

## Chartergates Fact Sheet

### SUBJECT: VAT SURCHARGE

#### *Introduction:*

We have recently seen a number of VAT Surcharge liability notices issued to clients for the late payment of VAT or the late submission of a VAT return.

In this fact sheet we look over the basic process of mounting an appeal against a VAT Surcharge.

#### *The Regime*

The surcharge liability regime is contained within the VAT Act 1994.

The regime seeks to penalise, in the main, those traders that consistently pay their VAT liability late or submit VAT returns late.

The first default (missed deadline) does not attract a surcharge but commences a surcharge period which lasts 12 months from the end of the period of the default.

If further defaults occur in the next 12-month period, the subsequent default(s) will attract a penalty and also extend the surcharge period by another 12 months from the end of the period of subsequent defaults.

The level of surcharge levied will depend on the number of defaults within the surcharge period, i.e.:

- ✓ The first default within the surcharge period will attract a penalty of 2% of the amount of VAT paid later (or outstanding).
- ✓ The second default within the extended surcharge period will attract a penalty of 5% amount of the amount of VAT paid late (or outstanding).
- ✓ The third default within the extended surcharge period will attract a penalty of 10% of the amount of VAT paid late (or outstanding).
- ✓ The fourth (and any subsequent defaults) default within the extended surcharge period will attract a penalty of 15% of the amount of VAT paid late (or outstanding).

If a default occurs, as the notices are computer generated, HMRC will send out a surcharge liability notice following the end of the quarter in which the default occurred.

Once issued there is no scope in the legislation to vacate the notice unless the taxpayer can satisfy HMRC (or a Tribunal) that he has a reasonable excuse (or the level of surcharge is below an amount which HMRC will not seek to collect- in this instance the default will still be counted and any subsequent defaults will incur an increased percentage surcharge in line with the list above).

The legislation does provide for a right of appeal- if an appeal is made and rejected by HMRC the taxpayer does not then have a right to request a statutory review (as is the case for direct taxes). Instead the case will need to be listed with the tribunal service to be heard independently.

## Grounds of Appeal

The legislation provides for a surcharge not to apply where the taxpayer can demonstrate:

### 1. Reasonable excuse

The case law for reasonable excuse within the VAT jurisdiction is different to that for direct tax purposes. The most notable case is Customs and Excise Commissioners v J.B. Steptoe [1992] STC757 the judgement helped define the principle of reasonable excuse:

*'If the exercise of reasonable foresight and of due diligence and a proper regard for the fact that the tax would become due on a particular date would not have avoided... the default, then the taxpayer may well have a reasonable excuse for non-payment...'*

Therefore, provided the taxpayer can demonstrate he was diligent in handling his affairs he may well have a reasonable excuse.

The legislation also restricts HMRC from allowing an appeal if the default occurred due to:

- ✓ The insufficiency of funds to pay any VAT
- ✓ Reliance placed on a third party to perform a task

One thing to note: case law has established, whilst cash flow itself is not a reasonable excuse, the underlying reason that led to the problem may well be sufficient to establish an excuse that is reasonable.

For this purpose, you would need to review the history of the adverse cash flow and identify the cause.

### 2. The return and/or the VAT was despatched at such a time in such a manner that it was reasonable to expect that it would be received by HMRC by the deadline

Any appeal based on this expectation will be extremely fact sensitive and is likely to include scenarios where a payment was despatched, but the payment was affected by a technical problem, e.g. the bank not exercising the transfer as instructed by the taxpayer.

The taxpayer when mounting such an appeal will need evidence to prove the errors or issues faced, such as a rejection notice from the bank or a print out of the request for payment to be made.

### 3. Proportionality

The legislation does not provide for this last ground of appeal. However, as HMRC do not have the power to mitigate a surcharge liability notice once it has been issued there may be an occasion where the legislation produces a substantial surcharge liability thereby leaving the taxpayer with no choice but to request sanctuary under the European Convention on Human Rights. The absence of the power of mitigation has led to a number of cases in the tribunal based purely on the significance of the penalty and the interaction with the Convention.

The concept of proportionality, as mentioned above, is enshrined in EU law rather than domestic law and is contained within the Convention, in particular Article 1 of Protocol 1, of the convention which allows a person freedom to enjoy their personal property.

The law surrounding proportionality is complex but is summarised in two well documented cases being Energys Holdings Ltd v HMRC [2010] UKFTT 20 (TC) and HMRC v Total Technology (Engineering) Ltd [2012] UKUT 418 (TCC).

In order to establish that a penalty is disproportionate the taxpayer must demonstrate the penalty issued is plainly unfair and goes well beyond what the penalty regime seeks to achieve.

The taxpayer should consider the following aspects when mounting an appeal (this is not an exhaustive list):

- ✓ The hardship the surcharge would inflict on the trader
- ✓ The actual delay in payment
- ✓ The previous compliance record
- ✓ The fact that there is no maximum penalty

#### 4. Previous Defaults

A trader can only suffer a surcharge liability notice where HMRC have sent out a notification to the trader stating that the trader is now in a surcharge period. If such a notice has not been sent out a surcharge cannot apply.

There may be other aspects of any previous defaults that can help with the current appeal. Again, this will be based on the facts of each case, but if an early default can be challenged under the above grounds (even if it was not actually appealed at the time) this may have a knock-on effect and reduce or eradicate the later surcharge.

#### *In Summary*

Where a surcharge liability notice is received any appeal to HMRC should cover all grounds you wish HMRC to consider as you have only one opportunity to present your case to HMRC.

Before submitting an appeal, you should check whether a previous notification has been received to notify you of the surcharge period.

The general grounds of appeal have been listed above however the facts of each case will affect the technicality and content of any such appeal. Please contact us to discuss additional aspects of filing an appeal.

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