Practical Tax People
Association of Taxation Technicians

HMRC PENALTIES: DISCUSSION DOCUMENT

Response by the Association of Taxation Technicians

1 Introduction

1.1 The Association of Taxation Technicians (ATT) is pleased to have the opportunity to respond to the discussion document *HMRC Penalties* (the Consultation) that was published by HMRC on 2 February 2015.

1.2 We very much welcome the fact that the Consultation is taking place during Stage 1 of the process. We have been impressed with the openness with which HMRC is approaching this exercise as demonstrated by the workshop on 12 March and the department's meeting with our representatives on the same day.

1.3 We respond in section 3 below to the specific Consultation questions. Before doing so, we comment in section 2 below on a number of more general matters.

1.4 To assist location of the key points of this response, they are summarised below with cross references to the main text:

- The increasing digitalisation must not increase the risk of penalties for the digitally excluded or those genuinely seeking help from HMRC. [2.2 and 2.3]
- Consideration should be given to the sustainability of the old penalties regime. [2.4]
- Attention is required to the application of penalties as well as to the law itself. [2.5]
- The invisible yield from modest automatic penalties should not be ignored. [3.1.2]
- The practicality of self-assessment of penalties/penalty points should be explored. [3.1.3, 3.1.4, 3.3.1 and 3.8]
- The *Donaldson* type scenario should be addressed. [3.1.5]
- We have identified a range of points in relation to VAT Default Surcharges. [3.1.7]
- Research could be useful into the impact of the statutory minimum penalties on unprompted disclosures. [3.1.9]

- Consideration is required to how the GOV.UK pages could do more to promote voluntary disclosures. [3.1.10]
- Penalties can be an inappropriately blunt response to customer behaviour. [3.2.1]
- There are anomalies and untidy interactions between penalties and taxes. [3.2.2 and 3.2.3]
- The suspended penalty provisions and their application require attention. [3.3.2 to 3.3.8]
- We have made detailed comments on the principles that should govern the design of penalty regimes. [3.4]
- There would need to be transparency in any approach that focused on individual behaviour. [3.5]
- We have suggested a possible system to deal with short failures. 3.6.1 and 3.6.2]
- We would not favour a differential interest rate for short failures. [3.6.3]
- Penalties are not an appropriate response to ineligible claims that are submitted in good faith for consideration of entitlement by HMRC or in relation to agreed technical adjustments. [3.7.4 and 3.7.5]
- The increased use of digitalisation should provide opportunities to identify potential non-compliance at an early date. [3.7.6]
- Tax compliance awareness courses could have a part to play. [3.8.1]
- A tabulated compliance history could be included in the customer's account. [3.8.3]
- Consideration could be given to an obligations awareness form. [3.9.3]
- Provisionally payable (and potentially repayable) penalties might incentivise compliance. [3.10.2]
- We would be pleased to conduct a survey of our members in relation to specific aspects of penalties if that would usefully contribute to the evidence base for the ongoing consultation. [3.12.3]

1.5 In February 2015 and in conjunction with the Chartered Institute of Taxation (CIOT), we conducted a survey of our membership concerning their views on *HMRC Powers: Penalties, Compliance checks and Reviews*. A copy of the joint report on the survey results will be provided separately to HMRC once it is finalised. In the meantime, we refer briefly in this response to the survey (the Membership Survey).

1.6 All references in this response that are prefaced by the letter '**C**' are to paragraphs in the Consultation itself. All other references are internal cross-references unless otherwise stated.

2 General matters

2.1 We note the statement at C3.7 that the principles that underpinned the Powers Review (as set out in C.3.6) 'remain largely relevant today'. Whilst we agree that there is a need to consider how the principles apply in changing situations, we suggest that the principles themselves must remain more than *largely relevant.* As we see it, the focus of the current review should predominantly be on the application of the principles.

2.2 We appreciate that the Consultation is based on the assumption of much greater digitalisation and, by implication, much reduced requirement for any involvement of HMRC officers. Whilst we recognise the potential benefits of that for HMRC and for more sophisticated customers (and those who are professionally represented) we think it is essential that the penalty system(s) can also cater for customers who need to speak with or have a face to face meeting with an HMRC officer and for those who for whatever reason are digitally excluded.

2.3 A particular situation where human contact is required is the Business Payment Support Service (BPSS) where customers are proactively contacting HMRC about problems with tax payment – with obvious penalty implications. It is vital that BPSS (or its future equivalent) is adequately resourced and that its officers are empowered to respond positively and to take ownership whenever a customer's circumstances demonstrate that they require help. As the Consultation notes at C.1.9, what HMRC wants is compliance not penalties. Positive accommodation of realistic time to pay proposals encourages compliance; rejection of such proposals may deliver penalties but it fosters resentment and does not therefore promote long term compliance.

2.4 If there is to be any significant redrafting of the penalties legislation, we think that there is a case for considering the ongoing practicality of retaining the 'old regime' of tax-geared penalties for years prior to those where the new regime provisions (introduced from FA 2007 onwards) apply. It is likely to become increasingly difficult both for HMRC officers and for practitioners to cope with the separate implications and considerations of the two consecutive regimes particularly as memories and experience of the old regime provisions diminish. We appreciate that the calculation of penalties under either regime is not consistently more favourable to the taxpayer or the Exchequer than under the other so any move to standardise on the new regime would produce winners and losers but we do think this could be an appropriate topic for inclusion at the next stage of consultation.

2.5 We think that it is essential within this consultation process to consider not only the legal basis of penalties but also the policy and practices adopted by HMRC in their application. The Membership Survey (see 1.5 above) identified inconsistencies in classification of behaviours and the consideration and application of suspended penalties.

2.6 The VAT Default Surcharge regime is noticeably out of line with more modern legislation but we have assumed in this response that it will be retained in the short term. If there is to be any significant overhauling of the penalty legislation generally, it would presumably make sense to implement the provisions of Schedules 55 and 56 of FA 2009 (as amended by the provisions of F(No. 3)A 2010) in relation to VAT at the same time after any appropriate revision of those

provisions in the light of this consultation. In this response we have not commented in detail on the FA 2009 provisions.

3 Response to the Consultation Questions

Our comments in this section 3 follow the numbering of the Consultation questions so that our 3.1 is in answer to question 1 and so on.

3.1 Question One

To what extent are the concerns expressed above* typical of actual situations?

(ie in section 4 of the Consultation)*

3.1.1 We have not conducted research on the point but we certainly recognise the concerns noted in the Consultation particularly the recurring themes of fairness and proportionality.

3.1.2 *Automated penalties generally*

In relation to automated penalties, we note the observation in C4.3 that;

'*they tend to be small and so to be more costly and resource intensive for HMRC to pursue than larger better-focused penalties (and cannot be increased in size without then being disproportionate to the failed obligation)'.*

We appreciate that the cost to the Exchequer of levying and enforcing a single automatic penalty might in some circumstances be greater than the penalty itself. However, we question whether that means that the relatively modest levels of automatic penalty require amending. We think that research is needed to establish the invisible yield from the automatic penalty regime – the extent to which they promote compliance. If they ensure that P% of the relevant population comply with a timing deadline, the cost of enforcing collection of automatic penalties from the Q% of the relevant population who fail to comply should be measured against the sum of the actual penalty yield from the Q% plus the value of the compliant behaviour of the P%.

3.1.3 If we are right in our underlying assumption that modest levels of automatic penalties promote compliance, digitalisation might support the self-assessment of automatic penalties ('I'm X days late so I am paying an extra £Y'). In this situation, £Y might be equally effective in encouraging future compliance even if it was *lower* than existing penalty levels.

Another alternative that harnessed digitalisation could be a points-based system with automatic suspension ('I'm A days late, so I have incurred B penalty points which I appreciate could result in my paying a penalty of £C unless I meet my compliance obligations for the rolling period of D years'). We comment further on penalty points in 3.8 below.

Either alternative could significantly reduce the burden on HMRC of raising and enforcing automatic penalties. Those taxpayers who did not self-assess their penalty or points would tend to be either those who considered that they had a reasonable excuse (which they could refer to on the return, etc) or the few from whom no amount of any proportionate penalty would produce compliance.

3.1.4 *Self-assessment returns*

In relation to self-assessment returns where there is no tax 'at risk', we think that our suggestion in 3.1.3 above could accommodate this by having a truly minimal level of self-assessment penalty (or points) which was just sufficiently large to serve as an incentive to do better next time. A concern identified in the Membership Survey is that significant penalties in respect of late filing where there is little or no tax at risk can undermine rather than promote future compliance.

3.1.5 One particular concern that we consider should be addressed in any revision of the late filing penalties for self-assessment returns is the scenario that was considered in *HMRC v Donaldson* [2014] UKUT 0536 (TCC). As the case demonstrates, there are traps in the current legislation for an unwary paper-filer who may discover only when it is too late that they had unknowingly been incurring what are commonly referred to as 'daily penalties'.

3.1.6 *VAT Default Surcharge*

The VAT default surcharge regime attracts an understandably large amount of criticism. We certainly recognise the concerns noted in the Consultations regarding:

- The risk that the initial warning letter can lead firstly to complacency and subsequently a shock upon receipt of a large surcharge; and
- The inability of the current system to differentiate between payments that are a day or two late from payments which are many months late – we think that digitalisation (see 3.1.3 above) has the potential to recognise gradations of delay.

3.1.7 Additionally, we identify the following concerns:

3.1.7.1. The suppression of surcharges at the 2% and 5% rates where they would not result in a surcharge of £400 or more significantly exacerbates the risk of complacency and subsequent shock as it increases the possibility of the first 'live' surcharge being at the 10% rate – we appreciate that the £400 'floor' may be designed to avoid what could be seen as the uneconomic pursuit of small amounts (on which see 3.1.2 above) but in the process it may remove the irritant factor that is needed to prompt good behaviour;

3.1.7.2. The policy of no surcharge on the second default for a business with an annual turnover of less than £150,000 can similarly encourage complacency;

3.1.7.3. The scale of surcharge rates for successive defaults (2%, 5%, 10% and 15%) is significantly more severe than the comparable rates for late paid PAYE (1%, 2%, 3%, 4%) – this difference leads to businesses comparing the relative cost of paying VAT or PAYE late (and comparing late

payment of either of them with the more lenient treatment of late payments of Corporation Tax);

3.1.7.4. The steep escalation in the surcharge rate, the inability of the current system to differentiate between very short and lengthier delays in VAT payment and the suppression of low level surcharges combine to produce disproportionate surcharges and do not sit comfortably with the modern concept of encouraging compliance;

3.1.7.5. The disproportionality referred to in 3.1.7.4 above can be particularly acute where a business has a turnover pattern which is either rapidly increasing or subject to significant seasonal variations - as in the well publicised case of *Enersys Holdings UK Ltd* in 2010, where the tribunal overturned a default surcharge of some £132,000 incurred by a business for being only one day late in paying the VAT for its busiest trading quarter;

3.1.7.6. There is no facility for a business to advise HMRC of a 'late reporting reason' – a helpful facility now available in relation to RTI;

3.1.7.7. The rolling 12-month surcharge period can mean that good compliance behaviour immediately following a default is completely ignored if there is then a subsequent default within the period – the focus is entirely on the two defaults and no credit at all is given for the intervening compliance;

3.1.7.8. The complete absence of any provision for suspension of surcharges – having a suspension facility could incentivise businesses to review their systems and seek appropriate advice on how to avoid further defaults.

3.1.8 *Behavioural penalties for inaccurate returns and other failure*

We are unconvinced (but open to persuasion) that new digital ways of working either necessitate or can make a useful contribution to changes in the behavioural penalties for inaccurate returns and other failures. If the thinking is that the new ways of working could enable taxpayers and their agents to undertake more of the work involved in an intervention and the calculation of penalties in return for a reduced penalty loading for that co-operation, we can see that could be mutually beneficial for taxpayers and HMRC. We would like to return to this point at a later stage in the consultation process when the thinking is more developed.

3.1.9 There is a concern that the statutory minimum levels of penalty are distorting the relationship between penalties and behaviours. It is possible that this could be addressed by some adaption of the special circumstances provision (paragraph 11 of FA 2007, Schedule 24). There is a view that the current provisions are discouraging unprompted disclosures and thereby counteracting the thinking behind the lower penalty levels for such disclosures. We think that it would be helpful to conduct research to establish whether that is indeed the case.

3.1.10 There is also a concern that customers who wish to make voluntary disclosures may be discouraged by the material available within HMRC's GOV.UK pages. During our preparation of this response, the front page on *Voluntary Disclosure* (https://www.gov.uk/government/organisations/hm-revenue-customs/contact/voluntary-disclosure-helpline) has been replaced with an announcement

that the section is being rebuilt. It is possible therefore that the following observations concerning the withdrawn pages are already under consideration:

- The pages tended to give the impression of an unfavourable pre-judgement by HMRC of the customer's behaviour;
- They did not support the view that HMRC wished to support customers to get things right (at least in terms of remedying a situation where things had gone wrong);
- They did not include a clear link to a payslip that could be used to help bring a customer's tax affairs up to date.

We think that maximum encouragement should be given to customers who wish to make voluntary disclosures – whether of a one-off nature (for example an omitted capital gain or termination payment) or by someone coming in from the cold. Common to both situations, we think that the provision of a standard form for providing HMRC with initial information about the disclosure would be mutually helpful.

We think that it should be possible to describe the processes relating to voluntary disclosure in a manner that helped the customer to appreciate that it was the right thing to do and would work to their advantage at the same time as not prejudicing HMRC's freedom of action in relation to the disclosure.

3.1.11 The Membership Survey suggests that failure to take reasonable care is HMRC's default position in respect of errors in returns.

3.2 **Question Two**

What do you consider to be the major areas of concern with our penalty regimes?

In addition to the points already mentioned and specific matters raised later in this response, we identify the following major areas of concern.

3.2.1 There appears to be a polarised perception of behaviours (see for example the reference in C.1.2 to the 'honest majority' and the 'dishonest minority). This critically fails to recognise for example that:

3.2.1.1. Adverse changes in the pattern of a customer's routine compliance behaviour are more likely to have been caused by 'life getting in the way' (as a senior HMRC officer succinctly put it at the workshop on 12 March) than by any decision to migrate to the dark side; or

3.2.1.2. An ongoing pattern of non-compliance (such as a continuing failure to file CIS returns) may indicate that someone has lost the plot or has succumbed to the brown envelope syndrome.

In these circumstances, the most appropriate initial response from HMRC should be more interaction with the customer to ascertain why the compliance pattern has changed adversely and in order that suitable action to rectify matters may be initiated rather than a presumption that a penalty should be imposed;

3.2.2 There are significant disparities between the various penalty provisions (because of their differing historical origins) – consider for example the absence of any provision for the suspension of a s.12B TMA 1970 (record keeping) penalty and the differences referred to in 3.1.7.3 above between the late payment regimes for VAT, PAYE and Corporation Tax.

3.2.3 There is currently insufficient joining up of the different taxes so there can be anomalies of interaction.

3.3 **Question Three**

What do you view as being the priority areas for the initial focus of this work?

We identify the following priority areas for the initial focus.

3.3.1 Consideration should be given to the feasibility of adapting the automatic penalty regimes so that taxpayers who are filing or paying late are alerted to the fact and given the opportunity (with a simple online calculator) to self-assess and pay any relevant penalty or surcharge – with an appropriate discount for their proactive engagement.

3.3.2 Research should be conducted into the use, experience and effectiveness of suspended penalties with a view to extending their application more widely and making any necessary refinements to ensure that they meet the objective of encouraging positive compliance behaviour. Over 70% of respondents to the Membership Survey indicated that they thought that:

- HMRC decisions on suspended penalties are by and large fair;
- the conditions imposed are appropriate; and
- the use of suspended penalties had promoted better compliance by the relevant clients.

These findings provide an encouraging base for greater use of suspension.

3.3.3 As a specific in relation to suspended penalties, we think it is essential to establish the extent to which HMRC's practice in relation to suspension (as summarised in *Compliance checks series – CC/FS10* – see https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/367508/cc-fs10.pdf) is restricting the suspension of penalties in situations where paragraph 14 of FA 20017, Schedule 24 would appear to permit suspension. The paragraph provides:

> '*HMRC may suspend all or part of a penalty only if compliance with a condition of suspension would help P to avoid becoming liable to* ***further penalties under paragraph 1 for careless inaccuracy****.'*

By contrast, CC/FS10 states:

> '*We can only suspend penalties for careless inaccuracies in returns or documents if we are able to set at least one suspension condition that will help you avoid* ***penalties for similar inaccuracies*** *in the future*.'

The significance in the distinction between the two emboldened phrases (supplied) is that the table within paragraph 1 of the schedule embraces Income Tax, CGT, PAYE, CIS, Corporation Tax, Annual Tax on Enveloped Dwellings, VAT, Inheritance Tax, Petroleum Revenue Tax, SDLT and Stamp Duty Reserve Tax.

We are concerned that the apparently restrictive wording of CC/FS10 may mean that suspension is being considered inappropriate when it could properly apply.

Compliance Handbook CH83143 provides a significantly more nuanced commentary on the implications of paragraph 14 (3) but it still concludes with the statement:

> '*When considering the likelihood of a future event, you cannot be certain what would happen. So you should not suspend a penalty for a careless inaccuracy where you are not reasonably certain that the specific suspension conditions would help the person to avoid a penalty for a different careless inaccuracy in a future return*.'

This seems to place the emphasis on the likelihood of future failure rather than on the potential for the condition to help the avoidance of future penalties for careless inaccuracies.

3.3.4 On a related point, we note that Compliance Handbook CH83131 states:

> '*You should only suspend a penalty where you establish that the person is likely to comply with any conditions you set*'.

Compared with the objective statutory wording of paragraph 14 (3) (see above), that guidance appears to introduce a subjective judgement and thereby unnecessarily limit the situations when penalties can be suspended. The statute gives no indication that HMRC must weigh up the likelihood of compliance with the suspension conditions.

3.3.5 Also in relation to suspension of penalties, we note that Example 1 in CH83143 illustrates an uncomfortable illogicality (whether in the law or HMRC's practice). It reads:

> '*A tennis club sells all of its land to the local authority for a road widening scheme. The club moves to new premises, which it rents from the local authority.*
> *The club omits the capital gain on the sale of the land from its return. It accepts that a penalty is due for a careless inaccuracy. The club also makes a return of its trading income, an employer's return and a VAT return. Each of those returns is correct and the supporting business records are of an acceptable standard.*
>
> *The club no longer has any land or other assets that, if sold, would lead to a capital gain. As there is no likelihood of a future capital gain, and there is no problem with their other returns or record-keeping, there is no condition that could be set to avoid an inaccuracy arising in future. So you cannot suspend the penalty*.'

So the penalty for the tennis club's omission of the capital gain from its return cannot be suspended because of the high quality of its compliance with its other tax obligations. If its general compliance had been poorer, suspension would have been possible.

Surely if penalties are 'primarily to encourage compliance and prevent non-compliance' (C.5.3 bullet 1), the tennis club should not be disadvantaged (by being denied suspension of the penalty for a one-off careless inaccuracy) because of its otherwise *satisfactory* compliance.

One of our members who reviewed this response at a draft stage reported that they had experience of a situation where suspension of a penalty had been denied because of the company's otherwise satisfactory compliance record.

3.3.6 We think it would be helpful to research the practicalities and relative effectiveness of carrots and sticks (and relevant combinations of the two such as the use of suspended penalties or the digital accumulation of positive 'loyalty' points and negative 'driving licence' points) in relation to the routine compliance obligations of filing and payment in order to make compliance as self-policing as possible.

3.3.7 We think that there could be a presumption towards the suspension of penalties where the failure related to new and significantly different legislation. Our attention has been drawn to refusals by HMRC to suspend penalties incurred in relation to ATED obligations – a situation where there would clearly be ongoing compliance obligations.

3.3.8 Overall, we think that there is a need for greater emphasis on the objectives of suspended penalties. There appears to be a general lack of familiarity with the suspension facility both within and outside HMRC. That can lead to inconsistencies in its application. For example, the Membership Survey indicated that in the cases where suspension was applied, it had been volunteered by the relevant officer in 31% of the cases, requested by the agent in 44% of the cases and resulted from a happy mix of the two in the other 25% of cases. We wonder whether officers understand the role of suspension within the drive to promote compliance or whether they still tend to see it as a soft option which could mean that offering it would adversely impact the assessment of their performance.

We think that there would be greater consistency in the application of suspension if the relevant departmental guidance was made less confusing and if it gave greater emphasis to the benefits of suspension.

3.4 Question Four

Do you agree the principles set out at paragraph 5.3 should govern the design of our penalty regimes? If not what other or additional principles should apply?

3.4.1 In relation to the five principles identified in the Consultation, we offer the following observations:

3.4.1.1. On principle 2, if past behaviour is to be taken into account in calculating a proportionate penalty, it will be essential for the process to be transparent so that the taxpayer understands the implications of their compliance history for any future non-compliance. Without such transparency, there could be scope for appeals to the tribunal on grounds of disproportionality and the tribunal would need to commit unnecessary time to establishing the particular taxpayer's compliance history. Overall, we think that there is a significantly stronger case (and

one that is more in keeping with the principles of justice) for taking account of past compliant (as distinct from non-compliant) behaviour in considering proportionality.

3.4.1.2. On principle 3, we think that there is a distinction to be drawn between the persistently or deliberately non-compliant (who ignore opportunities to become compliant) and the occasionally or unintentionally non-compliant (who respond positively to those opportunities). The policy of suspended penalties already recognises the importance of encouraging redemption. We think that the compliant majority would be at least as satisfied to know that their ranks were being swollen through the judicious use of carrots as to see the erstwhile non-compliant being subjected to penalty sticks which might perpetuate non-compliance.

3.4.1.3. On principle 4, we have commented in 3.1.2 above on the invisible yield (from the compliant) of what would in isolation appear to be the uneconomic yield from modest penalties. That said, we support the principle that the cost of collecting penalties should be borne by those on whom those penalties are charged. In that connection, we think there is scope for exploring the application of the parking fine system whereby there is a significantly reduced liability for early payment that requires minimal intervention by the receiving authority.

3.4.2 In addition to the principles identified in C.5.3, we think that the design of penalty regimes should also reflect the following.

3.4.2.1. There should be a presumption (or at least a greater readiness to accept) that an isolated and relatively minor occasion of non-compliance in the affairs of an otherwise compliant customer had arisen in circumstances where the customer had a reasonable excuse.

3.4.2.2. There should be a reduction of any late payment penalty or surcharge where the taxpayer had proactively contacted HMRC and entered constructive discussions of a time to pay arrangement within a short period after the payment date had passed – the intention here is to avoid the cliff edge situation where contact prior to the payment date might have completely avoided the penalty but where any later contact would not do so.

3.4.2.3. As a general point, we think that it is essential for penalty legislation to be as clear and concise as possible. That can help to:

- ensure common understanding of the provisions;
- reduce the need for explanatory guidance; and
- reduce the risk of inconsistency in application.

3.5 **Question Five**

Do you think that an approach which focused more on individual behaviour would help?

3.5.1 The simple answer (consistent with what we say elsewhere in this response) is 'Yes'. Careful consideration will, however, be required of the factors that should be taken into account and their relative weighting. Without such detailed consideration, there would be a risk that subjective

considerations could lead to an inconsistent and non-standardised approach (contrary to bullet 5 of C.5.3).

3.5.2 It would be essential to have transparency and for all taxpayers to have ready access to clear guidance.

3.6 Question Six

What would be the impact if we were to remove penalties for 'short' failures (a day or two late) and how would we incentivise compliance (would a higher interest rate work for example)?

3.6.1 We do not have an evidence base from which to answer this question but in terms of general concepts we suggest that the following system might work:

3.6.1.1. There would be a rebuttable presumption that the first occasion of a short failure was due to a reasonable excuse;

3.6.1.2. If there was no repetition of failure within a defined period, that would be the end of the matter;

3.6.1.3. If, however, there was a short failure repetition within a defined period, a suspended penalty/surcharge notice would be issued in respect of both failures (albeit reflecting the brevity of each occasion of non-compliance);

3.6.1.4. If there was no repetition within a defined period, the penalty/surcharge would be withdrawn but if there was a repetition within the period the penalty/surcharge would be payable along with any related to the new failure;

3.6.1.5. In the event of the suspended penalty becoming payable, the taxpayer would at that stage be able to advance any reason as to why there was a reasonable excuse for any or all of the defaults.

3.6.2 The thinking behind this concept is that:

3.6.2.1. It would cater for the isolated occasion of short failure with minimal intervention by HMRC;

3.6.2.2. It would increase the incentive to compliance by alerting the taxpayer to a known payable amount in the event of a third short failure;

3.6.2.3. It would protect the taxpayer’s right to demonstrate reasonable excuse in relation to the two earlier short failures without requiring the parties to address the issue unless there was a third failure within the defined period.

3.6.3 We would not favour the use of differential interest rates as that would inevitably taint the interest with the (not unreasonable) perception that it included a hidden penalty element (thereby breaching the principle that penalties should be distinct from interest).

3.7 Question Seven

What do you think should trigger a penalty?

3.7.1 This question is a difficult one to answer as there are such a wide variety of penalties and actions/inactions which can give rise to them.

3.7.2 Briefly stated, we think that a penalty should be triggered by any action or inaction:

- that involves a failure to meet a compliance obligation **and**
- for which there was no reasonable excuse* **and**
- which posed a real risk that the customer would wrongly benefit more than insignificantly at the expense of the Exchequer.

3.7.3 * Our reference in 3.7.2 above to 'reasonable excuse' would within the particular context include (where relevant) the exercise of due care.

3.7.4 One situation where we definitely consider it is ***inappropriate*** for a penalty to be triggered is where a customer has submitted a claim in good faith for consideration by HMRC of their entitlement to a particular relief and HMRC conclude that the claim is not competent. One situation where penalties appear to have been routinely considered in these circumstances is in relation to VAT refunds for DIY house builders. The claim form (VAT431C – see: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/372659/vat431c.pdf) includes a reference in the declaration to the possibility of penalties or prosecution '*if you give incomplete or inaccurate information in this claim*'. However, HMRC appears to have been assuming than any claim that is ruled ineligible might have the potential to trigger a penalty. An extreme example of the practice was considered in the case of *Palau* [2015] UKFTT 0038 (TC) (see: http://www.financeandtaxtribunals.gov.uk/Aspx/view.aspx?id=8226 where the tribunal robustly rejected the basis for any penalty

3.7.5 Another situation where we consider that penalties are inappropriate is where there HMRC and a taxpayer each take different but sustainable views on a technical matter. If the taxpayer subsequently accepts HMRC's view, we do not think that there should be a presumption that a penalty was appropriate. The reasonableness of the taxpayer's initial position should always be considered in such situations.

3.7.6 We anticipate that the use of digital tax accounts may reduce or eliminate the incidence of some penalties as the more joined-up approach to all of someone's tax liabilities and the underlying data should assist the early automated identification of critical events. The case of *Linda Sherratt v Commissioners for HMRC* [2015] UKFTT 83 (TC) illustrates how turnover data returned in relation to self-assessment could with appropriate digital systems have alerted HMRC to a failure to register for VAT. Such harnessing of digitalisation could work to the mutual benefit of HMRC and customers. A similar positive linkage could be made in other situations – for example the cessation of trading or substantial reduction of trading (apparent for self-assessment Income Tax purposes) should alert HMRC to the possibility that RTI or CIS returns might no longer be required.

3.8 **Question Eight**

Are there incentives HMRC could consider to encourage compliance?

3.8.1 We note and generally favour the option of cumulative penalty points (as for motoring offences). Extending the motoring offence analogy, we think that there could be a place for tax compliance awareness courses which taxpayers could opt to attend (at their own expense) instead of incurring penalty points (even if the points in question would have tipped them into a live financial penalty situation). Declaring a potential interest on behalf of our members, we would recommend that those courses were presented by non-HMRC (but HMRC-approved) tax professionals.

3.8.2 The converse of the penalty point concept could be some form of customer loyalty scheme. That is perhaps less fanciful than it sounds as the Consultation already recognises (in C.5.4 bullet 1) the possible non-application of penalties for an uncharacteristic failure by an otherwise compliant customer. That is effectively giving credit for past compliance.

3.8.3 One variant on the loyalty points idea might be the recording on a customer's account (visible to them, any authorised agent and HMRC) of their compliance history in terms for example of:

- the number of times when they had met compliance obligations;
- the number of times when they had failed to meet compliance obligations with the date(s) of the most recent failures;
- the number of occasions (with dates) when they had paid additional tax following any intervention (distinguishing between adjustments for technical and other reasons).

Without attempting to evaluate the customer's compliance history, this tabulated information would nevertheless enable the customer to be aware of how they were doing and how they might be seen by HMRC.

We anticipate that such information will be available to HMRC under digitalisation in any case so what we are suggesting would simply involve a sharing of that information with the customer and their authorised agent. There could be a facility for a customer to opt out of such inclusion of the detail on their account but that in itself would put a prospective new agent on notice of the possible need for additional enquiry and care.

3.8.4 We need to make the point that we offer the above suggestions to this question without claiming any expertise in what influences behaviours.

3.9 **Question Nine**

What could HMRC do better to explain sanctions and the role penalties play within them?

3.9.1 The GOV.UK website already refers to situations when penalties may arise. In some of these situations, there is arguably an excessive emphasis on the potential for penalties. There can be a fine line between giving adequate and excessive warnings.

3.9.2 There are currently 581 results from the opening GOV.UK page for 'penalties' with an HMRC filter. By contrast, if a customer goes straight to the HMRC front page

(https://www.gov.uk/government/organisations/hm-revenue-customs), it takes some imagination and patience to actually locate information on penalties.

Googling 'HMRC penalties' on the other hand leads quickly to a useful overview for agents and advisers (https://www.gov.uk/penalties-an-overview-for-agents-and-advisers).

What a customer is most likely to want to know is 'what penalty could I incur if I failed to meet this particular obligation?' We think that information is best provided through either a description or a link in the particular form, etc that the customer is dealing with at the time.

3.9.3 We think that it is unrealistic to expect customers to be very interested in sanctions and the role that penalties play within them unless they are personally facing the imposition of a sanction or penalty. This means, in our opinion, that HMRC should ensure that all customers who have incurred penalties are given a clear understanding of why a penalty has arisen and the action that they need to take to avoid penalties in future. Where an intervention involves face to face meetings, that can be done in a final meeting. In the increasingly more common situation where there is no such meeting, we think that there could be a place for a simple digital *obligations awareness* sign-off form which:

- briefly took the customer through the reasons for the penalty;
- indicated what action was required to avoid future penalties; and
- included options for the customer to indicate:
    - either that they understand what they need to do;
    - or that they require further information (whether electronic or by human intervention).

We would envisage the completion of the sign-off form being voluntary. Consideration might be given to some token incentive for its completion.

3.10 **Question Ten**

If we were not to charge penalties in all the circumstances that we do currently, how could we still get a strong message across to our customers which they will take notice of?

3.10.1 We have referred within this response to the use of suspended penalties (3.6) penalty points (3.8.1), tax compliance awareness courses (3.8.1) and tabulated compliance data (3.8.3) all of which we think could in appropriate circumstances have a part to play in conveying a strong message about the importance of compliance.

3.10.2 A variation on suspended penalties which might be appropriate in some cases might be a provision for repayment of some or all of a penalty if the customer maintained positive compliant behaviour over a defined period (so that the immediate payment of the penalty was effectively a forfeitable security). It could be useful to have advice from behavioural experts on the relative merits of suspension and provisional payment of penalties.

3.11 **Question Eleven**

To what extent does the present penalty regime help agents and advisers to influence their clients' compliance, and how might this be different if we were not to charge penalties in all the circumstances that we do currently.

3.11.1 In our experience, agents do definitely use the risk of penalties to influence their clients' compliance behaviour. Almost 60% of the respondents to our Membership Survey indicated that the risk of penalties for failure to take reasonable care helped them to persuade clients to take care with their tax.

3.11.2 If penalties were not charged in all the circumstances where they currently apply, the agents' messages to their clients would have to be adapted. However, as the Consultation is considering alternative ways of incentivising compliance from all customers (as distinct from abandoning any consideration of sanctions), agents would presumably refer to those alternative incentives in place of the current penalties.

3.11.3 There is no reason to expect the impact of the alternative incentives on represented customers to be different from their impact on unrepresented customers. On that basis, we do not think that there needs to be any special consideration of how agents would seek to influence their clients' compliance.

3.12 **Question Twelve**

Do you have any comments on the likely impact of any changes, or can you contribute to our evidence base?

3.12.1 If penalties were not charged in circumstances where they currently are, we anticipate that:

3.12.1.1. There would be fewer requests for statutory reviews of penalties;

3.12.1.2. There would be some reduction in the number of penalty appeals taken to the tribunal;

3.12.1.3. There might be some reduction in complaint and MP cases;

3.12.1.4. There might be some reduction in the pressure on HMRC's IT systems including that used for issuing Default Surcharges which we understand to be operating close to breaking point.

3.12.2 Less predictably, there could be an improvement in compliance behaviour if the change helped to eliminate the perception that penalties were operated in a manner that was unfair or unjust with that perception then leading customers to 'try and get even'.

3.12.3 We would be pleased to contribute to the department's evidence base through a survey of our members in relation to specific aspects of penalties if that would be helpful. Do please let us know if this offer has attraction.

4 Summary

The key points of this response (with internal cross references) are summarised in section in section 1.4 above.

5 Contact details

We would be pleased to join in any discussion with HMRC in relation to the ongoing consultation. **Should you wish to discuss any aspect of this response, please contact our relevant Technical Officer, Will Silsby, on 01905 612098 or at: wsilsby@att.org.uk.**

Yours sincerely

Paul Hill

Chairman, ATT Technical Committee

6 Note

6.1 The Association is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical experience and knowledge, we contribute to consultations on the development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible.

Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

The Association has over 7,700 members and Fellows together with over 5,600 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.