Right first time: a new approach to penalties?

Technical

01 April 2015

Key Points

Government is committed to making the UK tax system user-friendly and efficient Digitally-based services are key part of transformation How do you create a penalty regime that fits into a digital system?

The government has announced a consultation to look at designing a penalty system that works in a modern, digital world. You can find details of this on the CIOT website . It is a Stage 1 consultation to seek views on the policy design and any suitable alternatives before a further consultation on a specific proposal for reform.

What we need

We would like to hear your views on the proposals in the consultation document. Our early meetings with HMRC have indicated that HMRC will consider radical changes to the current system to meet their aims and, consequently, input from our members will be valuable in informing the debate.

One option being consulted on is whether there should be a progressive system, in the way that penalty points are handed down for motoring offences, so that initial financial penalties are avoided but more substantial ones will apply for more serious or persistent failures.

Another suggestion is whether removing penalties for being a day or two late would work, and whether a higher interest rate would improve compliance.

Do you agree with HMRC’s suggestions? Do you have any suggestions of your own?

Have you had a situation where a client has been liable for a penalty that you considered ineffective, disproportionate or unfair? We would like to know.

Background

The principles that underpinned the HMRC Powers Review between 2005 and 2012 were that penalties should influence behaviour, be effective and be fair. HMRC believe these principles remain relevant today, and we would not disagree with this. However, there remain anomalies and, because some of the tests of good and bad behaviour are subjective, there have been hard cases. In addition, some of the fixed automated penalties are seen as disproportionate to the original error.

In relation to VAT, the default surcharge system was not replaced and anomalies still arise, in particular the huge penalties that are levied for being just a few days late with a return.
The OTS suggested that there should be a post-implementation review, and that is what HMRC have decided to do.

What is the consultation about?

As HMRC move towards the provision of digital services, they want to look at designing tax policy for a modern, digital world. As they change the way they operate, they believe they will need to change how they apply penalties. The consultation document considers the options.

HMRC recognise that there have been problems with the current penalty regime. Some of these arise (as members have told us) because behaviour tests are subjective, so HMRC have challenged members on whether an error is careless or not. Such challenges take time and will detract from a system that relies on automation to be efficient. HMRC also recognise that some penalties fail to distinguish between a taxpayer who misses a deadline by one day and someone who has made no attempt to comply at all.

HMRC therefore want to consider whether they can ‘better differentiate between deliberate and persistent non-compliers and those who might make an occasional error for whom alternative interventions are more appropriate’. During much of last year LITRG held helpful discussions with senior HMRC officials about the hard cases

where people who have failed to file their self-assessment return because of confusion or illness (such as a mental health problem), but who owe little or no tax, are charged the same swingeing penalties as the deliberate and persistent defaulters. We also discuss below a possible trend regarding the unhelpful automatic application of inaccuracy penalties.

This consultation will have served a good purpose if one of the outcomes is to temper the harshness of automatic penalty regimes with a more proportionate approach.
HMRC's ultimate aim is that compliance should be looked at holistically so it is possible that in the future there will be a single tax account for all taxes, and all errors (and other events) will be taken into account in determining whether a taxpayer is compliant and, if not, whether there should be non-financial sanctions, such as penalty points, or a financial penalty.

CIOT members' input

Thank you to members who completed our member survey on HMRC powers in February. We will feed the survey results into our discussions with HMRC about this consultation document.

Now, please let us have your views on the penalties regime and how it can be improved and adapted to the digital age.

Email any direct tax comments to technical@ciot.org.uk or indirect tax comments to indirecttax@ciot.org.uk or, in the case of ATT members, for both direct and indirect taxes to atttechnical@att.org.uk.