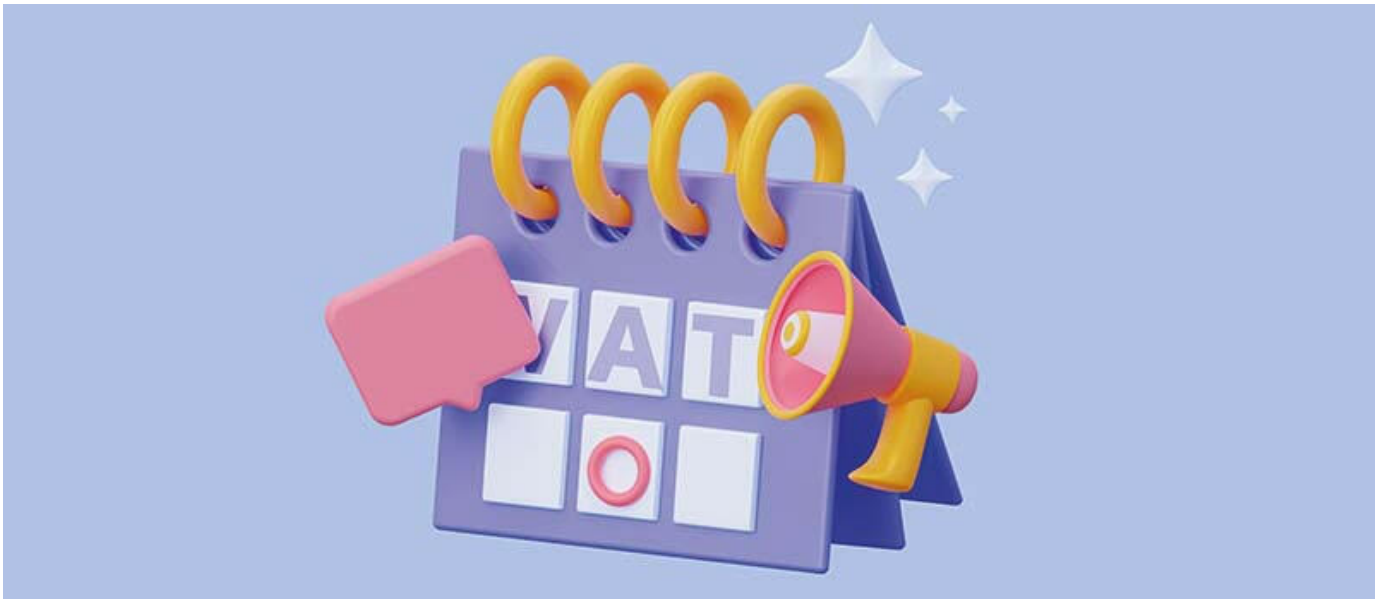
# Late VAT returns: points will lead to penalties

Indirect Tax




21 October 2022

From 1 January 2023, late VAT returns will be subject to potential penalties, including repayment returns.

## Key Points

### What is the issue?

A new penalty system will be introduced for VAT periods beginning on or after 1 January 2023 that, according to HMRC, will penalise ‘only the small minority who persistently miss their submission obligations rather than those who make occasional mistakes’.

### What does it mean for me?

A VAT registered business will be issued with a penalty point for each return it submits after the due date. A ;£200 penalty will be issued when a business submitting quarterly returns reaches four points and a business submitting monthly returns reaches five points.

**What can I take away?**

Points and penalties will also apply to repayment and nil returns that are submitted late. This is a major change to existing procedures. It is important to inform businesses which have a lot of zero-rated sales about this outcome so they can be fully compliant with the new rules.

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Older readers will remember the famous catchphrase of the late entertainer Bruce Forsyth with his game show quip that ‘points make prizes.’ As far as the new penalty regime for submitting late VAT returns is concerned – which takes effect for periods beginning on or after 1 January 2023 – it will be a case of ‘points make penalties’.

I will explain the new system in this article, including the major change that repayment returns will also be subject to points and potential penalties. Please send an urgent email alert about this change to your clients who are farmers, exporters, grocers, bookshops, builders working on new homes… and many others.

## Two systems

As explained in my previous *Tax Adviser* article ‘Radical changes: late VAT payments’ (October 2022), there will be two ;completely different penalty systems introduced on 1 January. One will deal with late returns and the other when tax has not been fully paid by the due date. Payment issues were considered in my previous article.

The new regime for late returns will be based on a points accumulation system: a business will get one point for each late return it submits and then a £200 penalty will be issued by HMRC when it reaches its points threshold. The threshold depends on the frequency that returns are submitted:

- monthly returns: threshold is five;
- quarterly returns: threshold is four; and
- annual returns: threshold is two.

The new system has been compared to a driver getting three points on their licence for each speeding offence they commit and being issued with a fine when they get to 12 points. The comparison is reasonable because there are plenty of lifelines with both systems, so to speak.

The generous thresholds mean that the earliest date for any late return penalty will be 7 July 2023. This will be issued to a business that submits late monthly returns from January to May 2023, reaching its threshold of five (the return for May 2023 having a submission date of 7 July).

## Purpose of the new rules

To share a tale from my Customs and Excise days, I visited a sole trader in Northampton, who had not submitted any VAT returns for three years. The department had not chased him until then because he traded as a milkman; i.e. making zero-rated sales. He therefore submitted repayment returns each period. The department's policy in those days was to not chase outstanding returns that would result in a refund.

However, unbeknownst to us, he had changed his business activity from a milkman to a maintenance engineer three years earlier, so those outstanding periods now owed a lot of VAT. He was no longer a repayment trader because his income was standard rated!

The moral of this tale is that HMRC expects – rightly – that all returns will be submitted on time, so that liabilities are properly declared and paid. This means that repayment returns will be subject to a ;penalty with the new regime.

## Repayment returns

In practical terms, a return can only have three outcomes. It will produce:

- a net payment to HMRC – which is most returns;
- a net repayment, e.g. for a business with mainly or all zero-rated sales, such as those I listed above; or
- a nil return, perhaps because a business is temporarily not trading.

All returns will fall within the late filing penalty regime. The priority, I feel, is for advisers to inform all businesses that submit regular repayment returns about the

new system so that they are aware of the changed goalposts from day one. It is a major change of direction in the legislation because it will be the first time in the lengthy history of our favourite tax that repayment returns will be subject to a potential penalty.

HMRC will carry out a publicity operation to highlight this issue to relevant repayment traders, such as farmers. I have not dealt with farmers for many years but a ;common habit was for them to submit four or five returns at the same time, usually when they needed some VAT refunds to buy a new piece of machinery.

## Escaping the points regime

A business submitting quarterly returns will get a £200 penalty once it has accumulated four points; i.e. four returns after the due date. Each subsequent late return will incur a further penalty of £200. However, all points will be wiped off the system once they are two years old. This common-sense approach is intended to prevent historic points and occasional recent failures awkwardly combining to produce a financial penalty. It is possible to wipe the slate clean and return to zero points if two conditions are fulfilled:

- All returns for the previous 24 months must have been submitted by the business.
- The business must have submitted all ;returns on time for 12 months after ;reaching the relevant points threshold. However, the relevant period is 24 months for a business on annual returns and six months for monthly returns.

See ***Florist Flo: late VAT returns***.

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## Florist Flo: late VAT returns

Florist Flo submits calendar quarter returns and submitted her 2023 quarterly returns late. She therefore incurred a £200 penalty for the December 2023 period when she reached the four points threshold.

She must submit all returns on time until December 2024 – the next four returns. Otherwise, each late return will incur a further £200 penalty.

If Flo has a clean slate until December 2024, and has also submitted all returns for the previous two-year period, she will return to zero points again.

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## Appeal procedures

The new system should produce a greatly reduced number of hearings in the First-tier Tax Tribunal about whether a business had a reasonable excuse for submitting a late return. This is because the new system will not produce massive penalties for a business that slips up with occasional misdemeanours, as is often the case with the current default surcharge system. And the threshold limits with the points system are generous. This will benefit both HMRC and taxpayers by reducing time-consuming internal appeals.

Appeals can still be made with the new system and the reasonable excuse provisions will still be relevant.

See ***Builder Bob: reasonable excuse for late submission***.

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## Builder Bob: Reasonable excuse for late submission

Bob is a builder who only works on new dwellings; i.e. his services and materials are zero-rated. He is a repayment trader for VAT purposes and submits monthly returns.

He was late submitting them for five successive periods from March to July 2023 and HMRC issued a penalty of £200 for his fifth late submission. However, the reason that Bob could not submit the July return on time was because he was in hospital during the first ten days of September when the return was due.

Bob will almost certainly be successful with a reasonable excuse appeal to HMRC for the July period. However, he still has four penalty points to his name for the other late returns, so must submit the next six returns on time to avoid a £200 penalty. If he does this, his points total will revert to zero.

Note: If Bob submitted quarterly returns, he would need to submit the following four returns on time to return to zero points.

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# End of repayment supplement

I have saved the bad news until last; namely, the withdrawal of the repayment supplement regime where a business gets a 5% windfall for any repayment on a return that is delayed by HMRC for more than 30 days after its submission.

The repayment supplement system has been in force for many decades and is a useful piece of legislation to encourage HMRC to deal with queries it raises before repaying a return in a timely and efficient manner. It will end on 31 December 2022 and be replaced by the introduction of repayment interest. But here is the disappointing fact: interest will be calculated according to the Bank of England base rate minus 1%. If the rate falls below 1% – unlikely for quite a long time – a minimum rate of 0.5% will apply.

Interest will be calculated from the day after the due date for the period in question or the date of submission – whichever is later – until the day that HMRC fully pays the repayment amount that is due.

I will not give any examples of how the numbers will work because we are talking about small amounts that will just about pay for a cup of coffee… but only a cheap one in a plastic cup!

## Conclusion

To give HMRC the final word, the aim of the new system is to penalise ‘only the small minority who persistently miss their submission obligations rather than those who make occasional mistakes’. The number of lifelines with the points system for late returns supports this objective.

Some commentators have questioned whether a £200 fine is sufficient to encourage compliance. Based on the frantic activity that goes on in the profession in the last weeks of January to avoid £100 self-assessment fines, I suspect the answer will be ‘yes’ – and think of the way that we acted when shopping bags first became subject to a 5p tariff!

Overall, the new rules for late return filing penalties are clear and logical. The ;£200 fine should be sufficient to encourage compliance without causing financial ruin to a business that falls foul of the rules.