

## Summary: Intervention & Options

Department /Agency: <b>HMRC</b>	Title: <b>Impact Assessment of Meeting The Obligations to File Returns and Pay Tax on Time</b>	
<b>Stage:</b> Consultation	<b>Version:</b> 1	<b>Date:</b> 19 June 2008
<b>Related Publications:</b>	Consultation Document – Meeting the obligations to file returns and pay tax on time	

### Available to view or download at:

<http://www.hmrc.gov.uk/better-regulation/ia.htm>

**Contact for enquiries:** [powers.review-of-hmrc@hmrc.gsi.gov.uk](mailto:powers.review-of-hmrc@hmrc.gsi.gov.uk)      **Telephone:** 020 7147 3223

### What is the problem under consideration? Why is government intervention necessary?

Most people pay their taxes on time and give information and returns to HMRC at the right times but some do not. HMRC has a number of different penalty structures across the taxes for late returns and payment inherited from its predecessor departments. This adds unnecessary complexity for taxpayers and makes the system burdensome for HMRC to administer. Consequently, HMRC is unable to give simple and clear messages about basic obligations, support and the consequences of failure. In year payments of PAYE represent an extra problem in ensuring taxpayers pay the right amount as HMRC doesn't receive a return showing a liability until the end of the year. A number of approaches to tackle this are explored.

### What are the policy objectives and the intended effects?

The policy objectives are:

- Alignment of penalty and safeguard structures to present clearer and simpler messages to taxpayers.
- To influence behaviour through fair and effective penalties and safeguards so more returns are filed on time and more tax paid on time.
- To encourage taxpayers to come to HMRC early when in difficulty and provide support when they do so.
- To reassure compliant taxpayers that failure to meet obligations is dealt with seriously by HMRC.

### What policy options have been considered? Please justify any preferred option.

1. Do nothing – continue to charge varied and inconsistent penalties across all taxes with inconsistent safeguards and support for those who pay late.
2. Legislate to modernise and align the package of penalties, support and safeguards for late filing of returns and late payment of tax. The key element of reform is the move to an aligned penalty regime that is fair, effective and influences behaviour balanced by aligned taxpayer safeguards. Alignment removes the complexities of different systems for different taxes and facilitates clear simple messages for taxpayers. A single regime aims to improve the proportion of returns filed and payment made on time. This is the preferred option. Possible approaches to tackle late payment of in year PAYE are identified.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** The policy would be reviewed 3 years after implementation. The final Impact Assessment will contain further analysis arising in the course of the consultation.

### **Ministerial Sign-off** For Consultation Stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible Minister: Jane Kennedy

.....Date: 19 June 2008

## Summary: Analysis & Evidence

Policy Option: 1	Description: : Do Nothing
------------------	---------------------------

<b>COSTS</b>	<b>ANNUAL COSTS</b>	Description and scale of <b>key monetised costs</b> by 'main affected groups' Current penalties will continue to apply differently across different taxes and duties.
	<b>One-off</b> (Transition) <span style="float: right;">Yrs</span>	
	<b>£ nil</b>	
	<b>Average Annual Cost</b> (excluding one-off)	
<b>£ nil</b>	<b>Total Cost (PV)</b>	<b>£ nil</b>
Other <b>key non-monetised costs</b> by 'main affected groups'		

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>	Description and scale of <b>key monetised benefits</b> by 'main affected groups' Taking this approach would mean missing the opportunity to extend further the modernisation and alignment of HMRC penalties.
	<b>One-off</b> <span style="float: right;">Yrs</span>	
	<b>£ nil</b>	
	<b>Average Annual Benefit</b> (excluding one-off)	
<b>£ nil</b>	<b>Total Benefit (PV)</b>	<b>£ nil</b>
Other <b>key non-monetised benefits</b> by 'main affected groups'		

**Key Assumptions/Sensitivities/Risks** Taking this option would mean that HMRC continues to have disparate penalty systems, sending out contradictory messages about how HMRC views non compliance leading to confusion for taxpayers.

Price Base Year	Time Period Years	<b>Net Benefit Range</b> (NPV) <b>£ nil</b>	<b>NET BENEFIT</b> (NPV Best estimate) <b>£ nil</b>
--------------------	----------------------	--	--

What is the geographic coverage of the policy/option?	United Kingdom				
On what date will the policy be implemented?	Already in force				
Which organisation(s) will enforce the policy?	HMRC				
What is the total annual cost of enforcement for these organisations?	£ N/A				
Does enforcement comply with Hampton principles?	Yes				
Will implementation go beyond minimum EU requirements?	No				
What is the value of the proposed offsetting measure per year?	£				
What is the value of changes in greenhouse gas emissions?	£				
Will the proposal have a significant impact on competition?	No				
Annual cost (£-£) per organisation (excluding one-off)	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">Micro</td> <td style="width: 25%; text-align: center;">Small</td> <td style="width: 25%; text-align: center;">Medium</td> <td style="width: 25%; text-align: center;">Large</td> </tr> </table>	Micro	Small	Medium	Large
Micro	Small	Medium	Large		
Are any of these organisations exempt?	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">N/A</td> <td style="width: 25%; text-align: center;">N/A</td> </tr> </table>	No	No	N/A	N/A
No	No	N/A	N/A		

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase - Decrease)
Increase of    £ nil	Decrease of    £ nil	<b>Net Impact    £ nil</b>

Key:    Annual costs and benefits: Constant Prices    (Net) Present Value

## Summary: Analysis & Evidence

Policy Option: 2

Description: Legislative Change for a new late filing and late payment penalty structure

<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' There may be some initial cost to taxpayers and their representatives while they familiarise themselves with a new penalty regime. There would be no additional costs for taxpayers who already comply with their filing and payment obligations. HMRC costs in developing the IT systems and processes could be significant.
	<b>One-off</b> (Transition)	<b>Yrs</b>	
	<b>£ unquantified</b>		
	<b>Average Annual Cost</b> (excluding one-off)		
	<b>£ nil</b>		<b>Total Cost (PV)</b> <b>£ unquantified</b>
Other <b>key non-monetised costs</b> by 'main affected groups' It is expected that penalties for those who deliberately fail to file their returns or pay their tax on time would be larger than penalties charged currently for some taxes.			

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups' There will be no effect for those taxpayers who continue to file their returns and pay the right amount of tax at the right time as they will not be penalised. The obligations remain the same, only the penalties would change. A simplified single penalty regime across all taxes will lead to some reduction in administration
	<b>One-off</b>	<b>Yrs</b>	
	<b>£ unquantified</b>		
	<b>Average Annual Benefit</b> (excluding one-off)		
	<b>£ unquantified</b>		<b>Total Benefit (PV)</b> <b>£ unquantified</b>
Other <b>key non-monetised benefits</b> by 'main affected groups' Simplification of penalties applied across the taxes, making matters less confusing and the consequences of failing to meet their obligations clearer for taxpayers. Another key benefit is that it should reassure those who meet their obligations on time that HMRC takes non compliance seriously.			

**Key Assumptions/Sensitivities/Risks** The costs and benefits of any new penalty model for late filing and late payment are yet to be quantified. HMRC continues to work on this. The ideas and suggestions made in this Impact Assessment are part of a package of measures and therefore there are elements that could be introduced and others that might not be introduced at all.

Price Base Year	Time Period Years	<b>Net Benefit Range</b> (NPV) £	<b>NET BENEFIT</b> (NPV Best estimate) £
--------------------	----------------------	-------------------------------------	---

What is the geographic coverage of the policy/option?		United Kingdom	
On what date will the policy be implemented?		Not yet known	
Which organisation(s) will enforce the policy?		HMRC	
What is the total annual cost of enforcement for these organisations?		£ N/a	
Does enforcement comply with Hampton principles?		Yes	
Will implementation go beyond minimum EU requirements?		No	
What is the value of the proposed offsetting measure per year?		£ N/a	
What is the value of changes in greenhouse gas emissions?		£ N/a	
Will the proposal have a significant impact on competition?		No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium      Large
Are any of these organisations exempt?	No	No	N/A      N/A

**Impact on Admin Burdens Baseline** (2005 Prices) (Increase - Decrease)  
 Increase of £ Negligible      Decrease of £ Negligible      **Net Impact** £ Negligible

Key:

Annual costs and benefits: Constant Prices

(Net) Present Value

### Introduction

This is the third consultation in a major programme of reform and modernisation of HMRC penalties and this next stage considers how HMRC can encourage people to file their tax returns and pay the tax they owe on time. A new, aligned penalty regime for errors in tax returns for the main taxes (Income Tax, Corporation Tax, PAYE, NIC and VAT), was introduced in Finance Act 2007 and Finance Bill 2008 contains proposals to extend the alignment to incorrect returns for all other taxes and failure to notify a new taxable activity. The proposals in this document are limited to “tax” returns declaring a liability or requesting a refund of tax from HMRC. HMRC also require a number of “information” returns (providing information but not directly related to the person’s liability) but penalties for late filing of these is outside the scope of this document and will be considered along with other regulatory penalties in future consultations.

There are currently a number of approaches available to HMRC to tackle late filing of returns and late payment of tax across different taxes. It is difficult to justify using different sanctions for different taxes given that each tax carries the same obligation. This results in confusion for taxpayers and risks giving the impression that one tax has greater priority over another. Having separate procedures for each tax increases the administrative costs to taxpayers and to HMRC.

In addition, the taxpayer safeguards and support available for taxpayers (for example the interaction of penalties and time to pay arrangements) are not consistent across the taxes. There has been strong support to move to an aligned and robust set of safeguards and simplified support for taxpayers who are in difficulty.

The aims of the reform are therefore to:

- align the penalty and safeguard structures to present clearer and simpler messages to taxpayers,
- influence behaviour through fair and effective penalties and safeguards so more returns are filed and more tax paid on time,
- encourage taxpayers to come to HMRC early when in difficulty and provide clear support when they do so, and
- to reassure compliant taxpayers that failure to meet obligations is dealt with seriously by HMRC.

The structured approach to late payment outlined in this impact assessment should be considered in the context of a separate consultation and associated impact assessment on the harmonisation of the rules on interest on tax paid late (and on repayments of tax overpaid) published alongside this consultation.

## **Wider Research**

### ***Literature Review***

There is a sizeable amount of research available looking at tax debt in general. A review of this research revealed the following key findings:

- Taxpayers still find forms and guidance complex and difficult to understand, they are often reluctant to contact HMRC for guidance and there is a sense of fear when talking to the 'tax man'. The variety of sanctions for late filing across the taxes also causes confusion.
- The majority of people want to pay their debts on time but some people are simply disorganised and leave things to the last minute. This often results in deadlines being forgotten and missed.
- Some people face a crisis that takes priority in their lives and financial and tax obligations take a back seat.
- Taxpayers fail to pay their tax on time because of other financial priorities. For businesses the financial pressures can be that much greater especially when other creditors can stop supplying goods or services if they are not paid.
- Some taxpayers have financial difficulties and simply do not have the funds to pay their tax debt. There is a clear difference between those who are unable to pay their tax on time and those who choose not to.
- Some have decided that they will not pay their tax for a variety of reasons. Some disapprove of how the government spends their money and others would simply rather keep the money for their own needs.

### ***External Research***

HMRC is continuing to develop its understanding of taxpayer behaviour and is commissioning external research which will explore what motivates individuals to pay their tax debt on time and what barriers they face in their dealings with HMRC. The research will focus on determining the reasons behind late payment and the extent to which different payment and enforcement regimes would be effective in encouraging payment amongst different customer groups. The information that this research provides will be used to inform the development of any new penalty structure.

### ***Internal research***

Running alongside the external research, HMRC will be conducting a review of its historical data to analyse the effectiveness of the different actions and sanctions taken across the different taxes to respond to late payment and late filing.

### ***International Comparisons***

Research has also been carried out into the late payment and filing penalties and sanctions used by other countries if businesses and individuals fail to meet their payment and filing obligations. Details can be found at Annex A.

## **Design Principles**

A number of design principles are proposed which can be used to assess the effectiveness of the existing sanctions and to guide the development of new penalty structures. These design principles are

- Influence behaviour – reinforcing legal obligations thereby encouraging compliance
- Be effective – clear, easily understood and applied consistently
- Be fair – proportionate, customer focused and subject to appeal

## **Existing penalty structures for late or non filing and payment**

There are currently many different ways across the taxes that HMRC reinforces the obligation to file a return or make a payment on time. Whilst few if any taxpayers deal with HMRC over the whole range of taxes and duties, many do for at least two or three but the penalty regimes may differ considerably. Some of these differences arise from the different structure of the taxes such as the frequency and filing obligations but many are simply due to the way tax legislation has evolved over the years particularly between two separate Government departments. The available research suggests taxpayers find it difficult to understand their obligations and the differing approaches HMRC has to address late filing and late payment only adds to this confusion.

Most taxes have a separate sanction for both late filing and late payment. These are described in the table attached at annex B.

### **Effectiveness**

There are many factors that affect whether a person files or pays on time, so it is difficult to measure the influence of penalties. However, the on time payment and filing rates vary across the taxes from around 60% to over 90% and it would be reasonable to assume that the penalty structures have some impact on these rates.

The one penalty that appears to be widely understood is the £100 penalty for late filing of an ITSA return; mainly due to a sustained advertising campaign but even here there is confusion over the date that the penalty is charged.

Responses to previous penalties consultations have questioned whether the level of the fixed £100 penalty for late filing of ITSA and corporation tax returns is sufficient to be effective. The amount has remained the same for over 10 years and therefore may have less influence on behaviour than it had in the past. But the overall structure of support, sanctions and safeguards is likely to be more important in determining effectiveness than the rates and levels. This consultation concentrates on the overall structure.

HMRC is commissioning external research to develop a greater understanding of how taxpayers are influenced by the varying penalty structures across the taxes.

### **Fairness and proportionality**

HMRC tries hard to ensure returns are only required where necessary but sometimes errors occur resulting in HMRC requiring a return to be filed that does not actually need to be filed. The error may be as a result of HMRC acting on incomplete or incorrect information. This could be due to an error on HMRC's part or a taxpayer failing to tell HMRC of a change of address. The end result is a penalty being issued for a return that was not required in the first place.

Gearing a penalty to the amount of tax unpaid provides proportionality but there are still problems. For example the VAT default surcharge is based on the amount of tax paid late but it does not take account of how late the payment is made after the due date. So a taxpayer who

pays one day late will pay the same percentage penalty as a taxpayer who pays a few weeks late.

Overall, the different ways in which late filing and late payment are dealt with across the taxes means that there is no consistency of treatment for what is essentially the same misdemeanour.

## **A possible aligned approach to penalties and safeguards**

### **The case for charging penalties**

Before exploring potential penalty structures, it is necessary to assess the case for penalties to influence behaviour. The majority of people in the UK will file their returns and pay tax due at the right time because they believe it is the right thing to do. In 2006/2007 HMRC expected to receive almost 23 million returns across all taxes, of these around 3 million were filed late or not at all. In the same year HMRC processed approximately 55 million payments and £64 billion was paid late (although most of this debt was paid within a short period).

Taxpayers who file their returns and pay their tax late have an unfair financial advantage over those who do file and pay on time. HMRC therefore has a responsibility to ensure that there are clear and visible sanctions in place to encourage behavioural change and reassure those who meet their obligations on time that HMRC takes non compliance seriously.

The purpose of aligned penalties should be to:

- reinforce the obligation to file a return and pay tax due on time,
- provide simple and clear messages about the consequences of late or non filing and payment,
- ensure that HMRC's response to a failure to meet an obligation is consistent.

One possibility for an aligned penalty structure could be to have a basic framework for charging penalties that is the same for all filing and payment obligations across taxes where it is possible to do so. But the penalty charges and rates could be different. (The diagrams on page 9 and 10 explore this in more detail)

### **A range of possible tools to tackle late filing and late payment**

This consultation is considering a range of existing tools available to HMRC to tackle late or non filing and payment and exploring different combinations in which these tools could be applied to best influence behaviour. A brief description of these tools and how they might be used is given below.

It is also necessary to consider how any penalties for late or non filing and payment interact with other penalties that HMRC might charge – for example for failure to notify HMRC of a new taxable activity. This is because the reason for both failures could be the same e.g. the reason a taxpayer pays late is because of the failure to notify. In these circumstances, it is clear that the taxpayer should not be charged multiple penalties.

#### Fixed Penalties to tackle late or non filing and payment

Fixed sum penalties are currently used in some taxes for late filing and can provide a simple and easy to understand penalty structure. The amount of the periodic fixed penalties could either increase over time, recognising the increasing lateness or, alternatively, could be the same amount at each point.

#### Tax geared penalties to tackle late or non filing and payment

Tax geared penalties are calculated as a percentage of the tax due which is unpaid at the time the penalty is charged. The penalty could either be charged periodically at the same percentage levels or the percentage level could escalate over time recognising the increasing lateness in filing or payment in steps.

### Daily penalties

This is a penalty of a set amount for each day a return continues to be late from the date a penalty notice is issued. It is for targeted use where HMRC consider a particular return or returns are required and other steps are not being effective. Daily penalties can be up to £60 per day currently for some direct taxes.

### Determinations and assessments

Determinations and assessments are not a penalty but are a further tool that HMRC can use to tackle non filing. An assessment or determination is an estimate of the amount of tax due in the absence of the return. The tax becomes due and payable on the assessment and generally the assessment cannot be appealed against but is automatically displaced once the return is filed.

### Enforcement Action

If all of the tools discussed above still fail to encourage a taxpayer to file a return or pay the tax due, HMRC can take enforcement action against the taxpayer. Enforcement action can include seeking recovery of the debts through county court proceedings or distraint action (i.e. seizing goods in lieu of tax unpaid).

## **Aligned Taxpayer safeguards**

A consistent theme of the Review of Powers, Deterrents and Safeguards has been that sanctions need to be balanced with robust safeguards to protect the taxpayer from unfairness. An aligned set of safeguards for late or non filing and payment should include:

- a clear process for the taxpayer to appeal both to HMRC and to an independent tribunal if they consider that a penalty has been imposed unfairly,
- removing any penalty if a taxpayer has a reasonable excuse for failing to meet their obligations and rectify the failure without an unreasonable delay. A reasonable excuse could for example include postal delays or unexpected illness close to the filing date, and
- powers for HMRC to reduce penalties where the individual case merits it

## **Policy Options that have been considered**

### **Option 1 – Do Nothing**

Taking this option would mean that HMRC continues using different penalty structures for different taxes for late filing and late payment. The penalty structures inherited from the predecessor departments would remain unaligned continuing the confusion for taxpayers and their agents and resulting in a missed opportunity to reduce administrative costs for both the taxpayer and HMRC and to increase the proportion of taxpayers filing and paying on time.

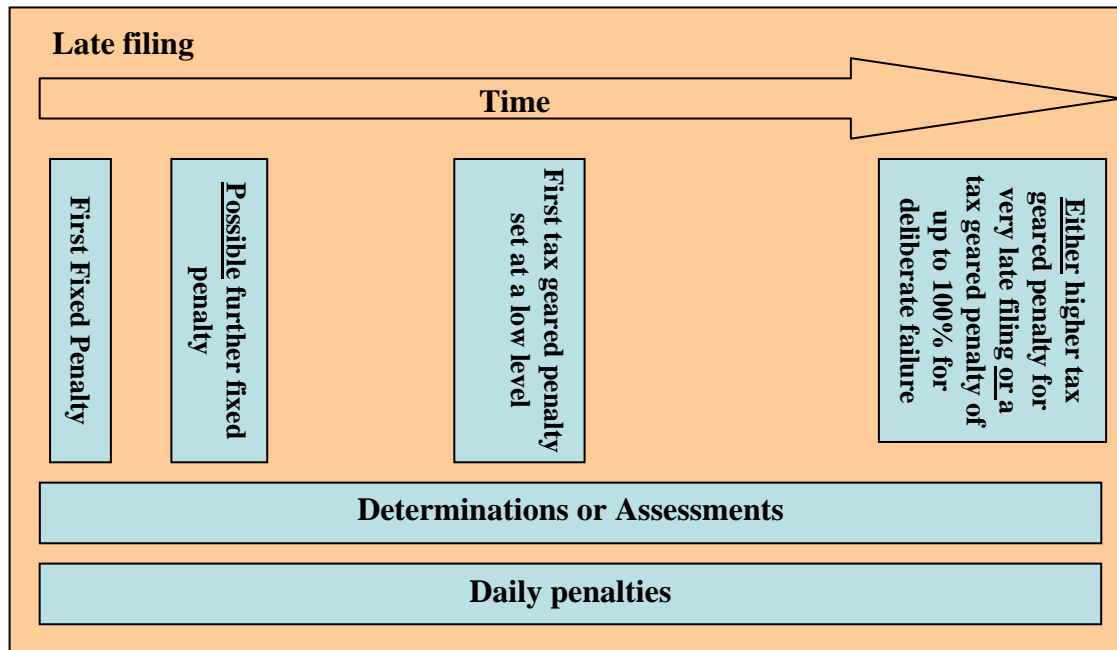
### **Option 2 – Legislative Change to introduce a new aligned late filing and late payment penalty structure**

There are many ways that the tools listed above could be structured in an aligned way to influence taxpayer behaviour. Some possible structures could include:

- Fixed penalties that could escalate the longer a failure continues
- Tax geared penalties that could escalate the longer a failure continues
- Some combination of fixed and tax geared penalties that escalate the longer a failure continues

### An illustrative example for Late filing

The diagram below shows as an illustrative example how penalties could be structured for late filing.



The structure could include:

- A fixed penalty shortly after the filing date
- Possibly a further fixed penalty a month or so after the filing date
- A taxed geared penalty a long time after the filing date (for example 6 months)
- A higher tax geared penalty 12 months after the filing date

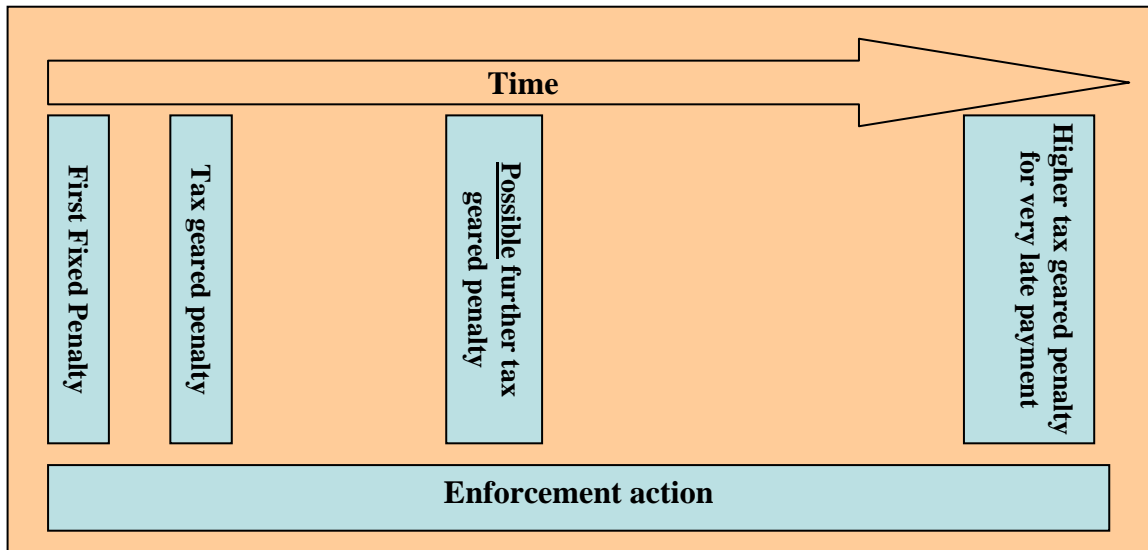
### *Tools that could be used at any time*

There are occasions when the use of penalties alone may not be sufficient to recover an outstanding return. Making assessments and determinations is seen as an effective tool and could be applied more widely. The advantage of an assessment or a determination is that it establishes the tax due, albeit an estimate. This helps taxpayers to be aware of their obligations and enables HMRC to commence enforcement action if required.

In some cases a more appropriate response might be to charge daily penalties. These can be particularly effective in cases where the taxpayer is trying to hide their activities or delaying as long as possible engaging with HMRC about a certain period.

### An illustrative example for Late payment

The diagram below gives an illustrative example of how the penalties could be structured for late payment.



The structure could include:

- A fixed penalty shortly after the due date
- A tax geared penalty a month or so after the due date
- Possibly a taxed geared penalty a long time after the filing date (for example 6 months)
- A higher tax geared penalty 12 months after the filing date

Daily penalties are not considered appropriate for late payment.

### ***Enforcement***

Enforcement action by way of county court proceedings, distraint and insolvency can be taken at any time a debt is legally due and payable against the taxpayer to protect tax revenues. It is important to note however that for some taxes liabilities can change legitimately after the due dates for filing and payment.

### ***Frequent filing and payment obligations***

A number of taxes have more frequent filing and payment obligations including VAT, excise duties, environmental taxes, Construction Industry Scheme (CIS) and in year payment of PAYE.

As for annual obligations, fixed and geared penalties could be used in sequence in response to late payment of tax or non filing of a return. And alongside these tools, determinations, assessments, daily penalties and enforcement might also be used at any time after the failure occurs. However frequent filing or payment obligations add an extra degree of complexity in designing structures to influence behaviour whilst still being simple and clear. Two approaches of reinforcing frequent obligations are explored below:

### ***Escalating penalties for repeated failures***

An issue with frequent obligations is that it may be easier to default on multiple obligations in a financial year. There is therefore a need to deter repeated failures. The VAT default surcharge has two main features that address the problem of repeated failures. These are a rolling 12 month default period and a progressive series of escalating penalties. Adapting the VAT default surcharge regime to tackle repeated instances of non payment or non filing of returns may

provide the basis of a penalty structure that deals with frequent payment and filing obligations but is aligned with other penalties. Changes that could be made include –

- separating the response to failure to file on time from failure to pay on time – effectively splitting the surcharge in two;
- replacing the first tax geared penalty with a fixed penalty for late or non filing and payment in the default period; and
- introducing a further penalty for prolonged non filing or non payment, similar to that for annual obligations.

### ***Reinforcing more frequent obligations***

Some taxes and duties, such as some excise duties and some environmental taxes, have monthly filing and payment obligations. For these taxes there is a need to reinforce all the filing and payment obligations whilst ensuring any penalty structure remains fair and simple. An escalating penalty structure could get quite high because of the number of obligations.

An alternative approach could be to treat each payment and filing obligation as separate and distinct and apply the same or very similar approach to penalties as that proposed for annual filing and payment obligations. Instead of a default period or escalation for repeated failure within that period there could be a sequence of fixed and tax geared penalties for each monthly return period escalating the longer the return or payment was outstanding.

Under this structure, the penalties could be applied as follows for late filing –

- A fixed sum penalty immediately after the due date
- A tax geared penalty if any return was more than say two or three months late
- A further tax geared penalty that could be in the range of 10 to 30% of the tax unpaid if the return was outstanding a long period of time (say 12 months) after the filing date. If HMRC could evidence that this failure was deliberate then this penalty could be increased up to 100% of the tax unpaid.
- If the penalties fail to influence behaviour determinations or assessments could be used to determine a liability to tax.

### **And for late payment –**

- A fixed sum penalty immediately after the due date for the first time the taxpayer fails to pay on time
- A tax geared penalty immediately after the due date for the second or any further time the taxpayer fails to pay on time.
- A further tax geared penalty if any payment remains outstanding 3 or so months after the due date
- A further tax geared penalty in the range of 10 to 30% of the tax unpaid if any payment is still outstanding a long time after the due date – for example 12 months after.

## **In Year Payment of PAYE**

The proportion of taxpayers currently paying their in year PAYE on time is significantly lower than the proportion paying other taxes on time at around 60% based on internal analysis. The only exception to this is large employers (more than 250 employees) subject to the surcharge, where payment rates have increased to over 95%.

Employers who delay payment of PAYE are putting their employees at risk of not being entitled to benefits and they are receiving a significant commercial advantage over employers who pay on time.

Although employers are required to make payments of tax and other deductions they have made from their employees on a monthly or quarterly basis, they are not required to file a return indicating the amounts collected until after the end of the tax year. This means that although there is an obligation to pay in year, HMRC does not know whether the employer is paying the correct amount until the end of the year when the return is submitted. The challenge is to address this problem without imposing a significant administrative burden on employers and HMRC.

Three possible approaches have been identified. However, HMRC recognise that there are disadvantages with each of these approaches, notably the fact that they could impose a significant administration burden on employers.

More work needs to be done in this area and as part of this consultation HMRC are seeking views from employers regarding as to how the proportion of taxpayers paying in year PAYE on time can be improved. In addition, HMRC are seeking views from businesses on the impact of any changes and associated costs such as new IT systems, higher agents' fees and changes in processes.

The approaches identified are as follows:

### **Monthly statements**

Employers could be required to file a short monthly statement setting out how much tax and other deductions is due. This would enable HMRC to compare the statement with the payment received. If the payment was too low or not received at all, then interest might be payable and sanctions for late payment may be considered in the same way as for other late payments.

A move to monthly returns would impose an additional administration burden on employers as well as a major operational change for HMRC.

A more limited option could be to impose a monthly statement requirement only on employers where HMRC has evidence that they have paid tax late on one or more occasions. This would avoid imposing any further burden on the compliant taxpayer although it would not identify employers who were merely making some payment but not the full amount of the deductions they had made.

### **Charging a penalty at the end of the year based on the number of times payment was made late in the year**

A second approach could be to extend the existing surcharge for late payment by large employers to other employers.

The surcharge works by charging a tax geared penalty at the end of the tax year based on the number of times the employer fails to meet the monthly obligations in year. The rate of the tax geared penalty depends on how many times a person has not met their obligations to pay in year.

A drawback with this option is that it would only influence behaviour at the end of the tax year whereas the obligation to pay arises each month throughout the year.

### **Charging penalties based on an estimate of the monthly tax due in year**

A third possible approach could be to estimate the payment due each month from the employer, based on the previous year payments and information from the taxpayer – for example on their previous end of year return. If the taxpayer paid less than the estimate then interest might be payable and sanctions for late payment may be considered in the same way as for other late payments.

### **Quantifying the expected costs and benefits**

HMRC is continuing to work with its analysts and information technology partners to measure the likely impacts and costs of aligning the penalty regime for late payment and late filing. This work, together with feedback from the consultation, will inform the way forward. A full impact assessment including quantified costs and benefits for the preferred options will be published in due course.

### **Administrative burdens**

Throughout the consultation, HMRC will be seeking views from businesses on how best to introduce any changes to late filing and late payment penalties without causing a significant impact on administration burdens. The aim though is not to charge more penalties but to influence behaviour so more people pay their tax or submit their return by the due dates.

### **Appeals**

The current tribunals to which taxpayers can appeal against penalties are in the process of being reformed. From April 2009 all appeals currently heard by the General and Special Commissioners and the VAT and Duties Tribunals will transfer to a combined independent tribunal. HMRC is continuing to analyse the impact the various approaches and options outlined in this consultation might have on the number of future appeals.

### **Specific Impact Tests**

#### **Competition assessment**

The proposed new penalty framework for late payment of tax and late filing of returns would improve competition by reducing the unfair advantage gained by those taxpayers who do not comply with their tax obligations. This will benefit all compliant taxpayers by providing a more level playing field. This would be particularly so by coming down hard on those who deliberately do not file their returns and do not pay their tax due.

#### **Small firms impact test**

HMRC intends to consult directly with small businesses and discuss whether the proposed changes could lead to additional associated costs such as increased agents' fees or changes in business processes.

Penalties will not apply to compliant businesses. The aim is for reduced compliance costs for small businesses. The overall alignment and simplification of penalties will make matters less confusing and lead to some reduction in administration costs.

Businesses with cashflow difficulties would no longer need to consider which of several different tax liabilities to pay first because the consequences of non payment would be the same for each tax.

**The remaining impact tests in the checklist below have been considered. The policy options do not impact on any of these.**

## Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

**Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.**

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

# Annexe A

## International comparisons

Research has been carried out into the late filing and late payment penalties and sanctions used in Australia, Canada, Ireland, New Zealand and United States of America. Each of these countries uses either fixed or tax geared penalties for late filing but for late payment, some of them have opted to use interest as a sanction rather than a penalty. However, the rates applied indicate that interest is charged more as a penalty than for the purpose of recompense.

### **Late Filing**

In Australia, the amount of penalties for late filing returns depends on the size of the entity and the length of the delay, ranging from \$110 for up to 28 days delay by a small entity to \$550 for over 113 days delay for a large entity.

In Canada, for businesses the late return penalty is linked to the tax unpaid and the extent of lateness: 5% of the balance owing, plus 1% for each full month the return is late up to 12 months. For GST (VAT equivalent) it is 1% balance owing plus 0.25% for each month the return is late. For individuals there is a fixed \$250 late filing penalty.

Ireland also tax gears late filing penalties at 5% of late tax due (capped at €12,695) or 10% (capped at €63,485) if over 3 months late (2 months for companies).

In New Zealand penalties for late filing by individuals, companies and employers attract penalties in a range from \$50 to \$500 depending on net income.

The USA charges a combined 5% (4.5% late filing and 0.5% late payment) penalty for each month or part month that a return is late up to 25%.

### **Late Payment**

In Australia, from 1 July 1999, General Interest Charge (GIC) replaced the late penalties system. GIC is a common rate of interest and is applied across all liabilities administered by the Tax Office. The GIC rate is updated quarterly and worked out using a statutory formula based on the monthly average yield of 90 day Bank Accepted Bills published by the Reserve Bank of Australia. It generally reflects the interest rate charged by financial institutions on unsecured loans.

Canada also charges interest on late payments made by individuals and corporations as opposed to penalties. The rate of interest charged can vary every three months. Interest will be charged on an overdue amount at the basic rate plus 4%. The basic rate is based on the rate charged on 90-day Treasury Bills, adjusted quarterly, and rounded up to the nearest whole percentage

Ireland is another country that uses interest rather than penalties as a sanction and is applicable to late payment of income tax, corporation tax and VAT. Interest at the rate of just under 10% per annum, is payable on all late payments of tax.

In New Zealand, late payment penalties apply to all taxes and duties but are not charged on unpaid amounts of less than \$100. An initial penalty of 1% is charged the day after the due date and a further 4% penalty is charged if the tax is still unpaid after 7 days. Every month the amount owing remains unpaid a further 1% incremental penalty is added. The level of penalty can be frozen if the taxpayer contacts the tax office and keeps to an agreed monthly payments plan.

In the USA, if after five months the tax is still not paid, the 0.5% late payment penalty will continue to run up to 25%, until the tax is paid.

## Annex B

### Existing sanctions

Tax	Sanction for late or non filing	Sanction for late or non payment
<b>Income Tax Self Assessment</b>	Fixed penalties of £100 for failing to file imposed at the filing date and 6 months later. Daily penalties of up to £60 per day can be charged. Tax geared penalties of up to 100% of the tax due for returns over 12 months late. The penalties are capped to the amount of tax payable at the filing date.	There is a surcharge (a one-off penalty based on the amount of tax unpaid at a particular date) of 5% of tax unpaid charged 28 days after due date and another 5% of tax unpaid charged 6 months later.
<b>Corporation Tax Self Assessment</b>	Fixed penalties of £100 at the filing date and another 3 months later. These escalate to £500 for a third or consecutive failure. A 10% tax geared penalty if the return is 18 months late and a 20% penalty if the return is more than 2 years late.	There are no surcharges or penalties for late payment, only an interest regime.
<b>VAT</b>	The VAT default surcharge relates to both filing and payment.  Daily penalties of up to £20 per day can be charged in cases of prolonged failure to file.	An automated system of progressive surcharges based on the number of defaults (a late return or late payment) in a rolling 12 months period which is extended for each subsequent late return or payment. After a warning the surcharge starts at 2% of VAT unpaid and rises to 5%, 10% and 15% geared to the amount paid late.
<b>Pay as You Earn (PAYE)</b>	End of year late filing penalties on employers escalate based on the number of employees. The penalty is £100 per month or part month late for each batch or part batch of 50 employees. This is capped to the amount of tax due on the return and can run for up to 12 months. If the return is over 12 months late a tax geared penalty of up to 100% may be charged.	For in year payments, there are no sanctions for employers with less than 250 employees. For large businesses, there is an in year surcharge. This tax geared penalty is based on the total liability and depends on the number of defaults (incidences of late payment) in a 12 month period. After 2 defaults, the surcharge starts at 0.17% of the total liability and rises to 0.83% of the liability for 12 or more defaults.

<b>Class 1A NIC</b>	End of year late filing penalties on employers escalate based on the number of employees and are of a fixed sum. If the return is over 12 months late a tax geared penalty of up to 100% may be charged.	Interest for late payment accrues from the due date.
<b>Class 2 NIC</b>	N/A	If payment is made later than the end of the tax year following that for which the contributions are made, the contributor can become liable to pay at the highest rate chargeable between the year the contribution is made and the year in which the contribution is paid.
<b>Inheritance tax</b>	£100 fixed penalties at the filing date and 6 months later and up to £3000 if the return is over 12 months late. Daily penalties up to £60 per day can be charged but they must be determined by a Special Commissioner.	There are no surcharges or penalties for late payment.
<b>Stamp duty land tax</b>	£100 fixed penalty if the return is not received within 30 days of the filing date and a £200 penalty if the return is still outstanding more than 3 months after the filing date. HMRC can also apply to the Special Commissioners for a daily penalty of up to £60 per day if the return is over 12 months late and a tax geared penalty of up to 100%	Interest is chargeable on late payments.
<b>Registered Pension Schemes</b>	£100 penalties for each quarter the accounting return is late for each batch or part batch of 10 persons. From the fifth quarter there is a penalty not exceeding the amount of the income tax for the quarter that the return was not made.	Interest is chargeable on late payment. There are no penalties for late payment.

<p><b>Excise and environmental taxes</b></p>	<p>Although the penalties vary from tax to tax most are a £250 fixed penalty for failing to file a return by the due date</p>	<p><u>Aggregates levy, landfill tax and climate change levy</u>: Rate of penalty interest is 10 percentage points higher than the ordinary interest rate  <u>Air passenger duty</u>: A penalty of 5% of the duty or £250 whichever is the greater is due for failure to pay the full amount of duty by the due date plus £20 for every day full payment of the duty is outstanding.</p>
<p><b>Construction Industry Scheme</b></p>	<p>£100 penalty for missing the filing date for each month or part month of lateness for each batch or part batch of 50 subcontractors. For failures continuing 12 months after the filing date, a maximum penalty of up to £3000 for each return is available.</p>	<p>Interest is chargeable on late payments</p>