be liable to a surcharge equal to whichever is the greater of the following, namely the specified percentage of the aggregate value of his defaults in respect of 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 subsection (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) 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, but for this section 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 for 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 is 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 the VAT not having been 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 on 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 section 69,

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.

Section 59A 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) 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 and) 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.

Section 59B Relationship between sections 59 and 59A.

(1) This section applies in each of the following cases, namely—

(a) where a section 28 accounting period ends within a surcharge period begun or extended by the service on a taxable person (whether before or after the coming into force of section 59A) of a surcharge liability notice under section 59; and

(b) where a prescribed accounting period which is not a section 28 accounting period ends within a surcharge period begun or extended by the service on a taxable person of a surcharge liability notice under section 59A.

(2) In a case falling within subsection (1)(a) above section 59A shall have effect as if—

(a) subject to paragraph (b) below, the section 28 accounting period were deemed to be a period ending within a surcharge period begun or, as the case may be, extended by a notice served under section 59A; but

(b) any question—

(i) whether a surcharge period was begun or extended by the notice, or

(ii) whether the taxable person was in default in respect of any prescribed accounting period which was not a section 28 accounting period but ended within the surcharge period begun or extended by that notice,

were to be determined as it would be determined for the purposes of section 59.

(3) In a case falling within subsection (1)(b) above section 59 shall have effect as if

(a) subject to paragraph (b) below, the prescribed accounting period that is not a section 28 accounting period were deemed to be a period ending within a surcharge period begun or, as the case may be, extended by a notice served under section 59;

(b) any question—

(i) whether a surcharge period was begun or extended by the notice, o

(ii) whether the taxable person was in default in respect of any prescribed accounting period which was a section 28 accounting period but ended within the surcharge period begun or extended by that notice,

were to be determined as it would be determined for the purposes of section 59A; and

(c) that person were to be treated as having had outstanding VAT for a section 28 accounting period in any case where the aggregate value of his defaults in respect of that period was, for the purposes of section 59A, more than nil.

(4) In this section “ a section 28 accounting period ”, in relation to a taxable person, means any prescribed accounting period ending on or after the day on which the Finance Act 1996 was passed in respect of which that person is liable by virtue of an order under section 28 to make any payment on account of VAT.

Section 96 Other interpretative provisions

(1) In this Act –

“VAT” means value added tax charged in accordance with this Act or, where the context requires, with the law of another member state;”

Respondents’ submissions

4. The Respondents case is that:

(1) The Appellants had been required to pay VAT in instalments under the Payment on Account Scheme under section 28A VAT Act since 2015 and had been supplied with the schedule of dates on which payments were to be made.

(2) The Appellant failed to make payments equal to the amount shown on its VAT return in accordance with section 59A VAT Act on time on four separate occasions since 10/15 and was therefore in the default surcharge regime.

(3) the Appellant paid the final balancing payment of £2,692,292.00 for the period 10/17 due on 1 December 2017, one day late.

(4) there was no reasonable excuse for the late payment of VAT in respect of the balancing payment due on 1 December and received on 2 December 2017.

(5) the decision to impose a surcharge in respect of the late payment of VAT due on 1 December 2017 under section 59A(4) in respect of 10/17 was a correct decision.

(6) the Appellant is therefore liable to a penalty at the prescribed percentage of 10% on £2,692,292 being the sum of £269,239.00.

5. The Respondents claim that the Appellant had no grounds to claim reasonable excuse in relation to the 2017 late payment or for any of the periods 10/15, 04/16, or 10/16. The payments were made in error and may have been made honestly and in good faith but the legislation does not pardon such errors. Only reasonable excuses can have that effect. The Respondents rely on:

(1) *Garmoss Limited v Parham Builders* [2012] UK FTT 315 (TC) in which the First-tier Tribunal rejected the notion that there can be a reasonable excuse merely because the taxpayer makes an honest mistake acting in good faith. The Tribunal considered the test of whether an excuse was a reasonable excuse was an objective test.

(2) *Coales v HMRC* [2012] UKFTT 477 (TC) where the First-tier Tribunal referred to the 1991 VAT Tribunal decision in the *Clean Car Company* [1991] VATTR 234 where Judge Medd considered whether a taxpayer acting in a manner which he believes to be compliant with his obligation was sufficient to provide him with a reasonable excuse. Judge Medd considered that the test is an objective test in this sense. "*One must ask oneself - was what the taxpayer did a reasonable thing for a responsible trader conscious of and intending to comply with his obligations regarding tax, but having the experience and other attributes of the taxpayer and placed in the situation that the taxpayer found himself at the relevant time, a reasonable thing to do.*"

(3) *Perrin v HMRC* [2008] UKUT 0156 where the Upper Tribunal sets out a four step approach to determining whether there is a reasonable excuse. The first is to establish what facts are relied upon which includes the attributes of the taxpayer, second to ascertain whether the facts relied upon are proved, thirdly ascertain whether objectively viewed, the facts give rise to a reasonable excuse. The fourth deals with the reasonable excuse ceasing, which is not relevant to this case.

The Respondents consider that the Appellant did not challenge or appeal any of the notices issued in respect of 10/15, 04/16 or 10/16. Regulation 40 of the VAT regulations requires a person to pay "*such amount of VAT as is payable by him in respect of the period to which the return relates not later than the last day on which he is required to make a return to pay the VAT to the respondents.*" The lateness of a payment is a question of fact. The length of the delay is immaterial.

6. The Respondents consider that the Tribunal has no ability under section 70 VAT Act to reduce a penalty imposed by section 59A.

7. The Respondents consider the tribunal has no ability to reduce the penalty on the ground of proportionality because the decision of the Upper Tribunal in the case of *Trinity Mirror* [2015]UKUT 421 (TCC) is binding on the FTT and precludes the ability of the FTT to consider the issue of proportionality. In *Trinity Mirror* the Upper Tribunal found that:

- (a) The default surcharge regime, viewed as a whole is a rational scheme.[65]
- (b) Using the amount of VAT unpaid as the objective factor by which the amount of surcharge varies is not a flaw in the system. On the contrary, it is appropriate as the achievement of the aim of fiscal neutrality, according to EU law, depends on the timely payment of VAT.[65]
- (c) The Upper Tribunal could not rule out the possibility that a default surcharge might be disproportionate but this is likely to occur only in a wholly exceptional case.[66]
- (d) The Upper Tribunal could not readily identify characteristics of such a case where a challenge on grounds of proportionality might succeed.[66]

(e) The Upper Tribunal accepted the default surcharge penalty regime was to penalise late payment and not to penalise for further delay.[68]

(f) The surcharge in *Trinity Mirror* of £70,906.44 could not be regarded as disproportionate under EU law or the European Convention on Human Rights.[71] and [72]

Therefore the Respondents consider the penalty for 10/17 was not disproportionate and complies with EU law and the convention on Human Rights.

8. The Respondents consider the Appellant has failed to take sufficient care in relation to compliance of its statutory obligations. The Appellant had received three prior notices and knew the consequences of future failure. The Appellant ought to have taken steps to protect the company from the consequences of future errors. The payment of £4,629.92 had been properly allocated to 04/16, the schedule of defaults remains unchanged and the default surcharge period that began at the end of 10/15 as a result of the default in that period had been extended in 04/16 to the end of 10.17, in consequence the number of defaults means that the prescribed percentage is 10% and must be applied to the amount of tax paid in 10/17. In consequence the 10/17 penalty must stand and the appeal should be dismissed.

The Appellant's Submissions

9. The Appellant submits that:

(a) There was no default for 10/15 ("*the default issue*") or alternatively that there was a reasonable excuse in respect of the 10/15 period such that the surcharge payable in respect of the default in 10/17 should be reduced by half to 5% level ("*the 2015 reasonable excuse issue*").

(b) There was a reasonable excuse for any default in respect of 10/16 period such that the default surcharge period had ended before 10/17 and no surcharge should have been charged at all in respect of 10/17 ("*the default surcharge period issue*").

(c) The surcharge is disproportionate and should be discharged ("*the proportionality issue*").

The appeal should be allowed.

The Default issue

10. The Appellant pointed to the wording of Para 40 of the VAT Regulations (SI 1995/2518) ("**the Regulations**") and sections 59 VAT Act. The Appellants consider that the two provisions should be read in a manner which is consistent and that the imposition of a surcharge should only be permitted where there is an amount of VAT due and owing to HMRC and not where the amount in a return is overstated, as is the case for 10/15, by reason of a failure of the taxpayer to claim a relief. In support of this the Appellant pointed to:

(a) The regulations which impose an obligation on a person to "*file a return and to pay to the Controller such amount of VAT as is payable by him in respect of the period to which the return relates not later than the last day on which he is required to make that return.*" [Bold emphasis added.]

(b) Section 59, which imposes the default surcharge where a person is required to file returns for a prescribed period and "*the Commissioners have received the return but have not received the amount of VAT shown on the return as payable by him in respect of the period*". Emphasis added.

(c) Section 59(4) which deals with the calculation of default surcharge and speaks of there being outstanding Value Added Tax in the period. If there is no liability to pay

Value Added Tax there can be no surcharge. In other words the amount shown in the return is not presumed to be the amount owed by the taxpayer.

(d) Section 59(6) supports this where in 59(6)(d) it states:

*"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 amounts of **any outstanding VAT** less the amount of unpaid payments on account;"* Bold emphasis added.

(e) The legislation is informed by the principle of fiscal neutrality and proportionality. Persons registered for VAT administer the VAT system and pass on to HMRC VAT paid by ultimate consumers of services. Fiscal neutrality also requires the VAT due to be paid on time. The surcharge regime is there to secure those objectives. A failure to pay VAT that is due is a default that ought to be the subject of consideration of the imposition of a penalty but failure to pay a sum that is not due is not a failure at which the legislation can legitimately be aimed. If, for example, a taxpayer completed a return and mistakenly placed the decimal point in the wrong place causing the liability shown on the return to be 100 times higher than the actual value of the VAT due applying the legislation blindly without regard to what is due would produce disproportionate results. Such an error might be taken to be covered by the reasonable excuse defence as is the case for 10/15 but not where the payment is also late for which there is no reasonable excuse.

11. In conclusion, for 10/15 there was no default at which the legislation is aimed. As there is no default for 10/15 the maximum number of defaults that can be taken into account in determining the size of the surcharge is reduced and the maximum surcharge for 10/17 would be 5%.

The 2015 reasonable excuse issue

12. Alternatively the taxpayer had a reasonable excuse for not paying the £399.92 because the £399.92 does not represent VAT due and payable. The legislation only requires sums to be paid that represent VAT due. That is objectively reasonable.

The default surcharge period issue

13. The Appellant contends that the default surcharge period in 10/16 arose out of the same issue as was alleged to have been a default in 10/15. If the alleged default in period 10/15 is not a default because there was no default as a matter of law or there was a reasonable excuse:

(a) The default surcharge notice ought not to have been issued and the default surcharge period could not have begun in period 10/15.

(b) There would be no penalty imposed in period 04/16.

(c) There would have been no underpayment in period 10/16 because the £399.92 and the penalty imposed in period 04/16 for its late payment was not due and therefore there could have been no underpayment in period 10/16. The default surcharge period could not have been extended by 12 months to end of period 10/17.

14. Alternatively, the above facts and circumstances amount to a reasonable excuse. The Appellant honestly and genuinely intended to pay the correct amount of VAT and believed that the correct amount of VAT had been paid in 2016. The belief was honestly and genuinely held and was objectively reasonable because the correct amount of VAT had in fact been paid. In consequence the two limbs of the test for reasonable excuse as set out by the Upper Tribunal at [70] in *Perrin* are satisfied in this case.

The proportionality issue

15. The Appellant contends that the penalty for 10/17 was disproportionate, not because it is based on the fact that the final instalment for 10/17 was only 12 hours late but because the penalty arises from an alleged underpayment of £399.92 which was not in fact due at all. There are three reasons why the £269,239 penalty is disproportionate:

(a) But for the underpayment compared to the return in 10/15 there would have been no default in 10/15, no penalty could have been imposed in 04/16, instead a surcharge liability notice would have been issued in 04/16, and the absence of a default in 10/16 would have caused the surcharge period to have ended in 04/17.

(b) Given the unusual nexus between the £399.92 and the subsequent defaults leading to a 10% penalty it is relevant to compare the penalty imposed of £269,239 with the £399.92 which on any view is disproportionate.

(c) Had HMRC not treated a default period as having begun in 10/15 there would have been no penalty due in 10/17.

Taken together the case is plainly exceptional and in light of *Trinity Mirror* these factors are not dependent on mere shortness of time. These factors should be sufficient to allow the Tribunal to reduce or discharge the penalty and allow the appeal in whole or part.

Discussion

16. The startling feature of this case is that the default surcharge regime has been applied and surcharges have been imposed at a specified percentage calculated by reference to events in periods for which the correct amount of VAT has been paid by the Appellant, i.e. for periods in which there was no loss of revenue to HMRC. The default in this case arose out of the fact that the Appellant failed to reflect in the return for period 10/15 that it was entitled to input tax relief for £399.92.

The default and reasonable excuse issues- 10/15

17. The Respondents consider that there has been a default because in accordance with the plain words of section 59(1) "*the Commissioners have received the return but **have not received the amount of VAT shown on the return as payable by him in respect of the period.***"

The mismatch in VAT paid and the sum shown in the return is a default and the provisions of the default surcharge regime can and should be applied.

18. The Respondents say that there is no reasonable excuse for the default. The Appellant had received a default surcharge notice after the first alleged event in 10/15 and was aware of the consequences of such a failure and objectively failed to take reasonable care to protect the Appellant.

19. The Appellant says that as the correct amount of VAT had been paid for the period 10/15 and so there was no default. Alternatively the Appellant honestly believed the £399.92 not to be due, the belief was honestly held as there was £399.92 input tax unclaimed for the period, HMRC agree the £399.92 was not due, and in consequence it was objectively reasonable for the Appellant not to have paid the sum shown on the return which was £399.92 greater than the amount of VAT due.

The default issue- 10/15

20. The parties agreed the £399.92 was not payable in 10/15 because of the existence of input tax relief that had not been deducted from the sum shown in the return.

21. It is clear that there is for the purposes of section 59A a default by a taxable person for a prescribed accounting period only if either there has been no return or "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" as required by section 59(1) VAT Act.

22. Section 59(1) provides that:

"If, by the last day on which a taxable person is required by regulations under [the VAT Act] to furnish a return for a prescribed accounting period,

(a) HMRC have not received that return; or

(b) HMRC have received that return but have not received the amount of VAT payable shown in the return as payable by [the taxpayer] in respect of that period

then the taxpayer is to be regarded for the purposes of section 59 as being in default in respect of that period".

23. It is common ground that a return was received by HMRC for 10/15 so no point arises on section 59(1)(a). What HMRC challenge is the compliance of the payment made with section 59(1)(b). The Tribunal starts from the elementary proposition that tax in the UK can only be imposed by law. Likewise, penalties and surcharges with respect to tax can only be imposed by law. The law in each case is made by Parliament, not by a taxpayer either deliberately or inadvertently, and not by HMRC, including by HMRC deciding in its discretion to impose a surcharge. Section 96(1) VAT Act underlines the primacy of legislation by defining "VAT" as:

"value added tax charged in accordance with [the VAT Act]"

So section 59(1)(b) means, taking account of section 96 and on a literal construction:

"...HMRC have not received the amount of VAT charged in accordance with [VAT Act] shown in the return as payable by the taxpayer in respect of that period"

In this case, the amount of value added tax charged in accordance with the VAT Act is different from, and lower by £399.22 than, the amount shown in the return as payable by the taxpayer. This is a contingency for which the legislation does not provide and falls to be resolved by construction, in other words by ascertaining the intention of Parliament. There are only two possible constructions of section 59 and 96 in such a case:

(a) The amount shown in the return (whether it is so shown as the result of a mistake or oversight or for some other reason) is the operative amount, in which case the Appellant must be regarded as being in default for 10/15 under section 59(1)(b); or

(b) The amount of VAT charged in accordance with the VATA 1994 is the operative amount.

24. Possible construction (1), which is espoused by the Respondents in this case, seems capable of leading, as this case illustrates, to very substantial penalty liabilities for failure by a trader to pay a particular amount in excess of that determined by Parliament in the VAT Act to be payable, just because that amount happens to be shown in his return. While no doubt tax administration could be simplified by basing penalties and surcharges on amounts calculated by the taxpayer and shown in his return, as if the return was conclusive, instead of the amounts prescribed by Parliament, the effect of such an approach would be that where taxpayers make honest errors in favour of HMRC in their return, HMRC may impose a surcharge. In the Tribunal's view, it would be inconsistent (given that tax and penalties are *imposed by law* as made by Parliament) to conclude that Parliament intended HMRC to benefit from mistakes made by taxpayers in HMRC's favour. This approach is consistent with the objective of

administering the VAT system to achieve fiscal neutrality. We conclude that there was no default in this case.

25. The Tribunal notes in passing that where the amount shown as payable in the return is lower than that lawfully payable, the amount shown in the return is not conclusive, as HMRC has an ability to assess the taxpayer to recover the amount lawfully payable. The Tribunal therefore concludes that possible construction (2) is that intended by Parliament in this case.

26. HMRC may wish to recommend that Parliament amends section 59(1)(b) to clarify Parliament's intention in a case where the amount of value added tax charged in accordance with the VAT Act is different from, and lower than, the amount shown in the return as payable by the taxpayer: that is not a matter for the Tribunal.

The reasonable excuse issue -10/15

27. We consider that there was a reasonable excuse for the £399.92 not having been despatched for 10/15 because it was not VAT as defined by section 96(1) and was not payable as discussed above. It was reasonable for the Appellant not to have paid it. The Appellant reasonably and honestly believed the £399.92 was not due because of the availability of the input tax relief. HMRC accepted it was not due because of the input tax relief due. Objectively that belief was reasonably held by the Appellant.

28. The consequence of the reasonable excuse for the non-payment of the £399.92 in respect of 10/15 is under section 59(7)(b) that:

- (a) the Appellant should not be subject to a surcharge in respect of the non-payment
- (b) the Appellant should be treated as not in default in respect of the prescribed accounting period
- (c) any surcharge liability notice which depended on that default shall be deemed not to have been served.

The default surcharge period issue

The alleged default in 10/15 would have generated a default surcharge period which ended one year after the end of the period i.e. on 31 October 2016.

In respect of 04/16, there were two errors – a late payment of the first instalment due in the quarter of £211,132.00 and the non-payment of the £399.92.

The following consequences flow from there being a reasonable excuse for the non-payment of £399.92 in 10/15:

- (a) there is no default in period 10/15
- (b) no default surcharge period began in 10/15
- (c) the non-payment 04/16 of the £399.92 cannot be a default for the same reason that it was not a default in 10/15
- (d) there can be no penalty in respect of the late payment of the first instalment for 04/16 because that is the first default for the period
- (e) A default surcharge period of 12 months began at the end of 04/16 which expired at the end of 04/17
- (f) The deduction from the amount due for period 10/16 of the £399.92 and the associated penalty of £4,629.92 cannot have resulted in an underpayment because they were never due. As there is no default, a surcharge period cannot begin at the end of 10/16.

(g) The failure in 10/17 to pay the final balancing payment by the due date is a default for which a surcharge notice must be issued and a surcharge period begins on 10/17 and ends on 10/18 but no surcharge is due owing to the event being the first default in the surcharge period. The surcharge penalty for 10/17 should be zero.

Proportionality

29. As the appeal is capable of being determined on the grounds there was no default or because of there was a reasonable excuse we do not need to consider the issue of proportionality. We would comment only that the Respondent's position in relation to proportionality that this Tribunal has no jurisdiction to consider the issue because of the decision of the Upper Tribunal in *Trinity Mirror* is incorrect. The Upper Tribunal could not identify a circumstance when a surcharge may be disproportionate but acknowledged it was possible albeit that the Upper Tribunal considered that the circumstances would be exceptional. A combination of events such as those before us might well have been exceptional circumstances but for the reasonable excuse defence.

Decision

30. We allow the appeal in full and the surcharge penalty for 10/17 is therefore reduced to zero.

Right to apply for permission to appeal

31. 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.

**JUDGE GETHING
TRIBUNAL JUDGE**

RELEASE DATE: 10 FEBRUARY 2020