Voluntary disclosures: how to correct mistakes in tax payments

Personal tax



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If you need to correct mistakes in tax payments, a voluntary disclosure can be less intimidating than facing an extensive enquiry or complex investigation.

Key Points

What is the issue?

HMRC provides several methods for taxpayers to tell it about their mistakes and bring their tax affairs up to date by making disclosures.

What does it mean to me?

Acting quickly to make a full, unprompted voluntary disclosure before HMRC asks questions should reduce any tax-geared penalties due, mitigate late payment

interest charges and avoid a full investigation.

What can I take away?

It is important that taxpayers choose the correct method for their disclosure and avoid the pitfalls.

The UK government regards tax compliance checks as a key tool to help tackle the tax gap and fund the Exchequer. In 2021 and 2022, the Chancellor increased HMRC's funding for tackling non-compliance, including by wealthy taxpayers and in relation to tax fraud. HMRC increasingly uses nudge letters to encourage taxpayers to check their tax returns and correct mistakes. Consequently, when mistakes come to light, it is vital for taxpayers to act quickly and proactively register to make voluntary disclosures.

What is a voluntary disclosure?

HMRC's ability to gather information and data on each individual taxpayer is wide reaching. Powerful software programs (e.g. Connect) glean large amounts of data from numerous sources, which HMRC uses to build a detailed picture not only of a person's tax position, but also their lifestyle. HMRC can access data from Companies House (including the new register of overseas entities owning UK property), banks and the Land Registry. It regularly receives overseas data under the Common Reporting Standard and will also receive data under the forthcoming digital platform reporting rules (Finance Act 2021 s 129).

Despite compiling this information, HMRC still doesn't know everything about every taxpayer and so may be unsure whether they have paid the correct amount of tax. This provides scope for taxpayers to act before HMRC's spotlight shines upon them, by means of a new enquiry or investigation.

Telling HMRC about mistakes voluntarily, without being prompted, is known as making a 'voluntary disclosure'. The key word here is 'unprompted'. This is defined as telling HMRC at a time when the taxpayer has no reason to believe that HMRC has discovered (or is about to discover) non-compliance (Finance Act 2007 Sch 24 para 9(2)).

Generic nudge letters, particularly educational ones, do not constitute prompting. However, receiving a specific, targeted nudge letter which HMRC issued as a result of analysing data usually means that the subsequent disclosure is prompted (Compliance Handbook CH82421).

The need to confess mistakes to HMRC can arise for several reasons, predominantly when someone becomes aware of undeclared income, profits or gains that were omitted from previous tax returns or realises that they should have filed returns. Sometimes taxpayers recognise that they failed to correctly implement planning, for example where a company makes mistakes in conducting its operations and triggers a UK permanent establishment.

On other occasions, taxpayers may realise that advice they received several years ago is now obsolete due to changes in the law but they failed to adapt their actions accordingly. Therefore, more tax is due – for example, by a person who did not refresh advice received about their tax residence status and consequently became UK resident after the statutory residence test was introduced.

Alternatively, they may realise, perhaps because of due diligence relating to a business transaction, that they incorrectly understood a technical issue or received incorrect advice in the past so their tax needs correcting.

Why disclose voluntarily?

Making a disclosure means that the taxpayer is starting the process so they may feel somewhat more in control, even if it starts after HMRC sends them a nudge letter. It is often considered less intimidating and more focused than facing an extensive enquiry or complex investigation.

If the disclosure is unprompted then the taxpayer may benefit from lower tax-geared penalties for errors (Finance Act 2007 Sch 24), failures to notify (Finance Act 2008 Sch 41) or Failure to Correct penalties (Finance (No2) Act 2017 Sch 18). For example, in the absence of a reasonable excuse, Failure to Correct penalties are a minimum of 100% or 150% of the tax (for unprompted and prompted disclosures, respectively) or 200% maximum.

Unprompted disclosures also reduce the chances of the taxpayer’s details being published even if the disclosure relates to offshore issues (Finance Act 2009 s 94).

Settling the tax following a disclosure stops late payment interest running, which motivates taxpayers to conclude disclosures given the current rate is at a 14 year high.

Disclosure facilities

There are several methods for taxpayers to tell HMRC about their mistakes, each with different criteria and benefits. The best option for the taxpayer will depend on the precise circumstances and the specific issue or issues to be disclosed.

The Contractual Disclosure Facility exists for disclosures of deliberate non-compliance involving tax return errors and failures to notify of any type of tax. The Contractual Disclosure Facility is within the Code of Practice 9 framework and is operated by HMRC's Fraud Investigation Service. Making full disclosures through this facility offers taxpayers immunity from criminal investigation, ensuring that the matter is resolved using civil law. Voluntary disclosures start with the submission of form CDF1.

The Digital Disclosure Service portal is used for the following facilities:

- The Worldwide Disclosure Facility: to disclose offshore income, gains or profits on which additional UK tax is due.
- The Digital Disclosure Facility: to tell HMRC about additional onshore liabilities of income tax, capital gains tax, inheritance tax, corporation tax, NICs and annual tax on enveloped dwellings.
- The Let Property Campaign: allows landlords to disclose tax non-compliance for let residential property, either in the UK or overseas.

There is no immunity from criminal investigation offered when using the Digital Disclosure Service. Consequently, it is primarily suited to taxpayers whose mistakes were not deliberate. Once HMRC acknowledges the taxpayer's intention to disclose, the taxpayer has 90 days to submit their disclosure and offer letter.

HMRC introduced a new facility in January 2023 enabling taxpayers to submit a form online to disclose electronic sales suppression (see bit.ly/42HesRc). In April 2023, HMRC started issuing nudge letters to those who it believes need to disclose additional tax due to electronic sales suppression.

Electronic sales suppression involves using software which manipulates electronic till systems to supress the level of takings recorded, thus reducing its declared taxable profits. Additionally, HMRC can now charge additional penalties to those who make, supply, promote or possess electronic sales suppression tools (Finance Act 2022 Sch 14).

Whilst HMRC's online form is available, electronic sales suppression involves fraudulent behaviour. Therefore, as set out in a posting by CIOT (see bit.ly/44McGjP), taxpayers should be hesitant to use it because the process offers no immunity from criminal prosecution. Advisers should consider whether the Contractual Disclosure Facility is the better option for clients to make disclosures of such deliberate non-compliance.

Large businesses and wealthy taxpayers usually have Customer Compliance Managers to contact with queries and disclosures, but mid-size businesses that need to make a disclosure should contact HMRC's Mid-sized Business Customer Support Team via bit.ly/42sMA3s. The Profit Diversion Compliance Facility may be used by multinationals to rectify transfer pricing issues which might otherwise give rise to diverted profits tax liabilities (see bit.ly/2Dc9xPj).

The disclosure process

Disclosures generally involve:

- notifying HMRC that the taxpayer wants to make a disclosure;
- receiving HMRC's acknowledgement, together with a registration number if the Digital Disclosure Service is used;
- submitting the disclosure, telling HMRC what went wrong, why the mistakes were made and quantifying the tax, interest and penalties due;
- HMRC checking the disclosure, asking questions to check whether the submission is correct and complete; and
- closure, usually via a contract settlement (Taxes Management Act 1970 s 54), although sometimes formal assessments are issued. A case may proceed to appeal if liabilities are not mutually agreed. Where time is needed to settle the liabilities, instalments may be included in contract settlements.

For unprompted Contractual Disclosure Facility disclosures, HMRC expects taxpayers to file an admission of deliberate behaviour and an outline disclosure within 60 days.

Subsequently, taxpayers must submit a statement of their assets and liabilities at a specific date, together with certificates of bank accounts and credit cards operated and their full disclosure reports. HMRC also requires a signed Certificate of Full Disclosure confirming that all non-compliance is disclosed and rectified.

It is essential that taxpayers carefully reflect before signing this document, because if HMRC discovers any inaccuracies in a period covered by a signed Certificate, this can be used in any future prosecution or taken into account in quantifying behavioural penalties in relation to those issues.

Potential pitfalls

Firstly, it is important to register for the most appropriate facility to suit the nature and extent of the mistakes to be corrected.

Secondly, all disclosure processes involve deadlines. Missed deadlines, without good reasons such as serious illness, may cause HMRC to take the initiative and open extensive compliance checks, seeking information and documents to establish the tax due, which may take years to resolve. Missed deadlines also risk lower penalty reductions, thus increasing the overall amount payable to finalise a disclosure.

Thirdly, the disclosure will be incomplete if it omits any non-compliance, so care is needed to disclose both the initial problem and tax arising from subsequent decisions. For example, if business profits were hidden from HMRC and the money invested in shares and buy-to-let properties, then the investment income, rental profits and associated capital gains must be disclosed in addition to tax on the undisclosed business profits.

Submitting incomplete disclosures risks HMRC asking extensive questions and investigating all the taxpayer’s tax affairs to establish the full extent of their mistakes, with increased penalties. In the most serious (Contractual Disclosure Facility) cases, if the Fraud Investigation Service suspects an incomplete disclosure, it can refer the taxpayer back to HMRC’s Criminal unit for further consideration. The terms of the Contractual Disclosure Facility only apply to the admissions contained in the outline disclosure (Fraud Civil Investigation Manual FCIM204050), so anything outside of that is potentially liable to criminal investigation.

The potential pitfalls and complexities of making disclosures, not to mention the Professional Conduct in Relation to Taxation, make it abundantly clear that advice should be sought from a suitably qualified tax dispute resolution specialist. The specialist will recommend the most appropriate method for the disclosure given the client’s circumstances and guide them through the process. This includes advancing suitable arguments on technical matters such as discovery, assessment time limits and penalties depending on what went wrong and any mitigating factors which may give rise to reasonable excuses or special circumstances.

Conclusion

Voluntary disclosures are an important mechanism for taxpayers to correct mistakes, putting their mind at ease and potentially bringing both financial and reputational benefits. However, care and experience are needed to choose the right disclosure method, avoid the pitfalls and reach a mutually acceptable agreement with HMRC.

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