Reform of behavioural penalties: HMRC consultation

Management of taxes



20 August 2025

CIOT, ATT and LITRG responded to HMRC’s consultation published in March 2025 seeking views on options to reform error and failure to notify penalties in FA 2007 Sch 24 (Penalties for errors) for direct taxes and FA 2008 Sch 41 (Penalties: Failure to notify and certain VAT and Excise wrongdoing). At the time of writing, the government is analysing responses.

The consultation proposed two different approaches to reform:

1. Reform the existing framework: This approach would retain key aspects of the existing penalty system but simplify how penalties are calculated and applied. This could involve reducing the number of penalty categories, standardising how behaviour is assessed and making the rules clearer and easier to follow.
2. An alternative model: This approach considered a more fundamental redesign of penalties to improve clarity and consistency. It looks at whether a different

structure could better achieve fairness, compliance and deterrence while reducing complexity for taxpayers, agents and HMRC.

The CIOT response

The CIOT agrees that the current error and failure to notify penalty regimes are complex, difficult to administer and in urgent need of simplification. They also need to provide stronger incentives for taxpayers to make disclosures and co-operate with HMRC compliance checks.

We support the removal of minimum 10% penalties for inaccuracies disclosed after three years and for failures to notify for non-deliberate behaviour after 12 months, and we agree that there is scope for penalty reductions for the type and quality of disclosure to be simplified. But we are not convinced that the suggestion of breaking down reductions between ‘telling’ and ‘helping’ and ‘giving access’ will simplify the regime. Arguably, there should be a single reduction for co-operation.

We agree with the principle that deliberate behaviour should be penalised more than careless behaviour. In our view, the current penalty ranges for deliberate behaviour are appropriate. We are not persuaded that they should be increased.

We struggle to see that there is any merit in increased penalty levels for continued/repeated errors because we consider this is already built into existing penalty calculations.

We support the simplification of offshore penalties. The rationale for having higher rates for offshore non-compliance is no longer valid now that there are sophisticated data sharing mechanisms with most overseas jurisdictions. The deterrent effect of higher penalties is also highly questionable. A simplification would be to restrict increased penalties to offshore matters where the behaviour is deliberate and where the offshore territory has not signed up to Automatic Exchange of Information Agreements.

We are attracted to the idea of replacing penalty suspension with a ‘caution’. We think the other suggestion in the consultation – of automatic suspension with the penalty being reinstated for another mistake (which may be unrelated) – is problematic, albeit well intentioned. It would be more complex to implement than a caution.

On the alternative model, our view is that the link between behaviour and penalties needs to be retained because it is an important principle. As such, we do not support stripping back behavioural considerations as is being suggested, but we can see the advantages of simplifying the current regimes. We therefore support retaining (but simplifying) the existing regime so that it remains necessary for HMRC to demonstrate careless or deliberate behaviour.

We do not agree with the proposed new non-financial sanctions, not least as they are too draconian and would deter taxpayers from making disclosures and agreeing to deliberate penalties.

The full CIOT response can be found here: www.tax.org.uk/ref1486

The ATT response

ATT fully advocate a modern tax administration system which seeks to prioritise informing and educating taxpayers of their tax obligations over penalising them, either financially or otherwise.

We support penalty systems which provide consistent graduated responses to taxpayer behaviour, ranging from providing extensive opportunities to voluntarily correct mistakes up to the pursuit of criminal sanctions for cases of serious fraud or evasion.

We consider that there are opportunities to simplify the current penalty regimes by:

- eliminating the minimum 10% penalties currently applied to inaccuracies disclosed after three years and to failures to notify disclosed after 12 months, in cases of non-deliberate behaviour;
- aligning onshore and offshore penalties; and
- replacing suspended penalties for careless errors and omissions with a ‘Must Improve’ letter.

We support HMRC looking at new and improved ways to modernise and simplify the penalty system, but we were not in support of the alternative legislative process put forward in the consultation. We had concerns that the delivery costs would outweigh any opportunities for simplification, particularly in relation to:

- the transitional costs of introducing new legislation;

- moving to new processes for administering and dealing with the penalties; and
- educating taxpayers on any new sanctions or safeguards.

Whilst the change would introduce a new misdeclaration/failure to notify penalty and a civil evasion penalty, we did not believe that these changes were radically different enough from the existing penalty systems to justify the overhaul.

The full ATT response can be found here: www.att.org.uk/ref482

The LITRG response

LITRG welcomes HMRC's continued engagement on penalties and agrees with the aim of simplification, while minimising any detrimental impact on perceived fairness. LITRG notes that HMRC have recently consulted on new ways of tackling non-compliance and the better use of improved third-party data, and it is important that they consider how reforms across these areas interact.

We also think that an important part of ensuring that behavioural penalties are fair is the question of the extent to which a taxpayer can rely on HMRC's guidance and tools on GOV.UK, as well as data provided by a third party. In either case, if the taxpayer places reliance on the guidance or assumes that third-party data is correct, but this leads to them incurring an inaccuracy or failure to notify penalty, this will also damage trust in HMRC and the tax system.

We recommend that the minimum 10% penalties should be removed for both inaccuracies disclosed after three years and failures to notify disclosed after 12 months for non-deliberate behaviour. The minimum 10% penalty for inaccuracies disclosed after three years does not have a basis in statute, which we do not think is appropriate as a matter of principle. We agree that the system of penalty reductions could be simplified. HMRC also need to consider how the distinction between unprompted and prompted disclosure interacts with their greater use of one-to-many campaigns.

We agree that penalties for offshore non-compliance could be simplified. Where behaviour is not deliberate, we do not think there is justification for different penalty ranges for different territories.

We would like to see HMRC make use of penalty suspension in a wider range of circumstances. Of the two approaches discussed in the consultation document,

we prefer the second, whereby HMRC would issue a ‘caution’ for a first inaccuracy or failure. We think this approach could help to build trust in HMRC.

We are not supportive of an alternative model for penalties that would not be behaviour-based. Behaviour-based penalties provide an important safeguard for unrepresented taxpayers.

In respect of all the proposed reforms in the consultation, it is essential that HMRC give careful thought as to how they will raise awareness of them at a time when non-compliance can be deterred or caught at an early stage.

The full LITRG response can be found here: www.litrg.org.uk/11066

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