Making Tax Digital: Sanctions for late submission and late payment

General Features **Management of taxes**

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The CIOT, LITRG and ATT have all responded to HMRC's latest consultation on late submission penalties and late payment penalty interest.

HMRC have been seeking input on the structure of late filing and late payment sanctions that would apply to individuals and businesses within Making Tax Digital (MTD). In their consultation document *Making Tax Digital – sanctions for late submission and late payment*, the government explains that their aim is to introduce a model for the new MTD filing obligations which will be consistent with the five principles set out in the 2015 consultation paper 'HMRC Penalties: a Discussion Document'.

The five principles are:

1. The penalty regime should be designed from the customer perspective, primarily to encourage compliance and prevent non-compliance. Penalties are not to be applied with the objective of raising revenues.
2. Penalties should be proportionate to the offence and may take into account past behaviour.
3. Penalties must be applied fairly, ensuring that compliant customers are (and are seen to be) in a better position than the non-compliant.
4. Penalties must provide a credible threat. If there is a penalty, we [HMRC] must have the operational capability and capacity to raise it accurately, and if we raise it, we must be able to collect it in a cost-efficient manner.
5. Customers should see a consistent and standardised approach. Variations will be those necessary to take into account customer behaviours and particular taxes.

CIOT response

The CIOT broadly supports HMRC's five penalty principles. In our response we refer to the principles to test whether HMRC's proposals are consistent with them or not.

Of the three models discussed in the consultation document, on balance, the CIOT prefers Model C 'Suspension of penalties' because it sets conditions which would encourage the submission of late filings to avoid a penalty (principle 1). In our view, the other models will not do this as effectively. We also think it is relatively easy to understand.

As part of our submission, we sent HMRC two spreadsheets showing how both a cumulative and annual suspension model might look, together with two flowcharts explaining how our proposed cumulative suspension model would operate.

We think that Model A 'Points based' also has some attractions. It will provide the taxpayer with a 'warning' that they need to work at improving their compliance in order to avoid a monetary penalty, but there is a risk that, without penalties having a 'shelf life', there could be a significant length of time between getting a point and getting a penalty. This could reduce the effectiveness of the model (principle 4).

We do not favour Model B 'Regular review of compliance' because the taxpayer will not know until sometime after their initial failure what the consequences will be of that and other failures as the review is not being done in real time.

We point out that not knowing how the penalty regime will operate when a taxpayer has multiple MTD filings within a particular tax (e.g. because a taxpayer has one or more self-employed businesses and/or a let property) made it harder to comment. Our view is that it would more closely respect the five penalty principles if the different filing obligations were kept separate for penalty purposes; in effect as if they were separate taxes.

Some of our comments on the various penalty models were inevitably made without a full understanding and appreciation of how the MTD software might work since it is currently still in the development and testing phase. Our comments were therefore made with the intention that they might influence how the software will eventually work in practice in order to support an effective penalty regime.

The consultation document did not consider the size of the penalty and we understand that no public consultation will take place on this aspect. Ideally, a simple penalty system is needed and that would be a fixed penalty at the start, even if this means forgoing a little fairness to get simplicity. We suggest that £100 is a good starting point. The consultation is also silent on whether there will be any repeat or escalation of penalties for continued non-compliance. Therefore it is not clear how the penalty model will deal with persistent failures to submit information.

We emphasise that agents must be able to see their individual clients' compliance history and penalty record, whichever penalty model is chosen. Furthermore, agents must be able to appeal on their clients' behalf against penalties and/or penalty points that have been issued to their clients. Where the appeal process is digital by default, agents must also be able to appeal by digital means.

We also make several general comments about the penalty regime including that HMRC should remain open-minded to giving all taxpayers more than 12 months to become familiar with their new MTD filing obligations before penalties apply. If penalties are introduced too soon it could undermine the whole system.

Our full response, together with our suggestions for how a suspension model might operate can be found on the CIOT website.

ATT response

In its response, the ATT reiterated its concern that taxpayers should be given experience of a full cycle of submissions including the relevant final submission (so more than a bare 12 month period) before submission penalties come into effect. Noting that the new sanctions would apply to 'individuals and businesses within and outside Making Tax Digital for Business', ATT also emphasised the importance of considering the impact of the proposals on those outside MTD including individuals who are unable to engage digitally and businesses with income below the threshold level.

Whilst welcoming the right of appeal against the recording of failures that do not immediately give rise to a penalty, ATT recommended consideration of the alternative of a registered objection.

Of the three suggested penalty models for late submission, ATT favoured Model C ('suspension of penalties') as the simplest to understand, the fairest in terms of quickly letting a taxpayer know where they stand and what they needed to do in order to avoid a penalty and the most effective in promptly encouraging a return to compliance following a submission failure. However, ATT suggested that the terminology should be changed to avoid confusion (with the suspension of penalties for careless inaccuracies) and to recognise that Model C really provided a limited conditional extension for compliance.

In order to improve the efficiency of penalties which became payable under Model C, ATT recommended consideration of an abatement of the penalty for prompt payment (a bit like over-stayed parking charges).

ATT's response included spreadsheets demonstrating how Model A ('points-based') penalties could work in practice. It concluded that, in conjunction with the absence of any overriding shelf-life for points, the proposal meant that patterns of more significant non-compliance could avoid penalties completely while more compliant patterns could incur multiple penalties.

Model B ('regular review of compliance') was dismissed by ATT as the least transparent of the three models. The response noted that 'its inherently retrospective nature …. could leave taxpayers feeling that they had been ambushed by HMRC'.

On interest on late payment of tax, ATT's main criticism was directed at the proposal to charge two parallel but distinct rates of interest once tax was overdue by more than a prescribed number of days. ATT commented that from a taxpayer's perspective, the two charges involved a distinction without a difference. Charging interest at two different rates on the same outstanding tax debt would not serve simplicity. It could complicate the presentation of the taxpayer's *Digital Tax Account* and add to problems of payment allocation.

The full ATT response can be found on the ATT website.

LITRG response

Although recognising potential benefits of the suspension model, the LITRG submission on balance favoured the points-based model albeit with some

modification.
We did not think that any of the proposed models as outlined in the consultation document would be helpful in terms of encouraging compliance by low-income taxpayers who might have fallen into arrears due to misunderstanding of the system.

Such individuals may not have a ‘reasonable excuse’ for non-compliance per se, given that ignorance of the law or perhaps, as in many cases, fear of the authorities is no excuse. Nevertheless, they may be fundamentally willing to comply if they get some help from HMRC and/or from the tax charities. TaxAid advisers, in particular, see many people in this situation. LITRG also receive enquiries to our website from people who are willing to comply but have simply not realised or understood their obligations.

The LITRG response therefore recommended that HMRC should offer to suspend late filing penalties for those who come forward to put their tax affairs in order after a period of non-compliance. After a period of compliance, HMRC might then waive or reduce the earlier penalties.

The full LITRG response can be found on the LITRG website.