Low Incomes Tax Reform Group
A voice for the unrepresented

Finance (No. 2) Bill 2021 – Clauses 112 and 113; Schedules 23, 24 and 25
Penalties for failure to make returns, pay tax, etc.
Briefing from the Low Incomes Tax Reform Group (LITRG)

1 Executive summary

1.1 While HMRC have taken on board comments on the structure of a new penalty regime throughout a period of consultation, the legislation in the Finance Bill is far more complex than originally envisaged. We highlight points in this briefing where we suggest the Bill should be amended. [1]

1.2 Although the new rules largely adhere to HMRC's five design principles for penalties,[2] we are concerned that HMRC face a significant challenge to explain the rules clearly to the unrepresented taxpayer. We suggest delaying their introduction by at least 12 months for certain taxpayers.

1.3 For penalties for late submission of tax returns:

- Giving HMRC two years to levy a £200 late submission penalty once the requisite number of penalty points has been reached is too long.

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[1] Many of which we have made previously on the draft Finance Bill 2018/19: https://www.litrg.org.uk/latest-news/submissions/180831-draft-finance-bill-2018-2019-penalties-and-interest

[2] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/400211/150130_HMRC_Penalties_a_Discussion_Document_FINAL_FOR_PUBLICATION__2_.pdf

- The legislation should oblige HMRC to keep the taxpayer informed of their penalty point total(s).

- Appeals to a tribunal against late submission penalties should always involve an affirmation or cancellation of the penalty points which have led to the imposition of the financial penalty, to give the taxpayer greater certainty.

- The de minimis penalties for deliberately withholding information should treat 'deliberate with concealment' as more serious than 'deliberate without concealment' (currently they do not differentiate).

1.4 For penalties for late payment of tax:

- The periods of time at the end of which penalties are calculated for non-payment of tax are too short.

- The penalties for a delayed or insufficient payment of tax due as part of a Time-to-pay (TTP) agreement are too severe and amount to retrospectively charging penalties for correctly paid tax instalments on the basis of a default in a TTP arrangement at a later date. The interaction of TTP arrangements with the late-payment penalty regime should be reconsidered.

- The legislation should be tighter such that penalties under Schedules 23 and 24 are definitively cancelled in cases where the associated notice to file is withdrawn.

2 About Us

2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998, LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low-income workers, pensioners, migrants, students, disabled people and carers.

2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Clause 112; Schedule 23 – Penalties for failure to make returns etc

3.1 We are concerned about the complexity of these rules and the consequent challenge upon HMRC to explain them clearly to the unrepresented taxpayer. It is proposed that the new penalty regime will apply from April 2022 for Making Tax Digital (MTD) for VAT and from April 2023 for MTD for Income Tax Self-Assessment (ITSA), which is also when the new MTD for ITSA regime itself will 'go live'.[1]

3.2 Taxpayers coming within MTD for VAT for the first time in April 2022 and within MTD for ITSA for the first time in April 2023 therefore face a complex and unfamiliar penalty regime at the same time as having to get to grips with their obligations under MTD. For these taxpayers, we believe that the introduction of the new penalty regime should be delayed by at least a year to allow them time to familiarise themselves with the new obligations before they begin to accrue penalty points for non-compliance.

3.3 In particular, the rules around the different 'groups' of returns for penalty points, and the various limits on points which can be accrued, seem to be especially complicated for anything but the simplest of cases. For individuals with a single source of income within MTD for ITSA, it appears that there are potentially six separate filing obligations over the course of the year.[2] There is one penalty point total,[3] but within that total there are limits on the number of points which can be accrued per month and per type of submission (periodic update, end of period statement, or final declaration).[4]

3.4 It is quite possible that a taxpayer may face deadlines for each type of submission within a short space of time, and thus might potentially face three penalty points as a result of failing each submission, as a result of a single event – for example, a period of illness.[5] The taxpayer would then be three-quarters of the way towards a fixed penalty, or if they were already at the threshold, they might face a total of £600 in penalties being charged at once. This is exacerbated by the fact that annual obligations under MTD are, for some reason, treated as if they were quarterly.

3.5 Because the software for MTD for ITSA has not yet been fully developed, it is not clear how an individual's obligations to complete both an end of period statement and a final declaration will operate in practice, and thus whether or not it is appropriate for an

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[1] For individuals within MTD for ITSA, the new penalty regime is to be introduced from 6 April 2023. For all other taxpayers within ITSA, the new penalties will apply from 6 April 2024.

[2] Four periodic updates, one end of period statement, and one final declaration.

[3] Group 1B of the Table in the draft Schedule 23

[4] Paragraph 5(3) of the draft Schedule 23

[5] Though, depending on the circumstances, such a taxpayer might have a reasonable excuse for the failures.

individual to accrue two separate penalty points if they are late in submitting both 'returns'. If the software which is used treats these obligations as part of the same digital submission (that is, the end of period statement and final declaration are submitted simultaneously as a result of a single click within the software), then a failure to make a single click by the deadline should only attract a single point. This approach would then reduce the rate at which penalties might accrue in some circumstances, such as those outlined at 3.4 above, to a more reasonable level.

3.6 So that taxpayers can have a clear and up-to-date understanding of the consequences of any late submissions, we suggest the legislation includes an obligation on HMRC to keep taxpayers regularly informed of their penalty points total(s), either through their Personal Tax Account or through some kind of regular written statement for digitally excluded taxpayers. At the very least, the taxpayer should be informed each time a penalty point is incurred.

3.7 Paragraph 17 specifies the time limit for assessments, allowing the period of two years. Why is this period so long? This extensive time limit seems to run counter to one of the aims of the penalty points regime – to encourage taxpayers who have been non-compliant (for whatever reason) to become compliant again quickly. In the majority of cases, HMRC will be fully aware of the taxpayer's accumulated points, and therefore the time limit should reflect the objective of encouraging a taxpayer to comply with their filing obligations. We suggest that the time limits for assessments are set in line with the time limits for the award of penalty points, as set out in paragraph 6.

3.8 On a related point, we are not clear on the position where an individual makes a late submission when they are already at the penalty threshold, but HMRC have not yet issued the penalty for the failure which brought the taxpayer to the threshold. We think that a taxpayer should only be charged the second penalty once the taxpayer has been given some opportunity to modify their behaviour as a result of the first. It would run counter to the design principles – and to natural fairness – if HMRC were to charge multiple penalties at once simply out of administrative convenience.

3.9 Paragraph 21(4) currently reads: "The notice under section 8B or 12AAA of TMA 1970 **may** include provision cancelling liability to the penalty point or the penalty from the date specified in the notice." Given this relates to the withdrawal of a notice to file a return, to achieve absolute clarity, we would expect this to state that the notice **must** include provision cancelling liability to the penalty point/penalty, since there can be no liability to a penalty point/penalty if there is no obligation to file. This should be communicated clearly to the taxpayer.

3.10 Paragraph 24(2) of draft Schedule 11 provides that the tribunal "may … affirm or cancel" any penalty point contributing to the penalty that is the subject of the appeal. We think that this paragraph should be amended such that either HMRC or the appellant (or both) have the ability to require the tribunal to consider and rule on any or all of the penalty points that contribute to the penalty that is the subject of the appeal. This would mean that the tribunal's decision would provide certainty on which penalty points remain valid.

4 Clause 112; Schedule 24 – Penalties for deliberately withholding information

4.1 Paragraph 3(3)(b) and (5)(b) set out the de minimis amount of the penalty for withholding information through deliberate and concealed behaviour and deliberate but not concealed behaviour respectively. In both cases, the draft legislation provides for an amount of £300, despite the fact that the percentages of tax liability to be applied in each circumstance are higher (as one would expect) in respect of deliberate and concealed behaviour.

4.2 We question whether the same de minimis amount should apply in each case and whether this is proportionate – in particular, by having the same de minimis amount, there is a risk of failing to encourage compliance, which is one of the purposes of the changes to the penalties regime. Moreover, having the same penalty amount does not seem to meet the five design principles for penalties set out by HMRC in *HMRC Penalties: a discussion document*.[1]

4.3 Paragraph 16(3) currently reads: "The notice under section 8B or 12AAA of TMA 1970 **may** include provision under this paragraph cancelling liability to the penalty from the date specified in the notice." Given this relates to the withdrawal of a notice to file a return, to achieve absolute clarity we would expect this to state that the notice **must** include provision cancelling liability to the penalty point/penalty, since there can be no liability to a penalty if there is no obligation to file, and this should be communicated clearly to the taxpayer.

5 Clause 113; Schedule 25 – Penalties for failure to pay tax

5.1 This clause introduces two penalties for the failure to pay tax on time. The first penalty comprises 2% of the amount of tax unpaid 15 days after the due date, plus 2% of the amount of tax unpaid 30 days after the due date. The second penalty is a 'penalty interest' rate of 4% per annum which applies from the 31st day of the tax being unpaid.

5.2 Proposing a Time-to-pay (TTP) arrangement within the 15- or 30-day period which is ultimately agreed with HMRC means that the late payment penalties which would otherwise apply are not charged. This effectively treats the taxpayer as if the tax had been paid at the point the TTP arrangement had been proposed by the taxpayer. However, if a taxpayer does not comply fully with the terms of the TTP arrangement then the legislation allows penalties to be applied retrospectively as if the arrangement had never existed.

5.3 We do not think it is reasonable to charge the first late payment penalty retrospectively if a TTP agreement fails. Indeed, a taxpayer may in any case have a reasonable excuse for failing

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[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/400211/150130_HMRC_Penalties_a_Discussion_Document_FINAL_FOR_PUBLICATION__2_.pdf

to pay the tax by the 15- or 30-day point, because a TTP was in place at the time. One might also argue a reasonable excuse against the second penalty (the 'penalty interest') on the same grounds.

5.4 While we agree that there should be some incentive to stick to the TTP agreement, the sanction for not doing so should be fair and proportionate. It also cannot be right to receive a greater sanction for missing, say, the tenth instalment of a TTP arrangement compared with the fourth, simply because of the way the penalty interest is calculated. The sanctions in each case should be the same.

5.5 If a taxpayer cannot keep up with their payments under a TTP agreement and they approach HMRC and explain why their circumstances have changed, an amended TTP agreement can be put in place. We are unclear on the impact of renegotiating a TTP arrangement with HMRC in this way on the charging of penalties. We do not believe this should trigger retrospective late-payment penalties either.

5.6 Overall, we think that the interaction of TTP arrangements with the late-payment penalty regime needs to be reconsidered entirely.

5.7 Regarding the first penalty, we note that HMRC must wait until after the 30-day period before they can be in a position to assess it. If the taxpayer were instead to receive a penalty at 15 days based on 2% of the amount of tax unpaid at that point, then this financial penalty would serve as an effective prompt to take action and ensure the amount is paid (or a TTP arrangement agreed) before incurring higher penalties at the 30-day point.

5.8 We think it would be much more effective, and in line with the design principles, if the taxpayer were to at least receive a notification at the 15-day point stating, for example, that they will be charged a penalty of at least £X, and if they do not make the payment in full or agree a TTP arrangement before 30 days then the amount could increase to £Y. In the absence of the taxpayer actually being issued with a financial penalty at the 15-day point, we feel that such an approach would be both more equitable and encourage more timely payment.

5.9 Yet, the period between 15 days and 30 days is a relatively short one and therefore might make this impractical, considering the time it could take HMRC to issue such a notification and for the taxpayer to act upon it. By the same token, the first 15 days is not, in practice, long enough for the taxpayer before a penalty charge accrues, considering that within that time period the following events might occur:

- HMRC issue a tax demand;
- the taxpayer receives the demand and takes time to consider it (including whether it is valid and for the correct amount); and

- the taxpayer takes appropriate action, whether that is arranging for payment, contacting HMRC to propose a TTP agreement, or seeking advice (whether from a paid adviser or a tax charity) to ascertain the appropriate next step.

5.10 We therefore think that the 15 days and 30 days should each be doubled.

LITRG
21 April 2021