Finance Bill 2018–19: Penalties and interest (Clauses 30-32 Schedules 11–14)

Indirect Tax **Management of taxes**

01 October 2018

The CIOT, ATT and LITRG have responded to consultations on the draft Finance Bill 2018-19 Clauses and Schedules in respect of penalties and interest.

Clauses 30-32 and Schedules 11–14 of draft Finance Bill 2018-19 deal with penalties for failure to make returns and deliberately withholding information; penalties for failure to pay tax; and repayment interest for VAT.

CIOT had a meeting with HMRC in August to discuss the draft legislation and followed this up with some written comments on Schedule 11 (penalties for failure to make returns) and Schedule 14 (VAT: repayment interest).

ATT submitted comments on all of Clauses 30-32 and Schedules 11–14, as set out below.

LITRG submitted comments on Clause 30 and Clause 31 and their accompanying schedules (11 and 12). In their general comments, LITRG noted that it has previously welcomed the aim of trying to differentiate between deliberate and persistent non-compliers and those who make occasional innocent errors, for whom alternative interventions might be appropriate. We think that largely the regimes provided for by the draft legislation achieve this, and for the most part adhere to HMRC’s five design principles for penalties.

LITRG accepts that simplifying and harmonising penalties and interest makes the regime simpler, but does not believe that it equates to making it easier for people to comply with their obligations. Ease of compliance depends on systems being easy to access and use, processes working smoothly and clear guidance being available,

accepting that a sensible and clear sanctions system for non-compliance should act as an incentive for people to comply with their obligations.

Clause 30 and Schedules 11 and 12

Clause 30 and Schedules 11 and 12 introduce a new points based penalty regime for late filing and make amendments to the penalty regime for deliberately withholding information from HMRC.

LITRG noted that the implementation date of the new penalty regime for income tax self-assessment filing obligations is to be announced in due course. As it is accepted that the proposed points based model is more appropriate than the current regime, we recommended that consideration is given to introducing the new penalty regime for income tax self-assessment from 6 April 2020 (assuming it will be introduced for VAT with effect from that same date), but subject to an appropriate familiarisation period. ATT made a similar point in relation to the commencement of the new penalty regimes and noted that an early and consistent start date would address the familiar problems associated with the VAT Default Surcharge regime and the income tax self-assessment late submission provisions (the *Donaldson* type cases).

LITRG recommended that HMRC carry out consultation with stakeholders prior to setting the penalty amounts, which are currently unspecified.

The LITRG response also noted that the two-year time limit for assessments as set out by paragraph 18 of draft Schedule 11 is too long and runs counter to one of the aims of the new penalty regime – to encourage taxpayers who have been non-compliant to become compliant again quickly. In the majority of cases, HMRC will be fully aware of the taxpayer's accumulated points. LITRG thought the time limit should better reflect the objective of encouraging a taxpayer to comply with their filing obligations. One option would be to set time limits for assessments that are in line with the time limits for the award of penalty points. ATT commented similarly on the time limit for assessing a penalty and also questioned the time limit for HMRC to award individual penalty points. CIOT noted that, in practice, if the issue of points and penalties is automated, there would seem to be no reason why they should not be issued as soon as the failure has occurred, and HMRC's systems should be set up so that this is the default position so as to enable the taxpayer to have time to put things right quickly and file their next return on time, that is to encourage compliance.

The LITRG response noted that paragraphs 24 to 26 of draft Schedule 11 provide for appeals against penalty points and/or penalties, but make no distinction between the appeal processes for penalty points and those for penalties. While welcoming the fact that taxpayers will be able to appeal individual penalty points as they are awarded, LITRG do not think taxpayers who choose not to appeal individual penalty points as they arise should be disadvantaged. We therefore requested confirmation that the legislation ensures that not appealing a penalty point when it arises does not prevent the taxpayer from challenging that point in the event of a subsequent penalty appeal, and that an appeal against a penalty automatically constitutes an appeal against all the penalty points contributing to that penalty, with certain exclusions. The ATT response made substantially similar recommendations. ATT noted that in the event of the tribunal hearing an appeal against a late submission penalty, the draft legislation did not necessarily provide the parties with certainty as to the validity or otherwise of all the constituent penalty points. ATT's response on Schedule 11 included a suggested solution to the point.

The CIOT commented that giving the Tribunal the power to consider not just the appeal against the penalty but at the same time the points awarded leading to the penalty is a flexible and practical approach. Taxpayers will all react differently to getting a point (some may appeal immediately, others won't), so the system needs to be designed as far as possible to ensure it runs smoothly and fairly for all concerned.

Given the likelihood of there being a substantial number of contested points and penalties for HMRC to deal with, the CIOT suggests that HMRC consider making it mandatory to first request a statutory review by HMRC before an appeal can be lodged with the tribunal. This process should help accelerate the resolution of disputes and significantly 'de-clog' the system before appeals reach Tribunal stage. From discussions with HMRC the CIOT understands that the taxpayer will be able to notify HMRC of a reasonable excuse in advance of a submission failure, for example one caused by a software or hardware issue. This will clearly be very useful, but we have said that it must also be available to agents (as must the facility to appeal points and penalties on clients' behalf) and this should be built into the systems under development.

On Schedule 12 (the revised penalty regime for deliberately withholding information from HMRC), LITRG questioned whether the *de minimis* amount of the penalty should be the same for deliberate but not concealed behaviour as it is for deliberate

and concealed behaviour, as provided for by paragraph 3(3)(b) and (5)(b) of Schedule 12. In particular, we question whether this is proportionate and whether it meets HMRC's five design principles for penalties.

ATT's main focus in relation to the replacement of existing paragraph 6, Schedule 55, FA 2009 by the draft Schedule 12 provisions was the abandonment in the latter of the current 12-month waiting period before the withholding information penalty can arise. Noting that the proposal meant in theory that the penalty could arise on the day immediately following the due date for submission, ATT's response recommended both the introduction of a motive test (the deliberate intention to frustrate HMRC's ability to assess and collect tax) and the inclusion of a modest but reasonable waiting period (three months suggested) before the penalty could arise.

ATT also commented on the application of Schedule 12 penalties to partnerships and company officers.

Clause 31 and Schedule 13

Clause 31 and Schedule 13 introduce a new two-tiered penalty regime for taxpayers that fail to pay tax liabilities on time.

Since there are elements of the new late payment penalty regime that introduce complexity, LITRG recommended that taxpayer guidance should be clear and ensure the regime is transparent, setting out all rights and obligations of both HMRC and taxpayers. For instance, examples setting out potential taxpayer liabilities should include both the initial penalty, the second (interest-related) penalty and (normal) late payment interest. Moreover, notifications issued to taxpayers should explain how penalties and interest will be worked out, so that the levels of the second penalty and any late payment interest do not come as nasty surprises.

Again LITRG recommended that HMRC carry out consultation with stakeholders prior to setting the penalty percentage amounts, which are currently unspecified.

ATT's main concern on Schedule 13 was the consequence of a time to pay agreement (a pivotal element in the proposed late payment regime) being breached. As drafted, such a breach requires a re-writing of history by deeming the agreement never to have existed. That involves tax payments which were paid late but in accordance with the terms of a time to pay agreement (TTP) being subjected to the same late payment penalties as if the taxpayer had never entered a TTP – a

particularly harsh consequence if the breach occurred at or close to the final instalment due under a TTP. ATT's response noted that the tribunal might well regard the reasonable excuse provisions as being relevant where a taxpayer had until the breach made all the instalment payments in accordance with the TTP which had been agreed by HMRC. ATT suggested alternative provisions which might avoid the retrospective re-characterisation of the taxpayer's actions.

Clause 32 and Schedule 14

Clause 32 and Schedule 14 make changes to Finance Act 2009 to bring VAT into the scope of the provisions for repayment interest.

These changes include the introduction of two key restrictions on the operation of repayment interest for VAT, which provide that an amount of VAT credit will no carry interest during any period where:

- HMRC has a reasonable inquiry or are correcting errors or omissions in the relevant VAT return; or
- other VAT returns are outstanding or there is a failure to comply with a notice to produce evidence or security.

Neither of these restrictions apply to repayment interest in income tax self-assessment or the equivalent provisions for corporation tax.

The ATT response noted that these extra restrictions appear to undermine the policy aim of harmonisation and will make the repayment interest regime more complicated for both HMRC and taxpayers.
Whilst it may be reasonable to withhold payment of repayment interest where returns are outstanding or inquiries are underway, the ATT cannot see how it can be correct for a business to completely lose its entitlement to repayment interest in such circumstances. In addition, the restrictions could have particularly inequitable consequences where an outstanding return shows no overall VAT liability, or where a VAT adjustment arises which results in an underpayment in one period (which will attract late payment interest from the due date) and an equal and matching overpayment in another period (which will not attract any corresponding repayment interest).

The ATT therefore believe that the restrictions on repayment interest set out above should be removed from the final legislation. All that is required is a provision which

ensures that interest will not be paid to the taxpayer until after the particular circumstances have been addressed. This would put VAT repayment interest on the same footing as ITSA and corporation tax, making the system more equitable and easier for both taxpayers and HMRC to apply.

The CIOT agrees that the draft legislation as it stands is unfair and suggests that a fairer approach would be:

- To pay interest in relation to periods for which there are enquiries by HMRC, on amounts of tax which (after HMRC's enquiries have been concluded) are properly repayable; and
- Where there are outstanding returns, to pay interest on the 'net' amounts outstanding, when those amounts can be finally calculated. (As currently drafted, even an outstanding earlier repayment or nil return would preclude interest from being paid on a properly submitted repayment return).

The CIOT submissions can be found on the CIOT website.

The ATT submissions can be found on the ATT website.

The LITRG submissions can be found on the LITRG website.