DEFAULT SURCHARGE - Proportionality - Four BACS payments varying from 4 to 12 days late - Surcharges equivalent to annualised interest of up to 912% - No power to mitigate - Whether surcharges disproportionate under EU law - VATA s.59

LONDON TRIBUNAL CENTRE

GREENGATE FURNITURE LTD - Appellant
- and -
THE COMMISSIONERS OF CUSTOMS AND EXCISE - Respondents

Tribunal: THEODORE WALLACE (Chairman)
MRS CAROLINE de ALBUQUERQUE

Sitting in public in London on 11 December 2002

R E Floyd, financial controller, for the Appellant

Jonathan Holl, senior officer advocate, for the Respondents

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INTERIM DECISION

1. This is an appeal against default surcharges totalling £14,855.56 in respect of late payment of VAT for the four periods ending 31 August 2000, 30 November 2000, 31 May 2001 and 31 August 2001. The Appellant normally made his payments by BACS and in 1988 the Commissioners had agreed to an additional 7 days for payments. The payments were 6 days, 12 days, 4 days and 12 days late respectively from the extended time. That for the period ending 28 February 2001 was in time. The surcharges of 2 per cent, 5 per cent, 10 per cent and 15 per cent were imposed in accordance with section 59(5) of the VAT Act 1994.

2. The Notice of Appeal was on the grounds that the default surcharges were excessive and should be set at a more reasonable level. It also referred to late payment by customers and bad debts.

3. Default surcharges are fixed by statute. The Tribunal has no power to mitigate or reduce them. The jurisdiction under the statute is limited to consideration of whether the statutory conditions for the surcharge are present and whether the Appellant has a reasonable excuse. It is all or nothing in respect of each surcharge.

4. The contention that the surcharge is excessive and unreasonable does however raise issues under Article 1 of the First Protocol to the European Convention of Human Rights and under Community Law as to proportionality. To this we return.

5. We consider first whether there was a reasonable excuse in respect of any of the defaults. Although an insufficiency of funds of itself is not a reasonable excuse, the underlying cause may be, see VAT Act 1994 s.71(1)(b) and *Commissioners of Customs and Excise v Steptoe* [1992] STC 757, CA.

6. The Appellant manufactures and sells upholstered furniture. It is the sole producer of Ralph Lauren furniture in the UK and supplies Harrods which at the time took around half of its sales. The next highest customer accounted for 10 per cent. Sales in the year to 30 November 2000 were £2,536,843. There were 40 employees and the staff costs were £656,672.

7. The return to 31 August 2000 showed outputs of £601,908 on which VAT was £93,721 and inputs of £428,821 on which VAT was £60,176. After VAT on EC Acquisitions (Box 2), net VAT was £33,613.90. Some outputs were exports.

8. The VAT was paid by electronic transfer on 13 October 2000. On that day the Appellant's opening balance at Lloyds TSB was £37,882.49 O/D, the sum of £836.20 was credited and payments, including VAT, totalled £39,553.10 giving a closing balance overdrawn of £76,522.39.

9. The surcharge at 2 per cent was £672.27.

10. The return to 30 November 2000 showed outputs of £791,952 with VAT of £118,396 and inputs of £390,125 with VAT of £60,751. VAT payable was £61,736.16.

11. The VAT was paid on 19 January 2003, on which day the opening overdraft was £65,153.51 and the closing overdraft was £131,690.05.

12. Mr Floyd told us that the agreed overdraft limit at the time was £!00,000. A special extension was agreed to cover the VAT payment.

13. The surcharge at 5 per cent was £3,086.80.

14. The audited accounts to 30 November 2000 showed net current assets at £8,160. Current assets were £975,363 of which the main item was trade debtors at £588,526, up from £281,708 a year earlier. Creditors totalled £967,203, of which trade creditors were £236,006 marginally down on the year; US creditors were not included in the £236,006; it did include loans to the company by two directors of £94,683. Short term bank loans and overdrafts were £82,939 and an additional £54,600 was due after more than a year. The overdrafts were secured by a charge as well as guarantees. There was a loss of £2,192 on the year after interest of £34,412 and provision for bad and doubtful debts of £26,570.

15. On 16 February 2001 Mr Floyd wrote to Customs stating that the last two payments had been late due to cash flow difficulties which had arisen because of customers delaying payment; he wrote that the Appellant was considering factoring debts. On 8 March he wrote that a surcharge of £3,759 for payments 6 and 12 days late was "punitive in the extreme". He offered to settle the next return 18 days early.

16. The VAT to 28 February 2001 was paid one day early.

17. On 5 June Customs wrote that the Appellant could not appeal on the ground that the penalty was too severe.

18. The return to 31 May 2001 showed outputs of £563,748 with VAT of £93,058 and inputs of £376,989 with VAT of £54,754. Net VAT payable was £38,304.21.

19. The VAT was paid 4 days late on 11 July 2001. On that date the opening overdraft was £13,823.54 and the closing overdraft was £73,430.17. There were no receipts on that day but other payments totalled over £20,000.

20. The surcharge at 10 per cent was £3,830.42.

21. The final period covered by the appeal was to 31 August 2001. The return showed outputs of £765,294 with VAT of £123,521 and inputs of £540,194 and VAT of £77,175. Net VAT due was £48,440.52.

22. The VAT was paid on 15 October 2001 when the opening overdraft was £11,448.32 and the closing overdraft was £75,122.81. On the following day the account went into credit.

23. On 17 January and 17 April 2002 Customs and Excise at Staines wrote inviting information as to the underlying causes of the shortage of funds/

24. Mr Floyd replied on 29 April 2002 enclosing substantial material including the 2000 accounts, a schedule of customer accounts outstanding at 30 November 2000, print-outs of aged debtors, sales and cash day books for the relevant months and for March 2002. He had already sent some bank statements.

25. On 9 May 2002 the Appellant was asked for further material including aged debt summonses and the sales ledger cash day book for each period. These Mr Floyd sent.

26. On 20 June 2002 Mr Marloes of Customs and Excise wrote that having examined the information for each period he had concluded that there were sufficient funds for each period : with the exception of 11/00 the amount of money received exceeded that invoiced. The excess invoiced in 11/00 of 13 per cent was a "normal business hazard".

27. In evidence Mr Floyd told Mr Holl that the thrust of this conclusion was correct. The period to November 2000 was a good period for sales but the Appellant failed to recover the cash as quickly as it should through poor cash control. This had since been improved. Factoring had been introduced.

28. He said that he could not point to any particular event or any combination of events causing the shortage. He said that furniture manufacture is a very difficult seasonal and cyclical industry. It could be difficult to predict sales even two months ahead. Production was now being concentrated on one site to cut labour and other costs. Discounting had been introduced to improve cash flow.

29. The leading case on reasonable excuse is *Customs and Excise Commissioners v Steptoe* [1992] STC 757 where the Court of Appeal considered what is now section 71(1) of the VATA Act 1994. Section 71(1) reads as follows:

"(1) For the purpose of any provision of sections 59 to 70 which refers to a reasonable excise for any conduct -

(a) an insufficiency of funds to pay any VAT due is not a reasonable excuse; and

(b) where reliance is placed on any other person to perform any task, neither the fact of that reliance nor any dilatoriness or inaccuracy on the part of the person relied on is a reasonable excuse."

Section 59(7) provides that if a person satisfies the Commissioners or a Tribunal that there is a reasonable excuse for late return or payment he is treated as not being in default. In *Steptoe* the Court of Appeal held by a majority that while insufficiency of funds could never of itself constitute a reasonable excuse, the cause of the insufficiency might do so. Lord Donaldson MR emphasised the concept of reasonableness.

30. In the present case it is unfortunate that the bundle produced by the Commissioners for the hearing omitted most of the material provided to them by the Appellant. This was not the fault of the Solicitors' Office since the bundle was produced for them by the local office.

31. In the event it does not appear that the omitted material would suffice to show a reasonable excuse. Mr Floyd accepted the thrust of Mr Marloes' letter of 20 June 2002. He told us that the largest customer paid monthly apart from an accounting dispute over some £20,000 which was reflected in the bad and doubtful debts in the 2000 accounts. The late payments did not approach those in *Steptoe*. The fact that the payments were only a few days late made it all the more difficult to show an event or events depriving the Appellant of the means to pay. The Appellant has not satisfied us that there was a reasonable excuse.

32. We turn therefore to the contention that the surcharges are excessive and unreasonable. The surcharges are equivalent to interest of 122%, 152%, 912% and 782% under the BACS payment scheme (or 56%, 96%, 332% and 282% without the extra 7 days) on an annualised basis taking the number of days late and the rate of surcharge. The surcharge takes no account of the number of days late. The surcharge of £3,830.42 for period 05/01 at 10 per cent was the same for 4 days late as it would have been for 40 days late or 400 days late.

33. The severity of the surcharge regime in this case is not however a relevant factor in domestic law. The default surcharge regime has been excluded from the power to mitigate under section 70. Clearly this is a case where the Appellant was in a difficult situation and made considerable efforts to comply with its obligations, three of the defaults being for less than a week. If the Tribunal did have power to mitigate, a reduction of some at least of the surcharges would have been appropriate. The fact is that we do not have such power.

34. Mr Floyd's complaint about the severity of the surcharges in this case was a layman's way of challenging its compatibility with Article 1 of the First Protocol of the Human Rights Convention and the requirement for proportionality in Community Law. Surprisingly, this has not been the subject of proper legal argument before the Tribunal.

35. The right to peaceful enjoyment of possessions under Article 1 of the First Protocol clearly applies to taxation, see *Aston Cantlow PCC v Wallbank* [2001] 3 WLR 1323, and must apply to penalties. Although the House of Lords has given leave to appeal in that case, it seems highly unlikely that the appeal will question the need for taxation legislation to be proportionate to the aim pursued. Furthermore, independently of the Human Rights Convention, Community law recognises the need for proportionality in relation to penalties, see *Paraskevas Lolodakis v Greece* (Case C-262/99) [2001] ECR I-5547, cited by Lord Phillips MR in *Lindsay v Customs and Excise Commissioners* [2002] STC 588 at paragraph 53. Clearly states have a considerable margin of appreciation. The default surcharge regime followed the *Keith Committee* in 1983 recommendations at Chapter 24.5.8.

36. The present case however raises in stark form the issue of proportionality if the surcharges are equated with annualised interest. The surcharges are the same whether the default is short or long, although default interest is not normally charged except for longer defaults. No default interest appears to have been charged in this case.

37. The question of proportionality was considered by Simon Brown J in relation to serious misdeclaration penalties in *Customs and Excise Commissioners v P&O Steam Navigation Co* [1992] STC 809 where he rejected a submission that section 14 of the Finance Act 1985 was plainly disproportionate. Although the case went to appeal, the Court of Appeal did not hear argument on proportionality and expressed no view, see [1994] STC 259 at 268. It is to be noted that, between the decision of Simon Brown J and the Court of Appeal hearing, provision for mitigation had been introduced by the Finance Act 1995. That does not apply to default surcharges.

38. We have concluded that the issue of proportionality should be listed for legal submissions, both in respect of Article 1 of the First Protocol and Community law. We will require written submissions in advance of the hearing from the Commissioners and from the Appellant if legally represented.

THEODORE WALLACE

CHAIRMAN

RELEASED:

LON/02/667

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