[2018] UKFTT 0285 (TC)

TC06515

Appeal number: TC/2017/01025

VAT –default surcharge – whether the appellant had a reasonable excuse – whether the surcharge was disproportionate - appeal allowed in part

FIRST-TIER TRIBUNAL
TAX CHAMBER

GODOLPHIN MANAGEMENT COMPANY LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE HARRIET MORGAN
MEMBER MRS JO NEILL

Sitting in public at Taylor House, 88 Rosebery Avenue, London on 6 October 2017

Mr Edward Brown, Counsel for the Appellant

Ms Adusei, an officer of the Respondents, for the Respondents ("HMRC")

DECISION

1. The appellant appealed against default surcharges of a total of £225,477.27 imposed by HMRC under assessments issued pursuant to s 59 of the Value Added Tax Act 1994 ("**VATA**"), comprising £8,041.48 in respect of the 08/16 accounting period and £217,435.79 in respect of the 09/16 accounting period. The appeal was made under s 83(1)(n) VATA.

2. The appellant operates a business of the breeding and racing of thoroughbred racehorses acting in association with Zampino Limited, which is the ultimate owner of the racehorses (through various trusts). The appellant has been registered for VAT since 1994 and submits VAT returns on a monthly basis.

Law

3. It is not disputed that the appellant was required to submit VAT returns by electronic filing and pay any VAT due by the date falling 7 days after the end of the month following the relevant VAT accounting period (the "**due date**").

4. In outline, the default surcharge regime operates to impose a surcharge where a taxable person is late in paying VAT by the due date as follows:

> (1) If a taxable person is in default for any accounting period (a "**default period**"), HMRC can serve a surcharge liability notice on that person stating that the period from the date of the notice until the anniversary of the last day of the default accounting period is a "surcharge period" (sub-s 59(2) VATA).
>
> (2) A person is in default for this purpose if, by the last day on which the person is required to furnish a return for the period (a) HMRC has not received that return or (b) HMRC has received that return but has not received the amount of VAT shown on the return as payable in respect of that period (sub-s 59(1) VATA).
>
> (3) The effect of the service of a surcharge liability notice is that the taxable person is potentially liable to a surcharge for each further default period falling within the surcharge period for which VAT due is not paid in full by the due date for the return. The rate of surcharge is the greater of a specified percentage of the outstanding VAT and £30 (sub-s 59(4) VATA).
>
> (4) The specified percentage of surcharge increases according to how many defaults there are in the surcharge period. The rate is 2% for the first default period, 5% for the second, 10% for the third and a maximum of 15% for all further periods (sub-s 59(5) VATA).
>
> (5) The surcharge default regime operates on an on-going rolling basis if the taxable person continues to be in default. HMRC can serve a surcharge liability notice in respect of each and every default period. Where a notice is served for a default period which falls within an existing surcharge period, the new surcharge period is treated as a continuation of

the existing one (sub-s 59(3) VATA). In other words the surcharge period is extended to the new end date specified in the later notice.

5. Under sub-s 59(7) VATA, if a person who would otherwise be liable to a surcharge satisfies a tribunal that,

> "in the case of a default which is material to the surcharge, -
>
> (a) the return, or as the case may be, the VAT shown on the return was despatched at such time and in such a manner that it was reasonable to expect that it would be received by the Commissioners within the appropriate time limit, or;
>
> (b) there is a reasonable excuse for the return or VAT not having been so despatched,
>
> he shall not be liable to the surcharge and for the purposes of the preceding provision 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)."

6. Sub-section 71(1)(a) VATA provides that:

> "(1) For the purposes of any provision of sections 59 to 70 which refers to a reasonable excuse for any conduct –
>
> (a) An insufficiency of funds to pay any VAT due is not a reasonable excuse;"

7. Section 108 Finance Act 2009 provides that a default surcharge may be suspended if a person comes to an agreement with HMRC to defer payment. Such an agreement must be reached prior to the due date for this relief to apply.

Evidence and facts

8. We have found the facts set out below on the basis of the documents produced to the tribunal and the witness evidence of Ms Simon, who acted as the appellant's accountant and Ms Linda Davis who acted as the appellant's assistant accountant. Both witnesses were employed by Zampino Limited, Ms Simon since 28 July 2014 and Ms Davis since April 2007, but both also performed accounting functions for the appellant.

9. Ms Davis attended the hearing and gave oral evidence. Ms Simon was unable to attend the hearing. By letter on 15 September 2017, the tribunal recorded that HMRC accepted Ms Simon's evidence and that it would be taken as read (and therefore there would be no challenge by way of cross-examination).

10. As Ms Simon and Ms Davis confirmed, historically (since around 1994) the appellant's VAT returns were always nil returns. This was on the basis that its accountable output tax was always offset by its input tax as its purchases/sales from/onto third parties were always (deliberately) exactly matched by sales/purchases from/onto the Zampino trusts.

11. However, in April 2016, following an inspection, HMRC decided that this approach was incorrect. In their view any intra-community acquisitions the appellant made on behalf of Zampino Limited should be recorded in the appellant's VAT return and it should account for output VAT on the onward supply of goods to Zampino Limited. The result of this is that the appellant has an additional VAT liability on all intra-community acquisitions which it cannot offset, leaving it with a net VAT liability each month in the amount of the VAT on those acquisitions. Ms Davis said that she was advised of the effect of this change in July 2016 and that, following negotiation with HMRC, it was decided that the new treatment would start as regards the return due in respect of the 06/16 period. Ms Simon said in her witness statement that she attended the meeting with HMRC on 6 July 2016 at which this was agreed

12. The appellant was within the default surcharge regime from the 06/16 accounting period. In outline the chronology of events from that period onwards is as follows:

(1) The due date for electronic submission of the VAT return and payment of VAT due for the 06/16 period was 7 August 2016. The return was submitted on 8 August and the VAT due was paid on 15 August 2016.

(2) On 7 September 2016 Ms Davis attempted to set up a direct debit for the payment of VAT, as further set out below.

(3) The due date for the electronic submission of the VAT return and payment of VAT due for the 08/16 period was 7 October 2016. The return for that period was submitted on that date. The payment for that period was received by HMRC on 18 October 2016.

(4) On 14 October 2016 a notice of default surcharge was issued by HMRC for the 08/16 period for £8,041.48 (calculated at 2% of the VAT due). This was received by the appellant on 17 October 2016 and Ms Simon contacted HMRC by telephone on that date.

(5) On 21 October 2016 there was a telephone call between Ms Davis and HMRC.

(6) On 1 November 2016 the appellant requested a review of the default surcharge for the period 08/16.

(7) The due date for the electronic submission of the VAT return and payment of the VAT due for the 09/16 period was 7 November 2016. The return for that period was submitted on that date. Again payment was made late on 8 November 2016.

(8) On 11 November 2016 HMRC issued a default surcharge notice for the period 09/16 for £217,435.79.

(9) On 2 December 2016 the appellant requested as review of the decision to issue the default notices for the 06/16 and 09/16 periods.

(10) On 23 December 2016, on review, HMRC upheld their decisions to issue all three of the default surcharge notices.

13. The late payment for 06/16 was not the subject of this appeal and it was accepted that it was late.

14. Ms Simon said in her witness statement that, due to the late payment for the 06/16 period, she decided that the appellant should set up a direct debit instruction through the HMRC website so that VAT due was automatically taken at the relevant time. She assigned this task to Ms Davis. The decision was taken specifically to ensure that payment was made by the due date.

15. On 7 September 2016, Ms Davis completed and submitted a "direct debit instruction" ("**DDI**") on the HMRC website. Just before submitting the DDI, Ms Davis printed off a copy of the completed form because the form advises this should be done. Ms Davis noted that after the "Next" button was pressed the form disappeared from the screen. Ms Davis said that she had completed other direct debit instructions on other supplier portals which she had found very straightforward and she had never had a problem. She said that if a mistake or omission is made on the form the online software usually prevents the submission of the form. Typically the website highlights any offending part of the form. In this case she thought the DDI was successfully submitted and that the direct debit was successfully set up. She did not receive any notification that the application was unsuccessful. When the VAT return was submitted on 7 October 2016 she was confident that the relevant sum of VAT due would be taken automatically in line with the DDI.

16. Ms Simon said in her witness statement that on 7 September 2016 Ms Davis indicated to her that she had completed and submitted the DDI on the HMRC website. Ms Davis showed her a printed copy of the completed form and as far as Ms Simon was concerned the direct debit was set up. She also was confident that the sum due for 08/16 would be taken automatically at the relevant time.

17. Ms Davis said she had no reason to hunt for evidence that the direct debit had been successfully created. She considered that if the DDI was submitted with no error message, then "I have done all I can do and should be entitled to rely on the integrity of the system I have used". She believed that the sole reason for the late payment of the VAT for the 08/16 period was the failure of HMRC's systems and their failure to notify the appellant of any problems.

18. As noted, the appellant submitted its return for the 08/16 period on the due date but the corresponding VAT payment was not successfully collected.

19. Ms Davis and Ms Simon said that they only knew there was a problem on 17 October 2016 when the default surcharge notice was received. Ms Simon said in her witness statement that, when she became aware of this, she immediately discussed this with Ms Davis who was very surprised, as Ms Davis confirmed was the case. Ms Simon said that she then called HMRC on that day (on 0300 2003853) and advised them that the appellant considered that the DDI has been lodged successfully. She said that she was advised on the call that HMRC had been experiencing some technical difficulties with the website. She then arranged for the outstanding VAT to be paid on 18 October 2016. She noted that the appellant did not receive any notification of any technical problems prior to 17 October. She also considered that the sole reason for the late payment was the failure of HMRC's systems and their failure to notify the appellant of any problems.

20. At the hearing HMRC produced a copy of their internal notes which appeared to record in note form (not as a transcript) a discussion between HMRC and Ms Simon on 17 October 2016. The notes state that payment was late due to "direct debit incorrectly set up…says DD was set up on this ref in September to pay the [returns]. Says has confirmation email from HMRC….She will appeal DS as thought DD in place and also call online helpdesk to confirm what has gone wrong with setting [DD] up." The notes also record there was a further call with Ms Simon on 19 October 2016 in which it was again recorded that payment was late due to a direct debt being "incorrectly set up". The note states that on that call HMRC asked about the updating of the address and Ms Simon said "she is doing this today as needs to find out why direct debit wasn't taken."

21. HMRC provided a transcript of the later telephone call from Ms Davis to HMRC on 21 October 2017. This records that an officer of HMRC advised that the appellant should provide the DDI confirmation print out in support of any appeal against a surcharge. As regards how a taxpayer can check if a DDI is set up, the officer said that when a VAT return is submitted, if there is no DDI in place, "it prompts you to set one up anyway but we always do recommend that you do set it up a good few days in advance of the return deadlines...". The adviser said that the appellant would need to set up the DDI again and that when the return was submitted if there was no prompt to set up a DDI then that meant that the instruction was in place. The HMRC officer explained that the direct debit was not recorded as having been set up: "It could be that it's just not accepted it, or it could mean that something's gone wrong and it's not been processed fully. The list could be endless but I can't see anything up."

22. HMRC also produced at the hearing copies of pages from their website showing the initial page relating to setting up direct debits (but not the subsequent pages a taxpayer would see when going through the process) and the website page which appears when a VAT return has been successfully submitted online. This gives instruction as to how and when payment of VAT due must be paid.

23. The VAT relating to the 09/16 period was paid a day late. The appellant received a default surcharge notice demanding payment of £217,435.79 (calculated at 5% of the VAT payable). The reason for this high surcharge was because of an exceptional monthly return.

Submissions

24. The appellant argued that:

(1) The default surcharge imposed in respect of the 08/16 accounting period is not due on the basis that under s 59(7) VATA:

(a) the payment was submitted at such a time and in such a manner that it was reasonable to expect that it would be received by HMRC within the appropriate time limit (under s 59(7)(a); or

(b) the appellant had a reasonable excuse for not submitting the payment (under s 59(7)(b)).

(2) The default surcharge imposed in respect of the 09/16 period is disproportionate. Further and alternatively, if the tribunal accepts the

appellant's arguments on the surcharge for the 08/16 period, the default surcharge for the 09/16 period should be calculated at 2% of the unpaid VAT and not at 5%.

25. The appellant considered that the DDI was successfully submitted but an error of some kind then occurred which prevented it becoming operational. It was therefore reasonable for the appellant to expect that the payment was made in such a manner that HMRC would receive it on time. Ms Davis' evidence is that she completed the task necessary to set up the DDI (as evidenced by the print out) and she then submitted the DDI without being notified of any error by clicking on the relevant button. This is sufficient to "*despatch*" the VAT. The relevant guidance on direct debit payments published by HMRC makes it clear that a taxpayer need only set up the DDI. There is no suggestion here that the DDI would not have been honoured, for example, by reason of insufficient funds.

26. The appellant continued that alternatively, if the DDI subsequently failed because of a computer glitch, the appellant had a reasonable excuse as it had taken the necessary and published steps to set up the DDI. Absent any communication otherwise from HMRC, it was reasonable for the appellant to expect that the despatch had been made at such a time that it would be received by HMRC by the due date.

27. The appellant noted that prior to the hearing HMRC accepted Ms Simon's evidence that, during her phone call with HMRC on 17 October 2017, she was informed that HMRC had been experiencing technical issues with its website. The technical issues were relied upon by HMRC in response to a direct enquiry by Ms Simon regarding the DDI and, presumably, were therefore identified as the likely cause of the non-payment. The appellant noted that HMRC raised at the hearing that the notes they produced did not record any mention of the technical glitch. However, as noted, HMRC had already accepted Ms Simon's evidence. In the appellant's view, is not appropriate to admit a challenge to this evidence at this stage. In any event the notes produced are just that. They are not a transcript of the conversation. The appellant submitted that Ms Simon's evidence should be accepted, in particular, as HMRC had clearly stated before the hearing that the evidence was undisputed.

28. The appellant continued that the question to be asked when determining whether there is a reasonable excuse is stated to be as follows in *Coales v Revenue and Customs Commissioners* [2012] UKFTT 477 (TC) (as approved in *Perrin v Revenue and Customers Commissioners* [2014] UKFTT 488 (TC)):

> "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 relevant attributes of the taxpayer and placed in the situation that the taxpayer found himself at the relevant time, a reasonable thing [sic] to do?"

29. In the appellant's view a computer error outside the appellant's control clearly satisfies this test: *Littlewood Hire Limited v The Commissioners for Her Majesty's Revenue & Customs* [2013] UKFTT 586 (TC) at [47]. By analogy a firm recollection of posting was held sufficient to satisfy the test in *Grenville Furniture Ltd v C & E Comrs* (1988) VAT Decision 3013. In *Kwik Move UK Limited v The Commissioners for Her Majesty's Revenue & Customs* [2008] Lexis Citation 818, the taxpayer had

again paid late where HMRC's computer server and helpline both failed to facilitate an electronic filing on the due date. Had HMRC's systems been working it would have accepted the return on time and thus the direct debt machinery would have meant the payment would have been on time. The tribunal in *Kwik Move* said at [13]:

> "Indeed there is something almost ridiculous in the proposition that the Appellant should suffer a penalty of nearly £1,000…all because of problems initially caused by a fault on the part of HMRC, rather than the Appellant at all."

30. The appellant noted that HMRC appear to contend that, even if the initial error was no fault of the appellant, the appellant should have taken steps to ensure that the direct debit was set up. The appellant took the steps required by HMRC's own computer system. The VAT Guide makes it clear that, once the relevant steps are taken, the responsibility for collection shifts to HMRC and the interbank payment system. That provides convenience and certainty in itself and removes the need to "double-check" as now is being asserted. There is nothing in the VAT Guide which supports HMRC's assertion that a taxpayer needs to carry out a double-check.

31. The appellant said that a similar assertion was dismissed by the tribunal in *HR Transport Services Ltd v HMRC* (2014) TC03230, [2014] UKFTT 090 (TC):

> "In respect of the further 14 day period which it took for the Appellant to recognise that the payment had not been processed on the due date, we have concluded that since there was nothing to suggest to the Appellant that the payment had not been processed in the normal way and on time, the Appellant had a genuine belief that the payment had been made and therefore we do not agree with HMRC that the Appellant did not act in a reasonable and prudent manner in failing to check that the payment had been made earlier."

32. The appellant noted that, as set out in Ms Davis' evidence, typically websites highlight errors where there has been an error in submitting a DDI. Ms Davis did not receive any error message and did not receive the "*prompt screen"* which HMRC state appears where the DDI has not been set up. As such, she was entitled to assume it had been successfully set up and it was reasonable for the appellant to proceed on the basis it had been.

33. The appellant continued that if the tribunal accepts that the appellant has shown that they are not liable to the surcharge in respect of the 08/16 period, s 57(7) VATA further provides that the appellant shall not be treated as having been in default. Therefore the default surcharge for the 09/16 period should be calculated at 2%.

34. Further and alternatively, it is the appellant's position that the default surcharge for the 09/16 period is disproportionate (whether calculated at 2% or 5%) and should be reduced. The appellant referred to the Upper Tribunal decision in *Trinity Mirror plc v HMRC* [2015] UKUT 0421 (TCC) where it was ruled that in exceptional cases the tribunal does have the power to reduce a default surcharge on the grounds that it is disproportionate.

35. The appellant noted that this power originates in EU law. In *Paraskevas Louloudakis v Elliniko Dimosio (Case C-262/99)* [2001] ECR I-5547 it was held:

> "that penalties must not go beyond what is strictly necessary for the objectives pursued, and 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."

36. The appellant noted that in *Trinity Mirror,* the underlying aim of the directive was described as fiscal neutrality "in in its sense of ensuring a neutral tax burden which protects the taxable person." Although the decision in *Trinity Mirror* went against the taxpayer, it was held that:

> "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."

37. The appellant said that it was not attacking the default surcharge scheme in general but was instead seeking to establish that the consequence of the scheme in these particular circumstances is disproportionate. *Trinity Mirror* leaves it open to the tribunal to find this in appropriate cases.

38. The appellant also referred to *Enersys v Holdings UK Ltd v Revenue and Customs Commissioners* [2010] UKFTT 20 (TC) as a case where the default surcharge was found to be disproportionate. The appellant relied on the following passage:

> "The last of those factors—the inexact correlation of turnover and penalty—has, as it happens, worked to EHUK's disadvantage, and it demonstrates what may be considered another flaw in the scheme. It will be observed from the details I have set out above that the other penalties imposed on EHUK, even allowing for the differing percentage rates, were far smaller. Its sales in the 12/07 period were unusually high, leaving it with a large net liability. Had the error occurred in another period the penalty, for exactly the same mistake, would have been much less."

39. The appellant argued that its VAT liability bears no resemblance to its profits. The reason its VAT liability was so high for the 09/16 period was because a large amount of Zampino Limited's racehorses were moved between EU jurisdictions in that period. The VAT liability for the 09/16 period was approximately ten times that for the 08/16 period. By imposing a default surcharge for the 09/16 period, HMRC gained a sum out of all proportion to the default and in terms which are unfair and punitive.

40. HMRC said that, as regards the 08/16 period the requirements of s 57(9)(a) or (b) were not met. They asserted that, when a VAT return is submitted where no direct debit has been recorded, a prompt to set one up is displayed on HMRC's website. In addition the e-acknowledgment which is received on submission of a return shows how payment is to be effected. Where no direct debit is held it shows the date by which payment should be made. They referred to the fact that their records show that on 21 October 2016 the appellant was advised that no direct debit mandate was on file despite its claim to have one in place (see [21] above).

41. In HMRC's view the appellant has failed to substantiate that it set up a direct debit on 7 September 2016. It has not provided an acknowledgment statement that it had successfully set up a direct debit. HMRC considered that the absence of such an acknowledgement was possibly because the direct debit mandate had not been submitted correctly. They asserted that, in the absence of confirmatory evidence that the DDI was successfully submitted, the appellant has failed to substantiate that it had a reasonable expectation that the VAT payment was despatched at such time and in such manner that HMRC would have received payment by the due date as required by s 59(7)(a) VATA.

42. HMRC continued that if there was an error on the appellant's part which resulted in the online DDI not being submitted correctly then this would be seen as a genuine error or mistake which does not provide a reasonable excuse as set out in Notice 700/50 at section 6.3. HMRC state there that: "Genuine mistakes, honesty and acting in good faith are not reasonable excuses."

43. HMRC also relied on the case of *Garnmoss Limited t/a Parham Builders* where at [12] it was said that:

> "What is clear is that there was a muddle and a bona fide mistake made. We all make mistakes. This was not a blameworthy one. But the Act does not provide shelter for mistakes, only reasonable excuses. We cannot say that this confusion was a reasonable excuse. Thus this default cannot be ignored under the provisions of [s 59(7) VATA]."

44. As regards the proportionality argument in respect of the 09/16 period, HMRC noted that in *Trinity Mirror* the Upper Tribunal said, at [66], that a default surcharge might be disproportionate, given the structure of the regime, only in wholly exceptional cases and that it could not readily identify characteristics of a case where a challenge to a surcharge would be likely to succeed.

45. In HMRC's view the Upper Tribunal did not in that case endorse the suggestion that exceptional circumstances could include circumstances such as those in *Enersys* where there had been what was described as a spike in profits for a particular period even if the consequent VAT was of a different order of magnitude than was normal for the trader concerned (see [67]). They noted that the Upper Tribunal accepted 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 (at [68]) in line with the decision of the Upper Tribunal in *Total Technology* (see in particular [88]). The Upper Tribunal concluded that the surcharge of £70,906.44 in that case could not be regarded as disproportionate.

46. HMRC argued that this decision supports the position that the surcharge for 09/16 is not disproportionate. In their view the appellant has not raised any wholly exceptional circumstances. They noted that neither HMRC nor the tribunal has power to mitigate the surcharge.

Discussion

47. It is clear that the conditions for imposing the default surcharges were met. There was no dispute that the VAT due for the 08/16 and 09/16 periods was paid late and that the appellant received the surcharge liability notices issued by HMRC.

48. As set out in full above, the appellant argued that the default surcharge is not due for the 08/6 period on the basis that (a) the "the VAT shown on the return was despatched at such time and in such a manner that it was reasonable to expect that it would be received by the Commissioners within the appropriate time limit", or (b) there is a reasonable excuse for the return or VAT not having been so despatched (under s 59(7)(a) and (b)).

49. We consider that the requirements of s 59(7)(a) are satisfied. We accept the evidence of Ms Davis and Ms Simon that a DDI was filled in (as shown in the printout produced to the tribunal) and submitted to HMRC online on 7 September 2016, a month before the due date for payment of VAT due for the 08/16 period. We cannot see that the appellant had any reason to question that the direct debit had been successfully set up having filled in the form with the relevant details according to the instructions given, in particular, as there appeared to be no problem with the online submission. The appellant did not receive an e-receipt of any kind expressly stating that the DDI was successful. However, on the other hand no statement was received that there was any problem either. In the circumstances we do not consider that the lack of a receipt should have alerted the appellant to the fact that there was a problem.

50. HMRC suggested that the appellant should have been alerted to the fact that the online submission of the form was not successful as, when submitting the VAT return online, a prompt should have appeared. However, Ms Davis did not recall seeing any such message when the VAT return in question was submitted and HMRC did not produce any printout from their website pages showing any such message. The only page produced was one showing the due date for payment and methods of payment (see [22] above). We cannot see that would prompt a taxpayer into thinking that a DDI submitted online was not successful.

51. We note also that HMRC questioned whether Ms Simon was told by HMRC on the telephone call of 17 October 2017 that there was a technical glitch with HMRC's system as she set out in her witness statement. HMRC asserted this was not likely to have taken place from the fact that the notes they produced to the hearing, which relate to a call between Ms Simon and HMRC on that date, do not record any mention of such a technical glitch (see [20] above). We note that it was not helpful that HMRC produced this only at the hearing. They had previously stated that they accepted Ms Simon's witness statement such that it was not necessary for her to be cross-examined. In any event, our conclusion is not affected by whether Ms Simon was told of the glitch by HMRC on 17 October 2017 or not. It is clear that the DDI was submitted as set out above and that there was no reason on or before the due date for the appellant to be concerned that the submission was not successful.

52. Given our conclusion on the application of s 59(7)(a), we do not need to consider whether the appellant has a reasonable excuse under s 59(7)(b). However, for completeness we note that we consider that the appellant did have a reasonable excuse for the late payment essentially for the reasons set out by the appellant. There is no statutory definition of what constitutes a reasonable excuse. On the basis of the wording and the approach taken in other cases in this tribunal, we understand the term to require consideration of what can reasonably be expected of a prudent business person exercising reasonable foresight and due diligence as regards his VAT obligations in the light of all the circumstances of the taxpayer's particular case. For

example in the case of *The Clean Car Company Ltd v Custom and Excise Commissioners* [1991] VATTR 234 HH Judge Medd QC put the test as follows:

> "It has been said before in cases arising from default surcharges that the test of whether or not there is a reasonable excuse is an objective one. In my judgement it 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".

53. We can see no basis for HMRC's view that in all circumstances there can be no reasonable excuse as a result of genuine mistakes. The test is simply what is reasonable in all the circumstances. In this case it was reasonable for the appellant to suppose that the direct debit had been successfully set up so that payment would be made by the due date for the reasons set out above.

54. Accordingly no surcharge is due for the period 08/16. This has the further effect that there was no default in that period so that the surcharge for the period 09/16 is to be calculated at the rate of 2% of the late paid VAT rather than at the 5% rate. The appellant did not argue that the surcharge for that period was not validly imposed or that the appellant had a reasonable excuse for the late payment of VAT for that period. The appellant's only argument was that the surcharge was disproportionate. We have decided that it was not disproportionate for the reasons set out below.

55. The question of whether the default surcharge regime or a particular surcharge can be defeated on the basis it is disproportionate, both from the perspective of EU law and of the European Convention on Human Rights, has been considered in detail by the Upper Tribunal in the *Total Technology* and *Trinity Mirror* cases to which the parties referred.

56. In *Total Technology* the issue was whether a surcharge of £4,260.26 imposed at the rate of 5% as a result of the late payment of VAT of £85,205 was disproportionate. It was held at [99] that there was nothing in the VAT default surcharge regime which led to the conclusion that its architecture was fatally flawed in the sense of the entire scheme being unlawfully disproportionate. However, there were some aspects of the default surcharge regime which may lead to the conclusion that, on the facts of a particular case, a penalty is disproportionate. The tribunal cautioned that in making any such assessment the tribunal must be astute not to substitute its own view of what is fair for the penalty which Parliament has imposed.

57. At [100] the tribunal noted that:

> "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."

58. The tribunal went on to suggest at [93] that the fact that there was no maximum penalty was a "real flaw" and that "there must be some upper limit, although it is not

sensible for us in the present case to suggest what that might be". This was on the basis that it was plain that the penalty in that case could not be described as "devoid of reasonable foundation" or "not merely harsh but plainly unfair" so that it comfortably fell below the possible upper limit.

59. Having concluded that the regime as a whole was not fatally flawed, the tribunal turned to considering whether the particular surcharge was disproportionate. At [101] the tribunal rejected the taxpayer's submissions that the penalty was unfair on the basis that payment was only one day late, previous defaults were innocent, the taxpayer had an excellent compliance record prior to the first of the defaults leading to it being in the regime and the amount of the penalty represented an unreasonable proportion of the taxpayer's profits.

60. The tribunal noted that even if the penalty was more than would be imposed if it were a matter for the decision of a tribunal, the amount of the penalty did not approach the sort of level which had been held to be disproportionate in an earlier case which was described as "unimaginable". It was noted that the result for the taxpayer may be seen by some as harsh, but that the tribunal did not consider that it could be regarded as "plainly unfair".

61. In the *Trinity Mirror* case the Upper Tribunal upheld a default surcharge of £70,906.44 imposed at the rate of 2% for the failure by one day to file a VAT return and pay the VAT due for the relevant period of £3,545,324. The tribunal agreed with the tribunal in *Total Technology* that the default surcharge regime, viewed as a whole, is a rational scheme (at [65]). The tribunal noted, however, at [66], that:

> "applying the tests we have described, the absence of any financial limit on the level of a surcharge may result in an individual case in a penalty that might be considered disproportionate. In our judgement, 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 characteristic of a case where such a challenge is likely to succeed."

62. The Upper Tribunal continued at [67] to note that they should not be taken to have endorsed the suggestion put forward 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".

63. The Upper Tribunal concluded, at [68], that, although payment was only one day late, they accepted that the scheme of the regime is to impose a penalty for failing to

pay VAT on time and not penalise further for any subsequent delay in payment. They considered that to be entirely consistent with the fiscal neutrality aim of the directive. They noted, at [70], that 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.

64. Finally the tribunal concluded at [70] and [71] that:

> "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.
>
> 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 characteristics as devoid of all foundation. The penalty might be considered harsh, but in our view it cannot be regarded as plainly unfair."

65. Following the approach in these cases, we have concluded that the surcharge imposed on the appellant in the period 09/16 is not disproportionate. We note that the appellant had been in default for a substantial period of time. The on-going notices and surcharges would have alerted the appellant to the fact that on-going penalties would be charged albeit we have now accepted that there was no default in the period 08/16 thereby reducing the rate of surcharge to 2%. We note the comments in *Total Technology* that a "spike in profits" is not of itself sufficient to comprise circumstances where a penalty may be regarded as disproportionate.

66. We also note that the appellant argued that the penalty was disproportionate as looking at the position of the appellant and Zampino Limited overall there is no VAT due to HMRC. However, we cannot see that is a relevant factor. The VAT was due from the appellant. The two companies were not in a group for VAT purposes.

67. Overall whilst in such circumstances the surcharge may be harsh we do not consider it to be plainly unfair having regard to the aim of the default surcharge scheme.

68. We note that do not have power to mitigate the surcharge. The default surcharge regime does not include a power to mitigate the amount of the surcharge. In *Total Technology* the Upper Tribunal concluded that the absence of such a power to mitigate did not render the regime as a whole disproportionate but, if they were wrong on that, then such a power should only be regarded as included in exceptional circumstances. We do not consider that there are any exceptional circumstances in this case.

Conclusion

69. For all the reasons set out above we have decided that the appellant is not liable to the default surcharge imposed by HMRC for the period 08/16 but is liable to a

default surcharge for the period 09/16 calculated at the rate of 2% of the late paid VAT.

70. The appeal is therefore allowed as regards the 08/16 period and dismissed as regards the 09/16 period except that the surcharge for the period must be re-calculated at the rate of 2% as set out.

71. 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.

HARRIET MORGAN
TRIBUNAL JUDGE

RELEASE DATE: 30 MAY 2018