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# HM Revenue and Customs

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## Modernising Powers, Deterrents and Safeguards

### Meeting the Obligations to File Returns and Pay Tax on Time: Consultation Responses and Refined Models

November 2008

# Contents

Chapter	Subject	Page
	<b>Summary table</b>	4
	<i>Scope of the consultation</i>	4
	<i>Basic information</i>	4
	<i>Background</i>	5
1.	<b>Introduction</b>	6
	<i>This consultation</i>	7
	<i>Other consultations</i>	7
	<i>How to comment</i>	8
	<i>Confidentiality</i>	8
	<i>The Government's Consultation Code of Practice</i>	9
2.	<b>Further Research</b>	10
	<i>Independent qualitative research</i>	11
	<i>Focus groups</i>	12
	<i>Internal analysis</i>	13
3.	<b>The June 2008 Consultation and Responses</b>	14
	<i>Overview of June 08 consultation</i>	14
	<i>Summary of responses</i>	14
	<i>Taxpayer safeguards</i>	16
	<i>Taxpayer support</i>	16
	<i>"Capping"</i>	17
	<i>Time to pay arrangements</i>	17
	<i>Late or non-filing</i>	18
	<i>Late or non-payment</i>	19
	<i>In-year payment of PAYE</i>	20
	<i>Frequent obligations</i>	21
	<i>Workshops and meetings</i>	21
4.	<b>Further Refinements – A Proposed Way Forward</b>	23
	<i>Support</i>	23
	<i>Payment Instalment schemes</i>	23
	<i>Time to pay</i>	23
	<i>Encouraging taxpayers who have a reasonable excuse to come forward early</i>	24
	<i>Strategy for disabled customers</i>	24
	<i>Other support initiatives</i>	25
	<i>Safeguards</i>	25
	<i>Alignment</i>	26
	<i>A different role for interest and penalties</i>	27
	<i>Separate obligation to file returns and to pay tax due</i>	27
	<i>The case for late payment penalties</i>	28

<b>Chapter</b>	<b>Subject</b>	<b>Page</b>
<b>4 (cont)</b>	<i>Employers' end of year returns</i>	29
	<i>Penalties as a deterrent</i>	30
	<i>Penalties and behaviour</i>	30
<b>5.</b>	<b>Proposed Penalty Models</b>	<b>31</b>
	<b><u>Late Filing</u></b>	<b>31</b>
	<i>Penalties for late filing for annual and "one-off" return obligations – a model</i>	31
	<i>Penalties for late filing for quarterly return obligations – a model</i>	34
	<i>Penalties for late filing for monthly return obligations – a model</i>	35
	<b><u>Late Payment</u></b>	<b>36</b>
	<i>Penalties for late payment of annual and one-off obligations – a model</i>	36
	<i>Penalties for late payment of quarterly obligations – a model</i>	38
	<i>Penalties for late payment of monthly obligations – a model</i>	39
	<i>Administration of penalties</i>	40
	<i>Illustrative examples</i>	40
<b>6.</b>	<b>In-year Pay as You Earn</b>	<b>45</b>
	<i>Illustrative examples</i>	48
<b>Annexes</b>		
<b>A</b>	<b>Consultation Questions</b>	<b>51</b>
<b>B</b>	<b>Organisations which attended consultation meetings or workshops with HMRC</b>	<b>52</b>
<b>C</b>	<b>Organisations which responded to consultation document</b>	<b>53</b>
<b>D</b>	<b>Draft guidance on reasonable excuse</b>	<b>54</b>
<b>E</b>	<b>Government's Consultation Code of Practice</b>	<b>58</b>

## Summary table

### Scope of the consultation

<b>Topic of this consultation:</b>	This consultation is concerned with basic obligations – to file returns on time and to pay tax due on time. It considers the circumstances in which taxpayers should become liable to civil penalties when they do not meet these obligations. It also considers how HMRC can better support taxpayers to meet their obligations and what an aligned set of safeguards for penalties should look like.
<b>Scope of this consultation:</b>	There are currently some fifteen different penalty structures that apply to returns that are filed late and to tax that is paid late. New, aligned penalty structures for late filing and late payment of all taxes and duties administered by HMRC were considered in the June 2008 HMRC consultation – “Meeting the obligations to file returns and pay tax on time”. This consultation explores the key themes that have emerged from the June consultation and seeks views on modifications made to the proposed penalty structures and relevant safeguards.
<b>Impact Assessment:</b>	An impact assessment is published alongside this consultation document.

### Basic Information

<b>Who should read:</b>	Those who have an obligation to make a tax return or are liable to tax in respect of any of the taxes and duties administered by HMRC. Also those who represent taxpayers or support them in meeting their obligations.
<b>Duration:</b>	From Pre Budget Report 2008 to <b>13 February 2009</b> .
<b>Enquiries:</b>	The Review can be contacted by telephone on 020 7147 3223 or at <a href="mailto:powers.review-of-hmrc@hmrc.gsi.gov.uk">powers.review-of-hmrc@hmrc.gsi.gov.uk</a> .
<b>How to respond:</b>	Responses should be sent to: <a href="mailto:powers.review-of-hmrc@hmrc.gsi.gov.uk">powers.review-of-hmrc@hmrc.gsi.gov.uk</a> ; or HMRC Review of Powers: Room 1/72, 100 Parliament Street, London SW1A 2BQ.
<b>Additional ways to become involved:</b>	HMRC will be inviting taxpayer representatives to meet with the Review team and discuss the issues raised in the consultation document. If you are interested in attending such a meeting, please contact the number above.
<b>After the consultation:</b>	Subject to consultation and Ministerial agreement, the new penalties would be legislated in Finance Bill 2009. Implementation would need to be phased over several years because of the system and process changes required.

## Background

<b>Getting to this stage:</b>	The Review of Powers, Deterrents and Safeguards was set up to provide a framework of law and practice for HMRC that is appropriate to the merged Department's tasks and allows those tasks to be carried out effectively and efficiently while also providing appropriate safeguards for citizens.
<b>Previous engagement:</b>	<p>The review has published the following formal consultation documents covering penalties. Other documents have covered compliance checks, criminal powers and debt.</p> <ul style="list-style-type: none"><li>• March 2006: The Developing Programme of Work</li><li>• December 2006: A new approach to penalties for incorrect tax returns.</li><li>• January 2008: Penalties reform: The next stage</li><li>• June 2008: Meeting the obligations to file returns and pay tax on time</li></ul> <p>The Review has continued to listen to issues raised during the legislative process, resulting in a number of amendments being made to the Finance Bill in response to concerns.</p> <p>These formal consultations have been supplemented by various methods of informal consultation through workshops, conferences and other meetings with taxpayers, advisers and their representative bodies, as well as regular meetings of the Review of Powers Consultative Committee which was established in June 2005.</p> <p><a href="http://www.hmrc.gov.uk/about/powers-appeal.htm">http://www.hmrc.gov.uk/about/powers-appeal.htm</a></p>

## Chapter 1: Introduction

- 1.1 The review of HM Revenue and Customs (HMRC) powers, deterrents and safeguards has been taking forward a programme of consultation and legislative change to provide a modern and effective framework of law and practice for the Department. The changes resulting from this work will help HMRC deliver the O'Donnell Review aims of better customer service, greater effectiveness and improved efficiency.
- 1.2 This consultation focuses on deterrents and the associated safeguards and considers the circumstances in which taxpayers should become liable to civil penalties when they do not meet their obligations to submit returns and pay the tax they owe on time. This is the third stage of a programme of reform of civil penalties. Finance Acts 2007 and 2008 introduced new regimes for penalties where a taxpayer submitted an incorrect return and where they failed to notify HMRC of a new taxable activity. Both were aligned regimes across the taxes and duties HMRC administers.
- 1.3 In June 2008 HMRC published a consultation "Meeting the obligations to file returns and pay tax on time". HMRC is grateful for the helpful and constructive responses received and to those organisations and individuals who took the time to attend one to one meetings with members of the Review of Powers team and workshops held in September. As a result of the responses to the June consultation a number of significant modifications have been made to the proposed penalty structures to ensure they better meet the design principles. The design principles are that any penalty structure should:

- Influence behaviour,
- Be fair and proportionate,
- Be effective and set out in legislation.

- 1.4 Some of the key modifications to earlier proposals are:
  - no second fixed sum penalties for late filing;
  - statutory restrictions on the charging of daily penalties for late filing of annual and one-off filing obligations: when they may start; how long they may run, the levels and prior notification;
  - no fixed sum penalty for late payment immediately after the due date. The first late payment penalty to be tax geared and charged one month after the due date;
  - for frequent payment obligations (such as VAT, CIS and PAYE) the first late payment will not attract a penalty;

- time between each penalty escalation for support, warnings and escape routes such as approaching HMRC for time to pay;
- a new model for late payment of in-year PAYE that has developed in consultation with stakeholders over the summer.

### ***This consultation***

- 1.5 This consultation is concerned with basic obligations: to file returns on time and to pay tax due on time and how the penalties and safeguards for failing to meet these obligations can be aligned and modernised.
- 1.6 **Chapter 2** looks at further research that has been carried out over the summer both internally and via external researchers into taxpayer behaviour and reaction to debt. This helps to build the evidence base for the reform of penalties.
- 1.7 **Chapter 3** outlines what the June 2008 consultation “*Meeting the obligations to file and pay on time*” covered and summarises how people responded to that consultation. It also discusses some of the outcomes from stakeholder workshops held over the summer.
- 1.8 **Chapter 4** looks at a proposed way forward based on the research and responses HMRC has received to the June consultation. It makes the case for charging penalties for late filing and late payment and highlights the importance of robust safeguards.
- 1.9 **Chapter 5** seeks views on penalty models for taxes with annual and one-off obligations and those where the obligation to file or pay is more frequent.
- 1.10 **Chapter 6** looks at the extra challenges of encouraging taxpayer to pay their in-year PAYE on time and presents a model that should overcome these difficulties.

### ***Other consultations***

- 1.11 This consultation is running alongside two further strands of work being taken forward by HMRC.
- 1.12 Firstly HMRC is exploring the case for harmonising and simplifying the rules on interest charged by HMRC on tax paid late and interest paid by HMRC on overpayments. A first round of consultation published on 19 June 2008 considered the principles that might underpin a modern interest regime and sought views on how to translate those principles into a regime that is clear, simple and easy for taxpayers and their advisors to understand. The consultation on interest harmonisation published alongside this consultation presents more detail on the proposals and explores a structure for paying and charging interest.
- 1.13 Second, HMRC is consulting on the next stage of a programme of consultation and legislative change on payments, repayments and

debt. This includes examining the case for regular payment schemes to help taxpayers manage their cash flow. It also includes examining the case for a range of measures to enable HMRC to better manage tax debts.

- 1.14 These three strands of work are further supported by improvements in the way HMRC engages with those who want to pay or those who have difficulty paying. Taken together they provide a framework designed to influence taxpayer behaviour so that more taxpayers than now file their returns and pay what they owe on time, and to recompense the taxpayer and HMRC for loss of use of money. Collectively they will make it easier for taxpayers to pay what they owe on time, make it easier for taxpayers to understand their obligations and the consequences of failure. They will also reduce the number of times HMRC needs to use its more intrusive enforcement powers to collect debt bringing benefits to taxpayers and HMRC.
- 1.15 In addition 'The Review's Work Programme' is published today. This describes why the review was set up, its aims, the importance of safeguards, the design principles and methodology, its work programme and emerging plans for implementation.

### ***How to comment***

- 1.16 The questions on which this consultation is focused are summarised in Annex A. However, HMRC welcome comments on any aspect of this consultation document. Comments should be sent by **13 February 2009**:
- by e-mail to: [powers.review-of-hmrc@hmrc.gsi.gov.uk](mailto:powers.review-of-hmrc@hmrc.gsi.gov.uk)
  - or by post to: HMRC Review of Powers, Room 1/72, 100 Parliament Street, London SW1A 2BQ
  - or by fax to: 020 7147 2375.

This document can also be accessed from the HMRC Internet site:  
[www.hmrc.gov.uk/consultations/index.htm](http://www.hmrc.gov.uk/consultations/index.htm)

Hard copies are available from the above address. The Review Team can be contacted by telephone on: 020 7147 3223.

### ***Confidentiality***

- 1.17 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004).
- 1.18 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of

this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If HMRC receive a request for disclosure of the information they will take full account of your explanation, but they cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

- 1.19 HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

***The Government's Consultation Code of Practice***

- 1.20 This consultation is being conducted in accordance with the Government's Code of Practice on Consultation. A copy of the Code of Practice criteria and a contact for any comments on the consultation process can be found in Annex E.

## Chapter 2: Further Research

2.1 Since June 2008, work has been continuing in five main areas. Each has influenced the developing work on supporting taxpayers to meet their filing and payment obligations and the models for penalties for late filing returns and for late payment of tax, outlined in chapter 5 of this consultation document. The five strands are:

- a) **Consultation with key external stakeholders** – input has been received via one to one meetings with 18 key interested parties, 28 written responses to the formal consultation and two workshops in September (see appendices B & C for lists of the organisations that attended meetings, workshops and provided responses). All of these have been extremely helpful, providing many innovative and constructive comments and ideas. HMRC is grateful for the time and effort taken. Whilst there has been a range of views, some common themes have emerged. Chapter 3 outlines these.
- b) **Independent qualitative research** by Ipsos Mori, commissioned by HMRC, into people's attitude to tax debt (a summary is at paragraphs 2.2 to 2.12). In addition HMRC ran two focus groups with small business and individual customers which have provided an insight into the customer's views. This research covers those who have first hand experience of being in debt to HMRC.
- c) **Analysis of historic HMRC data** showing filing and payment patterns, to ascertain the effectiveness and impact of current penalty regimes has continued. The Impact Assessment summarises this work.
- d) **Detailed policy development** has continued within HMRC, with specialists considering possible penalty models, from the perspective of the structure of each particular tax. HMRC's Individual and Business Customer Directorates have also been helping consider possible solutions from the perspective of different customer groups.
- e) Lastly, work has continued to understand and map the **business processes and IT systems**, supporting the current penalties for late filing and late payment (alongside interest). This is to enable a realistic assessment of the likely impact and costs (for both taxpayers and HMRC) of any changes required to introduce the new models.

### ***Independent qualitative research***

- 2.2 Ipsos MORI was commissioned this year by HMRC to undertake research with people who had been in tax debt during the past two years. The aim of the research was to develop a better understanding of late paying customers and the effect of different interest, penalty and support regimes.
- 2.3 Fifty-two in-depth interviews<sup>1</sup> were conducted with individuals or representatives of businesses that, based on HMRC records, had a tax debt in the recent past. There was no control group of compliant taxpayers who paid their tax on time.

### **Key findings**

- 2.4 Participants considered tax debt to be different from other debt both in terms of the mechanisms for paying and the relationship with HMRC. They described the relationship with HMRC as one way whereas that with suppliers, customers and employees it is two way. The two way relationships are stronger – the person can see a direct correlation between payment made and goods or services received, which are seen as essential to the viability of the business.
- 2.5 Some tax debtors had unfavourable perceptions of HMRC. They perceived it was difficult to get advice and guidance from HMRC when needed. From the viewpoint of many of the participants, this made it difficult for them to both explain the circumstances of their tax debt and to make arrangements to pay what was due. Those interviewed said that HMRC lacked knowledge about the circumstances and structure of their businesses. They felt that HMRC operated a one-size-fits-all approach when communicating with businesses.
- 2.6 The main reason why individuals and business got into debt was because of problems with cash flow. In nearly all cases, participants wanted to pay but, at a given point in time, could not do so because the funds were not available. Cash flow problems interact with tax payment schedules. Many debtors described how the misalignment between tax due dates and business invoicing dates caused short-term problems. This was especially so for those due to pay taxes with annual or twice yearly payment obligations, who may not have set aside money for these bills.
- 2.7 Participants reacted positively to the suggestion of flexible measures that allow them to pay off a debt over time and to pay their taxes on a different basis going forward so debts are less likely to arise. A shift towards paying tax on a monthly basis was warmly received by participants because it allowed them to pay smaller amounts more frequently and also reflected the way that other financial interactions are conducted, such as the payment of credit cards and utility bills.

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<sup>1</sup> Interviews carried out across the UK between 1<sup>st</sup> July and 2<sup>nd</sup> October 2008

- 2.8 Those interviewed recognised that interest and late payment penalties were necessary to achieve fairness, provide an imperative to pay tax due and to stop those who are less than conscientious “getting away with it”. But for those for whom cash flow problems caused them to get into debt, interest and penalties did not help, indeed they make matters worse.
- 2.9 Interviewees’ reaction to the proposed new penalty and interest structures were muted. The participants found it difficult to understand the differences between the new structures and the old structures. This suggests that HMRC must carefully communicate how the new penalty structures operate and tailor communications to different taxpayer groups. They did say that interest should be comparable to bank interest rates. For late payment penalties there was widespread dislike of an early fixed sum penalty for late payment as unfair and damaging the relationship between HMRC and the taxpayer. Any penalties should be related to the amount of tax unpaid. They thought that there should not be any penalties for late payment where the cause of the lateness was cash flow problems.
- 2.10 Overall, participants said they did not seek to avoid paying tax and understand their obligations. Incentives and processes that make tax easier to pay in the first place for an individual or business (which can include existing measures) are, according to participants, more effective than charging interest or measures intended to deter late payment. When a debt has occurred, flexibility in payment schedules which matches an individual’s or businesses’ circumstances was welcomed.

### ***Focus groups***

- 2.11 In addition to the work by Ipsos Mori, and as part of HMRC’s efforts to better understand its customers, two focus groups were held to discuss some of the proposals being worked on in relation to debt, penalties and interest. One was with individual non-business taxpayers and the other with business taxpayers, from a mix of ages (including pensioners), gender and ethnicity. Some had suffered from debt problems in the past, whilst others had never been in debt. Whilst this is not empirical research, it has provided valuable insights.
- 2.12 These groups confirmed the view expressed in the qualitative research that a fixed sum penalty for late payment was likely to cause more damage to relations between taxpayers and HMRC than the behaviour benefit (in reinforcing the due date) warranted. Respondents preferred late payment penalties to be related to the tax unpaid, and thought these should be applied sooner than 3 months after the due date. They acknowledged that these were required in addition to interest.
- 2.13 Regular payment schemes were considered to be a good thing for those entering the tax system for the first time and perhaps the disorganised, but of less value to those with long term payment difficulties. Direct Debit was welcomed by some, but not universally.

Incentives such as a percentage discount were suggested as a tool to encourage early or timely payment.

- 2.14 The groups were asked to comment on how HMRC is perceived and how HMRC might do more to help taxpayers. Some found HMRC very helpful whilst others were fearful of making contact. Some suggested that HMRC should make more regular contact with taxpayers and take into account previous compliant behaviour when considering issuing a penalty.

### ***Internal analysis***

- 2.15 There are some important lessons HMRC can learn from the current variety of penalty regimes that HMRC operate. These are elaborated more fully in the accompanying impact assessment, but include:
- small fixed sum penalties at filing date do positively affect filing patterns;
  - the current late filing penalty regimes are not very effective in addressing prolonged late filing (if people miss the deadline they often go onto be very late filers);
  - late payment penalties do positively affect payment patterns – most notably the income tax self assessment surcharge and VAT default surcharge.
  - where there is no interest or late payment penalty, payment rates are significantly lower, for example in-year PAYE;
  - warnings of daily penalties for late filing can be effective;
  - some of the current regimes can produce results which appear disproportionate and are perceived to be unfair.

**Question 1: Do you agree with the findings of the internal and external research presented above? Is there any other analysis or evidence that you could share with HMRC regarding penalties or tax debts?**

## Chapter 3: The June 2008 Consultation and Responses

- 3.1 This chapter outlines the content of the consultation document published on 19 June 2008 “Meeting the obligations to file returns and pay tax on time” and summarises the responses received. It also brings out further lessons learned at the meetings and workshops.

### ***Overview of June 2008 consultation***

- 3.2 The June 2008 consultation considered, at a high level, the issues surrounding late filing and late payment and proposed some general penalty structures that might meet the design principles: influence behaviour, effectiveness and fairness. It started by exploring the obligations placed on taxpayers to file returns and pay tax and the impacts on other taxpayers and HMRC when people fail to meet their obligations.
- 3.3 It then went on to look at the reasons why people fail to meet their obligations including a review of the available research and literature on the subject. A detailed look at the support available to enable taxpayers to meet their obligations on time was presented together with thoughts on how the support could be improved were presented
- 3.4 The later chapters of the June consultation looked at the safeguards that needed to be in place to protect taxpayers and how penalties might be used to encourage timely filing and payment. A number of generic penalty models were suggested for taxes with annual obligations and those with more frequent obligations and questions asked around how they met the design principles.
- 3.5 Finally the consultation looked at the specific issue of encouraging timely payment of in year PAYE. This represents a particular challenge as payments are required monthly but a return is only submitted at the end of the period (meaning HMRC does not know the correct payments for each month). Again a number of generic models to tackle this were presented and questions asked about how these met the design principles.

### ***Summary of Responses***

- 3.6 Responses were received from all segments of the community ranging from the individual taxpayer to the large corporate. A number of representative bodies also responded. HMRC held a series of meetings with representative bodies to explore the consultation document in more detail. In total 18 organisations were involved in the meetings and workshops and HMRC received over 28 formal responses.
- 3.7 A number of those who responded recognised the strengths of the proposals within the consultation document. However, other respondents were not necessarily convinced there was a need for an

overhaul of a system they felt worked well. Some of the main points from those who responded to the consultation are set out below:

- most respondents commented on the need for HMRC to simplify filing and payment obligations where possible, to take more steps to make it easier for people to comply with those obligations and to provide good support for those who had difficulties. Particular mention was made of the most vulnerable in society particularly those on low income without access to the internet, the growing number of elderly people and those with a disability who may in some cases have more difficulty in meeting their obligations;
- following on from this, respondents were clear that whilst penalties were necessary to reinforce the obligations, they were not the full picture and use of HMRC resources should reflect this;
- some respondents thought HMRC should explore the use of incentives as a means of encouraging taxpayers to file and pay on time;
- many respondents said that whilst penalties were appropriate for late filing, they were less sure this was the case for late payment. This was on the basis that recompense interest was sufficient to address late payment. However most accepted that very late payers and repeatedly late payers should be treated differently either by receiving penalties or closer scrutiny from HMRC. There were differing views as to what constituted very late payment;
- most responses indicated that they thought alignment across the taxes was a good thing for the taxpayer and was likely to simplify things and provide clarity;
- a small number of responses urged caution given the current economic climate.

3.8 Most responses agreed that the analysis of taxpayer behaviour in the consultation document was plausible. However, two respondents made the point that there was no reference to those taxpayers who may have more difficulty in meeting their obligations for example those without access to a computer (where online filing is required) or those with certain disabilities that may make completing a return either on paper or online difficult. It was also pointed out that support and education was important to promote compliance particularly amongst the most vulnerable in society.

3.9 Most respondents agreed that there was merit in alignment of penalties. Some felt strongly that alignment should only occur when it made sense to do so and not merely for its own sake. One respondent representing taxpayers on low incomes felt that the benefits were exaggerated and believed that most individual taxpayers are concerned with one or two taxes only. Another questioned whether so-

called withholding taxes should be considered in the same way as taxes on profits.

### ***Taxpayer safeguards***

- 3.10 The importance of having robust taxpayer safeguards was considered in the June consultation document. The document suggested that safeguards should include a single reasonable excuse provision in statute across all the taxes, a right of appeal against all penalties, and an aligned power for HMRC to reduce penalties where merited. New appeal procedures being developed separately will bring a facility for the taxpayer to apply to HMRC to have their case reviewed internally by someone not directly involved in their case, should the taxpayer wish to pursue this, as a first step before going to the Tribunal.
- 3.11 The consultation document proposed that no penalty would be chargeable where the taxpayer has a reasonable excuse for a failure and remedies the situation without unreasonable delay. It was suggested that the reasonable excuse and the special reduction provisions should mirror those in Schedule 41 Finance Act 2008, for failure to notify penalties.
- 3.12 The safeguards described in the June consultation document were felt to be reasonable by the greater majority of respondents. Whilst the internal HMRC review was welcomed, some noted that it should not be compulsory nor should it be a substitute for a tribunal hearing. This is firmly HMRC's intention. There was a call from a few respondents for clear guidance on what constituted a 'reasonable excuse'. A couple of those who responded felt that the safeguards were not sufficient. One respondent felt that the level of contact between taxpayer and HMRC was inadequate, relying too heavily on call centres and internet connections. The respondent also felt that there should be some form of compensation for taxpayers when HMRC gets it wrong. One respondent suggested a 'time to file' facility where taxpayers could request additional time to file due to unforeseen circumstances.

### ***Taxpayer support***

- 3.13 Several respondents suggested ways in which they would like to see HMRC provide better support to customers. There was call for increased face to face contact with HMRC officers and for home visits in particular for older and disabled customers. It was also suggested that HMRC should explore ways of identifying taxpayers who start acting out of character, in order to provide more targeted support. For example a customer who had regularly filed and paid on time becoming erratic, may need support, and direct contact from HMRC may be appropriate. It was also suggested that HMRC find ways to identify those with a disability that may hinder compliance.
- 3.14 A number of respondents suggested a 'time to file' facility whereby a taxpayer could make contact prior to the filing deadline requesting additional time to file due to unforeseen circumstances. Several

respondents asked for guidance to be easier to understand, taking account of the functional literacy level of the population. One respondent asked for recognition that the change in deadline date for paper filing for income tax self assessment may cause confusion and called for a 'lighter touch' in the first two years when dealing with missed deadlines. Better education about tax obligations was called for by a large number of respondents and many felt this would be the most effective tool in dealing with poor compliance. Some respondents asked for better promotion of the time to pay facility and for consistency in its application.

### ***"Capping"***

- 3.15 The unintended consequences of the current capping of the £100 fixed sum penalty for late filing an income tax self assessment return were explained in the June consultation document. The consultation asked whether capping still served a useful purpose.
- 3.16 Many of the responses indicated sympathy with the argument that capping was not as effective as intended, and suggested other ways to protect those on low incomes. Many recognised that a fixed penalty of £100 would be disproportionate to the tax payable for some, whereas for those who had a large tax liability such a fixed penalty might be insignificant. This led a small number of respondents to conclude that tax geared penalties were the most proportionate and therefore fairer, or that there should be different fixed sum penalties for different bands of business income. But most accepted that the value of a fixed sum penalty, as a simple and easily communicated message to reinforce the filing deadline, outweighed concerns about its proportionality, provided the sum was not large.

### ***Time to pay arrangements***

- 3.17 Time to pay arrangements are designed to help those who have cash flow difficulties by allowing instalment payments. Currently, time to pay arrangements can be applied inconsistently and the relationship with penalties is not always clear. The consultation suggested that this relationship should be made clearer, possibly by including this in statute.
- 3.18 When comparing the relationship between time to pay and penalties many respondents felt that as long as the terms of the time to pay arrangements are adhered to then penalties would be inappropriate. Many respondents also stated that if the terms were not adhered to then a penalty should be applied as normal. Conversely, a small number of those who responded felt that it was pointless loading more debt onto taxpayers who were clearly already in trouble.

### ***Late or non-filing***

- 3.19 For late filing of returns, the June consultation set out a possible approach made up of several steps:
- a first fixed sum penalty immediately after the filing date, accompanied by a warning letter explaining that a subsequent fixed sum penalty would become due a month or so after the filing date;
  - if the return was still outstanding 6 months after the due date, a tax geared penalty at a fairly low level. There was also a suggestion that if the return is still outstanding 12 months after the filing date a higher rate tax geared penalty should be issued. The tax geared penalty could be increased to 100% of tax outstanding if HMRC could show the taxpayer has deliberately failed to file their return;
  - daily penalties were also explored as another tool to influence behaviour with the suggestion of a new safeguard of statutorily limiting the number of days for which daily penalties could be charged, in place of pre-authorisation.
- 3.20 The possible structure for late filing outlined in the consultation document was given consideration by the respondents. There were many who felt the models had value and many respondents saw an opportunity to broaden the debate to explore other possible tools such as the greater use of determinations and assessments. Some respondents accepted that daily penalties may be appropriate in certain circumstances and some concerns were expressed over the disproportionate nature of fixed penalties especially when there is a nil return. Several saw advantage in an escalating tax geared penalty. Other respondents would like to see incentives explored as a means of encouraging compliance. It was emphasised again by several respondents that there is a great need for clear understandable guidance and a belief that this would lead to greater compliance. One respondent suggested that penalties could be refunded if behaviour improved.
- 3.21 The issue of daily penalties as explored in the consultation document was examined by the respondents and the opinions expressed were measured. Many of the respondents were concerned by the removal of pre-approval but most were reassured by the additional restrictions proposed for daily penalties. Several respondents felt that daily penalties should only be issued when the tax return was very late. One respondent was concerned about the automation of daily penalties and felt that the most vulnerable taxpayers were likely to be adversely affected.
- 3.22 The consultation document explored the issue of 'near misses', that is taxpayers who are late but only by a very short time, and taxpayers who are very late. Some of those responded felt that those who are

slightly late should not be treated differently whilst others thought the penalties should be less. Tougher penalties for severe delays were broadly supported but some who responded felt that repeated lateness indicated a need for support not penalties.

- 3.23 The consultation document also explored the role that may be played by assessments or determinations, estimated and issued by HMRC in the absence of the return. Some respondents strongly supported these as an effective tool.

### ***Late or non-payment***

- 3.24 In considering sanctions for late or non-payment, the June consultation document explored the option of a fixed penalty for missing the payment deadline (a new concept) and tax geared penalties at intervals, for those who are very late in paying, with these at increasing levels where the payment is more than 12 months late. One possibility explored was that such a tax geared penalty could be calculated daily but charged at fixed intervals. This approach would enable the penalty charged to be related more precisely to both the amount of tax unpaid and how late it is.
- 3.25 The issue of taxpayers paying shortly after the due date and serial late payers was explored in the consultation document. HMRC sought views on how these two groups might be treated.
- 3.26 When considering the outline of a possible structure for late payment penalties, many respondents thought that interest was the most appropriate way of addressing late payment by taxpayers. One respondent would like to see suspended penalties used and there was again a call for the increased use of assessments or determinations as a means of establishing the tax debt. The pointlessness of loading penalties on people who are likely to be struggling to pay was emphasised. However, most recognised that HMRC may need some additional tools to tackle persistent or prolonged late payment, in addition to interest and enforcement action.
- 3.27 The relationship between late filing and late payment was also raised as it was felt by some that to have two different penalty regimes running simultaneously had the potential to be disproportionate and some felt it was penalising a taxpayer twice for what was essentially one misdemeanour. One respondent also thought that to have two penalty regimes running along side each other would lead to confusion amongst some taxpayers. Another respondent also felt strongly that the partnership return penalty is unfair on individuals who cannot influence the person responsible for the delay in filing and felt that new legislation needs to address this.
- 3.28 When asked to consider the design principles and proportionality of the models, those who responded could see merit in tax geared penalties in that they were linked to tax owed and therefore inherently proportionate. Other respondents felt that fixed penalties had the

advantage of being clear and easily understood. A number felt that the two penalty regimes running simultaneously was disproportionate. One respondent felt that a penal rate of interest would be a better approach.

### ***In-year payment of PAYE***

- 3.29 The June 2008 consultation explored the issue of late payment of in-year PAYE which poses significant challenges to HMRC. PAYE obliges the taxpayer to pay the tax due every month or quarter but a return is only required at the end of the year. This means that the total amounts that should have been paid in-year are only known to HMRC at the year end and no details are known about how much should have been paid each month. Only around 60% of small and medium employers pay their PAYE on time (whereas the payment rate is very much higher for large employers subject to late payment surcharges). A number of possible approaches to improving PAYE payment patterns were explored.
- 3.30 One option discussed was to extend the current surcharge for late payment for large employers to medium sized employers. This is a tax geared penalty at the end of the tax year based of the number of in-year failures during the period. The total liability for the year is used when calculating the surcharge. The consultation document recognised that there were some drawbacks to this approach, in particular that it could produce disproportionate results.
- 3.31 Another possible approach considered was the introduction of monthly statements for all employers, but the document recognised there may be concerns about the possible administrative burden and stressed the need for careful analysis. A possible way to limit the burden would be to only require those who had previously missed in-year payments in the past to submit monthly statements. Lastly, the consultation document explored the possibility of estimating the tax due per month. Both of these approaches would allow for charging interest and penalties on amounts unpaid in-year. Any penalty charged could be a fixed sum or tax geared.
- 3.32 Most respondents agreed with the drawbacks identified about the three approaches suggested. Some respondents thought that monthly returns were a reasonable proposition but other respondents felt these were too burdensome.
- 3.33 A number of respondents took up the offer of suggesting an alternative way to encourage more employers to pay in-year PAYE on time. This was to expand the entries on the P35 end of year return, requiring employers to provide details of the sums that should have been paid each month. Any inconsistencies between what should have been paid and what was actually paid could be used to charge or pay interest and if appropriate late payment penalties, after the year end.

### ***Frequent obligations***

- 3.34 The June 2008 consultation considered the complexities associated with frequent filing and looked at appropriate ways to influence behaviour. The sequential nature of fixed and tax geared penalties means that they could be used for frequent obligations.
- 3.35 The current VAT default surcharge system was examined and its benefits and limitations explored. Possible adaptations to the VAT default surcharge were considered, notably separating the response to late filing from late payment – in effect splitting the surcharge in two, by introducing an initial fixed penalty and a penalty for prolonged non-filing/payment. The consultation document acknowledged that care would have to be taken to ensure proportionality.
- 3.36 It was suggested in the consultation document that some of the taxes with frequent filing obligations, for example excise duties and environmental taxes may be better suited to an approach similar to that for annual obligations. In this approach each filing obligation would be treated as distinct resulting in a sequence of fixed and tax geared penalties for each monthly return period, escalating the longer the return or payment was outstanding.
- 3.37 The consultation document asked a number of questions about how the models could be adapted for frequent obligations and how the proposals met the design principles. A number of respondents felt that the penalty regime for frequent filing was too complex. One respondent with a particular interest in VAT pointed out that where a VAT return was filed late then inevitably the payment would be late thus indicating only one misdemeanour. The respondent also suggested that penalties for late filing should not apply where the return resulted in a repayment; however they accepted that persistent late filers should have penalties imposed. Where a VAT repayment was due it was suggested that a fixed penalty would have to be imposed for late filing as there was no tax liability to calculate a tax geared penalty.

### ***Workshops and meetings***

- 3.38 Consultation workshops were held in September to give another opportunity for interested parties to ask questions and provide comments. Many of the points made echoed written responses but there were some additional suggestions and comments made:
- more imaginative engagement between HMRC and taxpayers: for example SMS messaging; thank you letters for on time filing and payment; better contact with carers for the elderly and those with disabilities; and submitting appeals online;
  - raising the profile of time to pay arrangements and ensuring consistency across HMRC;

- better use of warnings and communication to try and affect behaviour before a person becomes liable to a penalty;
- consistent clear guidance on reasonable excuse with examples;
- fixed sum penalty for late payment seems onerous and unfair;
- concern about the interactions between different penalties;
- repeated late filing or payment may be an indication that a taxpayer needs help or it may be a pattern of non-compliance;
- should more be done to protect those on low income from penalties (removing the requirement to file returns may be one way)?
- more use of assessments, determinations and enforcement actions for those very late e.g. after the 6 month stage.

3.39 The comments made at the workshop on in-year PAYE have been incorporated in chapter 6.

## Chapter 4: Further Refinements – A Proposed Way Forward

- 4.1 A number of key themes have emerged from consultation, research and internal analysis over the summer, which are shaping the proposed way forward. Before going into the detail of possible models it is worth exploring the themes that have emerged further.

### *Support*

- 4.2 There is absolutely no doubt that in considering how to encourage people to file returns and pay tax due on time, penalties are only a small part of the picture. Simplifying those obligations where possible, clearly communicating what taxpayers need to do, and providing accessible targeted support, are likely to have more effect than penalties on their own. HMRC is continuing to work on improving support for taxpayers.
- 4.3 But having a simpler penalty regime aligned across taxes, where possible, makes it possible for HMRC to present clear messages about the consequences of not filing or paying on time. And there are things that can be done around the interaction between penalties and support mechanisms which help turn the sanction into an incentive.

### *Payment Instalment schemes*

- 4.4 “Prevention is better than cure” is a key message from the research with people who have been in debt to HMRC. They would like to see more help to facilitate putting money aside to meet tax bills (and help to resist raiding the pot) and more regular and accessible mechanisms for paying tax. HMRC is consulting on proposed new payment instalment schemes to help taxpayers budget for tax liabilities. There would be no penalties for late payment where a person kept to their payment schedule. In this context, penalties for late payment represent an incentive to keep to payment plans and not to draw down on money set aside for tax bills.

### *Time to pay*

- 4.5 Where such support has not worked, for whatever reason, and a person has difficulty in meeting a tax bill, penalties for late payment can become a barrier that prevents taxpayers seeking help from HMRC and simply exacerbate the problem. HMRC wants to ensure that if taxpayers get into difficulty meeting their tax obligations, they come forward and discuss those difficulties with HMRC at the earliest opportunity. It is for this reason that the proposals for suspending penalties where a person enters into a time to pay arrangement have been reviewed again since the June consultation. The proposal now is that if someone comes forward to HMRC seeking time to pay (at any time) and an arrangement is agreed, then all late payment penalties from that point onwards for that tax debt would be suspended and

would be subsequently cancelled, unless the taxpayer defaults on the arrangement. Interest would however continue to run.

**Question 2: Is the proposal outlined above that penalties should be suspended where a taxpayer has entered into a time to pay arrangement with HMRC an appropriate way of supporting taxpayers who have difficulties in meeting their payment obligations?**

***Encouraging taxpayers who have a reasonable excuse to come forward early***

- 4.6 If a person has a reasonable excuse for filing a return late and they file without unreasonable delay once the excuse has ceased, then they will not be liable to a penalty. The provision is often considered only in the context of appeal hearings against a penalty already charged. But it has effect at any time. So if a person comes forward to HMRC with a reasonable excuse, even before they have missed the filing deadline, or after they have missed the deadline, but before a penalty has been charged, then they will not be liable to a penalty, provided the return is filed without unreasonable delay once the excuse has ceased. HMRC is keen to encourage people who may have a reasonable excuse for a failure to come forward early so that support can be provided and to ensure that future penalties are inhibited.
- 4.7 Further it is important to note that what constitutes a reasonable excuse for one taxpayer may be different to another. HMRC officers must be free to consider each case on its merits.
- 4.8 This is not new, but as part of the work introducing any new penalties, HMRC need to consider how to increase understanding and access to reasonable excuse provisions, including before a penalty has been charged.

***Strategy for disabled customers***

- 4.9 Following an audit across HMRC the department is committed to improving those services which are not Disability Discrimination Act compliant and have put in place an action plan for delivery. The results of research about disabled customers have been disseminated throughout HMRC to spread knowledge of this customer group's particular issues.
- 4.10 In addition HMRC is running a pilot to produce a training package for staff which will increase their awareness of disabled customers and enhance their skills in dealing with them. Once the pilot is complete HMRC will have a package that can be adapted for particular business areas, for the training of their own staff.

### ***Other support initiatives***

- 4.11 HMRC is currently involved in several initiatives designed to improve the experience for the taxpayer and to help HMRC better understand taxpayers. HMRC is working with schools to educate on matters relating to financial awareness and management and HMRC is also working closely with the Financial Services Authority as part of a drive to improve financial capability throughout the population. HMRC are also designing an enhanced service (incorporating an education service) to the growing number of pre-pensioners, new pensioners and existing pensioners. Guidance is being rewritten in plainer English. Alongside this, work is underway to place all HMRC guidance in one place making it easier to navigate and to provide self help tools online to provide information on some of the more common issues faced by taxpayers.
- 4.12 HMRC will be working closer with the Department of Work and Pensions to enhance and support the 'better off' calculator, which will allow taxpayers to see the impact of their employment decisions. HMRC will continue to have an advertising campaign that is both eye-catching and informative telling taxpayers about filing deadlines. Customer complaints are monitored to identify issues raised and learning points for HMRC.

### ***Safeguards***

- 4.13 The proposals for safeguards outlined in the June 2008 consultation were praised as being appropriate and robust. These include:
- a right of appeal to an independent Tribunal against all penalties;
  - access to internal review before an appeal hearing if the taxpayer wishes;
  - a common legislative formulation of reasonable excuse aligned across taxes which is the same as that devised for penalties in Finance Act 2008;
  - provision in law for reduction of penalties in special circumstances, not otherwise covered.

This should be backed up by clear, accessible guidance. **Appendix D** is a first draft of such guidance. **HMRC would welcome comments on this guidance.**

**Question 3: Are the safeguards proposed appropriate? Is the draft guidance appropriate? What modifications, if any, are required?**

- 4.14 Several respondents commented that perhaps a more important safeguard would be to ensure that any new penalties are designed in a way that is fair and minimises penalties being issued incorrectly. Allied to this was the call for clear warnings about impending penalties easy access to escape routes for people who think that no penalty is due and help and support if people are unsure how to meet their obligations. This represents a particular challenge for one-off taxes where HMRC may not be aware that a return or payment is late. For these situations, more reliance would have to be placed on generic information rather than specific warnings for individual taxpayers. Communication with agents would be central.
- 4.15 One of the ways that the design of the penalty models has been modified over the summer is to reduce the overall number of different penalties and to ensure that there is sufficient time between them to contact taxpayers – offering help, escape routes and to warn of impending penalties. For example the proposed restriction on charging daily penalties for late filed returns, to no sooner than 3 months after the filing due date, is to ensure just such time is available.

***Alignment***

- 4.16 The great majority of respondents re-emphasised their support for alignment across taxes where it makes sense. This is because they recognised that alignment promises the benefits of clearly reinforced obligations, easily understood consequences, a sense of equity and simpler administration for all. A small minority continue to feel that so-called withholding taxes e.g. VAT and PAYE should be considered differently from taxes on profits. However, it is considered that in essence the requirement to file a return on time and pay tax by the due date is the same whichever tax or duty is involved.
- 4.17 But, and it is a significant “but”, full alignment is neither possible nor sensible for late filing and late payment penalties.
- 4.18 The main reasons for this are:
- the frequency of the filing and payment obligations – whilst it makes sense to align across taxes with annual obligations, those with more frequent obligations may need a slightly different approach;

- where the requirement to pay is significantly before the requirement to file the return (as for Corporation Tax), there may need to be special arrangements.

### ***A different role for interest and penalties***

- 4.19 One of the key themes in the work on payment of tax has been to be clear that interest and penalties play quite different roles. Interest is simple recompense for not having use of the money (for either party) whereas penalties are a deterrent, intended to influence behaviour. The parallel but separate consultation documents in June 2008 sought to make this theme clear – some acknowledged this, others still saw some confusion or disagreed with HMRC's interpretation.
- 4.20 Whilst being clear that interest and penalties perform different roles, it is important to recognise that for late payment, both may operate in the same arena. It is for this reason that the two consultations are again being presented together. Any penalties for late payment must recognise that recompense interest will also be running on any underpayments. This will affect both the level of any penalty and the time when it is imposed.

### ***Separate obligation to file returns and to pay tax due***

- 4.21 The work over the summer has strengthened the view that to design coherent, effective responses to late filing of returns and late payment of tax, the two activities have to be considered separately. There was much time given in consultation responses to which is more important – filing the return or making the payment. Filing and payment are both crucial elements in an effective tax system. Returns provide the information to enable HMRC to check that the correct tax is being paid (among many other important roles). Payment provides the Exchequer with the requisite funds. Self assessment has been a key principle of the UK tax system for over 10 years – right across the taxes. But it does not extend to simply making a payment to the Exchequer which HMRC are unable to verify.
- 4.22 So in order to encourage both filing and payment on time, the penalties for late filing and late payment must be separate from each other. This means the late filing penalties should be unrelated to whether the tax has been paid (in the same way as incorrect return penalties do not take account of payment). But in the real world there are three scenarios: people who pay but do not file; people who file but do not pay and those that neither file nor pay. In considering the rates, levels and structure of the penalty regimes it is important to consider how they will impact for all three situations.

### ***The case for late payment penalties***

- 4.23 Many of the consultation responses start from the premise that late payment of tax is not a form of non-compliance and that recompense interest should be sufficient to put HMRC back into the position it would have been if the payment was on time. Whilst this has an appealing simplicity, it does not address the range of behaviours causing payment to be late. It also fails to address the fact that a failure to pay on time is a failure to meet an obligation required by Parliament and that those who fail to pay on time may gain a significant financial advantage over other compliant taxpayers.
- 4.24 An absence of penalties for late payment would mean HMRC having to rely more on enforcement action (including through the courts) in cases where payment was significantly late. Such action is very intrusive and damages the relationship between taxpayers and HMRC as well as being expensive for HMRC to administer. Whilst respondents question the need for late payment penalties, most recognise HMRC may need some further tools to deter prolonged or repeated late payment.
- 4.25 In response to consultation and recognising some of the findings of the qualitative research, the proposal for a fixed sum penalty for late payment immediately after the due date, has been dropped. The research emphasised the importance of the relationship between taxpayers and HMRC in influencing decisions to pay tax due on time. Further analysis suggested that the risk of damaging that relationship by charging early fixed sum late payment penalties outweighed the benefit of reinforcing the deadline. Consultation respondents made the same point and questioned whether it was an appropriate response to what may be only a small delay in payment.
- 4.26 Evidence of the effectiveness of current surcharge arrangements, (for example income tax self assessment and the VAT default surcharge), suggests that late payment penalties, charged as a small percentage of the tax unpaid at fixed points in time after the due date – say 1, 6 and 12 months, can act as effective deterrent milestones. When clearly communicated they can be useful in reinforcing in people’s minds a clear date by which they must take action. If a taxpayer fails to pay by the first penalty date, the second will help to clarify in the taxpayers mind a future milestone by which to make payment.
- 4.27 When a tax bill is not paid by the due date, the taxpayer would be warned that failure to pay the bill within one month<sup>2</sup> (or to come forward to HMRC to seek help) will result in a penalty charge. This is intended to prompt the taxpayer into action and remind them that whilst they had failed to meet the obligation, if they made payment by a certain date that they would not suffer a penalty. HMRC’s objective is not to charge penalties but to encourage the taxpayer to engage with HMRC either by making payment or approaching HMRC for support.

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<sup>2</sup> 3 months for Corporation Tax because the due date for payment is before the return filing date.

- 4.28 Whilst the more overdue a debt becomes, the more likely it is that HMRC will consider direct enforcement action, there is still value in having late payment penalties at 6 and 12 months. These penalties may reduce the need for enforcement action against some taxpayers resulting in less stressful experiences for taxpayers and reduced costs for HMRC. Further, when HMRC officers contact the taxpayer to pursue payment, as well as confirming the validity of the debt, they need levers to encourage the taxpayer to settle the debt. Accruing interest and the threat of court action are two such levers. Explaining that continued non-payment may result in a further penalty is another lever and our internal data suggests that some taxpayers respond to such engagement.
- 4.29 There is a correlation between the rate of interest charged on late payment and any late payment penalties. As a stakeholder commented, *“it maybe better to have a lower rate of recompense interest for all and a late payment penalty for the few, who are significantly late paying, than to have a higher rate of interest for all.”* The existence of late payment penalties for the prolonged and repeatedly late payments is an important way in which the neutrality of the interest regime as simple recompense is preserved.

### ***Employers’ end of year returns***

- 4.30 Returns for all taxes are a crucial source of information for the effective running of the tax system. But an employer’s annual return, comprising form P35 and forms P14, is not simply a return setting out the PAYE and national insurance contributions payable for the year. The return includes key data essential for the effective and smooth running of the tax and benefits system and as such any delay in filing the return has the potential to adversely affect the employees included in the return. The timely receipt and processing of National Insurance data for each employee ensures that individuals’ National Insurance records accurately reflect contributions paid which is important in terms of contributory benefit entitlement. The late submission of an employers end of year return may also have other adverse consequences for employees, for example, continued deductions of student loan repayments after the student loan has been paid.
- 4.31 It follows that the larger the employer the greater the potential adverse impact, in terms of numbers of employees affected, if a return is submitted late. In the interest of simplicity and alignment, the proposed changes to the penalty regime for late filing set out in chapter 5, suggest that the initial fixed sum penalty for late filing should be the same regardless of the size of the employer. This may be perceived as not recognising the greater adverse impact of a large employer returns being filed late compared to a smaller employer. HMRC will continue to focus particularly on ensuring returns which affect large numbers of employees are submitted on time.

### ***Penalties as a deterrent***

- 4.32 The whole rationale for having civil penalties for failing to meet tax obligations is to deter. Late filing and late payment penalties reinforce filing and payment deadlines. Where the deadlines are not met the subsequent penalties are deterrence milestones, providing a clear downside, at fixed points in time, to continuing delay.

### ***Penalties and behaviour***

- 4.33 In contrast to the approach for incorrect return penalties, it is neither practical nor appropriate to consider the underlying behaviour behind every late return or late payment, before deciding whether a person is liable to a penalty. The numbers involved make it impractical. For this reason, in the models suggested, the degree of lateness or the number of times the taxpayer has defaulted is used to some extent as a proxy for the underlying behaviour.
- 4.34 But at the margins it is right that the cause of the lateness should be considered. At one end of the spectrum the ability to escape from penalties where a person has a reasonable excuse achieves this and the higher penalty for deliberate non-filing does this at the other end of the spectrum.
- 4.35 There are some parallels that may be drawn between different forms of non-compliance. These may inform the rates and levels at which penalties are set.
- 4.36 Where there is a reasonable excuse, remedied without unreasonable delay, there should be no penalty. This is a crucial safeguard and has parallels with not charging penalties for mistakes, despite taking reasonable care in completing returns.
- 4.37 Deliberate non-filing of a return is another way that some taxpayers evade tax, comparable to deliberately failing to notify HMRC or deliberately understated tax due.
- 4.38 Where a person neither files a return nor makes payment for a particular return period for say 12 months, but there is no evidence of deliberate failure, this may be seen as having parallels with failing to take reasonable care.

## Chapter 5: Proposed Penalty Models

5.1 This chapter describes a number of proposed penalty models for the various taxes and duties covered by this work.<sup>3</sup>

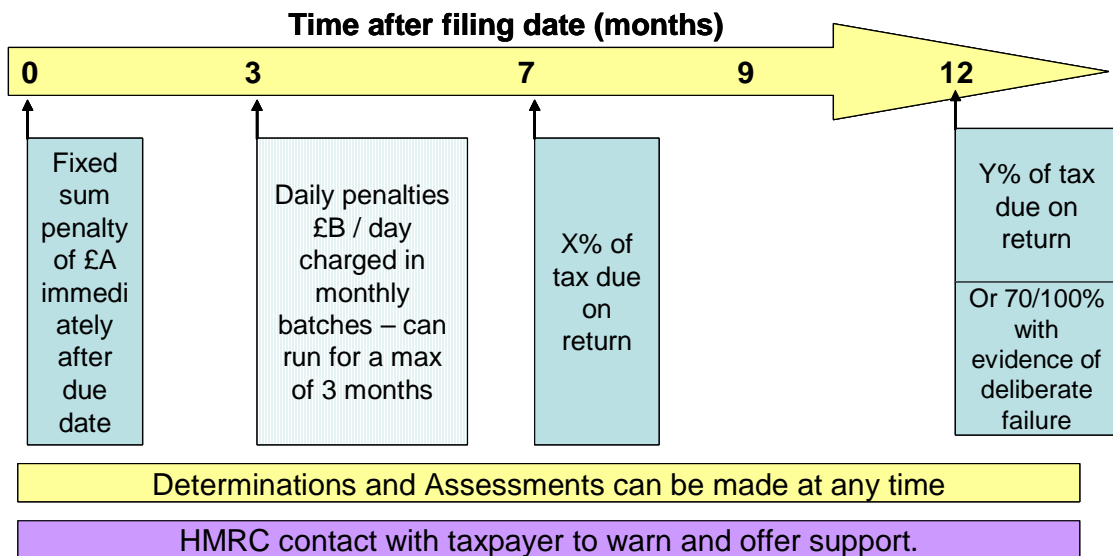
### Late Filing

#### ***Penalties for late filing for annual and “one-off” return obligations – a model***

5.2 The diagram below sets out the proposed framework for penalties for late or non-filing of returns where the obligation occurs annually or is a “one-off” obligation. More detail is provided both in the following narrative. It is proposed that this model would apply to Income Tax Self Assessment, Corporation Tax Self Assessment, Stamp Duty Land Tax, Stamp Duty Reserve Tax, Inheritance Tax, Petroleum Revenue Tax, Pension Schemes, end of year PAYE returns (P35) and annual accounting for VAT and some other indirect taxes.

5.3 Modified models for more frequent filing obligations are set out in paragraphs 5.13 – 5.21.

#### **Late filing (annual and “one-off” obligations)**



5.4 The proposed first response to a return not being received by close of the filing date is a ***fixed sum penalty***, unrelated to the amount of tax due or paid. Such a response is widely acknowledged as a useful tool to reinforce the filing obligation, motivate the disorganised and push back the human tendency to procrastinate. Whilst some may suggest the amount needs to be increased from the current £100, most agree the existence of a fixed-sum penalty immediately after the filing date as a deterrent is more important than its value. HMRC’s current view is that there appears little reason to increase the level of the first response penalty. Further analysis of existing penalty regimes

<sup>3</sup> HMRC is still considering how to encourage timely payment of National Insurance Contributions.

supports the view expressed by most in consultation that a second fixed sum penalty beyond the first fixed sum penalty is unlikely to be effective. For this reason, this has been removed from the model.

- 5.5 To keep the “file on time” message simple and clear, it is important not to introduce confusion by relating the penalty to whether tax had been paid. This means removing the so called “capping” for some taxes from the structure. Capping was acknowledged in consultation as not providing very effective protection for those on low income whilst causing confusion to taxpayers and reducing the effectiveness of the penalty.
- 5.6 Many constructive suggestions were made in consultation responses as to how HMRC might improve support to those needing to file returns. Paragraphs 4.2 – 4.12 consider how HMRC might take forward those suggestions giving particular attention to those on low incomes.
- 5.7 Where the delay in filing is prolonged, it is proposed that HMRC should be able to charge modest **daily penalties**. These are designed to encourage people to focus on completing the return and to provide a progressive response to delay. In consultation, respondents recognised that daily penalties can be effective in influencing behaviour but can become disproportionate because they can run indefinitely and they can be charged inconsistently. For this reason HMRC considers that there should be significant restriction on the use of this power set out in legislation. It is suggested that these restrictions should be:
- more than three months must have elapsed since the filing date for the return before the daily penalties can be charged;
  - the penalty to be a fixed sum per day set out in statute (rather than “an amount not exceeding”);
  - daily penalties may not be charged for longer than 3 months for any outstanding return;
  - HMRC to be required to inform the taxpayer before starting charging daily penalties.
- 5.8 The restriction as to when daily penalties may start, and requirement for HMRC to tell the taxpayer before they do, are both aimed at strengthening the deterrent effect of daily penalties. They ensure that HMRC has sufficient time to, and does indeed, remind people that the deadline has passed, explain how to access help and set out the consequences of continuing failure to file. They also provide time for appeals against the fixed sum penalty to be considered. Whilst none of the rates and levels will be decided until the framework is finalised, it is clear that the level of daily penalties would be very significantly less than the current maximum of £60 per day for income tax self assessment. The restriction to how long daily penalties may run is to recognise that if this lever has not worked within 3 months, it is unlikely to work at all.

- 5.9 As with all penalties, the taxpayer would have a right of appeal against daily penalties to an independent Tribunal (including internal review). It is suggested that these restrictions represent a fairer and more effective safeguard than the current practice of pre-authorisation by the General or Special Commissioners.
- 5.10 It is proposed that for very late returns there should be **tax geared penalties** – that is the penalty is a percentage of the tax due on the return, payable at 7 and 12 months after the due date. Analysis of current filing patterns suggests that where the initial fixed sum penalty has not been effective in reinforcing the deadline, late returns sometimes take a long time to be submitted. There are many reasons for this and a variety of different responses that HMRC can and should take. But it has to be recognised that for some the benefits of withholding information from HMRC are sufficiently great that neither fixed sum nor modest daily penalties will be effective. For others, very late returns may well be an indicator of a wider problem with compliance with tax obligations.
- 5.11 As with the other late filing penalties it is proposed that the tax geared late filing penalties should be unrelated to whether the tax has been paid. However, in setting the levels it will be important to realise that some will be very late in both filing returns and payment of tax due and penalty levels should reflect this. See paragraphs 4.31–4.36 for a description of the interactions between penalties. The timing of the tax geared penalties at 7 and 12 months is to ensure there is time for contact about support, escape routes and warnings between the end of daily penalties and liability to any tax geared penalties.
- 5.12 The approach to late filing penalties has been to say that it is not generally practical or appropriate to consider the underlying cause of the lateness before deciding if someone is liable to the penalty. Instead the onus is on the taxpayer to show they have a reasonable excuse and should not be liable to a penalty. This is a different approach to penalties for incorrect returns, which are behaviour related. There is one area where it is considered appropriate to consider the underlying cause of lateness before deciding the level of penalty and that is where the return is more than 12 months late. The proposal is to provide for a standard tax geared penalty but also for much higher penalty levels where HMRC can demonstrate that the non-filing was **deliberate** and higher still if the taxpayer has taken active steps to conceal the tax liability. This is to meet one of the underlying themes of the Review of Powers, Deterrents and Safeguards, by coming down hard on those who seek an unfair advantage by non-compliance. The aim is for deliberate non-compliance, in whatever form it takes, to be penalised to the same degree.

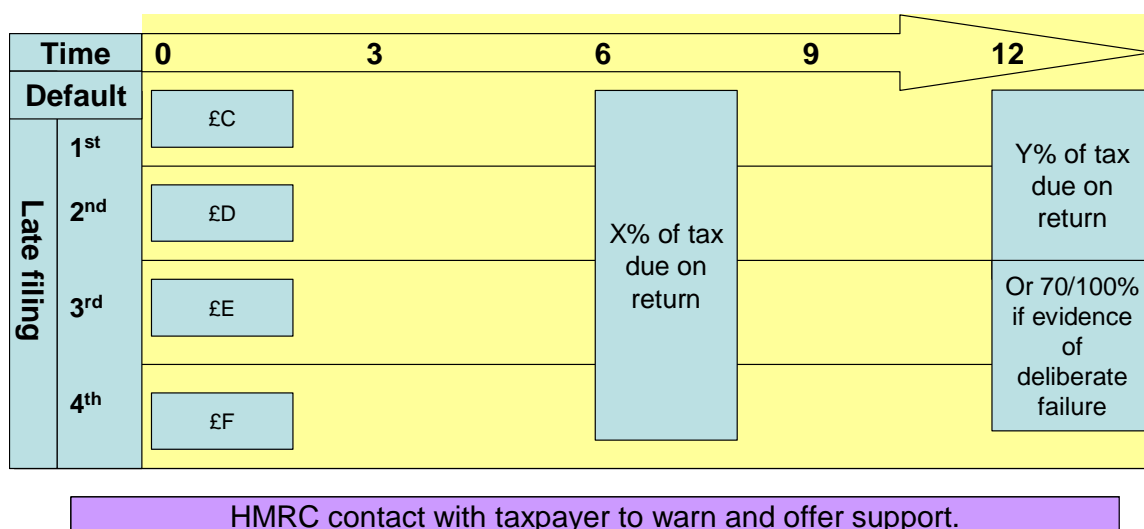
**Question 4: Does the model presented for late filing meet the design principles – fairness, effectiveness and influences behaviour?**

***Penalties for late filing for quarterly return obligations – a model***

5.13 Where the requirement to file returns is quarterly rather than annual or one-off, the proposal is that the structure should be slightly different but with many of the same features. The differences are to take account of the more frequent filing obligations and to make it possible to vary the level of the penalties depending on the frequency of the default. This penalty structure would apply to most VAT traders and to Insurance Premium Tax, Aggregates Levy, Climate Change Levy and Landfill Tax.

5.14 Again a diagram may be the best way to illustrate the proposed model.

**Late filing – quarterly obligations**



5.15 An important feature of this model is that it has a rolling default window as with the current VAT default surcharge. The intention is that the first time the taxpayer defaults (fails to submit a return by the filing date), they enter a default window which expires on the anniversary (12 months) of the default. Any further defaults extend the default window until the anniversary of the latest default. It is important to point out this would be a rolling default period purely in relation to late filing. The proposal is that late payments would be considered separately (see para 5.35). This is unlike the current VAT default surcharge which wraps up late filing and late payment penalties in one regime. The effect would be to have two rolling default windows in operation, one for late filing and one for late payment.

- 5.16 The level of the penalty would then be calculated by reference to the number of returns filed late in the default window. The first default – the default that starts the default window should make the taxpayer liable to a fixed sum penalty of £C.
- 5.17 Any further defaults in the default window would be penalised according to the following table:

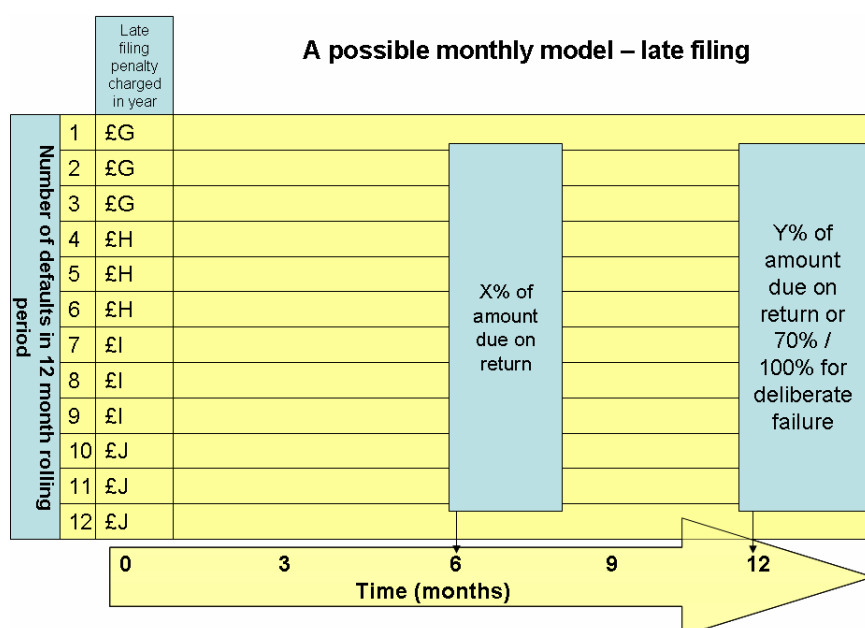
Number of additional defaults in the rolling default window	Fixed sum penalty
1	£D
2	£E
3 or more	£F

- 5.18 This model also makes possible a softer response to the first late filing in a default period e.g. a warning letter rather than a fixed sum penalty. One of the effects of this change is to make the initial response to late filing for these taxes a fixed sum penalty, as for annual taxes. At the moment for VAT, a late return extends a trader's exposure to tax geared penalties (of up to 15%) for a further 3 months. It is considered that this is a more tailored and proportionate response to late filing of VAT returns. It represents a change from the June 2008 consultation in moving from tax geared to fixed sum penalties as the initial response to late filing.
- 5.19 One of the weaknesses of the current penalties for indirect taxes is that there is no deterrent to very late filing. Whilst repeated failure is addressed in the VAT default surcharge regime, prolonged failure is not. The proposal is that the tax geared penalties for very late filing at 6 and 12 months (including those for deliberate non-filing) should also apply to any quarterly return that is this late.
- 5.20 As the obligation to file is more frequent, there does not seem to be a case for daily penalties for late filing of quarterly returns. In effect the higher initial penalty for a second default serves the same purpose, to encourage people to focus on completing the returns and as a progressive response to delay.

***Penalties for late filing for monthly return obligations – a model***

- 5.21 There are some taxes and duties where the obligation to file returns is monthly such as Construction Industry Scheme and many Excise duties (or a monthly obligation is an option for some taxpayers – for example in VAT). In principle the model for quarterly returns could be adapted for these situations. This would mean a rolling default window, with escalating fixed sum penalties for repeated defaults and tax geared penalties for prolonged failure.
- 5.22 Work is continuing to understand whether this is the most appropriate approach for those taxes and schemes that have monthly filing obligations – notably Excise Duties and the Construction Industry Scheme.

5.23 The diagram below shows one way that the quarterly model could be modified for monthly obligations.



5.24 Under this model, the penalty charged immediately after the filing date would be a fixed sum and would depend on the number of defaults in the rolling default period. The first time the taxpayer defaulted, the penalty could be at quite a modest level and could increase with the increasing number of defaults.

5.25 Again, as for monthly and quarterly taxes, if a return was outstanding beyond 6 or 12 months, the taxpayer could be charged an additional penalty that would be tax geared based on the amount of tax on the return. The penalty at 12 months could be increased if HMRC could evidence that the failure to submit the return was deliberate.

**Question 5: Are the modifications to the late filing penalty model, to reflect the frequency of the obligations, appropriate?**

**Late Payment**

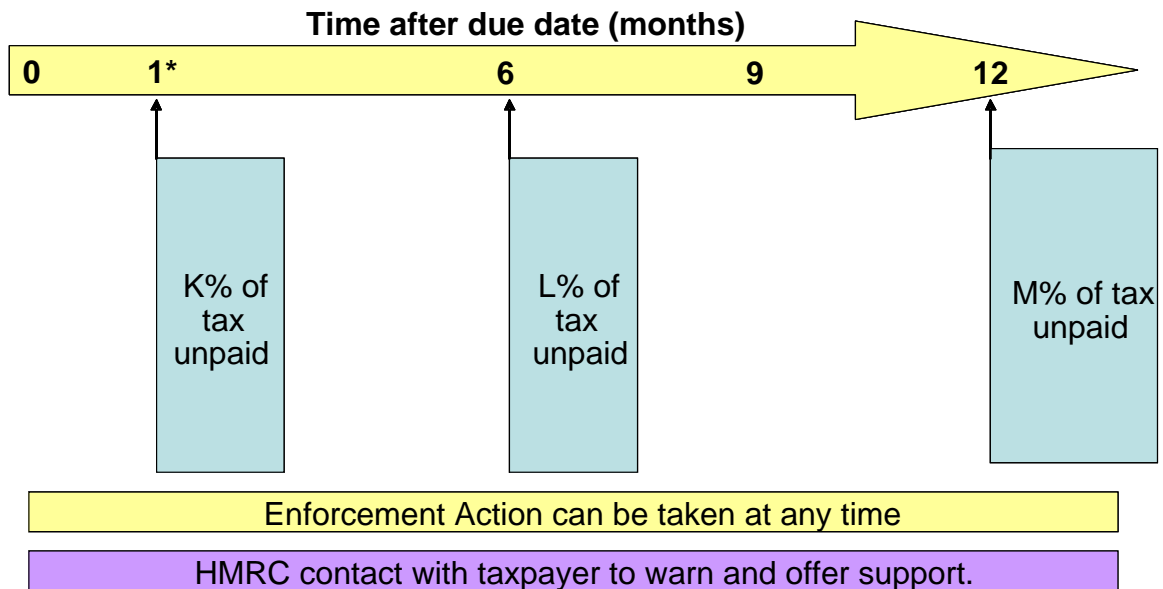
***Penalties for late payment of annual and one-off obligations– a model***

5.26 Paragraphs 4.23 – 4.29 set out why late payment penalties are a necessary part of HMRC’s deterrence toolkit for late payment, alongside recompense interest and enforcement action.

5.27 The proposal is quite simple and is designed to encourage the reluctant payer to pay on time, to raise the profile of HMRC debts (whilst not re-creating preferential creditor status) and to deter very late payment. It is also designed to deter taxpayers using HMRC as a quasi bank. This model would apply to: income tax self assessment, corporation tax self assessment, stamp duty land tax and stamp duty

reserve tax, inheritance tax and petroleum revenue tax. It would also apply to taxes where there is an option or requirement to pay annually for some taxpayers – for example VAT annual returns. Again a diagram helps to demonstrate the proposed structure.

**Late payment (annual and one-off obligations)**



\*3 months for corporation tax.

- 5.28 The suggestion is that at fixed points in time after the due date for payment, say 1 month, 6 months and 12 months, a taxpayer becomes liable to a penalty of a fixed percentage of any tax due but unpaid at that point in time, charged as lump sum. Thus as these points in time come near, there becomes an incentive to make the payment or to contact HMRC to seek time to pay, in order to avoid the penalty. These could be described as deterrence milestones.
- 5.29 Corporation tax is unusual in that the due date for payment is 3 months before the due date for filing returns, whereas for most taxes the filing and due dates are the same. Companies sometimes find it difficult to make accurate payments at the due date (9 months after the end of the accounting period). In recognition of this, whilst interest will continue to run from the due date, it is proposed that the first late payment penalty should be 3 months after the due date (rather than 1 month). There would be no additional penalty for those in Quarterly Instalment Payment regimes (QIPs), but the penalty above would apply as normal if any tax was unpaid 3 months after the due date.
- 5.30 In practice HMRC may not always be able to charge the penalties at the 1,6 or 12 month point if the return has also not been submitted, because the tax due will not be known. But this does not prevent the deterrent effect and the penalties would be charged once the tax due was known, provided there was not a reasonable excuse or a time to pay arrangement in force. And if estimated determinations or assessments have been made, late payment penalties may be charged

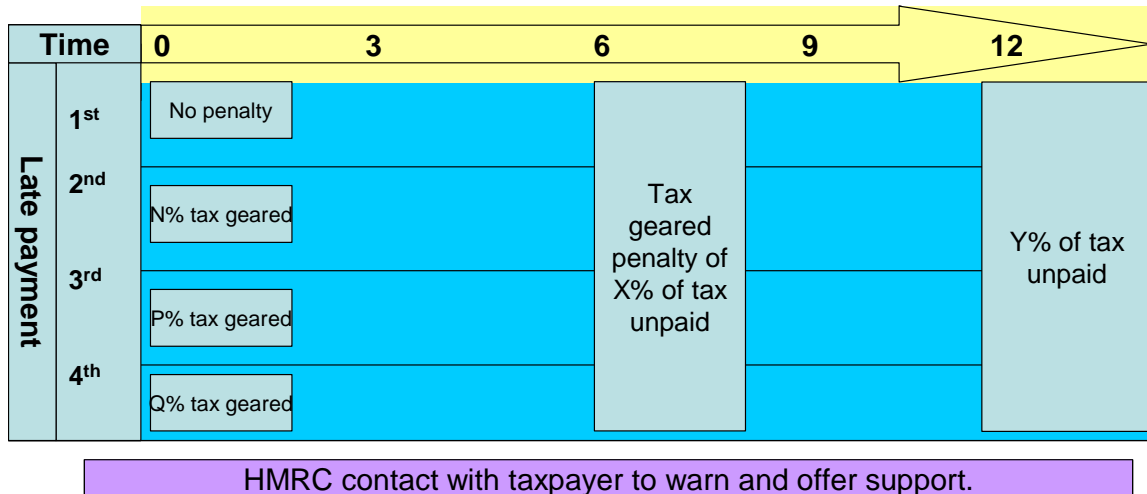
based on these estimates and later corrected when the true liability is known.

- 5.31 It is important to be clear in this context what is meant by the due date for payment. Each tax and each return period has set out in law or regulations a date by which tax is due to be paid (usually known as the due date). For most straight forward cases this will be the date from which the 1, 6 and 12 month points are measured when considering if late payment penalties apply.
- 5.32 There are a number of different ways in which additional tax becomes due later than the normal due dates: taxpayers may amend or correct their returns or HMRC may make a discovery assessment. In each of these circumstances it seems right that late payment penalties should only apply if payment is delayed from more than 1 month from the date that the extra tax became due.
- 5.33 For example a person submits their income tax self assessment return on time showing £3,000 due at 31 January 2012. They subsequently realise the return contained an error and submit an amended return on 30 June 2012, showing a further £500 is owed. This additional £500 becomes due and payable 30 days from the date the amended return is filed. Late payment penalties would only be payable if the £500 was not paid before 31 July 2012.
- 5.34 In order that late payment penalties are effective in deterring very late payment for all, it is considered appropriate that they should be subject to a minimum value.

**Question 6: Does the model presented for late payment penalties meet the design principles – fairness, effectiveness and influences behaviour?**

***Penalties for late payment of quarterly obligations– a model***

- 5.35 As for late filing penalties it seems appropriate that the model should be adapted to take account of more frequent payment obligations and make possible varying the level of the penalties depending on the frequency of the payment default. This penalty structure would apply to most VAT traders, Insurance Premium Tax, Aggregates Levy, Climate Change Levy and Landfill Tax.



5.36 Again the suggestion is for a rolling default window (but separate from the filing one) so that the first time the taxpayer defaults, they enter a default window which expires on the anniversary (12 months) of the default. Any further defaults extend the default window until the anniversary of the latest default. The taxpayer can therefore only leave a default window by paying on time for 12 months.

5.37 The penalty would then be calculated by reference to the number of defaults in the default window. The first default – the default that starts the default window would not trigger a penalty at all. Instead HMRC would issue a default notice notifying the taxpayer of the default window and warning them that any further default will result in a penalty.

5.38 Any further defaults in the default window would be penalised according to the following table:

Number of defaults	Penalty (calculated as a percentage of the tax unpaid)
1	No penalty – warning letter
2	N%
3	P%
4 or more	Q%

5.39 And as for annual or one off payment obligations, if the payment is more than 6 or 12 months late then further penalties are charged, calculated as a percentage of the tax unpaid at those points in time.

***Penalties for late payment of monthly obligations– a model***

5.40 The model suggested for quarterly obligations could be adapted for monthly obligations. Work is continuing to understand whether this is the most appropriate approach for those taxes and schemes that have monthly payment obligations – notably Excise Duties (excluding environmental taxes).

- 5.41 The particular issues surrounding late payment of in-year PAYE are addressed separately in chapter 6. Construction Industry Scheme deductions are collected through the PAYE system and therefore the PAYE model presented in chapter 6 would apply.

**Question 7: Are the modifications to the late payment penalty model, to reflect the frequency of the obligations, appropriate?**

### ***Administration of penalties***

- 5.42 New streamlined and aligned penalty machinery provisions were included in Schedule 24 Finance Act 2007 for penalties for incorrect returns. These covered assessing (including time limits for assessing) notifying, enforcing collection and administering appeals. The same machinery provisions were seen to be appropriate for penalties for failure to notify and it is suggested are again suitable for late filing and late payment penalties. In essence HMRC is moving swiftly towards one set of rules for the administration of civil penalties, which should be similar and clearer for all, and help to make the appeal mechanisms more accessible.

**Question 8: Is the overall package of penalties suggested for late filing and late payment likely to be effective, fair and to influence behaviour?**

### ***Illustrative examples***

- 5.43 The following pages provide illustrative examples of how the penalty models for late filing and late payment described above could work for Income Tax Self Assessment and VAT. The examples firstly show what penalties the taxpayer would currently receive under the existing penalty provisions and then for comparison what they could receive under the proposals in this chapter.

## **An example of how the new penalty structure could work for ITSA**

The following is an illustrative example of how the models suggested may work for an individual taxpayer due to file an income tax self assessment return. It assumes the taxpayer has not responded to advertising, guidance notes, a number of notification and warning letters and has not requested time to pay or a flexible payment arrangement.

### **Current penalty regimes for ITSA**

#### *For late filing:*

- £100 fixed sum penalty as soon as possible after the due date - capped to the amount of the tax unpaid at the due date,
- a further £100 if the return has still not been sent 6 months after the filing date,
- if the failure continues beyond 12 months, the taxpayer could be charged a penalty of up to 100% of the tax due for failing to submit a return subject to abatement for cooperation, disclosure and seriousness, and
- HMRC may also seek daily penalties of up to £60 per day for failing to submit the return, at any time and for an unlimited period, with prior authorisation from a Commissioner.

#### *For late payment:*

In addition to recompense interest:

- a surcharge of 5% of the tax unpaid 28 days after the due date. If the return is still outstanding at this point, the penalty will be charged once the return is submitted or after a determination has been made, and
- a further surcharge 5% of tax unpaid if the failure continues beyond 6 months.

### **New penalty models for ITSA**

#### *For late filing:*

- a fixed sum penalty of £A immediately after the due date,
- possibly daily penalties of £B per day, starting no earlier than 3 months after the filing date and running for no more than 3 months.

- if the return was still outstanding 7 months after the filing date a penalty of X% of tax due on the return.
- if the return was still outstanding 12 months after the filing date a penalty of Y% of tax due on the return or if HMRC have evidence the failure was deliberate the penalty could be 70% of tax due or 100% if there is also concealment (subject to reductions for disclosure).

*For late payment:*

In addition to recompense interest there would be:

- a penalty of K% of the amount of tax unpaid 1 month after the due date.
- if the payment was still outstanding 6 months after the due date a further penalty of L% of the amount of tax unpaid at that point.
- if the payment was still outstanding 12 months after the due date a further penalty of M% of the amount of tax unpaid at that point.

**For Corporation Tax the first late payment penalty would be imposed 3 months after the due date (the filing date).**

## An example of how the new penalty models could work for VAT

The following is an illustrative example of how the models suggested may work for VAT trader due to file and pay quarterly. It assumes the taxpayer has not responded to guidance notes, notifications and warning letters and has not requested time to pay or a flexible payment arrangement.

### Current VAT default surcharge regime:

- Interest does not run on late paid VAT from the due date.
- For the first default (either late filed return or late payment), the taxpayer receives a warning **notice** that they have entered the default surcharge regime. The default window ends on the anniversary of the default.
- For any further defaults, either late filing or late payment, the default window is extended to the anniversary of the latest default. If the taxpayer has unpaid tax, they become liable to a penalty as follows:

Additional defaults in default window	Penalty as a % of amount of tax unpaid
2 <sup>nd</sup>	2%
3 <sup>rd</sup>	5%
4 <sup>th</sup>	10%
5 <sup>th</sup> or more	15%

### New VAT model

#### For late filing:

- The first time the taxpayer files late, they would be charged a penalty of £C and the taxpayer receives a warning **notice** that they have entered the default surcharge regime. The default window ends on the anniversary of the default.
- Further defaults would extend the default window to the anniversary of the latest default and make the taxpayer liable to a penalty according to the following table:

Additional default in default window	Penalty
2 <sup>nd</sup>	£D
3 <sup>rd</sup>	£E
4 <sup>th</sup> of more	£F

- In addition if any return is outstanding for more than 6 or 12 months, the taxpayer would be liable to an additional penalty of Y% and X% respectively. If HMRC have evidence the failure was deliberate the penalty could be 70% of tax due or 100% if there is also concealment (subject to reductions for disclosure).

For late payment

In addition to recompense interest there would be:

- The first time the taxpayer paid late in a default window, they would receive no penalty and receive a warning **notice** that they have entered the default surcharge regime. The default window ends on the anniversary of the default defaults would result in a penalty.
- Further defaults would extend the default window to the anniversary of the latest default and make the taxpayer liable to a penalty according to the following table:

Additional default in default window	Penalty
2 <sup>nd</sup>	N%
3 <sup>rd</sup>	P%
4 <sup>th</sup> of more	Q%

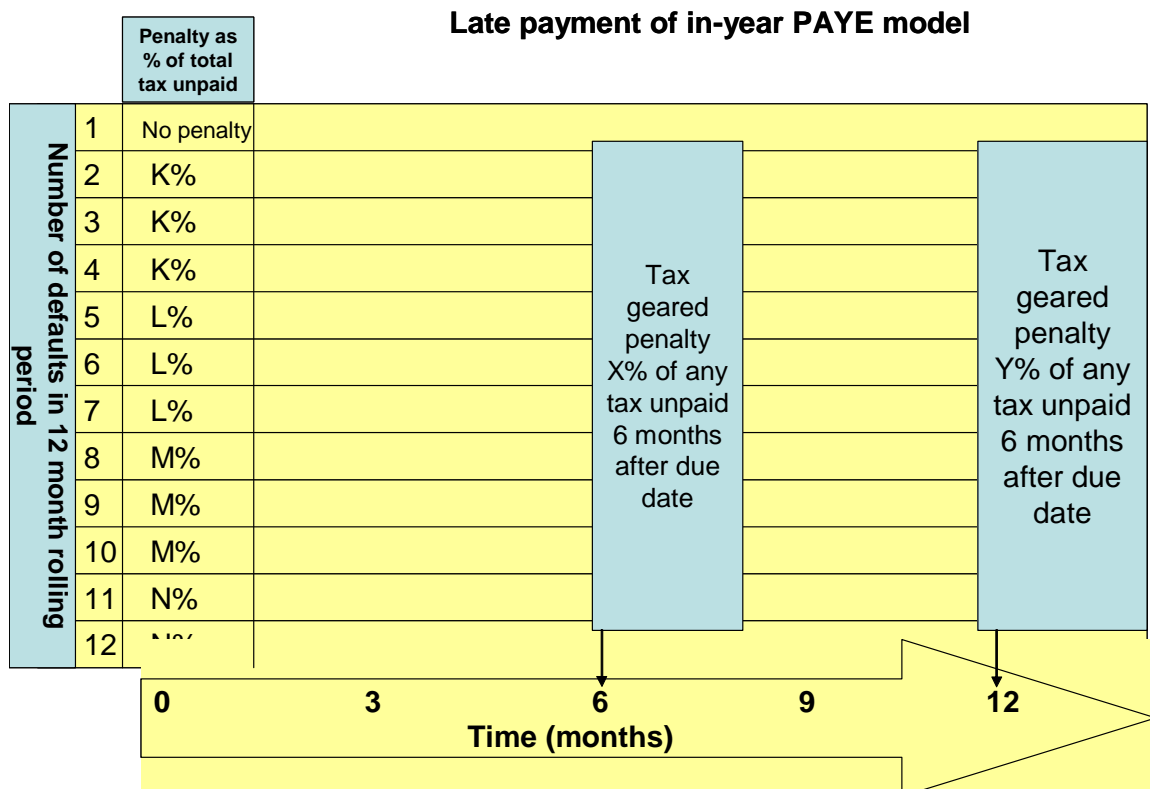
- In addition if any payment were outstanding for more than 6 or 12 months, the taxpayer would be liable to an additional penalty of R% and S% respectively of the amount of tax unpaid at that point.

## Chapter 6: In-year Pay as You Earn

- 6.1 Encouraging employers to pay monthly in-year PAYE, NICs and other payments on time is a particular challenge. This is because employers are required to pay tax and other deductions in-year usually on a monthly basis (or quarterly basis for some employers), but are only required to submit a return at the end of the year which still does not show monthly amounts due. This has the effect that HMRC does not know whether the payments it receives in-year are correct without intensive and expensive audit. Indeed the National Audit Office and the Public Accounts Committee have highlighted the lack of an effective deterrent to late payment of in-year PAYE and recommended that one be introduced.
- 6.2 There are many reasons why in-year PAYE is paid late, ranging from disorganisation and temporary cash flow problems through to those who choose to delay payment and those who are determined never to pay. These reasons are the same as for other taxes and duties. However, the absence of any deterrence to late payment most likely contributes to significantly lower on time payment rates than for other taxes and duties. For some businesses delaying paying in-year PAYE has become a regular way to manage their cash flow, at the expense of the Exchequer. This represents an unfair competitive advantage compared to the majority of employers who make sure they do pay on time.
- 6.3 Many respondents expressed disquiet about the three possible options, put forward in the June consultation, to address late payment of in-year PAYE: monthly statements, monthly estimates or extending the large employers' surcharge. It is therefore heartening to report that a fourth and better option, suggested early in the consultation is being considered in more detail in this consultation. This fourth option was suggested in a significant number of written responses.
- 6.4 To overcome the problem of HMRC not knowing how much is due each month this proposal involves requiring employers to report some additional information either on or alongside the end of year P35 return. This would be the amount due to be remitted to HMRC for each month of the year. The monthly figures would be an aggregate for each month, *not* split into PAYE, NIC, Student loans, Statutory Payments or CIS payments nor by employee.
- 6.5 If an end of year return was submitted late, the taxpayer would be liable to penalties similar to those for other annual obligations for the late return. See chapter 5 and paragraphs 4.31- 4.32 for details of the penalty structure and further considerations.
- 6.6 HMRC would be able to reconcile this expanded end of year return with the in-year payment record and to identify any discrepancies e.g. month 4 payment received 3 weeks late. Interest would then be charged (or paid) together with late payment penalties, if appropriate.

The focus of this reconciliation would be on whether payments had been made on time. If HMRC considered an employer was manipulating these entries on the return they could be subject to audit.

- 6.7 It is hoped that requiring employers to report amounts due to be paid, albeit after the year end, together with the knowledge that interest and possibly penalties will be applied, will deter people from paying their PAYE late. Where there are genuine difficulties meeting liabilities, it will encourage people to come forward to HMRC to seek a time to pay arrangement, knowing that late payment penalties will be suspended if they do.
- 6.8 The proposal is that employers would become liable to interest on late paid in-year PAYE (along with other amounts due<sup>4</sup>) from the date the money was due to the date it is paid, in the same way as for other taxes. This is discussed in more depth in the interest consultation document.
- 6.9 Furthermore if payments were repeatedly late, or the delay in payment was prolonged, employers would be subject to late payment penalties in a similar way to other taxes. The suggestion is that if there was only one late payment in a tax year there would be no penalty. If there was more than one default, the penalty would be calculated by first calculating the total amount of tax paid late in the 12 month period (excluding tax for the first default). This amount would then be multiplied by a percentage, which would be higher where there were more defaults in the year. The proposed penalty structure is shown in the diagram below:



<sup>4</sup> NICs, student loan deductions, statutory payment recoveries and Construction Industry Scheme payments

- 6.10 This would replace the current large employers' surcharge (over 250 employers) and might apply to all employers, although more detailed consideration is required on the question about whether there should be any exceptions, and on how it might apply to those paying quarterly. Importantly the new penalties would be related to the amounts unpaid not the total liability for the year shown on the P35, which should make it a more proportionate response than the current large employers' surcharge.
- 6.11 In addition, to address very late payment, it is proposed that for any amount remaining unpaid 6 months after the due date, the employer would be liable to an additional penalty of X% of the tax unpaid at that point in time. And if any amount of tax remains unpaid 12 months after the due date, the taxpayer would be liable to a further penalty of Y% of the tax unpaid. This would be consistent with the approach to very late payment across all taxes and duties.
- 6.12 This new option was explored in more detail at a recent workshop with some key stakeholders (annex B is a list of the organisations represented). Some very useful suggestions were made to minimise the administrative burden and to improve the design, including:
- widespread education and publicity well in advance of implementation to enable employers to adjust payment patterns and avoid interest or penalties and to give time for payroll software providers to prepare;
  - charging interest in-year where it is already clear that a payment had been made late, even if HMRC do not yet know if the payment is the full one;
  - consider ways to improve the support given to employers to understand and meet their obligations;
  - look for ways to warn people of impending penalties before they become liable to them;
  - the 12 in-year figures on the return should be those calculated for payment each month (ignoring later adjustments);
  - the 12 in-year figures do not need to reconcile to the total figure.
- 6.13 It is important to stress that the focus of HMRC's employer compliance activity would not change as a result of these measures.

**Question 9: Will the proposal for penalties for late payment of in-year PAYE meet the design principles: be fair, effective and influence behaviour?**

**Question 10: Do you have any information or evidence that you can provide about the likely administrative burden of providing an aggregate monthly breakdown at the end of the year? It would also be helpful if you could provide any information on the processes you have for completing the P35 (for example what checks are involved, seniority of staff involved etc).**

***Illustrative example***

6.14 The following pages provide an illustrative example of how the proposed penalty model for PAYE could operate. For comparison, it first shows how a large employer who pays late would be penalised currently under the existing surcharge and then what penalties they could be liable to under the proposals in this chapter.

## **PAYE – late payment**

The following compares how a large employer (>250 employees) who pays in-year PAYE late would be treated under the existing and proposed regime.

### **Current regime**

- The first two late payments in a year receive no penalty
- Thereafter, the employer would be charged a penalty after the year end, calculated as a percentage of the total liability on the P35 for the year, depending on the number of late payments in the surcharge period according to the table below.
- The surcharge period starts on the date of the first default and continues until the taxpayer has had twelve months of paying on time.

<i>1. Default number (within a surcharge period)</i>	<i>Penalty percentage</i>
3 <sup>rd</sup>	0.17%
4 <sup>th</sup>	0.17%
5 <sup>th</sup>	0.17%
6 <sup>th</sup>	0.33%
7 <sup>th</sup>	0.33%
8 <sup>th</sup>	0.33%
9 <sup>th</sup>	0.58%
10 <sup>th</sup>	0.58%
11 <sup>th</sup>	0.58%
12 <sup>th</sup> and subsequent defaults	0.83%

### **New in-year PAYE model**

In addition to recompense interest:

- The first late payment in a tax year would receive no penalty.
- Subsequent late payments in the tax year would attract a penalty, calculated by summing the total amount of money paid late in a year (excluding that for the first default) multiplied by the relevant % in the table below depending on the number of late payments in the year. The penalty would be charged after the year end.
- Late payments will be identified by comparing the amounts paid with the amounts due to have been paid each month, as shown on a modified end of year return.

No of late payments in the tax year (beyond the first)	Penalty (as a % of total amount paid late in-year).
1	K%
2	K%
3	K%
4	L%
5	L%
6	L%
7	M%
8	M%
9	M%
10	N%
11	N%

*So for example, assume a taxpayer should have paid £1000 each month but in four months paid this amount 10 days late. The first default would be excluded so the total default would be £3000 (3 defaults after the first). This would be multiplied by the relevant percentage for 3 additional defaults in the table above (in this case K% £3000).*

- In addition, if any payment were outstanding 6 or 12 months later, the taxpayer would be liable to an additional penalty of X% and Y% respectively.

### Consultation Questions

**Question 1:** Do you agree with the findings of the internal and external research presented above? Is there any other analysis or evidence that you could share with HMRC regarding penalties or tax debts?

**Question 2:** Is the proposal outlined above that penalties should be suspended where a taxpayer has entered into a time to pay arrangement with HMRC an appropriate way of supporting taxpayers who have difficulties in meeting their payment obligations?

**Question 3:** Are the safeguards proposed appropriate? Is the draft guidance appropriate? What modifications, if any, are required?

**Question 4:** Does the model presented for late filing meet the design principles – fairness, effectiveness and influences behaviour?

**Question 5:** Are the modifications to the late filing penalty model, to reflect the frequency of the obligations, appropriate?

**Question 6:** Does the model presented for late payment penalties meet the design principles – fairness, effectiveness and influences behaviour?

**Question 7:** Are the modifications to the late payment penalty model, to reflect the frequency of the obligations, appropriate?

**Question 8:** Is the overall package of penalties suggested for late filing and late payment likely to be effective, fair and to influence behaviour?

**Question 9:** Will the proposal for penalties for late payment of in-year PAYE meet the design principles: be fair, effective and influence behaviour?

**Question 10:** Do you have any information or evidence that you can provide about the likely administrative burden of providing an aggregate monthly breakdown at the end of the year? It would also be helpful if you could provide any information on the processes you have for completing the P35 (for example what checks are involved, seniority of staff involved etc).

## Organisations which attended consultation meetings or workshops with HMRC

Association of Chartered Certified Accountants  
Association of Taxation Technicians  
British Bankers' Association  
British Computer Society  
Chartered institute of Taxation  
Confederation of British Industry  
Deloitte  
Ernst and Young  
Federation of Small Businesses  
Forum of Private Businesses  
Institute of Chartered Accountants in England and Wales  
Institute of Chartered Accountants of Scotland  
Institute of Directors  
Institute of Indirect Taxation  
Institute of Payroll Professionals  
KPMG  
Law Society  
Law Society of Scotland  
Low Incomes Tax Reform Group  
TaxAid  
PriceWaterhouseCoopers  
Professional Contractors Group  
Tenon Group  
VAT Practitioners Group

### Organisations which responded to consultation document

Association of International Accountants  
Association of Accounting Technicians  
AstraZeneca  
Aviva  
British Bankers' Association  
British Property Federation  
CBI  
CIOT  
Deloitte  
Ernst & Young  
Federation of Small Businesses  
ICAEW  
Institute of Directors  
Institute of Payroll Professionals  
KPMG  
Law Society  
LITRG  
London Society of Chartered Accountants  
PriceWaterhouseCoopers  
Professional Contractors Group  
Schroders  
Scotch Whisky Association  
STEP  
The Institute of Chartered Accountants of Scotland  
The Society of Professional Accountants  
VAT Practitioners Group

### Draft guidance on reasonable excuse

1. A person won't be liable to a penalty for a non-deliberate failure to file or pay on time if
  - they have a reasonable excuse for not doing so, **and**
  - they put right the failure without unreasonable delay after the excuse ends.
2. If the person does not put right the failure without unreasonable delay after the excuse has ended, they will remain liable to a penalty.
3. Reasonable excuse does not apply where the failure is deliberate.
4. Reasonable excuse is not defined. What is a reasonable excuse will differ from person to person depending on their particular circumstances and abilities. However, the following are excluded from being reasonable excuses
  - lack of money, unless due to events outside the person's control, or
  - relying on someone else, unless the person took every reasonable care to avoid the failure.
5. If a person fails to file their return or pay their tax on time, you should find out the reasons for the failure and decide whether the taxpayer has a reasonable excuse.
6. If you decide not to accept that the person has a reasonable excuse, the person can appeal to the Tribunal.

#### ***What is a reasonable excuse?***

7. Reasonable excuse is not defined. It is likely to be an unforeseeable exceptional event beyond the person's control.
8. The following are some examples of what might be acceptable as a reasonable excuse for a non-deliberate failure to file a return or pay tax on time.

### *Bereavement*

9. The death of a close relative or domestic partner just before the time the person should have filed the return or paid the tax would in most circumstances be treated as a reasonable excuse.

### *Communications problems*

10. The return, form or cheque representing payment was lost or delayed in the post because of an unforeseeable exceptional event disrupting the postal service. For example
  - fire or flood at the sorting office where the form would be held, or
  - industrial action trapping the form or cheque in the post.

### *Sudden serious illness*

11. Sudden serious illness or deterioration of an existing condition of the person or of a close relative just before the time the person should have filed the return or paid the tax will be considered as a reasonable excuse.
12. However, an excuse will not necessarily be accepted because it seems to fit into one of these categories. It depends on the individual circumstances of each case.
13. Remember that the failure **must** be put right without unreasonable delay after the excuse has ended, see below, otherwise the person will still be liable to the penalty.
14. The person can appeal to the Tribunal if HMRC do not accept their excuse. See paragraphs 22-27 below for guidance about when a reasonable excuse ends.

### ***How will HMRC be satisfied a reasonable excuse exists?***

15. There are many different circumstances that may represent a reasonable excuse for non-deliberate late filing and late payment. Each case must be considered on its own merit. The circumstances of each individual case will determine whether HMRC need supporting evidence and, if so, what that will be.
16. The onus is on the person to satisfy you that they have a reasonable excuse. They must tell you the reason and you must listen carefully to what you are told.
17. You should consider the explanation carefully taking into account all the circumstances and available information. It is a matter of judgement. If you consider the excuse to be reasonable, you must accept it. If not, you should consider requesting evidence to support the person's position.

18. You must ensure that any request for evidence you make is reasonable and proportionate. If you need to ask for information, you must apply this guidance in conjunction with the HRA procedures at [EM1351](#) and [EM1360](#). Although the Enquiry Manual is a direct taxes manual, the section on HRA is applicable to all taxes

***What is not a reasonable excuse?***

19. A person may have a reasonable excuse for a non-deliberate failure to file a return or pay tax on time. However, there are some situations which HMRC will not normally accept as a reasonable excuse.

- The tax return is too difficult to complete.
- Pressure of work.
- Lack of information.
- HMRC did not remind me.
- Ignorance of basic law.

20. The law specifies two situations that are not reasonable excuses. These are

- shortage of funds and
- reliance on another person.

21. Each of these has an exception:

Shortage of funds

A lack of money is not in itself a reasonable excuse for filing a return late or paying tax late. In order to be a reasonable excuse, the lack of funds must have been due to an unforeseeable exceptional event outside the person's control:

- which could not be anticipated, **and**
- which prevented them from either filing the return or paying the tax on time.

Reliance on another person

Where a person (A) has asked another person (B) to do something for them, A remains responsible for ensuring that B carries out the task.

A cannot claim they had a reasonable excuse because the task was B's responsibility and that B failed to complete it.

The only exception is if A can show us that they themselves took reasonable care to make sure that B completed the job asked of them.

### ***When does a reasonable excuse end?***

22. Where a person has a reasonable excuse for non-deliberate late filing or payment, they must remedy that failure without unreasonable delay once the excuse ends.
23. Provided that there is not an unreasonable delay in either filing the return or paying the tax once the excuse ends, HMRC will treat the excuse as continuing until the date they remedy the failure.
24. You need to consider carefully the point at which a reasonable excuse ends and the actions the person took thereafter to either file their return or pay the tax. Each case must be dealt with on its own merits.
25. In the example below, the taxpayer paid the amount due as soon as the reasonable excuse for her non-payment, the freeze on her only funds, ceased.

### ***Example***

26. **What follows is only an illustration. The facts and circumstances of each case and the abilities of the individual concerned will determine whether they have a reasonable excuse for a failure. So even if the facts of your case appear superficially the same, the person will not necessarily have a reasonable excuse.**
27. Davina works as a self-employed electrician. She always sets aside a sufficient amount in a deposit account during her trading year to enable her to make her final balancing payment on 31 January following the tax year. However, on 29 January, the bank collapses and her account is frozen. She has no other savings or cash, so she is therefore unable to pay the tax due on time. However, on 12 February, her account is unfrozen and she immediately pays the outstanding amount.
  - a) Davina is not liable to a penalty for paying her tax late because:
    - she has a reasonable excuse, and
    - she remedied the failure without unreasonable delay after the excuse ended.
  - b) The shortage of funds was the result of an exceptional event that Davina could not have anticipated. It was entirely outside her control and it stopped her paying her tax on time. So it is not prevented from being a reasonable excuse.
  - c) Davina paid the tax (remedied the failure) without unreasonable delay once the account was unfrozen. She did this as soon as she had access to her money.

## The Government's Consultation Code of Practice

### ABOUT THE CONSULTATION PROCESS

This consultation is being conducted in accordance with the Government's Consultation Code of Practice. If you wish to access the full version of the Code, you can obtain it online at:

<http://www.berr.gov.uk/files/file47158.pdf>

#### The Consultation Criteria

1. **When to consult** - Formal consultation should take place at a stage when there is scope to influence the policy outcome.
2. **Duration of consultation exercises** - Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
3. **Clarity of scope and impact** - Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
4. **Accessibility of consultation exercise** - Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
5. **The burden of consultation** - Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
6. **Responsiveness of consultation exercises** - Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
7. **Capacity to consult** - Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

If you feel that this consultation does not satisfy these criteria, or if you have any complaints about the process, please contact:

Richard Bowyer  
Better Regulation Unit  
020 7147 0062 or [richard.bowyer@hmrc.gsi.gov.uk](mailto:richard.bowyer@hmrc.gsi.gov.uk)