

CHAPTER 18

DEFAULT SURCHARGE

18.1 Introduction

A "default" will occur when either a VAT return is submitted late or a payment of VAT is made late. In such a case a default surcharge may be imposed on the wrongdoer.

[VATA 1994,
s.59](#)

The **first time** a default occurs, HMRC issue a **warning**. The warning is the form of the issue of a surcharge liability notice (SLN). The notice is effective for a period of 12 months. This **12 month period is called the Surcharge Period**.

A default during this 12 month surcharge period has 2 consequences:

- 1) a surcharge is calculated. The surcharge is a percentage of the unpaid tax due; and
- 2) the surcharge period is extended to 12 months from the end of the quarter of default.

18.2 The Surcharge

The amount of surcharge depends on previous defaults in the current surcharge period.

No. of defaults during current surcharge period	% of unpaid VAT
1	2%
2	5%
3	10%
4 or more	15%

The surcharge is a percentage of the VAT paid late.

The surcharge is levied in addition to the unpaid VAT.

[VATA 1994,
s.59](#)

HMRC will not collect a surcharge of less than £400 unless the 10% or the 15% rate applies. Where the 10% or 15% rate applies, there is a minimum charge of £30.

Notice 700
Para 21.2

A surcharge will not apply if a nil or a repayment return has been submitted late. Nor will it apply if the tax is paid on time but the return itself is submitted late.

In these instances, the return is late therefore there is a default. The surcharge period will therefore be extended. However, such an event does not increase the rate of surcharge for the next default in the surcharge liability period.

In addition, penalties will not be applied automatically for late payment where the taxable turnover of the business is less than £150,000. This is designed to assist small businesses by easing the penalty burden for minor offences.

Example 1

Alpha Ltd has submitted recent VAT returns as follows:

Quarter to	Date submitted	VAT due £	Date VAT paid	Default
31.3.09	28.4.09	5,000	28.5.09	<input type="checkbox"/>
30.6.09	20.7.09	10,000	20.7.09	<input type="checkbox"/>
30.9.09	25.11.09	(5,000)	N/A	<input type="checkbox"/>
31.12.09	25.1.10	15,000	25.1.10	<input type="checkbox"/>
31.3.10	21.4.10	12,000	21.4.10	<input type="checkbox"/>
30.6.10	17.7.10	10,000	25.7.10	<input type="checkbox"/>
30.9.10	2.11.10	13,000	2.11.10	<input type="checkbox"/>
31.12.10	19.1.11	11,000	19.1.11	<input type="checkbox"/>

Tick the box to show which returns are in default.

Illustration 1

Alpha Ltd has submitted recent VAT returns as follows:

Quarter to	Date submitted	VAT due £	Date VAT paid	Default
31.3.09	28.4.09	5,000	28.5.09	<input checked="" type="checkbox"/>
30.6.09	20.7.09	10,000	20.7.09	<input type="checkbox"/>
30.9.09	25.11.09	(5,000)	N/A	<input checked="" type="checkbox"/>
31.12.09	25.1.10	15,000	25.1.10	<input type="checkbox"/>
31.3.10	21.4.10	12,000	21.4.10	<input type="checkbox"/>
30.6.10	17.7.10	10,000	25.7.10	<input type="checkbox"/>
30.9.10	2.11.10	13,000	2.11.10	<input checked="" type="checkbox"/>
31.12.10	19.1.11	11,000	19.1.11	<input type="checkbox"/>

The first default return is the return to 31 March 2009. This is the first ever default so a "warning" is issued in the form of a surcharge liability notice (SLN). This covers the 12 month period from 1 April 2009 to 31 March 2010.

The next default return is the return to 30 September 2009 - this is during the surcharge period and so a surcharge will be calculated.

This is the first default in the surcharge period, so a 2% surcharge applies.

However, there is no VAT due to HMRC so no surcharge can be levied. However, the surcharge period is still extended to 30 September 2010, i.e. 12 months from this current default. The 2% penalty rate is not used and is 'saved' for next time.

The next default just falls into the 12-month surcharge period because it is the return to 30 September 2010.

The 2% surcharge is still available. Thus 2% of the VAT due (£13,000) gives a £260 penalty. However, since this is less than £400 it will not be collected by HMRC. The surcharge period is extended to 30 September 2011.

18.3 Avoiding Default Surcharge

The only way to "escape" the surcharge period is to **submit 4 returns on time and pay the VAT due on time**. In this way the surcharge period elapses and the trader starts again with a "clean sheet".

If a trader defaulted again outside the surcharge period, this would be a "first" default so the process restarts - a warning is issued in the form of a SLN, lasting for 12 months, but no penalty is charged. If the trader defaults in that surcharge period, he would be liable to the 2% penalty and so on.

A **default can be disregarded** for the purposes of the penalty in two situations.

- 1) where the **return and the tax were dispatched** to HMRC at such a time and in such a manner that it was **expected that they would arrive on time**. HMRC have indicated that posting a return first class at least 1 working day prior to the due date is accepted as reasonable.

From 1 April 2010 HMRC have said that cheques received by post will be treated as received when payment **reaches HMRC's bank account** rather than when the **cheque arrives**.

- 2) where the trader had a **reasonable excuse for his default**.

Finally, it should be noted that default surcharge **cannot be mitigated** - it is an all or nothing penalty.

18.4 Alternatives

The default surcharge system is not appropriate for every trader.

For example, a trader that submits every fifth return late, will never actually be penalised under the default surcharge system. For such traders, HMRC have the option of imposing an alternative daily penalty.

There is also a separate default surcharge system for large traders who have to make payments on account.

Example 2

Tick the answer box if the statement is correct:

1. If the tax is paid on time, a late VAT return does not constitute a default
2. If the return to 30 September 2009 is late, the surcharge period will run to 30 September 2010.
3. A surcharge of less than £400 will never be collected by HMRC.
4. Default surcharge can be mitigated by HMRC.
5. A VAT return sent on time but which arrives late due to a postal strike, is disregarded for default surcharge purposes.

There is a summary of the VAT penalties covered over the last few chapters at the end of this chapter.

Answer 1

Quarter to	Date submitted	VAT due £	Date VAT paid	Default
31.3.09	28.4.09	5,000	28.5.09	<input checked="" type="checkbox"/>
30.6.09	20.7.09	10,000	20.7.09	<input type="checkbox"/>
30.9.09	25.11.09	(5,000)	N/A	<input checked="" type="checkbox"/>
31.12.09	25.1.10	15,000	25.1.10	<input type="checkbox"/>
31.3.10	21.4.10	12,000	21.4.10	<input type="checkbox"/>
30.6.10	17.7.10	10,000	25.7.10	<input type="checkbox"/>
30.9.10	2.11.10	13,000	2.11.10	<input checked="" type="checkbox"/>
31.12.10	19.1.11	11,000	19.1.11	<input type="checkbox"/>

When looking at the return for the quarter ended March 2009 it is obvious that the VAT is paid late, although the return itself has been submitted on time, so this is a default.

In the next return, both the VAT and the cash is on time.

Looking at the return to 30 September 2009, this time the return is late, but there is no VAT to be paid because it is a repayment return. However, because the return is late it is still in default.

The next 3 returns are all submitted on time and the cash is paid on time.

The 30 September 2010 return is a situation where both the return and the cash is late - thus another default.

Answer 2

1. If the tax is paid on time, a late VAT return does not constitute a default
2. If the return to 30 September 2009 is late, the surcharge period will run to 30 September 2010.
3. A surcharge of less than £400 will never be collected by HMRC.
4. Default surcharge can be mitigated by HMRC.
5. A VAT return sent on time but which arrives late due to a postal strike is disregarded for default surcharge purposes.