

## **Disproportionate penalties**

### ***Energys Holdings UK Ltd [2010] UKFTT 20 (TC)***

On the facts of the case, the levying of a 5% default surcharge as a consequence of a one-day delay in submitting VAT returns and payment was disproportionate to the offence and discharged the penalty.

#### **Background**

The Taxpayer was one day late in making returns and payment of VAT under the 'Payments on Account' regime. Having previously been late in prior periods, a penalty of 10% of the VAT due was imposed under the default surcharge penalty regime. The surcharge was reduced to 5% after HMRC considered that the Taxpayer had a reasonable excuse for one of the earlier defaults. The Taxpayer appealed against the 5% penalty on two grounds, the first being that it had a reasonable excuse for a prior default and, secondly, that the penalty was so disproportionate to the offence that the legislation should be disapplied (under the EU law principle of proportionality).

HMRC submitted that the penalty regime must strike a fair balance between the need to ensure compliance and the rights of taxpayers, simply put the penalty must not impose an excessive burden. HMRC argued that it was only 'most exceptionally' that the court could properly strike down (disapply) legislation. HMRC further submitted that a measure may not be disapplied unless it was not merely harsh but plainly unfair.

#### **Held**

On the reasonable excuse argument, the Tribunal applied the relevant tests and determined that there was no reasonable excuse for the earlier default.

The Tribunal rehearsed the principles underpinning the default surcharge regime in particular as being designed to promote VAT compliance. The Tribunal noted that the system has clear advantages, particularly, that it is mechanical in operation and the absence of mitigation relieves HMRC of any obligation to consider cases individually, but only in circumstances where a Taxpayer challenges the penalty. The Tribunal noted the criticisms of the scheme particularly in relation to failing to discriminate between 'trivial slips' and 'deliberate late payments' and the consequential failure to cater for degrees of culpability. Further, the Tribunal noted that the penalty is the same irrespective of the length of delay in payment, and the absence of correlation between the size of the trader and the size of the penalty.

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Although the Taxpayer argued points based upon human rights legislation, the Tribunal considered the matter from the perspective of applying the ECJ judgment in *Garage Molenheide* (Joined cases C-286/94, C-340/95, C-401/95 and C-47/96) to the effect that the principle of proportionality is applicable to national measures relating to VAT. The Taxpayer argued that the penalty was grossly disproportionate, being equivalent to 16% of its annual profits.

The Tribunal considered that a pertinent question to ask was whether, if the penalty were not determined mechanically but by a court or tribunal with the power to set a monetary penalty without statutory constraint, would they have imposed the quantum in this case for an error of this kind? In answering that hypothetical question, the Tribunal considered that it would be unimaginable to do so. Taking the penalty imposed in this case in isolation, though balanced against public interest considerations regarding the prompt payment of taxes, the Tribunal considered the penalty to be disproportionate. Having no power to mitigate or amend the quantum of the penalty, the Tribunal were faced with the stark choice of either disapplication of the legislation and discharge of the penalty or leaving the penalty in place. The Tribunal chose to discharge the penalty and allowed the appeal.

The Tribunal decision can be accessed from the BAILII website - [link](#).

### ***Comment***

*It is understood that HMRC will appeal this case, but nevertheless it is significant in that it is the first time that we are aware of the Tribunal acting in this matter to set aside a disproportionate penalty and therefore in such extreme cases and where a penalty appears to be clearly unfair, their may be an avenue for challenge which previously may have been perceived as unavailable.*

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