



Appeal number: FTC/138/2014

*VALUE ADDED TAX: default penalty surcharge; payments on account regime; effect of increase in threshold; meaning of 'basic period' in art 2 of payments on account order; whether non-availability of 7 days additional time to pay breaches EU principle of equal treatment; reasonable excuse for material default*

**UPPER TRIBUNAL  
TAX AND CHANCERY CHAMBER**

**MARSDENS CATERERS OF SHEFFIELD**

**Appellant**

**- and -**

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

**Respondents**

**TRIBUNAL: MRS JUSTICE ROSE: CHAMBER  
PRESIDENT  
JUDGE CHARLES HELLIER**

**Sitting in public at The Rolls Building, Fetter Lane, London EC4A 1NL on 12  
and 13 January 2016**

**Michael Firth instructed by Blake Morgan LLP for the Appellant**

**Peter Mant, instructed by the General Counsel and Solicitor to HM Revenue and  
Customs, for the Respondents**

## DECISION

5 1. This is an appeal against the decision of the First-tier Tribunal (Judge Hacking and Ms Newns) dated 2 July 2014. In that decision, the FTT dismissed the Appellant's challenge to the default surcharge of £38,724 that had been imposed on it in respect of late payment of VAT for the quarter ending 30 September 2011.

10 2. Marsdens is a substantial business operating take-away food outlets. The 09/11 quarter was the first quarter in respect of which the Respondent ('HMRC') had notified Marsdens that they were required henceforward to pay VAT under the payment on account (POA) regime. This meant that instead of paying all the VAT owed for the 09/11 quarter by 7 November (that being one month and seven days after the end of the quarter), they had to make a payment on account of their VAT liability on 31 August and 30 September 2011 and then make a balancing payment of the remaining VAT for that quarter by 31 October 2011. HMRC contend that all three  
15 payments required under the POA regime for the 09/11 quarter were made late:

(1) The first payment on account due on 31 August 2011 was only in fact received by HMRC as a CHAPS payment on 19 September 2011;

20 (2) The second payment on account due on 30 September 2011 was paid by cheque posted on 1 October 2011 and cleared a few days later;

(3) The balancing payment for the remaining VAT due on 31 October 2011 was paid by electronic payment only on 7 November 2011.

3. The aggregate tax paid late over the 09/11 period amounted to £774,491.94.

25 4. When calculating the surcharge to be paid by Marsdens, HMRC took into account their contention that Marsdens had already made two late payments in respect of previous quarters. The surcharge provisions are set out in section 59A of VATA 1994 and work as follows. A first default, which may be a default in the making of a VAT return or in making a payment of VAT by the due date, does not give rise to any liability to a penalty but triggers the issue of a surcharge liability notice. That notice  
30 creates a 'surcharge period', which begins on the date the notice is issued and ends on the first anniversary of the VAT period for which the default arose (s 59A(2)). The significance of the surcharge period is that if there is a second default in respect of a VAT period which ends within that surcharge period, and the aggregate value of the defaults in respect of that VAT period is more than nil, the defaulting trader is liable  
35 to a surcharge calculated at a specified percentage of the aggregate value of the defaults in respect of that VAT period (s 59A(4)). For a first default within a surcharge period, the specified percentage is 2 per cent (s 59A(5)).

40 5. Where a default occurs within a surcharge period, that surcharge period is extended (s 59A(3)). On subsequent defaults within that extended period (as further extended by any such subsequent defaults), the specified percentage applied to the aggregate value of the defaults for the relevant VAT period increases with successive VAT accounting periods of default to 5 per cent, then 10 per cent, and finally to a

maximum of 15 per cent (s 59A(5)). There is no surcharge if the taxable person demonstrates a reasonable excuse for non-payment (s 59A(8)). However, neither HMRC nor the tribunal has power to mitigate a surcharge.

5 6. HMRC asserted, and this is now accepted by Marsdens, that Marsdens were late  
paying the VAT due for the quarter ending 31 March 2011. They were not subject to  
a penalty for this late payment but it meant that they were thereafter in a surcharge  
period. HMRC also contend that Marsdens were late with paying their 06/11 quarter  
VAT. This would render them liable to a surcharge of 2 per cent because that quarter  
ends within the surcharge period starting on the date of the surcharge liability notice.  
10 Thus, on HMRC's case, the 09/11 late payments were the third occasion on which  
Marsdens had been late, so that a surcharge penalty percentage of 5 per cent applied.  
Hence the amount of surcharge imposed was 5 per cent of £774,491.94.

15 7. At the hearing before the FTT, Marsdens accepted that they were in the POA  
regime because their VAT liability had exceeded the relevant threshold for the quarter  
ending 31 March 2011. Their appeal was based on a submission that they had a  
reasonable excuse for being late with their payments in respect of the period ending  
30 September 2011, namely that the group financial controller, Mr Imran, had left the  
company abruptly in July 2011 without serving out his notice and the payment of the  
September instalments had been overlooked. The FTT rejected that contention and  
20 upheld the surcharges.

8. Before us, Marsdens mounted a more fundamental challenge to the imposition of  
the penalty surcharge. They argued that:

25 (1) HMRC were wrong to assert that Marsdens fell within the POA regime  
for the quarter 09/11 because in fact Marsdens' VAT liability had not  
exceeded the relevant threshold in 03/11. This was because that threshold  
had been increased by statutory instrument made in January 2011 and  
coming into force on 1 June 2011 and their VAT for the period to 03/11  
fell below the new threshold although above the old threshold.

30 (2) Even though Marsdens accepted that their 06/11 VAT liability was  
above the new threshold, they contend that the first quarter to which they  
could be subject to the POA regime was not the quarter ending 30  
September 2011 but the later quarter ending 31 December 2011 – thus the  
two payments in September and October had been early not late.

35 (3) The final 7 November 2011 payment for the 09/11 quarter was not late  
because Marsdens should have been granted the seven day extension that  
HMRC grants to other traders. HMRC's refusal to grant this seven day  
extension for traders within the POA regime is, Marsdens submits,  
contrary to the EU law principle of equal treatment.

40 (4) Marsdens contends that FTT should have considered the question  
whether Mr Imran's abrupt departure amounted to a reasonable excuse not  
only for the September quarter defaults but for the default in making late  
payment for the 06/11 quarter. If the FTT had concluded, as it should have  
done, that Marsdens had a reasonable excuse for that default, then under

the surcharge regime, a lower specified percentage would apply in respect of the 09/11 quarter default.

5 (5) Marsdens finally contends that the FTT erred in law in concluding that the departure of Mr Imran did not amount to a reasonable excuse for the 09/11 quarter default, if, contrary to their primary argument, such a default occurred.

### **The POA regime**

9. Most traders account to HMRC for their VAT after the end of the quarter in which the liability arises, that is at the end of the first month after the end of the relevant quarter. When a person registers for VAT they are told what their quarterly cycle, or prescribed accounting period ('pap') is –

10 (1) some traders have PAPs ending 31 March, 30 June, 30 September and 31 December so that their payment dates (including the extra seven days allowed) are 7 April, 7 July, 7 October and 7 January;

15 (2) some traders have PAPs ending 30 April, 31 July, 31 October and 31 January so that their payments dates are 7 May, 7 August, 7 November and 7 February;

20 (3) the final group have PAPs ending 31 May, 31 August, 30 November and 28 February so that their payment dates are 7 June, 7 September, 7 December and 7 March.

10. The POA regime is set out in the Value Added Tax (Payments on Account) Order 1993 (S.I. 1993/2001) ('the POA Order'). The text set out below is as amended by the Value Added Tax (Payments on Account) (Amendment) Order 1995 (SI 1995/291) but before the thresholds were increased in 2011.

25 11. The obligation to make POAs is imposed by article 4 which provides:

30 "4.—(1) A taxable person falling within article 5 or 6 below shall be under a duty to pay, on account of any tax he may become liable to pay in respect of each prescribed accounting period exceeding one month beginning on or after 1st April each year, amounts (in this Order referred to as "payments on account") determined in accordance with this Order at times so determined, provided that in the case of a taxable person falling within article 6 below there shall be no duty to pay such amounts in respect of a prescribed accounting period other than one beginning after the basic period.

35 (2) Where such a taxable person has a prescribed accounting period exceeding one month which begins on or after 2nd March each year and ends on or before 30th June each year, he shall be under a like duty to make payments on account also in respect of that prescribed accounting period."

12. Article 4(2) is not relevant to the issues in this case and we have left it out of account in the discussion which follows.

13. Article 4(1) of the POA Order directs the taxpayer to articles 5 and 6 to see upon whom the obligation is placed:

5           **“Persons to whom this Order applies**

5.—(1) ... a taxable person falls within this article in any year if the total amount of tax which he was liable to pay in respect of the prescribed accounting periods the ends of which fell within the period of one year ending on the last day of his last prescribed accounting period ending before the previous 1st  
10           December exceeded £2,000,000.

...

6.—(1) ... a taxable person who does not fall within article 5 above shall fall within this article if the total amount of tax which he was liable to pay in respect of the prescribed accounting periods the ends of which fell within any one  
15           period of one year ending on the last day of a prescribed accounting period of his ending after 30th November of the previous year exceeded £2,000,000.”

14. Article 7 of the POA Order deals with when a taxpayer can leave the POA regime:

**“Cessation of duty to make payments on account**

7. If the total amount of tax which a taxable person who is under a duty to  
20           make payments on account was liable to pay in respect of the prescribed accounting periods the ends of which fell within any one period of one year ending after the end of the basic period was less than £1,600,000, then, with effect from the date of the written approval by the  
25           Commissioners of a written application by the taxable person to that effect, he shall not be under a duty to make payments on account.”

15. Articles 11 and 12 deal with how much the payment on account should be for those falling within the regime under Article 5 or 6 respectively:

“11.—(1) ... the amount of each payment on account to be made by a taxable  
30           person who falls within article 5 above shall equal one twenty-fourth of the total amount of tax, ... which he was liable to pay in respect of the prescribed accounting periods the ends of which fell within the period (in this Order referred to as “the reference period”)—

(a) 1st October to 30th September in the basic period where he has a  
35           prescribed accounting period beginning in April in any year in which he is under a duty to make payments on account,

(b) 1st November to 31st October in the basic period where he has a prescribed accounting period beginning in May in any year in which he is under a duty to make payments on account, and

5 (c) 1st December to 30th November in the basic period where he has a prescribed accounting period beginning in June in any year in which he is under a duty to make payments on account.

12. ... the amount of each payment on account to be made by a taxable person who falls within article 6 above shall equal one twenty-fourth of the total amount of tax, ... which he was liable to pay in respect of the prescribed accounting periods the ends of which fell within the basic period.”

16. The term ‘basic period’ which is used in several of those provisions is defined in article 2:

15 “the basic period” means, in relation to a taxable person falling within article 5 or 6 below, the period of one year in which there ended the prescribed accounting periods in respect of which his liability to pay a total amount of tax exceeding £2,000,000 caused him to become such a taxable person;”

17. The VAT (Payments on Account) (Amendment) Order 2011 (SI 2011/21) was made on 10 January 2011 (‘the Threshold Order’). It provided in article 2:

**“Amendment of the Value Added Tax (Payments on Account) Order 1993**

20 2. The Value Added Tax (Payments on Account) Order 1993 is amended as follows—

(a) in article 2(1) in the definition of “the basic period” for “£2,000,000” substitute “the figure specified in article 5(1) or 6(1)”;

(b) in article 5(1) for “£2,000,000” substitute “£2,300,000”;

25 (c) in article 6(1) for “£2,000,000” substitute “£2,300,000”;

(d) in article 7 for “£1,600,000” substitute “£1,800,000”; and

(e) in article 16(1) for “£2,000,000” substitute “the figure specified in article 5(1) or 6(1) respectively.”

18. Article 1(b) of the Threshold Order provides that the Order comes into force on 1st June 2011 save for the increase in the threshold in article 5(1) which comes into force on 1st December 2011. The Explanatory Note attached to the Threshold Order stated that the changes to the thresholds ‘are in consequence of the change in the standard rate of VAT from 17.5% to 20% with effect from 4th January 2011’.

19. The question raised by this appeal is at what point does one apply the increased threshold to determine whether a taxpayer is a person who falls within article 5 or

article 6 and hence is a person who, according to article 4, is obliged to make payments on account?

20. It is important to work out how the POA Order provisions work before considering how the increase in the thresholds was meant to apply.

5 21. Article 5 of the POA Order operates by a series of steps.

(1) Identify the previous 1 December, for example if one were applying the test on 5 January 2016, the previous 1 December would be 1 December 2015.

10 (2) Identify for this taxpayer the last PAP which ended before 1 December 2015 – in this case that would be the taxpayer’s PAP ending 30 September 2015.

(3) Identify for this taxpayer the period of one year ending with that date, that is here the period 1 October 2014 to 30 September 2015.

15 (4) Identify the taxpayer’s PAPs ending within that period of one year, namely the PAPs ending 31 December 2014, 31 March 2015, 30 June 2015 and 30 September 2015

(5) If the VAT the taxpayer was liable to pay in those PAPs exceeds the threshold, that taxpayer is a person falling within article 5 and therefore a person on whom the obligation in article 4 is imposed.

20 22. If the taxpayer falls within article 5 then article 6 is not relevant because the two provisions are mutually exclusive.

25 23. The operation of article 6 is rather more complicated although it was common ground that it is intended to bring taxpayers into the POA regime ‘in year’ that is to say in between the application of article 5 one year and its application the following year. Article 6 applies therefore at the end of PAPs other than the PAP which is the last one occurring before 1 December in any year. Suppose, therefore, that the taxpayer who went through the article 5 steps on 5 January 2016 did not fall within article 5. In order to decide when first to apply article 6 you must:

30 (1) Identify the last day of a PAP of the taxpayer ending after 30 November of the previous year - this would be 31 December 2015.

(2) Identify the period of one year which ends on the last day of that PAP ending after 30 November, that would be the period 1 January 2015 to 31 December 2015.

35 (3) Identify the PAPs which ended within that period of one year. These would be the PAPs ending 31 March 2015, 30 June 2015, 30 September 2015 and 31 December 2015.

(4) If the VAT the taxpayer was liable to pay in those PAP exceeds the threshold, that taxpayer is a person falling within article 6 and therefore a person on whom the obligation in article 4 is imposed.

24. If article 6 is applied at, say, 5 April 2016 there is more than one possible period of one year to consider. As at 1 April 2016, the period which ends on 31 December 2015 is still ‘any one period of one year’ ending on 31 December 2015 (that date being the last day of a PAP of the taxpayer ending after 30 November 2015). But  
5 there is now an additional 12 month period that needs to be considered because his PAP ending 31 March 2016 is also a PAP which ends after 30 November 2015. The PAPs the ends of which fall within the period 1 April 2015 to 31 March 2016 are the PAPs ending 30 June 2015, 30 September 2015, 31 December 2015 and 31 March 2016. If his VAT liability in those PAPs exceeds the threshold then he falls within  
10 article 6.

25. If article 6 is applied at, say 5 July 2016, again there is more than one possible period of one year to consider because as at 5 July, both the PAPs ending 31 December 2015 and 31 March 2016 are PAPs of his ending after 30 November 2015 and hence the PAPs ending within the period of a year on either 31 December 2015 or  
15 31 March 2016 are PAPs for which one could compute the VAT liability to see whether the taxpayer was above the threshold. But there is an additional period of one year to consider because by 5 July 2016 there is an additional PAP the last day of which falls after 30 November 2015, namely 30 June 2016. In the period of one year ending on 30 June 2016 there were four PAPs ends 30 September 2015, 31 December  
20 2015, 31 March 2016 and 30 June 2016. If the total VAT liability in those four PAPs exceeds the threshold, then the taxpayer falls within article 6.

26. If article 6 is applied at, say 5 October 2016, there will be four possible years to consider because the taxpayer will have 4 PAPs the last days of which fall after 30 November 2015, namely those ending 31 December 2015, 31 March 2016, 30 June  
25 2016 and 30 September 2016. But if one applies article 6 at, say, 5 January 2017 then all the PAPs ending before 30 September 2016 are **no longer** PAPs “ending after 30 November of the previous year”, which would by then be 30 November 2016 not 30 November 2015.

27. If the threshold does not change over the course of the year, then, whether the  
30 examination of a particular period of a year resulted in the conclusion that the taxpayer either did or did not fall within article 6, there will be little point in re-examining that earlier year period because though it is a period which ends with a PAP ending after 30 November of the previous year, it is not the most recently ended  
35 PAP, given the date the provision is being applied. So generally speaking, if as at 5 July 2016, the VAT in the paps ending within the year to 31 March 2016 did not exceed the threshold, then if the threshold does not change, the VAT in those four PAPs will still not exceed that threshold if one looks again at that same period of a year from the standpoint of 5 October 2016. Similarly if, as at 5 July 2016, the VAT in the PAPs ending within the year to 31 March 2016 was higher than the threshold,  
40 then if the threshold does not change the VAT in those four PAPs will still exceed the threshold if one looks again at that same period of a year from the standpoint of 5 October 2016. In those circumstances the only way the taxpayer can drop out of the POA scheme is if article 7 applies.

28. Marsdens contend however that where there has been an increase in the threshold the taxpayer is entitled to re-evaluate those earlier years in the light of the new threshold to see whether he now falls below the new threshold by reason of the VAT liability in that period. What they argue, broadly, is that you must re-evaluate the applicability of the threshold to a given set of four PAPs ending on the last day of a PAP ending after 30 November of the previous year at the point when you are deciding whether, in respect of a forthcoming PAP, the taxpayer has an obligation to make payments on account for the VAT due in that forthcoming PAP. So at the time one is considering in respect of any PAP, whether the taxpayer is under an obligation to make payments on account for the tax liability in that PAP, one must consider whether the threshold is still met or not in respect of the four earlier PAPs in each of the years ending after the preceding 30 November.

29. Marsdens point out that the reference period to which HMRC applied the in-year threshold to conclude that they were required to make payments on account was the year to 31 March 2011. In that year, Marsdens had a total VAT liability of £2,267,255. They accept therefore, that from 1 April 2011 until 31 May 2011, the Appellant was a person within article 6(1) because its tax liability exceeded £2m (the in-year threshold then in force). But after article 6 was amended Marsdens ceased to be a person within article 6 because the in-year threshold was £2.3 million and its tax liability in the four PAPs ending 31 March 2011 was less than that. The 09/11 period in respect of which HMRC contends that Marsdens has to make payments on account began on 1 July 2011, after the date on which the increase in the threshold in article 6 came into effect. It was not a period in respect of which Marsdens could be said to have had a duty to make payments on account.

30. We cannot accept Mr Firth's construction of the relevant provisions. The key question in our judgment is this: when a taxpayer falls within article 5 or 6 and is therefore subject to the duty to pay on account, for how many PAPs does that duty last? It is important to distinguish for this purpose between the reference year, which is the year in which the VAT liability did or did not exceed the threshold and the POA period in which, if triggered, the POA regime applies. One must identify the start and finish of the reference year and then the start and finish of the period for which POA must be made.

31. Looking at article 5, the reference year is very clear. It is the year comprising the PAPs the ends of which fell within the period of one year ending on the last day of the taxpayer's PAP ending before the previous December. One can then apply the threshold to that year. To ascertain the consequences of crossing the threshold one must go to article 4. The consequence is that the taxpayer is under a duty to make payments on account of any tax he may become liable to pay in respect of each PAP beginning on or after 1 April each year, subject to the proviso about the basic period.

32. Article 4 is less explicit about when the obligation ends (assuming that article 7 is never triggered). However, we consider that it is tolerably clear that the obligation is intended to apply for the four PAPs which end during the period of one year running from 1 April of the following year. Article 5 refers to the taxpayer falling within article 5 'in any year' and there is only one possible relevant period of one year to

compute, that is the year ending with the end of the last PAP ending before 1 December. This construction is also supported by the fact that the payments are calculated as one twenty fourth of the VAT paid in the reference year so that over the course of the period for which the taxpayer is in the POA regime he will pay one half of that earlier liability in advance of his actual VAT liability.

33. Thus taking a taxpayer applying article 5 on 5 January 2016, if his last PAP ending before 1 December 2015 was the PAP ending 30 September 2015 and in the previous four PAPs he paid more than the threshold amount of VAT, his first PAP subject to the POA obligation will be the PAP beginning 1 April 2016 and ending 30 June 2016. That is the first PAP which begins **on or after** 1 April 2016 as required by article 4.

34. As to how long the obligation lasts, article 4 read literally might be thought to apply forever because every subsequent PAP begins after 1 April 2016. It cannot mean that and HMRC do not contend that it does. The calculation of POAs is by reference to a particular prior year's VAT liability and cannot be treated as applicable after a year has passed and a new calculation can be done. We find that it applies until it is superseded either by the application of article 7 or by the re-application of article 5 on the following 1 December 2016. The taxpayer will therefore then pay on account during the PAPs ending 30 June 2016, 30 September 2016, 31 December 2016 and 31 March 2017. Whether his obligation to pay on account continues after that will depend on the re-application of article 5 after 1 December 2016. But in our judgment the reapplication on that date cannot be intended to remove the liability to make POA for the PAP ending 31 March 2017, given the yearly cycle of the legislation.

35. If the taxpayer was on a different stagger of PAPs so that his last PAP ending before 1 December 2015 was the PAP ending 30 November 2015 then the first PAP subject to the POA obligation will be the PAP beginning on 1 June 2016 and ending 31 August 2016 (because his previous PAP begins on 1 March 2016 and that is not a date "on or after" 1 April 2016).

36. Turning to article 6, which is the article applicable in Marsdens' case, we recognise that the words 'in any year' do not appear in article 6 as they appear in article 5. The reference year for article 6 is defined in article 6 itself as the PAPs the ends of which fell within any year ending on the last day of the PAP which ended after 30 November of the previous year. Again, to ascertain the consequences of falling within article 6, one must go to article 4. Again, the start date of the obligation to pay on account is dealt with in article 4. It is the first PAP which begins on or after 1 April 2016 provided that PAP is not within the basic period as defined in article 2.

37. The question is what is the last PAP to which the obligation in article 4 applies where it applies by virtue of article 6? We agree with Mr Mant's submissions on behalf of HMRC that the duty to make payments under Article 4 applies in respect of "each prescribed accounting period... on or after 1 April each year". Once the duty arises it continues for all remaining accounting periods in that year to April. Where the taxpayer falls within the regime because of article 5, this will be for four PAPs

starting the April after the 1 December at which the computation takes place. If the taxpayer falls within the regime because of article 6 then the number of PAPs for which he will be liable to make POAs because of article 6 will depend upon how far into the year he is. It will either be for three, or two or one PAP until it is overtaken by the next application of article 5 which may, if he falls above the threshold as applied by that article, result in him being obliged to make POAs for the next year starting the following April, or May or June, depending on what PAP stagger he operates. It is true that the amount that he will end up paying on account will not be one half of the VAT liability in the reference year as it is for the taxpayer who falls within the regime because of article 5. But we consider it is significant that article 4 deals compendiously with the application of the POA regime whether the taxpayer falls within the regime because of article 5 or because of article 6 and that the one twenty-fourth payments for the article 6 taxpayer still relate to the annual cycle of the reference year.

38. We conclude that on the proper construction of articles 4, 5 and 6 of the POA regime, the obligation that arises to make POAs applies to however many PAPs there are which begin on or after 1 April (and outside the basic period) until the next 31 March, though the precise end date will depend on which PAP stagger the taxpayer operates. That obligation is fixed for the rest of that accounting year, unless or until article 7 applies.

39. Having come to our conclusion as to how the regime works, we now turn to how the increase in thresholds applies. We note first that the Threshold Order contains no transitional provisions; it simply substitutes the new figures for the old in the different provisions. It does not provide for any additional exercise in identifying a reference year as being necessary because of the change in thresholds.

40. The application of the threshold increase, applied as from 1 December 2011 by the Threshold Order did not create any difficulty for article 5 because article 5 focuses on a single period evaluated at one point in the year, that is after 1 December in any given year.

41. Mr Firth argues that because the duty to pay on account arises in respect of each PAP, the taxpayer must be a person falling within either article 5 or article 6 at the start of each such PAP in order for that duty to arise. We do not agree. For the reasons set out above, we find that the duty that arises is to make POAs for the rest of the accounting year. There is nothing in the Threshold Order that indicates that Parliament intended to extinguish an obligation to make POAs that had already arisen before the increase took effect.

42. Indeed the difference between the dates on which the changes in the Threshold Order come into force for the purposes of article 5 and article 6 suggests to us that the contrary is the case. By linking the date of the change to the threshold in article 5(b) to the date by reference to which article 5 operates the Threshold Order emphasises that it comes into force to affect the article 5 reference period test rather than the application period. That indicates that the same construction is intended for the change to article 6.

43. The result of the Marsdens' submissions would also cut across the justification for the increase in the threshold. As the Explanatory Note indicates, the increase in the thresholds followed the increase in VAT rates from 17.5 per cent to 20 per cent on 4 January 2011. The aim is to make sure that people do not fall within the POA regime merely because their VAT liability has increased as a result of the higher rate rather than as a result of any growth in their underlying business. Because the reference year is always a period some months in the past, the increase in VAT rates will take some time to feed through into higher VAT liabilities in reference years. If a taxpayer was in the POA regime on 1 June 2011 because of the size of his VAT liability in a reference year that ended on 30 November 2010 or 31 January 2011, it would not make sense to remove him from the scheme after 1 June 2011 because none or only a small amount of that liability in the reference year reflected the increased 20 per cent rate. It seems to us that Parliament chose 1 June 2011 as a rough mid-point in the year because reference periods ending after that date would include a substantial amount of VAT that was charged after the increase to 20 per cent took effect on 4 January 2011.

44. On Marsdens' first ground of appeal we therefore hold that:

(a) Marsdens was a person falling within article 6 after 31 March 2011 because in the reference year which ended on 31 March 2011 they had a VAT liability higher than the £2 million which was the threshold applicable at that date;

(b) Marsdens therefore became subject to an obligation under article 4 to make payments on account for the PAPs ending 30 June 2011, 30 September 2011, 31 December 2011 and 31 March 2012;

(c) that obligation was not affected by the fact that by the time they came to make the payments on account in those PAPs, the threshold had increased to £2.3 million even though their VAT liability in the reference year ending 31 March 2011 did not exceed the new threshold of £2.3 million.

#### **The meaning of 'basic period' in article 4**

45. Our findings on the construction of the regime and the Threshold Order mean that it is not necessary for us to deal with the alternative ground relied on by HMRC for imposing the default surcharge. However, as the matter was fully argued before us and in case we are wrong on the first ground, we will set out our findings on the secondary argument.

46. We note here that if, as we find, Marsdens fell within the POA regime because their VAT liability in the year to 31 March 2011 exceeded the then applicable threshold of £2 million, the first PAP for which HMRC would say that they could have required them to make POA was the PAP ending 30 June 2011. That would be a PAP beginning on or after 1 April 2011 and would not, HMRC contend, be a PAP beginning before the end of the basic period. However, for whatever reason, HMRC did not notify Marsdens of their liability to make payments on account until 7 July 2011 and the first PAP in respect of which HMRC asked Marsdens to make payments

on account was the PAP ending 30 September 2011 (first payment due on 31 August 2011). Although HMRC has treated Marsdens as being in default in respect of payments for the 06/11 quarter, this is not because Marsdens failed to make payments on account that quarter but because they failed to make any payment until after 7 August 2011 when the whole payment in respect of 06/11 PAP was treated as due.

47. HMRC contend that even if Marsdens is right that its obligation to make POAs because of its VAT liability in the reference year ending 31 March 2011 came to an end on 1 June because that liability did not exceed the new threshold then coming into force, it was still within the POA regime for the PAP ending 30 September 2011 because of the application of article 6 to the reference year ending 30 June 2011. Given that the defaults for which the surcharge was imposed were late payments of VAT in the 09/11 PAP, the surcharge was still validly imposed.

48. Marsdens accepts that in the four PAPs ending 30 June 2011 their VAT liability was more than the new threshold of £2.3 million set in the Threshold Order. They accept therefore that they became a person falling within article 6 at that point. However they contend that on the proper construction of article 4 the first PAP to which that obligation attached was not the 09/11 PAP but the 12/11 PAP (ending 31 December 2011). This is because of the proviso to article 4 to which we have already referred. Reading the proviso in article 4 together with the definition of basic period in article 2, the first PAP to which the duty to make payments on account applies is the first PAP which begins after the period of one year in which there ended the PAPs in respect of which the taxpayer's liability to pay VAT took him above the threshold.

49. The PAPs in respect of which Marsdens fell within article 6 were, on this hypothesis, the PAPs ending 30 September 2010, 31 December 2010, 31 March 2011 and 30 June 2011. Mr Firth points out that the period 30 September 2010 to 30 June 2011 encompasses all four PAP end dates but is, of course, shorter than a year. There are a range of periods of one year – he has calculated that there are 92 - which could accurately be described as the period of one year in which there ended the prescribed PAPs in respect of which Marsdens' VAT liability caused them to fall within article 6. All but one of those possible one year periods ends after 30 June 2011 and for all those possible one year periods, the PAP in respect of which HMRC contends the POA obligation arose was not a PAP which began after the end of that year. So for example, looking at the one year period, say, 17 August 2010 to 16 August 2011, that is a year which encompasses the end dates of all four relevant PAPs here because the four dates, 30 September 2010, 31 December 2010, 31 March 2011 and 30 June 2011 all fall within that one year. It is therefore, Marsdens argue, a possible basic period. If Marsdens chose that period 17 August 2010 to 16 August 2011 as their basic period for the purposes of article 2, the first PAP which begins after that basic period for the purposes of the proviso in article 4 is not the PAP ending 30 September 2011 because that PAP began on 1 July 2011, before the end of the basic period. It is rather the PAP ending 31 December 2011 because that started on 1 October 2011 which is after 16 August 2011.

50. Marsdens argue that they are entitled to choose the basic period that is more favourable to them from the range of 92 different basic periods that could be the basic

period in their situation. They say that they wish to choose one of those which starts after 1 July 2010 so that their basic period goes beyond 1 July 2011.

51. We do not find any support in the POA Order for this suggestion that the basic period operates as a core period of nine months and one day within a penumbra incorporating a variety of years including those nine months and one day. On the contrary, if there were more than one possible basic period as Marsdens submit, there would need to be some provision conferring on either the taxpayer or HMRC the right to choose what basic period they want and some mechanism in the POA Order for whoever makes the choice to inform the other what basic period is to be. Without such a mechanism, HMRC is unable to work out what the first PAP to which article 4 applies would be once it has calculated that the VAT liability in the taxpayer's reference year has exceeded the threshold. There is no duty imposed by the POA Order on HMRC to choose the basic period most favourable to the taxpayer or most favourable to the Exchequer.

52. Further, we agree with Mr Mant that it is significant that the definition of basic period in article 2 refers to 'the period of one year' rather than 'a' or 'any' period of one year. Mr Firth tried to counter this indication by relying on the wording of articles 11 and 12 of the POA Order. Article 11 (a), (b) and (c) refer to dates 'in the basic period' which would not, Mr Firth submits, be necessary if the basic period had to be the year between those dates. Article 12 also refers to the end of the relevant PAPs falling 'within the basic period'. We do not consider that those indications can bear the weight that Marsdens places on them. The use of 'the' in the definition of basic period to describe the period of one year, and the absence of provisions one would expect to see if there were a choice to be made as to what the basic period is are more powerful indications, in our judgment, that the basic period is the year encompassing the whole of the PAPs which cause the taxpayer to fall within the regime.

53. We therefore conclude that since Marsdens was a person falling within article 6 because their VAT liability exceeded the threshold in respect of the PAPs ending in the year to 30 June 2011; the first period in respect of which they were obliged under article 4 to make payments on account was the PAP ending 30 September 2011 because that PAP began after 1 April 2011 and also began after the end of the basic period because it began on 1 July 2011 which was after 30 June 2011. That latter date is relevant because it is the end of the period of one year in which there ended the PAPs in respect of which their liability to pay more than £2.3 million of VAT caused them to fall within article 6.

#### **Alleged unequal treatment**

54. Marsdens argue that even if they were within the POA, the balancing payment made on 7 November should not be treated as a late payment because of the EU principle of equal treatment. Had that principle been applied to Marsdens, its payment on 7 November 2011 would have been in time and there would have been no penalty in respect of £585,655. This would mean that the surcharge on the remainder would be only the lower figure of £9,447 rather than the penalty of £38,724 charged.

55. Article 206 of the Principal VAT Directive (2006/112/EC) confers on Member States a discretion in relation to the date of payment of VAT and allows the Member State to require ‘interim payments’. HMRC accepted that this discretion must be exercised by them in accordance with the general principles of EU law, including the principle of equal treatment.

56. The principle of equal treatment in the VAT context was considered by the Court of Justice of the European Union in Case C-309/06 *Marks & Spencer plc v HMRC* [2008] ECR I-2283. That case arose from an overpayment of VAT by Marks & Spencer (‘M&S’) on a chocolate covered tea cake which, between 1973 and 1994, HMRC wrongly classed as a biscuit when it was a cake. Once HMRC reclassified the tea cake as a cake, M&S submitted a claim for repayment of £3.5 million overpaid VAT. HMRC refused to repay the bulk of the money on the grounds that M&S would be unjustly enriched because it had passed the VAT onto customers. M&S asserted that this was a breach of the principle of equal treatment because unjust enrichment was not available as a ground for preventing ‘repayment traders’ getting the benefit of the repayment, repayment traders being those who receive a payment from HMRC in the relevant period because their input tax exceeds their output tax. The Court stated that in this connection, the general principle of equal treatment requires that similar situations are not treated differently unless differentiation is objectively justified. The Court held that the general principle of equal treatment, the infringement of which may be established, in matters relating to tax, by discrimination affecting traders who are not necessarily in competition with each other but are nevertheless in a similar situation in other respects, precludes discrimination between ‘payment traders’ and ‘repayment traders’, which is not objectively justified.

57. The question of which differences between taxpayers are material when considering whether they are entitled to equal treatment was explored by Advocate General Sharpston in her opinion in Case C-227/04P *Lindorfer v Council of the European Union* [2007] ECR I-6767. That case concerned the calculation of the length of pensionable service credited in the Community pension scheme to Ms Lindorfer, a Council official, following the transfer of pension rights previously acquired by her under a national scheme compared with the length of pensionable service calculated for someone who had worked for the Council for the same period. The Advocate General described the court’s task as follows:

“21. The general principle of equal treatment, or prohibition of discrimination, has consistently been defined as requiring that comparable situations must not be treated differently and different situations must not be treated in the same way unless such treatment is objectively justified.

22. That definition implies a two-stage analysis. First, are the situations comparable, so that they call for the same treatment, or are they different, so that their treatment should be differentiated? Second, if the two situations are not treated as indicated by the answer to the first question, is there objective justification for the divergence?

23. In practice, however, there may be some blurring between the assessment of characteristics which differentiate situations and the assessment of objective justification for differentiated treatment of otherwise comparable situations (or for uniform treatment of otherwise different situations).

5 24. Clearly, situations are never identical in all respects, and assessment of comparability, difference or justification must concern characteristics which are relevant to determining the nature or terms of the treatment in question. Unlawful discrimination occurs when criteria which are not relevant are relied upon to override those which are relevant. It will always be necessary, therefore,  
10 to ascertain first which criteria are relevant to the choice of treatment and which are not.”

58. She considered that the position of someone transferring into the Community scheme after years of service elsewhere was not comparable to the position of someone who had worked for the Community institutions for the same period.  
15 Similarly in *Reed Employment Ltd v HMRC* [2014] EWCA Civ 32 Arden LJ said that in comparing rules applicable to different claims for the purpose of the equivalence principle, the court is to have regard to their purpose, cause of action and essential characteristics. She stressed, at paragraph 58 that essential characteristics must not be examined in the abstract: ‘Formalism is not the right approach here. First principles  
20 are.’”

59. Mr Firth compared the position of Marsdens to two different kinds of taxpayer – the ordinary taxpayer who pays their VAT quarterly in arrears, one month after the end of their PAP and the taxpayer who submits monthly VAT returns and pays monthly. Both are allowed the additional 7 days to make the payment.

25 60. As regards the ordinary taxpayer, Mr Firth submits that the unequal treatment is particularly stark because the balancing payment that the taxpayer makes under the POA is as a matter of law and fact precisely the same payment as is made by the ordinary taxpayer. He points out that there is no provision in the POA Order requiring the taxpayer to make the final payment after the two payments on account.  
30 The POA Order only imposes the obligation to make the two payments on account of 1/24<sup>th</sup> of the VAT in the reference year. The obligation to make what for the POA trader is a balancing payment is only the straightforward obligation imposed by rule 40 of the VAT Regulations 1995 (SI 1995/2518) (‘the VAT Regulations’) to pay all VAT due for the PAP by the end of the month following the end of the PAP:

35 **“VAT to be accounted for on returns and payment of VAT**

40. Save as the Commissioners may otherwise allow or direct—

40 (a) any person making a return shall account therein for all his output tax and all VAT for which he is accountable by virtue of Part XVI of these Regulations in respect of the period to which the return relates, and the amounts to be entered on that return shall be determined in accordance with these Regulations; and

(b) any person required to make a return shall 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.”

5 61. That obligation is reduced for the POA trader by the fact that he has made a part  
payment towards his liability for that quarter by the two payments on account made  
during the quarter. But given that it is the same legal obligation, Marsdens argue that  
it is a breach of the principle of equal treatment to extend the period for payment for  
10 the ordinary trader for seven days but not grant that same extension to the POA trader.  
They are in a directly comparable position and no objective justification has been  
proposed by HMRC for treating them differently.

15 62. Mr Firth made clear in his written and oral submissions that Marsdens are not  
challenging the imposition of the POA regime itself as unfairly discriminating against  
traders who fall above the threshold. But they assert that the difference in treatment  
between the payment made by a POA trader pursuant to regulation 40 of the VAT  
Regulations who is not given the seven day extension and the treatment of an ordinary  
trader making a payment pursuant to the same regulation who is given an extra seven  
days is unjustified.

20 63. Secondly, Marsdens contrasted their position with the position of a trader who  
submits VAT returns and makes payments monthly. Such a person is outside the POA  
regime because article 4(1) of the POA Order only applies to PAPs exceeding one  
month. According to HMRC’s VAT Notice 700/60 updated on 21 October 2015, if  
the taxpayer submits monthly VAT returns, he may be allowed up to seven extra days  
to pay and submit the VAT return. Marsdens submit that the position of a POA trader  
25 is similar to that of a trader making monthly returns and there is no reason to treat  
them differently. They also submit that the fact that Marsdens could opt to submit  
returns and pay monthly rather than be in the POA regime does not render a  
difference in treatment non-discriminatory: see Case C-440/08 *Gielen v*  
*Staatssecretaris van Financiën* [2010] ECR I-2323, paragraphs 49 - 54.

30 64. We do not agree that POA traders are comparable to ordinary traders or to large  
traders who have opted to be outside the POA regime and make monthly returns  
instead. There are a number of different payment regimes applied by HMRC to  
different categories of trader and each regime has a bundle of obligations which have  
developed over time and which have to be considered together. For example, we note  
35 that the POA Order originally drafted provided for the monthly payment on account  
to be one twelfth of the VAT liability in the reference year but included article 10  
which allowed a POA trader to have an additional seven days for his payments on  
account if he paid by credit transfer. That seven day extension was withdrawn by the  
Value Added Tax (Payments on Account) (Amendment) Order 1996 (SI 1996/1196)  
40 which revoked article 10 but that same order also amended articles 11 and 12 to halve  
the amount of the payments on account to one twenty-fourth. This shows the danger,  
in our view, of trying to pick out one attribute of a payment regime and compare it  
with another regime rather than looking at the regimes as a whole.

65. As regards the comparison with ordinary traders, POA traders are treated differently from ordinary traders because their business is large enough to generate a VAT liability of over £2 million in the reference year. Section 28 of the VATA which empowers HM Treasury to make the POA Order empowers them to do so ‘if they consider it desirable to do so in the interests of the national economy’. HM Treasury consider that it is desirable that large traders should make a payment on account each month so that the national economy receives sooner the VAT which the company has collected from its customers rather than the company holding on to that VAT for one or two months. The amount that the POA trader is required to pay is a comparatively small amount (one twenty-fourth of the reference year’s liability) but he must pay it promptly and he must pay the balancing payment promptly at the end of the month following the end of the PAP. In our judgment, the size of the VAT liability over a reference year is the “essential characteristic” which causes a trader to become subject to the POA regime in the first place and we find that this distinguishes him from the ordinary trader who is not so subject.

66. The trader who opts for monthly returns and payments has exercised that option (assuming that HMRC has allowed him to do so) because the nature of his business is such that it is advantageous for him to do so. Again, the essential characteristic which has prompted him to apply to HMRC to pay monthly, and has prompted HMRC to accept his application, is what distinguishes him from the POA trader who has not made that choice. As a result of his choice, he not only has to make a payment every month but also has the additional burden of submitting a VAT return each month rather than just once a quarter. The additional seven days granted to him applies to the submission of the monthly return as well as to the monthly payments.

67. Given our finding that Marsdens was not in a comparable position to either ordinary traders or to taxpayers who make monthly returns and payments, we do not need to consider the question of objective justification. We note only that HMRC stated that it was not relying on the desirability of encouraging payment by electronic transfer as a justification for the extension of time.

### **Reasonable excuse for previous defaults**

68. The sole question decided by the FTT in this case was whether the unexpected and abrupt departure of the group financial controller in July 2011 was a reasonable excuse for the defaults that occurred in the 09/11 payments. The FTT described what had happened:

“8. The matter advanced by [Marsdens] for the tribunal’s consideration as constituting a reasonable excuse for the delay in payments was the sudden and unplanned departure from the company of its group financial controller, Ali Imran on his return from holiday in July 2011. The evidence was that Mr Imran had been ill for some time. The previous delays in payment for the 03/11 and 06/11 periods had apparently resulted from the company struggling to keep up with its responsibilities in the absence, much of the time, of its group financial accountant.

9. The tribunal accepts that the departure of Mr Imran, when it came was unexpected. However that was in July 2011 and the payments under consideration in this appeal were those which were due in August, September and October 2011.

5 ...

12. The Tribunal readily accepts that Mr Imran's departure must have given rise to difficulty. However the company has and had at the material time other accounts staff in its finance section. At no time was it suggested that the regular preparation of the information needed for the VAT return was exclusively the task of Mr Imran. He would no doubt wish to see the return before its dispatch but in his absence there were others who would have been able, in the finding of the tribunal, to deal with this as, indeed, did actually happen.

13. It is the duty of the directors of the company to ensure that the VAT returns and payments are dealt with in a timely fashion. Given Mr Imran's abrupt exit from the company it hardly seems credible that all thought of dealing with VAT departed with him. That would be the sign of a wholly disorganised company. That was not the impression the tribunal had gained of the Appellant."

69. Mr Firth submits that the FTT fell into error in two respects. The first was that they did not consider whether the departure of Mr Imran provided a reasonable excuse for the default that occurred in respect of the 06/11 PAP as well as of the 09/11 PAP. He accepted that this point was not raised by Marsdens at the FTT. The only reference to the late payment in respect of the 06/11 quarter is in paragraph 25 of the FTT decision where the FTT states simply that Marsdens was in the surcharge regime at the time as a result of defaults recorded for the 03/11 and 06/11 VAT periods.

70. However Mr Firth relies on the decision of the First-tier Tribunal in *Aardvark Excavations Ltd* VAT Decision 20468; Judge Hellier's decision of 6 September 2007 where the tribunal consider which defaults are 'material to the surcharge' for the purposes of section 59(7) VATA. The tribunal held that when a taxpayer wishes to challenge a penalty on the basis that he had a reasonable excuse for a material default, the defaults that are material for this purpose include not only the default that has led to the imposition of the penalty challenged but also any previous default that either triggered the surcharge liability notice or operated to increase the percentage to be applied under the escalating scale of penalties. Thus, as the Tribunal held in *Aardvark Excavations* the tribunal is entitled to have regard in the application of section 59(7) to a prima facie default other than that directly giving rise to the surcharge under appeal for the purpose of determining whether such a default whose existence may affect the amount or existence of the default under appeal, may be ignored: see paragraph 58 of that decision.

71. In the present case, this means that in considering a challenge to the 09/11 default here, the FTT would have been entitled to take into account whether Marsdens had a reasonable excuse not only for the late payments made in respect of that quarter but also whether they had a reasonable excuse for the two earlier defaults in the 03/11 and 06/11 quarters which are material defaults for this purpose.

72. The *Aardvark Excavations* decision has been followed by other First-tier tribunals but has not so far been considered at appellate level. We assume for the purposes of this appeal, but without deciding, that it is correctly decided.

73. Mr Firth accepts further that he must rely only on the facts found by the FTT since it is not open to Marsdens to raise on appeal a point which would have required further fact finding below. But he says he can rely on the evidence recorded by the FTT in its decision to establish that Marsdens did have a reasonable excuse for the late payment in respect of the 06/11 PAP. The FTT held that the departure of Mr Imran did not constitute a reasonable excuse for the payments due in August, September and October only because too much time had elapsed between that departure and the due dates for those payments – the company should, the FTT found, have made alternative arrangements for processing its VAT payments by the time the 09/11 quarter came around. On that basis, Mr Firth submits, Mr Imran’s departure should be a reasonable excuse for the more proximate default in making the 06/11 PAP payment.

74. We have concluded on this point that it is not fair to allow Mr Firth to raise this point on appeal when it was not raised before the FTT. We agree that it appears that the FTT based its dismissal of the appeal on a finding that too much time had elapsed between Mr Imran’s departure and the 09/11 quarter defaults for that departure to operate as reasonable excuse for the 09/11 default. But we do not consider that the FTT would inevitably have found that it was a reasonable excuse for the 06/11 default, if the point had been raised before it. Rather we consider that the FTT would have wanted to explore more fully in evidence the procedures and staffing within the company before arriving at a conclusion on that point. We accept Mr Mant’s submission that HMRC prepared its submissions before the FTT on the basis that only payments in respect of the PAP 09/11 were under consideration. We consider that the FTT hearing might have taken a different course had this point been raised at that stage.

75. Finally Mr Firth criticises the FTT for its findings in paragraphs 12 and 13 of the decision, submitting that the approach of the FTT effectively makes it impossible for the departure of a finance controller ever to provide a reasonable excuse for a company to be late in paying its VAT. On the FTT’s logic, Mr Firth argues, either there is no other person engaged who could take over the processing of VAT payments, in which case the company is to be regarded as ‘wholly disorganised’ or it does have other people to take over the task, in which case those other people should have ensured that payments were made on time. This analysis amounts to an error of law, he submits, because other cases make clear that the departure of a key member of staff can amount to a reasonable excuse. Mr Firth relies on the First-tier Tribunal decision in *Armkor Ltd* [2014] UKFTT 140 (TC) where the tribunal held that the

illness and unexpected death of the taxpayer company's administrator should be considered a reasonable excuse for the late payment of VAT. This event had led to significant disruption to the small team and that even a conscientious businessman might have struggled in those circumstances.

5 76. We do not read the FTT's decision in Marsdens' case as inconsistent with the  
decision in *Armkor*. We consider that it will be more difficult for a large company  
like Marsdens to show that the departure of a single employee, even when that  
departure is abrupt and unexpected, provides a reasonable excuse for late payment  
10 than it is for a smaller company like Armkor. But the FTT was not ruling out that in  
different circumstances it might do so, it was merely saying that it did not get the  
impression that Marsdens was so disorganised that no one could have dealt with the  
VAT in Mr Imran's absence. We do not regard this issue as raising a point of law on  
which we should interfere with the FTT's conclusion.

### **Disposal**

15 77. We therefore dismiss Marsdens' appeal. Although we have rejected all Marsdens'  
grounds of appeal, we wish to record our thanks to Mr Firth for his comprehensive  
submissions on behalf of Marsdens and for the clear and helpful way he took us  
through these convoluted provisions.

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**MRS JUSTICE ROSE**

**JUDGE CHARLES HELLIER**

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**RELEASED 22 FEBRUARY 2016**