Low Incomes Tax Reform Group.

A voice for the unrepresented.

Tax Administration Framework Review: enquiry and assessment powers, penalties and safeguards
Call for evidence
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 We welcome the opportunity to respond to this broad call for evidence covering HMRC's enquiry and assessment powers, penalties and safeguards. In each area, we agree with the principles identified in the 2012 Powers Review, and with the broader objectives for the Tax Administration Framework Review. Our comments on each of the reform opportunities set out in the call for evidence document are focused on the position of unrepresented taxpayers who are unable to pay for professional advice.

Enquiry and assessment powers

1.2 On enquiry and assessment powers, we note there is a focus on post-submission compliance. Alongside this important review, we would encourage HMRC to be cognisant of the level and type of data that they receive and have in their possession pre-submission. HMRC should have a greater focus on making the best possible use of data up front, rather than waiting for non-compliance to occur and then making use of data to raise assessments or open enquiries. In essence, HMRC should be making greater use of data in the 'promote' and 'prevent' strands of their 'promote, prevent, response' compliance strategy.

1.3 We can see that there would be advantages for HMRC, the tax profession and some taxpayers if enquiry and assessment powers were consistent (or more consistent) across tax regimes. However, it should be noted that for many individual taxpayers such alignment is likely to have little impact as the only HMRC-administered tax they come into contact with is income tax. However, there are examples of mismatches within single tax regimes, which it would certainly be helpful to remove.

1.4 Our other comments on enquiry and assessment powers include:

- Transitioning to a new set of consistent powers would initially create cost and time burdens for all stakeholders. Once in place, there should be benefits to HMRC in administering the powers and in being able to move staff more easily.

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- A consistent approach across all taxes would give taxpayers a better chance of knowing and understanding what to expect as it should be easier for advisers and HMRC to explain the process. Greater consistency in approach may also help to develop trust in the tax system.

- The concept of carelessness when determining which time limits apply can lead to disputes between HMRC and taxpayers. One option to address this might be to have an assessment system that makes use of only two, rather than three or more, time limits – drawing a distinction between deliberate and non-deliberate behaviour.

- For an assessment regime to work well, HMRC need to have access to data that would allow them to check the accuracy and completeness of returns. In addition, HMRC have to be able to make use of that data properly and efficiently. There would have to be safeguards for the taxpayer to ensure HMRC use the data promptly.

- We are not certain that it would be appropriate to have a single set of consistent powers across all tax regimes, however. This is because of the different ways in which certain taxes or regimes work.

- Whatever approach is taken, it is essential that appropriate taxpayer safeguards are maintained. In general, whenever a new HMRC power is introduced, there should be balancing taxpayer safeguards.

- There is the potential to remove some mismatches, such as those relating to time limits for failure to notify and errors, offshore time limits and consequential amendment powers.

- The introduction of consequential amendment powers across tax periods and regimes would have to be accompanied by taxpayer safeguards, such as statutory time limits for making those amendments. In addition, in the interest of fairness, this should be accompanied by the right for the taxpayer to make any consequential claims. Thus, the final position should be the same as if the taxpayer had not made the error and had made any appropriate claims at the correct time.

- We recognise that there are difficulties with the current discovery powers. To provide more certainty for taxpayers, there should be strict time limits, and HMRC must act promptly once they have information in their possession. We are in favour of an evidence of facts rule, obliging HMRC to act within a certain period of obtaining or receiving information that supports their assessment[1].

- We recognise the difficulties HMRC face in dealing with claims for tax relief and credits. In relation to high volume repayment agents, we think there are steps (unrelated to enquiry and assessment powers) HMRC could take to mitigate the issues, such as fully assessing the end-to-end processes of these agents.

[1] For this to be a true safeguard the time limit would need to run from when HMRC first receive the information rather than from a later date, such as when a HMRC officer first looks at the information.

- We note that HMRC have concerns about their powers to correct obvious errors and taxpayer rejections of these. The call for evidence suggests requiring the taxpayer to provide evidence to support a rejection. If this were pursued, the taxpayer would need longer than the current 30 days to do so. Another idea is that HMRC should be obliged to provide the taxpayer with a clear explanation and evidence for their correction of an obvious error as this might lead to fewer taxpayer rejections.

- We are in favour of HMRC making more use of digital services and communications, provided that alternatives for those without digital access or capability remain available, accessible and of a good quality.

- A digital by default approach to communications requires certain safeguards and processes to be in place. For example, HMRC need to be able to identify if a communication has failed to deliver, and have processes in place such that they make use of an alternative channel. In relation to statutory notices, it is vital that there are taxpayer safeguards. This might require the development of new legislation defining when a statutory notice has been served on a taxpayer digitally.

Penalties

1.5 On penalties, our comments are focused on how unrepresented taxpayers can find themselves in penalty situations which feel unjust – particularly where historic compliance is involved. We discuss opportunities to improve the suite of penalties which can apply to these taxpayers, with a view to minimising these inequities at the same time as simplifying the various regimes.

1.6 Although there can be a case for penalty alignment, we question whether this would benefit the taxpayer (as opposed to HMRC and the tax profession) as an objective in itself. That being said, the suite of penalties most relevant for self assessment taxpayers (that is, failure to notify, inaccuracy, late submission and late payment) contains many examples of misalignment which can feel unfair and may incentivise behaviour unintentionally.

1.7 In particular, the fact that these obligations each have separate penalty regimes, when in reality they are bound together as whole process, can lead to instances where multiple penalties are charged relating to the same underlying point (for example, lack of awareness that a source of income was taxable). Accordingly, we would prefer HMRC to take a more holistic approach.

1.8 Our other comments on penalties include:

- We think behaviour-based penalties should remain, but they might be simplified to take account solely of whether or not the behaviour was deliberate. HMRC should consider whether it might be practicable to remove penalties for all non-deliberate behaviour.

- Offshore penalties have become too complex and should be simplified.

- The failure to notify regime can be simplified so that question of whether the disclosure is made within 12 months of the tax becoming due is no longer relevant.

- Non-statutory 'rules of thumb', such as where HMRC limit reductions on penalties based on timing of the disclosure or whether it is prompted, should be avoided as they make the regime in practice more complex.
- Penalty suspension should be broadened, but we would prefer HMRC to issue warning letters in case of the first default.
- We are tentatively in favour of proportional fixed penalties, though we note that they would add complexity.
- Penalty escalation for continued and repeated non-compliance may have a role to play in incentivising the right behaviour, but they are not always appropriate. Other incentives may be more suitable. Taxpayers should always have a chance to respond to one level of penalty before the next one is charged.
- Taxpayer communication should be improved, both before and after the charging of a penalty, to incentivise the right behaviours, reduce confusion and improve taxpayer understanding and engagement.
- We accept there is a case for uprating of fixed penalties, though doing so without also uprating other aspects of the tax system in the taxpayer's favour risks damaging trust.
- We agree HMRC should increase transparency by publishing more penalty statistics.

Safeguards

1.9 We set out the importance of ensuring that access to safeguards is optimised for taxpayers who are not represented by an agent. To that end, we are pleased HMRC is taking an opportunity to consider improvements to the current appeals system.

1.10 A key element to improving access to safeguards will be increasing taxpayer awareness and understanding, with a particular focus on unrepresented taxpayers, who will often find the process of a tax dispute daunting and distressing. We can see great benefit in HMRC reviewing the information provided to taxpayers to explain the safeguards available to them. This information should be presented in a way that is clear, concise, unambiguous and in plain English.

1.11 The call for evidence sets out various areas of proposed reform and we have provided our initial thoughts on each, which are broadly summarised as follows:

- We are supportive of HMRC's interest in aligning the processes of appeal across direct and indirect taxes. Though it is perhaps uncommon that an unrepresented taxpayer will need to navigate both appeal systems, it is still a possibility. Different systems make such a situation more difficult.
- We would like to see this idea of alignment explored in more detail, with a view to an outcome that is focused on overall simplicity for the taxpayer.

- HMRC are also considering the merits of aligning the payment requirements for tax matters under dispute. We believe it should remain possible to postpone direct tax liabilities until such time as a dispute is settled, and we would therefore not favour alignment with the indirect tax regime which only allows postponement in agreed cases of hardship.

- Requiring a taxpayer to pay disputed liabilities up front puts them at a cashflow disadvantage and could mean they do not have the resources to pursue the matter further. In turn, this could be a barrier to reaching a fair outcome.

- We appreciate the importance of statutory reviews and ADR; unrepresented and/or lower income taxpayers may not have the time and/or resources to take their dispute to Tribunal. Encouraging uptake of these methods is welcome, provided they are adequately resourced with appropriately skilled staff. Improved take-up is likely to flow from a better taxpayer understanding of the process.

- The mandating of statutory reviews would clearly 'force' increased take-up. While we are not necessarily opposed to this, it must be shown that HMRC can handle the increased caseload effectively.

- Further, if the taxpayer has no choice in the matter, then it will be even more important to demonstrate that statutory reviews are fair and unbiased, and not merely a formality that tends to uphold the original HMRC decision. Taxpayer trust in the system could be damaged if the latter is perceived.

- HMRC are considering whether the option of a statutory review could be removed altogether in certain cases. We would be opposed to this course of action. Our general view is that taxpayer safeguards must be available across the board if they are to maintain their integrity, and to ensure HMRC meets its obligations under the Charter.[2]

- Finally, we are broadly supportive of moving to a digitalised system of appeals. However, this process should not be rushed and, initially, should be introduced alongside the manual process.

- Only once the digital system is established, settled and extensively used should there be any move to making the process digital by default. At all times, there must be continued non-digital access for the digitally excluded population.

2 About Us

2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998, LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those who are least able to pay for professional advice. We also produce free information, primarily via

[2] https://www.gov.uk/government/publications/hmrc-charter/the-hmrc-charter

our website www.litrg.org.uk, to help make a difference to people's understanding of the tax system.

2.2 LITRG works extensively with key stakeholders such as HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the tax system. LITRG also considers the welfare benefits system, and other related systems, to the extent that they interact with tax.

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

3 Enquiry and assessment powers

3.1 We welcome this opportunity to comment on potential reform to HMRC's enquiry and assessment powers. HMRC's enquiry and assessment powers enable them to check the accuracy of information they receive from taxpayers, and also are a tool for tackling non-compliance. As we note in our response, HMRC have other powers and tools available to tackle non-compliance, which do not fall within their suite of enquiry and assessment powers. Where appropriate, we try to point out where we think that HMRC might wish to consider using other tools, rather than turning to their enquiry and assessment powers.

3.2 As an organisation, LITRG does not cover the whole spectrum of HMRC taxes – we mainly concern ourselves with income tax, National Insurance contributions, capital gains tax, inheritance tax, VAT and council tax, and in particular those taxes as they affect taxpayers who are unable to afford to pay for professional tax advice. On the other hand, we come across interactions between the tax system and other related systems, such as those for welfare benefits. As the call for evidence document points out, there are various opportunities to make the powers more consistent across taxes. Given our areas of interest, and that this is an early stage call for evidence, we do not comment definitively on the opportunities, benefits and risks of moving to a single set of enquiry and assessment powers across all taxes.

3.3 In our response below, we consider each of the reform opportunities in turn. For this purpose, we have effectively grouped our answers to the questions under each reform opportunity, thus our response under reform opportunity A covers our thoughts on questions one to four of the call for evidence document.

Reform opportunity A: consistent powers across tax regimes

3.4 Reform opportunity A brings forward the idea of replacing HMRC's current suite of enquiry and assessment powers with a single set of powers that apply across all taxes. It also offers an alternative idea of taking steps to identify where a common approach would work, but also those taxes that need a different approach. This second approach would allow diversion where appropriate, but would hopefully achieve greater consistency overall.

HMRC use of data

3.5 We note that this call for evidence is focused on HMRC using information after the fact, looking at enquiry and assessment powers. We think that any powers that involve looking at post-submission compliance need to be cognisant of the level and type of data that HMRC receive and have in their possession pre-submission. Where HMRC could have supported the taxpayer to be compliant, because of the data they already held, there has to be accountability by HMRC. Indeed, HMRC should have a greater focus on making the best possible use of data up front, rather than waiting for non-compliance to occur and then making use of data to raise assessments or open enquiries. In essence, HMRC should be making greater use of data in the 'promote' and 'prevent' strands of their 'promote, prevent, response' compliance strategy. Moreover, in situations such as the example below (see paragraph 3.6), HMRC tend to penalise the taxpayer. Where HMRC could have used data in their possession to ensure that the taxpayer complied successfully, but HMRC failed to do so, there should be a question as to whether HMRC should penalise the taxpayer at all.

3.6 For example, a common error is for subcontractors under the Construction Industry Scheme (CIS) to think that they are employees, because the payment and deduction statement they receive from the contractor show deductions for tax (unless they are paid gross) and it shows an 'Employer's Tax Reference' number. They then complete a tax return and place their CIS income on the employment pages, rather than the self-employment pages. This is surely an 'obvious error' that HMRC have the data and power allowing them to correct.[3] For many subcontractors in this position, we understand that no such correction has been made by HMRC. During the coronavirus pandemic, this unfortunately meant that affected subcontractors were unable to claim self-employment income support scheme (SEISS) grants. In addition, those same subcontractors needed to correct their tax position. In this instance, all the negatives were borne by the subcontractors, but the situation could have been avoided if HMRC had been able to make better use of the data they held. We understand that in this instance, HMRC felt they were unable to join up the data they held, because it was on different systems. However, this simply highlights the importance of having appropriately joined-up systems and processes within HMRC to support compliance both before and after the fact, especially when HMRC are trying to move taxpayers onto digital services.

Guidance

3.7 In addition to making better use of data for upstream compliance initiatives, HMRC need to consider taxpayer reliance on HMRC guidance, and HMRC advice given via forums and Twitter. Where this guidance or advice is misleading or incorrect, its impact on compliance needs to be considered. Where a taxpayer has failed to comply as a result of misleading or inaccurate guidance or advice from HMRC, there is a question as to whether they should be penalised for the non-compliance. We note that the Australian Tax Office[4] deal with this issue by setting out a comprehensive table of

[3] Section 9ZB Taxes Management Act 1970: https://www.legislation.gov.uk/ukpga/1970/9/section/9ZB

[4] https://www.ato.gov.au/about-ato/ato-advice-and-guidance/how-our-advice-and-guidance-protects-you#ato-Relyingonouradviceandguidance

different forms of guidance and advice, including items such as minutes of consultative forums and tools and calculators, along with a clear decision on whether it is binding in terms of protection from tax shortfall, protection from interest on the shortfall and protection from false or misleading statement penalty. This gives taxpayers some certainty about the position for each product.

Consistency

3.8 While there would undoubtedly be costs and time burdens for all stakeholders (HMRC, agents and taxpayers) to introducing major reforms, these could be alleviated to some extent by ensuring that there is a well-planned timeline for any changes and a good awareness-raising strategy in place. Transitioning from one system to another in a scheduled manner, with clear steps, should mean fewer queries from taxpayers and agents, and make it easier for HMRC to educate staff and ensure operational systems are in place and working correctly.

3.9 Once a consistent set of powers is in place, there would hopefully be advantages on all sides. It is to be hoped that future consultation will ensure that any consistent set of powers is straightforward and operates on an objective basis. For HMRC, it would be easier to move staff internally to different compliance risk areas as required – once staff are trained in the single set of powers, less retraining would be required.

3.10 A consistent and straightforward approach across all taxes would give all taxpayers, even those who are unrepresented, a better chance of knowing and understanding what to expect. Where taxpayers are represented, or seek guidance from HMRC, it would be easier for advisers and HMRC to explain the process to taxpayers, and therefore for trust in the system to develop.

Enquiry and assessment powers

3.11 When moving to a single set of consistent powers across taxes, thought needs to be given to which powers might be viable across taxes.

3.12 Enquiries tend to have a time limit in terms of a timescale within which HMRC must open an enquiry. Thereafter, however, there are no formal time limits that curtail how long an enquiry continues for. Taxpayers may apply to the First-tier Tribunal for HMRC to issue a closure notice.

3.13 As noted in the call for evidence, all assessments are subject to time limits. These time limits are a very important safeguard as they can help to provide the taxpayer with certainty.

3.14 It is notable that currently, different taxes try to deal with different kinds of taxpayer behaviour in different ways. Any new set of powers will have to be capable of covering a wide range of compliance behaviours, from one-off accidental errors/failures to deliberate defaulters. This does not necessarily mean that there needs to be a complex range of time limits.

3.15 One area of complexity that creates a lot of uncertainty and contention is the concept of ‘carelessness’ for direct taxes. Another problematic concept, which we discuss below, is that of discovery (see comments under reform opportunity D). When considering how many years HMRC can go back for raising a discovery assessment or assessment in respect of a direct tax, the concept of carelessness is important, as it can mean HMRC can go back six years rather than only four. This

involves a subjective judgement as to whether careless behaviour is involved, which can extend discussions and lead to Tribunal cases simply dealing with the question of whether the assessment should relate to four or six years. This creates significant uncertainty and stress for taxpayers, as well as costing all stakeholders involved in terms of time and money.

3.16 One option to address the difficulties caused by the concept of carelessness might be to have a system that makes use of assessment powers with only two, rather than three or more, time limits – a shorter one for non-deliberate compliance failures, and a longer one (20 years as now) for deliberate compliance failures. This would mean a distinction was drawn purely between deliberate and non-deliberate behaviour in terms of time limits. This idea mirrors our suggestion later in this submission that behaviour-based penalties might also only consider whether or not the behaviour was deliberate (see paragraph 4.23). However, further work would be needed to understand the impact of such a change. For example, HMRC would need to explore whether this would simply transfer the type of issues that currently exist around carelessness to the distinction between non-deliberate and deliberate behaviour. This is because that distinction would still be based on subjective views of behaviour, with a significant difference in time limit either side of that line.

3.17 The call for evidence suggests that it might be possible to move to an assessment-only system, with no enquiry powers. We can see that removing the enquiry powers that exist for certain taxes would remove the uncertainty that arises around the closure of enquiries and the lack of certain closure limits. However, there would still need to be safeguards for the taxpayer, such that they could dispute any HMRC assessment.

3.18 In order for an assessment-based regime to work well, HMRC would need to have access to data that would allow them to check the accuracy and completeness of returns. In addition, HMRC would have to be able to make use of that data properly and efficiently. There would also have to be safeguards for the taxpayer to ensure HMRC use the data promptly. It is not clear how an assessment-based regime could operate effectively where HMRC do not have relevant data. If this led to HMRC raising inaccurate assessments that a taxpayer then had to disprove, this might result in unfair outcomes for the taxpayer and would no doubt be extremely stressful.

3.19 An option might also be a system based on assessment and discovery, with a more strictly drawn discovery rule as discussed below (see reform opportunity D).

3.20 Further additions to this might be consequential amendment and consequential claim provisions, and also an ‘evidence of facts’ rule. These could have associated statutory time limits. There is currently an ‘evidence of facts’ rule for VAT assessments – the time limits, such as four years for raising an assessment, apply subject to the assessment being made within one year of HMRC having sufficient evidence of facts to justify the assessment.

3.21 Currently, regimes that make use of three different time limits tend to use four years, six years and twenty years. Under a regime with only two separate time limits, HMRC may feel that the lower limit, for non-deliberate compliance failures should be increased to six years. For many taxpayers, a basic time limit of six years might feel extremely long as a window within which HMRC can make an assessment. In this instance, we would suggest that this could be tempered somewhat by the inclusion of an ‘evidence of facts’ rule. This would be statutory and would require HMRC to raise an

assessment within a specified time limit once data or evidence becomes available to them. In order for such a system to operate fairly, data or evidence would need to be viewed as 'becoming available to HMRC' on the date that they receive it into their systems – whether from the taxpayer or a third party source.

Specific powers

3.22 We are not certain that it would be appropriate to have a single set of consistent powers. This is because of the different ways in which certain taxes or regimes work. There are some clear examples where different approaches may be necessary or appropriate.

3.23 VAT returns contain significantly less information than income tax and corporation tax returns. There are currently enquiry powers for the latter two, but only assessment powers for VAT returns. It might not be possible to implement enquiry powers successfully in respect of VAT returns. Similarly, a 'right to correct' a VAT return in the case of an obvious error might not be a viable power for HMRC, given the lack of detail in a VAT return.

3.24 However, if the decision was to move to a purely assessment-based regime for all taxes, then it might be possible for there to be consistency across taxes.

3.25 Equally, PAYE is mentioned in the call for evidence. This is not strictly a tax, but a method of collecting tax. Employers collect tax on behalf of individual employees and hand this over to HMRC; it is thus subtly different from income tax self assessment, and may require a different approach. With regards to PAYE, it is important that HMRC exercise their powers appropriately and in accordance with the legislation. Currently, where there is an income tax underpayment due to employer error, under Regulation 80 of the Income Tax (Pay As You Earn) Regulations 2003,[5] HMRC should issue a determination to the employer. However, in many cases, HMRC do not examine whether there has been employer error, and simply issue a P800 tax calculation to the taxpayer and demand that the taxpayer pays the underpayment. Moving forward, whatever the new set of enquiry and assessment powers look like, HMRC need to operate them in accordance with the law, and in a manner that does not appear to favour one type of stakeholder over another.

3.26 Arguably VAT falls into the same category as PAYE, as to some extent (for example, subject to partial exemption status), the organisations that submit VAT returns are administering VAT that is paid by the final consumer, not the organisation.

3.27 One option might be to think about different taxes according to their type and what is involved. It might be possible to create certain groups of taxes that could have the same approach.

[5] https://www.legislation.gov.uk/uksi/2003/2682/regulation/80/made

Safeguards

3.28 Whatever approach is taken, it is essential that there are appropriate taxpayer safeguards. Indeed, it should be noted that some of the differences that currently exist between taxes are there to safeguard taxpayers in particular areas.

3.29 Time limits are an important safeguard, as honest taxpayers have a fundamental right to closure after a reasonable time has elapsed.

3.30 Where there are time limits, for example in relation to raising an assessment, for taxpayer certainty and fairness it is important that HMRC act within a reasonable timeframe. This means that if there is a time period of four years for raising an assessment, if HMRC have the information at hand within the first couple of years of that time period, they should not be waiting until the four years have almost concluded to issue the assessment. An important safeguard for an assessment regime, as well as time limits for issuing assessments, is the evidence of facts rule discussed above in paragraph 3.21. This would mean that HMRC have an overall time limit of say four years, but they have to act on information in their possession within one year, for example.

3.31 As noted above (see paragraph 3.16), HMRC could move to an assessment-based regime only, perhaps with only two separate time limits. If the lower limit was changed to say six years, we would suggest that it would be fair if the time limit for taxpayer claims for tax reliefs, for example, was also changed to align.

3.32 As a general rule, whenever HMRC are granted more powers, there should be accompanying taxpayer safeguards, to ensure that the position is balanced.

Other compliance powers

3.33 There are other compliance powers that HMRC currently use that sit outside the enquiry and assessment powers, for example, the use of one-to-many campaigns, whether these are educational nudges, or to encourage disclosure where a risk has been identified. It is important that thought is given to how such powers will interact and integrate with any new set of enquiry and/or assessment powers.

Reform opportunity B: aligning powers and addressing gaps

3.34 The call for evidence identifies a few areas across HMRC's suite of enquiry and assessment powers where there are mismatches or gaps. These can undermine actual and perceived fairness and also create unnecessary costs, both for HMRC and taxpayers. We consider a few of these areas.

Differing time limits

3.35 There are three time limits for inaccuracy assessments, but only two in respect of failure to notify. This mismatch results in complexity and makes it difficult to explain the different rules to ordinary taxpayers. Failure to notify time limits also do not take account of behaviour as such. As noted above (see paragraph 3.16), removal of the middle time limit for careless behaviour might solve a few

issues – it potentially may simplify the framework and it would also remove a concept (carelessness) that generates significant contention. This is because carelessness requires a subjective judgement, and the distinction between taking reasonable care and being careless means a move from a four-year time limit to a six-year time limit. However, as noted above, further work would need to be done to understand what issues might arise with a subjective decision between non-deliberate and deliberate.

Consequential amendments

3.36 Consequential amendment provisions allow HMRC to make amendments in respect of other taxes when they find an error in respect of one tax. This power currently exists for corporation tax, but not income tax self assessment. The call for evidence suggests that this mismatch could be removed by introducing consequential amendment provisions for income tax. We think it could be helpful for there to be consequential amendment provisions across all taxes; if there are consequential amendment provisions giving powers to HMRC, there should be consequential claim provisions, allowing taxpayers to make claims, elections and amendments in their favour (see paragraph 3.40 below for more detail). These are rules that would provide safeguards for taxpayer money in general, but also for the taxpayer as an individual.

3.37 As noted above (see paragraph 3.20), while consequential amendment and claim provisions can form part of a regime that is based on both enquiries and assessments, consequential amendment and claim provisions could equally be part of a regime that is based purely around assessments, with two different time limits.

Offshore non-compliance

3.38 Currently, there are extended time limits in respect of non-compliance that relates to overseas tax issues. These were introduced prior to the existence of the Common Reporting Standard (CRS) and the Foreign Account Tax Compliance Act (FATCA). HMRC should therefore consider whether the special extended limits for overseas tax are still required or whether they could be aligned with those for UK tax under any reforms. We consider penalties for offshore non-compliance at paragraph 4.27 below.

Reform opportunity C: consequential amendments and assessments across periods and across taxes

3.39 The call for evidence suggests that one option might be to grant HMRC the power to correct the tax consequences resulting from non-compliance across all affected tax periods and tax regimes. Consequential amendments and claims would remove some of the unfairness and costs of the current system, as pointed out in the call for evidence. It would allow an HMRC officer to focus on the compliance issue they are concerned about, without having to open additional enquiries or make protective assessments in the meantime.

3.40 If HMRC gain such a power, there should be statutory time limits associated with the consequential provisions, such that once the need for the consequential amendment is known and the relevant details have been ascertained, there is a specific time limit within which the consequential

amendments and/or claims must be made. This will allow for the consequential amendments and claims to be made, but also provide certainty as to the overall tax position within a reasonable timescale. This is essential, as consequential amendment powers that are not subject to statutory time limits could create perceptions of unfairness and also create uncertainty.

3.41 It should not only be possible for HMRC to make consequential amendments in favour of the Exchequer; it is essential that taxpayers have the right to make consequential amendments and/or claims in their favour. The final position following the correction of an error and consequential amendments should be that the taxpayer has paid the correct amount of tax overall. Thus, the position should be the same as if the taxpayer had not made the error and had made any appropriate claims at the correct time. This is particularly important in cases of non-deliberate error.

3.42 The position in respect of consequential claims or amendments in favour of the taxpayer may be more problematic in cases where the taxpayer behaviour is deliberate. However, arguably, the aim should still be to get to the correct tax position overall. Penalties for deliberate behaviour should provide the appropriate penalty; arguably it would be a harsh, additional penalty if the right of the taxpayer to make consequential claims was removed because of deliberate behaviour.

Tax credits and welfare benefits

3.43 The taxpayers we come across often interact not only with the tax system, but also with the associated tax credits and welfare benefits systems. Tax credits are extremely unlikely to exist by the time any reforms to enquiry and assessment provisions for taxes come into effect. And although welfare benefits stand outside the purview of HMRC, there are often interactions with income tax and National Insurance contributions – it is possible that an individual who has made a mistake in relation to their income tax has also made a mistake in relation to their welfare benefits claim. In addition to consequential amendment and claim provisions being potentially useful across taxes, we would suggest that this review should also be cognisant of the fact that where amendments are made to an individual's income tax position in particular, there may also be a need for that individual to amend or reconsider their welfare benefits position. This means that, at the very least, there needs to be improved guidance as to how discovering an error in tax reporting might also mean an error has been made in relation to welfare benefits and what, if anything, might need to be done as a consequence. We explored this topic in our 2019 response to the HMRC call for evidence on Amendments to tax returns.[6]

Reform opportunity D: conditions for assessment

3.44 The call for evidence notes various concerns with the current discovery rules and conditions in relation to knowledge of the facts. In reality, the case *Langham v Veltema*[7] resulted in the barrier for disclosure being extremely high, to the extent that it is very easy for HMRC to issue discovery assessments. The balance of power in respect of discovery is heavily skewed in favour of HMRC at

[6] See section 9: https://www.litrg.org.uk/submissions/amendments-tax-returns-call-evidence

[7] *Langham v Veltema* (2004) STC 544

present. Moreover, the aforementioned case dates back twenty years. Time has moved on considerably in terms of the nature and volume of data that HMRC collect. HMRC should be aiming to make effective and efficient use of that data. This means that the days of raising assessments going back many years and/or making discoveries should be disappearing, as HMRC should be able to deal with matters within normal enquiry time limits or before the non-compliance has been allowed to continue for too long. It may therefore be better to either redraw the powers in relation to discovery assessments or remove the concept of discovery entirely. As discovery powers in essence are related to enquiry powers, and in particular to the time limits HMRC are held to for opening an enquiry, if the wider review results in a system that involves assessments only, and no enquiries as such, the removal of the concept of discovery may be possible.

3.45 The ease with which HMRC can now exercise their discovery powers creates a further issue. There is a perception that HMRC do not use enquiry windows properly, and instead rely on their discovery powers. They also often seem to only issue discovery assessments just before the time limit expires. This approach to exercising enquiry and discovery powers is possibly what drives some of the challenges to the validity of such assessments. If HMRC were to make more timely use of their powers and data available to them, not only would they be able to nip some non-compliance in the bud, but the response from some taxpayers would be less antagonistic. This is because the problem would not have been allowed to continue and the resultant tax and penalties would be lower. In addition, it is far easier for taxpayers to remember things that happened recently – if a taxpayer has to look through records from four to six years ago to deal with an HMRC assessment, it is automatically more difficult to recall events, and make sense of the records (however well-kept). This means the taxpayer is in a more stressful situation and more likely to feel threatened by HMRC and perhaps behave antagonistically towards HMRC.

3.46 It is essential that there are strict time limits for assessments. This provides the taxpayer with some certainty. Otherwise, the lack of certainty can create a variety of problems for the taxpayer, for example, excess uncertainty and stress can lead to mental health and physical health problems, and if errors are allowed to continue for long periods, this can exacerbate tax debts.

3.47 Ideally, there should also be some kind of evidence of facts time limit within the overall time limit. This should have the aim of providing certainty – i.e. for example, if a taxpayer has made full disclosure, they should expect certainty after one year, say, although the overall assessment time limit (for non-fraudulent cases) might be four years or six years. This should encourage timely use of data by HMRC. As noted in paragraph 3.44 above, the current bar for full disclosure is extremely high for a taxpayer to fulfil. In order for 'full disclosure' to be a reasonable safeguard for an ordinary, unrepresented taxpayer, there needs to be consultation on what bar is suitable to set such that it balances the right of the taxpayer to certainty with fairness of the tax system as a whole.

3.48 A further safeguard might be that if HMRC wanted a longer time limit in relation to a particular case, they would have to apply to the First-tier Tribunal for permission. There they would have to prove that any delay to issuing an assessment was not their fault and they were not acting unreasonably.

Reform opportunity E: tailoring HMRC's powers

Claims for tax relief and credits

3.49 The call for evidence singles out claims for tax relief and credits as posing a challenge. In particular, while HMRC wish to administer payments to taxpayers promptly where there is an accurate and genuine claim, they also wish to take the time to identify and tackle those who make inaccurate and fraudulent claims. HMRC wish to consider possible approaches to enquiry and assessment powers as they relate specifically to claims for tax relief and credits.

3.50 HMRC's general approach to claims for relief and credits is to 'process now, check later'. As noted in the call for evidence, this can create problems. For example, the taxpayer may initially receive a refund. If it turns out that they were not entitled to some or all of the refund, this creates a debt, that the taxpayer may struggle to pay. This approach also creates a perception among ordinary taxpayers that the claim has been agreed or approved. This is especially the case, as people are aware that HMRC hold much more information about them – this means they think HMRC have the data and the systems in place to enable them to check claims fully before paying them out.[8] If taxpayers receive a tax refund, these perceptions mean they are less likely to be amenable if they later receive an enquiry or an assessment from HMRC. This position is exacerbated where a taxpayer has been making similar claims for years that have gone unchallenged.

3.51 A major challenge in relation to claims for relief and credits is the exploitation of the 'process now, check later' approach by high volume repayment agents (HVRAs). Over several years, LITRG has brought problems associated with the behaviour of these HVRAs to the attention of HMRC. HMRC's ability to check claims has suffered due to the volume of claims that these HVRAs submit. HMRC have already altered their model slightly for R40 tax refund claims in respect of payment protection insurance (PPI) payouts and P87 tax relief claims in respect of employment expenses. In many of the cases we come across, the taxpayers have been exploited and may not even be aware that the claim has been made; indeed, HMRC were even receiving R40 claims from multiple HVRAs in respect of the same taxpayer.

3.52 The evidential requirements that HMRC have introduced in respect of the aforementioned claims may assist to dampen the sheer volume of inflated and inaccurate claims that HMRC receive from HVRAs. However, we have previously suggested other complementary options for tackling such claims.

3.53 Agents who wish to receive tax refunds on behalf of their clients via nominations should have to undergo various checks. In particular, we suggest that HMRC should request evidence of the end-to-end process involved in signing a customer up to the agent's services, at a company level, so that HMRC can tell that taxpayers have knowingly agreed to the submission of the tax refund claim, have agreed and signed the nomination and understand what is happening. This should help HMRC

[8] See section 5 of our response to the 2023 consultation on information and data at https://www.litrg.org.uk/submissions/tax-administration-framework-review-information-and-data

identify whether they should be dealing with such an agent, and/or whether they should be following any nomination in respect of a tax refund for all individuals using that company.

3.54 The call for evidence suggests another possible reform might be to introduce a grant-type model, whereby claims undergo processing structured around an application, decision, appeal approach. We would be concerned that such an approach might create significantly more work for HMRC, and might hinder their ability to deal with legitimate and accurate claims promptly and efficiently. It would be helpful to understand if HMRC believe they will have sufficient data analysis capabilities and integration of systems to alleviate any concerns. It is clear that it would be too resource-intensive to operate a grant-type model through human processes, so HMRC would need the means to make automated checks of claims before payment is made with some manual checks as required.

3.55 If a new regime is introduced, or changes are made to the current regime, with a view to addressing the exploitation of the 'process now, check later' approach, it is essential that HMRC take steps to anticipate and plan how to prevent likely attacks on the new/changed regime by keeping abreast of developments and adopting lateral thinking as to what areas might be exploited. It is also essential that HMRC make good use of the data they gather and are able to integrate their databases effectively to support their processing of accurate and genuine claims for tax relief and credits.

HMRC correction of obvious errors

3.56 In the call for evidence, HMRC suggest that the correction of obvious errors can be problematic, because of the ability of the taxpayer to reject the correction without providing supporting evidence.[9] In relation to claims submitted by HVRAs, particularly those submitted without full knowledge of the taxpayer, we doubt that this fear is justified. In fact, a notice of correction sent to the taxpayer offers them the opportunity to check their position.

3.57 As noted in the call for evidence, one possible solution is to amend the legislation such that the taxpayer must provide evidence if they wish to reject the correction. In this instance, we would suggest that the timescale for rejecting the correction would have to be extended too – it is currently 30 days. If the taxpayer is required to gather evidence to support their rejection, this timescale should probably be significantly longer. Provision would also have to be made for taxpayers who have lost or damaged records and have provided estimates or need to provide estimates to support their rejection of the correction.

3.58 Another possibility would be to amend the legislation such that HMRC must supply evidence and a clear explanation to support their correction of the obvious error. This would help the taxpayer understand why HMRC have made the correction, check their records and make a more reasoned decision as to whether to accept or reject the correction. In some cases, perhaps particularly where a taxpayer is unrepresented, it is possible that they reject the correction because they simply do not understand why HMRC have made it.

[9] Section 9ZB Taxes Management Act 1970: https://www.legislation.gov.uk/ukpga/1970/9/section/9ZB

Reform opportunity F: modernising administration and communications

3.59 LITRG is in favour of HMRC making more use of digital services and communications, provided that those services work well and alternatives for those without digital access or capability remain available, accessible and of a good quality. As noted in our response[10] to the 2023 discussion document Simplifying and Modernising HMRC's Income Tax services through the tax administration framework[11] we think a guiding principle for HMRC when moving to greater use of digital services and communications should be to ensure that all obligations under HMRC's Charter,[12] as well as the HMRC principles of support for taxpayers who need extra help,[13] are properly met.

3.60 Regarding the use of digital communications in relation to compliance activity, we would make the following points.

Digital notifications

3.61 The 2023 discussion document raised the idea of moving to digital by default for certain forms and notifications. Notifications can be further separated into those that create a legal obligation (such as the SA316 notice to file), and those that do not. These different categories potentially require different approaches.

3.62 We commented in detail (in our response to the 2023 discussion document) on a suggested change to require new income tax self assessment registrations to be made online, and a digital by default approach to subsequent notices to file, and a requirement for annual returns to be made digitally.[14] We focus here on digital by default notices to file.

3.63 As we noted in our 2023 response, a notice to file creates a legal obligation on a taxpayer to file a tax return, even if the individual does not owe any tax for that tax year or meet HMRC's income tax self assessment criteria.

3.64 A digital by default approach means that the notice to file would be served digitally even if the taxpayer has not actively chosen to receive it digitally. It does not feel appropriate that such an important document is issued digitally without the taxpayer having asked for that to be the case: the

[10] https://www.litrg.org.uk/submissions/simplifying-and-modernising-hmrcs-income-tax-services-through-tax-administration-framework

[11] https://www.gov.uk/government/consultations/simplifying-and-modernising-hmrcs-income-tax-services-through-the-tax-administration-framework

[12] https://www.gov.uk/government/publications/hmrc-charter/the-hmrc-charter

[13] https://www.gov.uk/government/publications/hmrc-charter/hmrcs-principles-of-support-for-customers-who-need-extra-help

[14] See section 5 of our response at https://www.litrg.org.uk/submissions/simplifying-and-modernising-hmrcs-income-tax-services-through-tax-administration-framework

risk is that if the taxpayer has not actively chosen to receive this notice digitally then they may not be expecting it digitally. This might especially be the case if the taxpayer has received other communications from HMRC in the post prior to that point (such as confirmation of their unique taxpayer reference (UTR)). Therefore, the email notification of the notice may be missed, or go to a person's spam inbox, or may be more easily forgotten – all of which may lead to penalties for non-compliance with that notice and ultimately more HMRC resource to resolve.

3.65 We understand that HMRC are able to monitor for emails that have failed to deliver. HMRC need to have the ability to opt for a different communication channel if an email leads to a 'failure to deliver' response. However, responding and reacting to delivery failures is insufficient if alerts relating to statutory notices are to be delivered digitally. The delivery of an email to an inbox, or indeed a spam folder, does not mean that a taxpayer has received it.

3.66 When communicating with taxpayers HMRC need to have the capability to identify whether a specific communication has been opened. This could relate to communications such as emails telling a taxpayer they have a message in their personal tax account, like a statutory notice to file a tax return, that could lead to compliance failures if the taxpayer does not receive or does not act on, or communications that relate to compliance failures that have already occurred. If certain notices are not accessed digitally within a certain period, we think HMRC should in the first instance follow-up with a further prompt. However, if the prompt is not accessed and there is no sign that the taxpayer has opened an email, text message, or HMRC app push notification within a specified timeframe, this should lead to HMRC adopting an alternative communication channel, such as a paper equivalent.

3.67 In relation to notices that place a statutory obligation on a taxpayer, further safeguards may be required. For example, HMRC may be able to tell that a taxpayer has opened and read a notification email that sends the taxpayer to their personal tax account to read a digital notice to file. However, they then need to be able to tell whether the taxpayer has gone into their HMRC app or personal tax account and looked at that notice to file. Therefore, HMRC need to carefully consider how they might be able to demonstrate that they have served a notice properly and fairly. This might require developing a modern equivalent to section 7 of the Interpretation Act 1978,[15] and for HMRC to be able to prove that they have carried out certain actions in order for a notice to be validly served.

Digital accounts

3.68 Greater use of digital communications and secure messaging, and the consequent cost and time benefits, hinges to a great extent more taxpayers being able to set up a digital account. This means that greater use of digital communications needs to be supported by ensuring that the process of setting up a digital account is both robust (in terms of security) and straightforward. It also cannot be entirely dependent on forms of identification, such as driving licences, that are not available to a

[15] https://www.legislation.gov.uk/ukpga/1978/30/section/7

significant proportion of the population. We appreciate that it is very difficult to get the balance right.

3.69 It may be that the introduction of 'One Login for Government' significantly improves access to HMRC online services – this may in itself increase take up of those services. Before there is greater use of digital in relation to forms, communications and notices that have statutory compliance consequences, it is essential that online services are properly embedded, improved and accessible.

Digital exclusion and compliance

3.70 There will always be some taxpayers who are digitally excluded. In order to prevent non-compliance, there should be options that support digitally excluded taxpayers to comply. For example, a move to digital by default for forms means there is a complementary and ongoing need for a dedicated telephone order line for paper forms for those who are unable to use online services or access forms via GOV.UK. Ideally this would be separately staffed and allow such taxpayers to bypass any long waiting times on other helplines.

3.71 We think that forms, such as the SA100 and its associated supplementary pages, should remain available on GOV.UK for download, even under an approach that does not allow for paper versions to be routinely sent out. Removing access to the forms online creates an unacceptable barrier for taxpayers, who are still entitled to a choice by law. Removing such forms from GOV.UK would make it more difficult for certain groups of taxpayers to comply with their obligations, whereas the intention is surely to ensure that any changes should make it easier for taxpayers to comply with their obligations. For example, some digitally excluded taxpayers currently rely on trusted friends, family or voluntary sector advisers to download and print forms, so that they can complete them on paper.

4 Penalties

4.1 We welcome HMRC's continued engagement on penalties. We understand in this call for evidence HMRC's focus is on penalties other than late submission and late payment penalties for income tax self assessment and VAT, given the advanced stage of reform for these specific regimes. However, we do comment on these penalties as appropriate, given the broad scope of the call for evidence.

4.2 Our focus is on penalties which are most likely to be encountered by the low-income, unrepresented taxpayer, in their capacity as an individual taxpayer or as a small business. These include:

- late submission penalties for individuals (including under the current regime and under penalty reform for ITSA – in the latter case both in and outside of MTD for ITSA, and in-year reporting for capital gains tax) and for small businesses (including for corporation tax, PAYE, VAT and partnerships)
- late payment penalties related to each of the above obligations
- failure to notify penalties
- inaccuracy penalties
- increased penalties for offshore matters

- penalties for failure to keep records

Penalties for obligations relating to inheritance tax and stamp duty land tax are perhaps less likely to be encountered by those we represent, so are not considered in any depth.

4.3 We agree with the principles identified in the 2012 Powers Review, and with the broader objectives for the Tax Administration Framework Review as they apply in the context of penalties.[16] In particular, we understand that one of HMRC's primary objectives is for a simpler penalties system, which is easier to understand and cheaper to administer, while minimising any impact on perceived fairness which may in turn risk undermining trust in HMRC and the tax system. Balancing these objectives is no easy task, but we do feel that improvements can be made to the current system (ranging from the small to the more radical) which can meet these goals.

4.4 It is especially positive to see HMRC engaging with stakeholders at an early stage on different areas for reform, and taking account of economic theory, behavioural science and experience from other tax jurisdictions in deciding next steps. LITRG has been an active stakeholder in the development of penalty reform for ITSA and VAT, beginning in earnest with the 2015 discussion document 'HMRC Penalties'[17] through the present day in its participation in HMRC's penalty reform forum. Penalty reform for both ITSA and VAT look set to be an improvement on the older systems. We look forward to working closely with HMRC to ensure that the new regimes are as successful as possible. A significant part of the discussion relating to other penalty regimes will be considering how the improvements under penalty reform for ITSA and VAT can be extended to other areas.

4.5 A general point we would like to make on the fairness of penalties is when they are charged retrospectively: either where the taxpayer was not aware they had an obligation, or for several years and/or related obligations at once, or both. While we accept that penalties must exist in order to encourage compliance with an obligation, and it is right they are charged in the case where the taxpayer is aware of that obligation and knowingly does not comply with it, often penalties are charged in situations where taxpayers are not aware of the mistake they have made. For historic failures, it is possible for taxpayers to be charged multiple penalties relating to the same underlying mistake – this may be different penalties for multiple missed obligations (but relating to the same source of income), or escalated penalties charged at once relating to the same missed obligation. This can feel very unfair.

4.6 One of the most egregious examples in recent years of a poorly designed penalty regime was the 'failure to correct' penalties of up to 200% of the unpaid tax for certain offshore non-compliance which was not corrected by 30 September 2018. Some taxpayers received nudge letters from HMRC to regularise their position **after** that deadline. This was consistently felt to be unfair in cases where taxpayers were ignorant of the need to report the foreign income until it had been pointed out to them that it was taxable in the UK (often the income was reported and taxed in the country of

[16] See Annex A of the Call for Evidence

[17] https://www.gov.uk/government/consultations/hmrc-penalties-a-discussion-document and https://www.litrg.org.uk/submissions/hmrc-penalties-discussion-document

source), and when it was too late for them to meet the September 2018 deadline. Furthermore, HMRC's position was to treat the nudge letter as a 'prompt', meaning that the minimum penalties applicable were 150% of the unpaid tax. Because non-compliance often ran across several years, we have seen cases where the tax liabilities for people with limited means ran into five-figure sums. Not only is this wholly disproportionate, but HMRC also took a very hard line on reasonable excuse claims based on ignorance of the law – leaving unrepresented taxpayers feeling scourged by the tax authority for an innocent mistake.

4.7 To offer some learning from this, we encourage HMRC to think of any redesign of penalties not just from the point of view of the penalties acting as a deterrent or encouragement **before** a deadline, but also how they might apply once a deadline has passed. This is especially the case where the taxpayer was not aware of the obligation (reasonably so or otherwise). Escalation may have a place here (see our later comments on this) – otherwise a one-off, harsh penalty like 'failure to correct' for meeting a deadline can even act as a deterrent to compliance once that deadline has passed (i.e. to avoid being charged a penalty a taxpayer may choose to not disclose the income).

4.8 We offer comments on each of the reform opportunities below.

Reform opportunity G: aligning penalties across tax regimes

General comments

4.9 Alignment of penalties across different tax regimes would bring benefits similar to those discussed in paragraphs 3.8 onwards in the context of consistent powers across taxes (that is, it would be easier to train HMRC staff and taxpayers would have a better chance of knowing what to expect). But, although this may feel like a simplification, it is important to bear in mind taxpayers' experience of the system in addition to the perspective of HMRC and the tax profession. For example, whether penalties for late submission of a self assessment tax return are aligned with penalties relating to alcohol duty or petroleum revenue tax is not likely to be of any relevance to most taxpayers. While larger and more complex entities are more likely to face issues which cut across several different tax regimes, the case for alignment is weaker from the perspective of smaller, unrepresented sole traders – many of whom may not even be VAT registered or have PAYE responsibilities as an employer. The benefit of alignment (as a simplification objective) is therefore likely to be experienced more by the former group, as well as HMRC and the tax profession, rather than those we represent.

4.10 There may be a justifiable reason for non-alignment across different penalty regimes. The nature and seriousness of the obligation, the purpose of the related penalty, and the required adjustment to influence behaviour and rebalance the cost-benefit analysis of not meeting an obligation, should all be the same or similar before the penalties are aligned. For example, late submission penalties for in-year CGT reporting might be justifiably lower than for self assessment tax returns, because the sole purpose of the CGT reporting is to bring forward the payment of CGT on certain disposals, and the disposal would (in most cases) be reported via self assessment in any case. By contrast, self assessment has a broader purpose, scope and significance. The consequences for the individual and for HMRC are greater when that deadline is missed. It is therefore arguably more important for the

government to encourage timely filing of self assessment returns rather than CGT returns, which in turn might justify a different approach to penalties.

4.11 More broadly, penalties for obligations relating to one-off transactions or events should be considered separately from obligations which are likely to be recurring. HMRC does not appear to make this distinction in the call for evidence document. For example, the points-based system under penalty reform for ITSA and VAT would clearly not be suitable for returns for capital taxes like in-year CGT reporting, inheritance tax on death estates or stamp duty land tax.

4.12 On the other hand, there is a strong case for alignment where the underlying obligation is fundamentally the same. For example, a self assessment tax return for a sole trader might be considered similar in purpose to a corporation tax return for a limited company – so the associated late filing penalties should be aligned (which they currently are – though there will be some departure from this as taxpayers move to MTD for ITSA and are subject to the new points-based system). Where there is not such alignment, it could be seen as unfair, or provide unintended incentives in favour of one business model over another.

Penalty reform for ITSA and MTD for ITSA

4.13 In particular, it is concerning that penalty reform for ITSA is being tied to the introduction of MTD for ITSA. This will likely mean that, for several years, there will be two unaligned penalty regimes running side by side – with MTD taxpayers able to access a system under which the maximum penalties relating to a single obligation are just £200, and with those not in scope or unable to comply with MTD 'stuck' behind on the old system, where the penalties for a delay of 12 months are a minimum of £1,600. We encourage HMRC to invest resources to understand how their IT limitations can be overcome such that penalty reform for ITSA can be rolled out to all taxpayers as soon as possible.

Self assessment penalties

4.14 Another area where lack of alignment is problematic is between the penalty regimes for failure to notify and inaccuracy. Compare two taxpayers, one in self assessment and one not, who fail to disclose a source of foreign income in, say, 2021/22, because they do not realise it is taxable in the UK. The taxpayer in self assessment who corrects the inaccuracy with an unprompted disclosure can get their penalty reduced to nil, but the other can only get the penalty reduced to 10%.[18] Why the difference? If there should be any difference, then it could be argued that the taxpayer in self assessment should be penalised more – after all, they are the ones who would have been prompted while completing the return to consider whether they needed to report any foreign income, but the taxpayer outside of self assessment receives no such prompt. The situation is exacerbated by the

[18] In the case of a careless inaccuracy, the maximum reduction for the quality of the disclosure reduces the penalty to 0% of the potential lost revenue (FA 2007, Schedule 24, paragraph 10). By contrast, penalties for non-deliberate failures to notify, under Schedule 41 of that Act, can only be reduced to 10% when HMRC become aware of the failure more than 12 months after the tax becomes unpaid (paragraph 13(3)(b)).

fact that the taxpayer outside of self assessment has no opportunity to get the penalty suspended (see further comments below on this) and faces a 20-year assessment window (compared to up to 12 years for careless inaccuracies relating to offshore matters). This might even be viewed as a systemic bias against taxpayers not in self assessment – who are perhaps more likely to be unrepresented.

4.15 Where there is historic non-compliance, there is also confusion and lack of alignment between the failure to notify regime and the late payment regime. We understand that the law allows HMRC to charge both failure to notify and late payment penalties in relation to the same tax liability.[19] A failure to notify penalty can be up to 30% of the potential lost revenue for a non-deliberate, prompted disclosure, and late payment penalties can be a further 15% on top of that. This would be on top of late payment interest (at the time of writing, this is currently 7.75% pa). It is our understanding, however, that HMRC does not routinely charge late payment penalties on top of failure to notify penalties – though we cannot see this position set out in HMRC's manuals.

4.16 This means that the penalty position is not clear for such individuals. Further, charging both types of penalty at once would feel unfair. Aside from the point that the escalated late payment penalties are charged at once (see later comments on escalation under reform opportunity K), this is a situation where there is one underlying mistake (i.e. the non-disclosure, which may have arisen out of a misunderstanding or ignorance), a primary missed obligation (the failure to notify), and a consequential missed obligation (the non-payment). It is arguably unreasonable for a taxpayer to be exposed to penalties for consequential missed obligations (even if they are not charged in practice): they cannot reasonably be expected to aware that they have a payment obligation when they were not even aware they had a tax exposure they had to notify to HMRC. In this situation, the two obligations are missed together, and the two are generally resolved together, so it feels like a 'double whammy' to be charged penalties as if they are completely unrelated obligations.

4.17 The separation of the obligations to notify liability, submit returns, and pay tax, with separate penalties for each, also leads to a contrasting anomaly: someone who fails to notify their liability to tax is effectively protected against late submission penalties which would have arisen for someone who notified their liability on time. That is sensible, because it is a consequential missed obligation, as discussed in the paragraph above. And because failure to notify penalties are a percentage of potential lost revenue, the penalties in this situation may even be nil. By contrast, someone who notifies their liability to HMRC (by registering for self assessment, for example), exposes themselves to penalties of up to £1,600 (or more) for the late filing of the return which is issued – even if there is no tax to pay. It does not feel right that the taxpayer which has actually been more compliant (because they have registered on time) is penalised more.

4.18 Therefore, rather than alignment, we would prefer to see a more holistic approach to the various obligations under self assessment, which provides the taxpayer with some protection from these scenarios.

[19] See paragraph 9A(c) of Schedule 56 FA 2009 and HMRC's Compliance Handbook, CH158100.

Penalty for failure to keep records

4.19 The call for evidence suggests that the penalty (for up to £3,000) for failure to keep records may benefit from modernisation and alignment. We are not sure there is a strong case for alignment in relation to this penalty. One might align the quantum with other penalties – but it would be more important to set the penalty at a level which is proportionate to the nature of the offence. We also note that this penalty seems rarely to be issued in practice – this means that taxpayers aren't clear on the circumstances in which a penalty would actually be charged, and if so, how much it would be (up to the £3,000 statutory limit). It may be simpler to remove it entirely.

Alignment of circumstances which trigger the same penalty

4.20 A final observation on alignment concerns alignment of not just the penalty itself, but also the circumstances in which it is charged. For example, taxpayers who file a self assessment tax return on paper between 1 November and 31 January will receive a £100 late filing penalty, whereas taxpayers filing online in the same period receive no such penalty. We understand that the earlier deadline for paper filers is a deliberate policy decision in order to encourage online filing – but we continue to maintain that a digital channel shift is best achieved by making digital services as easy as possible rather than legislating for unequal treatment of those who prefer to file on paper.[20]

Reform opportunity H: simplifying individual and related penalties

4.21 While we support the overall objective of simplification, as pointed out in the call for evidence it should be done in such a way as to minimise the introduction of any unfairness, which might undermine trust in the tax system. For example, while we appreciate that there are practical difficulties in determining the underlying behaviour and intentions behind non-compliance, the fact that some penalties are behaviour-based offers a very important protection to unrepresented taxpayers who make unintentional mistakes in their tax affairs. For this reason, we would not support a move from behaviour-based to non-behaviour-based penalties.

4.22 For example, on HMRC's suggestion for inaccuracy penalties to be based purely on co-operation and history of non-compliance – while we appreciate this may be easier for HMRC, we do not agree that taxpayers who make errors despite taking reasonable care should be penalised just as if they had deliberately defaulted.

4.23 However, we do think the different categories of behaviour can be simplified. One of the most important points when considering behaviour is whether it was deliberate or not deliberate. The additional category of 'deliberate and concealed' could be removed. At the other end of the behaviour spectrum, HMRC could treat all non-deliberate behaviour equally and simply not charge a penalty in these cases. While such a change might be challenged on the grounds that would not incentivise taxpayers to take care over their tax obligations, it is not necessarily the case that the

[20] See LITRG's submission to HMRC's 2015 discussion document, HMRC Penalties, for further discussion on this point.

penalty system needs to provide that incentive: there would still remain other motivations to take care over one's tax affairs. Principally, this would be wanting to get your tax right to ensure that you do not overpay (this would include claiming relevant allowances and reliefs), but also to avoid the possibility of later bill if your tax is found to be incorrect. But it would also include attitudes towards the government, the tax system and the tax authority, morality and other social influences. Clearly, not charging penalties in non-deliberate cases would represent a simplification for both the taxpayer and HMRC.

4.24 If it is felt necessary to retain the distinction of whether non-deliberate behaviour is careless, then we think the government should review the 'twin' concepts of having taken reasonable care versus having a reasonable excuse. The two are legally distinct, but HMRC seems to conflate them.[21] It would be useful to have clarity on the overlap, as well as to have an understanding on the kind of situations where one would exist without the other. One possibility may even be to make them legally identical. This would make the position clearer for taxpayers and save judicial time in considering whether one or both applies depending on the circumstances.[22]

4.25 Another opportunity for simplification, specifically in the failure to notify penalty regime, would be to remove the question of whether a non-deliberate failure is disclosed within 12 months of the tax becoming due. This would also represent an alignment with the inaccuracy penalty regime (see paragraph 4.14). Most failure to notify injustices occur when the taxpayer was not aware of the requirement but is not able to successfully claim they had a reasonable excuse (either because they do not meet the legal test, or where they do but the appeals process itself is a barrier). In these cases, most taxpayers disclose as soon as they become aware of the underpayment of tax. It seems strange in this situation to charge different penalties for the most recent tax year – where the culpability for that year is the same as for earlier years.

4.26 We appreciate that the above suggestion may be challenged, because if the initial failure was not deliberate then such a simplified system may not encourage disclosure as soon as the non-compliance is identified. But there would still be an incentive to disclose promptly, because of the reduced penalty ranges for an unprompted disclosure and the penal rate of interest which applies to late paid tax.

4.27 On offshore penalties, we agree this is an area which is ripe for simplification. In recent years, the government's offshore tax compliance strategy has seen this regime become terribly complicated – especially with the higher penalty rates which apply from April 2016, the failure to correct regime, fractional percentages and different territory categories. Unrepresented taxpayers are likely to have

[21] See, for example, HMRC's Compliance Handbook CH160200, which states "HMRC consider reasonable excuse to be something that stops a person from meeting a tax obligation despite them having taken reasonable care to meet that obligation".

[22] The case law test for whether a reasonable excuse exists is more nuanced than HMRC's position, and is set out in *Perrin v HMRC* [2018] UKUT 156 (TCC) at [70]–[73].

a very challenging time navigating them, especially when they are required to self-assess the penalties in an offshore disclosure.

4.28 While each individual complexity related to offshore penalties may be justified, we feel that the overall complexity is not. For example, different penalties for different territories may be justified if it is assumed that the taxpayer is acting deliberately and choosing which country to hide their offshore income. But for non-deliberate errors which are subsequently disclosed to HMRC, the distinction has had no behavioural impact, and assessing different penalties based on different overseas territories is ultimately a fiddly and pointless process.

4.29 A final point on simplification is where HMRC layer non-statutory 'rules of thumb' over the statutory framework. For example, HMRC can limit reductions on penalties based on the timing of the disclosure and whether it is prompted, but these limits do not appear in statute.[23] This not only adds complexity, but it breaches the principle of penalties being clear in statute. HMRC should avoid this practice.

Reform opportunity I: reforming the use of penalty suspension

4.30 Currently, the ability to suspend a penalty is only available in the case of a penalty for a careless inaccuracy. But suspending a penalty might potentially be suitable for failing to meet any recurring obligation, or indeed any tax obligation, if one takes a broader approach to considering suspension conditions rather than simply considering the specific obligation in question.

4.31 For recurring obligations, we would prefer an approach whereby HMRC issue a 'warning letter' in case of first default.[24] This would differ from a suspension in the sense that a penalty would only be charged in respect of future defaults rather than the original one. This would also be aligned with the points-based system under penalty reform for ITSA and VAT, whereby a taxpayer is warned that they have missed a filing obligation (through the 'award' of a penalty point) before they receive a financial penalty for future obligations of the same type. It would help avoid situations where taxpayers receive a penalty for obligations they did not realise they had, or which they did not realise they had not met. Such situations damage trust and perceptions of fairness, so they should be avoided wherever possible. A warning letter would also help avoid the difficulty of determining suitable suspension conditions for the obligation in question.[25]

4.32 If that is not possible, or even if it is, we would be in favour of penalty suspension applying more broadly than at present. The rationale for restricting penalty suspension to careless inaccuracies is not clear to us. For example, it could be made possible to suspend penalties relating to failure to notify, late payment, late submission and failure to keep records. In particular, the inability to

[23] See paragraph 4.6 on failure to correct penalties.

[24] We recommended this in our response to HMRC's 2015 discussion document.

[25] See, for example, *Fane v HMRC* [2011] UKFTT 210 (TC), in which HMRC refused to suspend an inaccuracy related to the one-off event of a person's termination of employment.

suspend failure to notify penalties is an awkward misalignment with the inaccuracy penalty regime (see paragraph 4.14), which favours taxpayers in self assessment over those outside it. The point is especially relevant for unrepresented PAYE taxpayers when making a disclosure of an income source they did not realise was taxable.

4.33 HMRC's suggestion that penalty suspension might apply automatically without conditions for the first non-deliberate failure may be worth exploring. It is, however, suggested that the penalty would become payable if there are further instances of non-compliance within the next 4 years. We note this is at odds with the 2-year period under penalty reform for ITSA and VAT (after which penalty points can be cancelled). We would suggest alignment to a 2 -year period on this point if it were pursued.

4.34 Automatic suspension of any form would be an improvement on the current system. This is largely because it is not clear whether HMRC currently considers it in all cases where it might apply[26] – meaning that it can depend on whether the taxpayer asks for it. Consequently, unrepresented taxpayers might miss out if they are not aware of the option and/or unable to articulate suitable suspension conditions (lacking the experience and knowledge of what HMRC would typically accept).

4.35 Finally, we question whether it is reasonable that the taxpayer cannot appeal the HMRC decision on whether conditions have been met at the end of the suspension period. There may be some dispute on the point (for example, whether a taxpayer's record-keeping has improved sufficiently) and it is important for the taxpayer to have the option of a third-party redress if they disagree with HMRC.

Reform opportunity J: proportional fixed penalties

4.36 Currently, some penalties are fixed (such as the initial £100 penalty for late submission of a tax return, or the £200 fixed late submission penalty under penalty reform for ITSA and VAT), some are tax-geared (such as inaccuracy, late payment and failure to notify penalties), and some are a mixture of both (for example, under the current regime when a tax return is 6 months and 12 months late, the penalty is the higher of £300 or 5% of the tax due). The mixed landscape from this perspective contributes to the overall complexity of these penalty regimes.

4.37 There are valid arguments both for and against the making of penalties more proportional. In general, from the perspective of the low-income taxpayer, we are in favour of proportional penalties because fixed penalties (especially those which have escalated) can feel wholly disproportionate to the tax at stake, which can feel unfair and can undermine trust. In addition, it can also feel unfair to this group that the financial impact of these penalties is much greater to them than it would be wealthier taxpayers. On the other hand, fixed penalties are clear and simple to apply, and unlike tax-geared penalties, it is not necessary to establish the tax liability before the quantum of the penalty can be identified and the penalty can be charged. They can also be automated. Penalties which are

[26] Finance Act 2007, Schedule 24 paragraph 14(1), states that HMRC 'may' suspend a penalty, but HMRC's guidance at CH83110 says that they 'must consider whether we can suspend it'.

of the form 'the higher of £X or a certain percentage of Y' represent a compromise with some of the benefits of both types of penalty.

4.38 The call for evidence says that £200 is equivalent to 0.8% of average annual income for a UK taxpayer after tax. So HMRC's example of making certain penalties the higher of £200 or 0.8% of taxable income would not affect those with below average income, at least from a financial perspective, though it may help that group feel that the penalty system is fairer because it would penalise more those with greater resources. We would therefore tentatively be in favour of exploring further this option, though we note that it is not a change which simplifies the system.

4.39 If penalties are to be proportional, there is a question over what measure is used. From the perspective of influencing behaviour, one might consider that the most important point is that the penalty is proportional to a taxpayer's resources. However, given that the UK does not have a wealth tax or any other easy way of identifying individual total resources, this would be difficult to implement. Taxable income can then be used as a proxy for an individual's resources (perhaps a better proxy than a person's tax liability), though net income after tax would perhaps be the most appropriate measure. Of course, this adds complexity, and we note that the Australian and New Zealand systems of applying different penalties based on bands/size of taxpayer would perhaps be a simpler approach compared to taking a percentage of a specific figure for a specific year. We suggest HMRC explores further whether these systems present any challenges for administration in practice.

4.40 There is also the question of how specific the penalty should be to the non-compliance in question. For example, since 2010/11, minimum late submission penalties are charged regardless of a person's tax liability. Many people feel this is disproportionate and unfair. We understand that if there is no incentive to file a tax return on time, including where there is no tax due, it can be problematic for HMRC to keep their management of the self-assessment cycle on track.[27] We note that under penalty reform for ITSA and VAT, the point is circumvented because the financial penalty is triggered based on cumulative non-compliance to date, rather than being solely connected with missing a single obligation. For recurring obligations, we would favour this kind of approach.

Reform opportunity K: penalty escalation for continued non-compliance

4.41 We appreciate that once an obligation has been missed and a penalty has been charged, there should still be an incentive to meet that obligation even if it is late. Penalty escalation may have a role to play here, but there are other ways that an incentive can be provided. For example, for payment obligations, there is also late payment interest. For inaccuracy and failure to notify penalties, there are lower penalty rates if the taxpayer comes forward with an unprompted disclosure before they are prompted by HMRC. As discussed above, the failure to notify regime also has lower penalty rates if the taxpayer discloses within 12 months of the tax becoming due. In any case, escalation is unlikely to be appropriate for inaccuracy cases, as the obligation is not linked to taking an action by a certain deadline.

[27] There is, however, an incentive to file one's tax return where a refund arises, given that the submission of the return triggers the refund process.

4.42 Late submission and late payment penalties (under the current regime which applies to self assessment) are the key example of escalated penalties which can apply in practice. Escalated penalties can be effective where they incentivise the taxpayer to comply with an obligation **before** the higher, successive penalties are charged. However, it is important that the taxpayer has an opportunity to meet the obligation between the different levels of penalty. In the normal course of things, if all other obligations are met on time, this is how the penalties work: for late payment penalties, there is a gap of 5 months between the first and second penalties, and a gap of six months before the next.

4.43 But one of the key flaws of escalated penalties at present is where all penalty levels are charged at once for historic non-compliance. The taxpayer is denied the opportunity to respond to one level of penalty and correct the non-compliance before the next is charged. In cases where the late payment is combined with a failure to notify, the penalties accrue in the background, at a time when the taxpayer may be unaware that they had a liability, let alone what the amount of that liability was, or a whether they have a Unique Taxpayer Reference in order to be able to make the payment. For the taxpayer to be charged three separate penalties for late payment, on top of late payment interest, feels unjust. As mentioned above in paragraph 4.17, this is in contrast to the position on late submission penalties for self assessment (but not, for example, in-year capital gains tax reporting) whereby the taxpayer must be notified in advance (by means of a notice issued under s8 Taxes Management Act 1970) before late submission penalties can apply.

4.44 Although the position is changing under penalty reform for ITSA (and has already changed under penalty reform for VAT), these issues are still present for late submission for other regimes – such as for in-year capital gains tax reporting.

4.45 A related issue, which can occur with late submission penalties as well as late payment penalties, is where the taxpayer finds out about escalated penalties all at once, because notifications have not been received (for example, they have been sent to an old address). This can be a consequence of a taxpayer not keeping HMRC up-to-date with their address. We discuss this further under reform opportunity N (modernising administration and communications).

4.46 Where late submission penalties have been ‘maxed out’, the penalty regime provides no further incentive to get that return in on time. This can lead to a slightly strange position for taxpayers in a position where they are late in filing several years’ worth of returns: in order to keep penalties to a minimum they are likely to be incentivised to file later years first, given penalties for earlier years are already at their maximum level.

4.47 In general, if escalated penalties are to be a feature of a system, then ideally they should not be linked to time which has elapsed after the relevant deadline, but instead linked to time which has elapsed after the first penalty notice is validly served on the taxpayer. Taxpayers then need a safeguard whereby subsequent, escalated penalties can be cancelled if it can be demonstrated that it was not reasonable for them to have been aware of the initial penalty notice being issued.

Reform opportunity L: penalty escalation for repeated non-compliance

4.48 In general, we are in favour of a penalty regime which treats occasional non-compliance differently from repeated non-compliance – at least in the case where the repeated non-compliance is deliberate or careless. However, where there a genuine reasonable excuse for the non-compliance it should not impact how subsequent non-compliance is treated. Despite the additional complexity, penalty reform does this for ITSA and VAT, and this should be explored for other suitable recurring obligations. Higher penalties for repeated non-compliance with one-off obligations would arguably be less appropriate – for an obligation which is infrequent and transaction-specific, it is perhaps less reasonable to expect the taxpayer to have the familiarity, systems and controls in place to prevent non-compliance.[28] Consideration would need to be given as to whether a penalty for an inaccuracy in one type of return should have any bearing on a subsequent inaccuracy in a different type of return.

4.49 But like penalty escalation for continued non-compliance, the taxpayer must be given the opportunity to improve their behaviour before higher levels of penalties are charged. For example, in a disclosure case, it would not be appropriate for higher levels of failure to notify or inaccuracy penalties to be retrospectively applied simply because the non-compliance subsisted for several years owing to a single underlying issue (e.g. lack of awareness that a source of income was taxable).

4.50 The combination of penalty escalation for continued **and** repeated non-compliance could lead to significant and disproportionate penalties across several tax years, especially in cases of historic non-compliance, so this would need to be considered very carefully. It is unlikely to be appropriate. It may be necessary to consider some kind of penalty cap to prevent this.

Reform opportunity M: designing new penalties to discourage undesirable behaviour

4.51 Introducing broad new penalties, especially those which hinge on a subjective definition (e.g. 'undesirable' or 'unreasonable'), would not align with the objective to simplify the suite of penalties administered by HMRC. They would be difficult for HMRC to administer, difficult for taxpayers to understand and difficult for the courts to settle disputes on.

4.52 However, where specific new penalties are aligned with the 2012 Powers Review principles and are designed to tackle a new kind of non-compliance which has been identified, we would be supportive of a discussion with a view to understand the ways in which the current suite of penalties (and wider deterrents) are insufficient to tackle this particular kind of non-compliance, and to understand the case for introducing new ones.

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[28] In paragraph 4.30, we suggested that it might be possible for HMRC to take a broader approach to considering suspension conditions, rather than simply looking at the specific obligation in question. Although this might allow suspension conditions to be set more readily for one-off obligations, we do not think this would justify harsher penalties for repeated non-compliance with such obligations. The former is a question of how HMRC respond to the non-compliance in order to encourage broader compliance in that taxpayer, with benefits for both HMRC and the taxpayer; the latter is simply a question of fairness.

Reform opportunity N: modernising administration and communications

4.53 Penalties must be communicated on a timely basis to taxpayers. This should include an appropriately timed reminder that penalties are about to be charged, and also a prompt notification that the penalty has in fact been charged. This is important so that taxpayers are able to respond quickly and hopefully avoid the penalty, or otherwise deal with the non-compliance promptly after it has occurred.

4.54 The call for evidence highlights two particular cases where this does not happen: when penalty notifications are sent to an old address, and/or when they are sent after the period to which they apply (for example, for daily penalties under self assessment). It damages trust in the tax system for taxpayers to learn that penalties have accrued without their knowledge.

4.55 It is important, therefore, for taxpayers to notify HMRC of a change of address on a timely basis. Updating one's address with HMRC can easily be overlooked when moving residential address, so HMRC should consider what more they can do in order to raise awareness of the importance of this. Part of that might be making it a legal requirement to update your residential address with HMRC, much like it is currently a legal requirement to update your residential address with the DVLA. The current lack of a legal obligation to update HMRC with your address means that Tribunals regularly have to resort to the Interpretation Act 1978 to determine whether or not communication is deemed to have been received, including in cases where the taxpayer claims that it hasn't. Having a clear obligation in law, which is communicated to taxpayers, may help avoid this issue.

4.56 Broader lessons could also be learned from DVLA's approach, where there is clear messaging on envelopes to remind people of the need to update their address with the DVLA if they move house. There is also an opportunity for linking up between government departments such that there is a central place for an individual to update their address and they need only do it once. HMRC does occasionally 'auto-update' a taxpayer's address based on other data sources (e.g. employer RTI submissions). While this can be useful, it can also be problematic if that other data source is incorrect or inappropriate, and it can lead taxpayers into thinking that they have no need to keep HMRC up to date with their address personally.

4.57 HMRC should, of course, use multiple methods of communication in case one fails. This will include use of digital communications (such as emails, texts, notifications via the personal tax account or HMRC app) or even, depending on the circumstances, telephone calls. To this end, we note that HMRC said in their summary of responses to the 'Simplifying and modernising HMRC's income tax services' consultation that they would be exploring a legal requirement for taxpayers to keep HMRC to up to date with electronic contact information.[29] This might be extended to cover a taxpayer's residential address and telephone contact details.

[29] https://www.gov.uk/government/consultations/simplifying-and-modernising-hmrcs-income-tax-services-through-the-tax-administration-framework/outcome/simplifying-and-modernising-hmrcs-income-tax-services-through-the-tax-administration-framework-review-summary-of-responses

4.58 HMRC communications should, of course, communicate the latest position in the clearest possible way. Where penalty notifications and statements of account are sent separately, they might indicate different amounts payable and can cause confusion. In particular, a statement of account might not reflect penalties which have been charged after the statement was issued but before the taxpayer receives the statement. A taxpayer needs to check the latest position on their personal tax account (or HMRC app) or otherwise contact HMRC, which drives contact demand.

4.59 HMRC should consider carefully what the best approach is in cases where successive penalties are being charged to taxpayers, but where these penalties are not prompting the taxpayer into action. For example, this might suggest that taxpayers are not receiving notifications. In some cases we have seen, the first a taxpayer becomes aware of late filing penalties can be when they are automatically coded out, leading to a significant decrease in take-home pay. Once this happens, it becomes more complex to deal with the penalty debt because it has been taken outside the self assessment system. To avoid this, HMRC might exhaust other ways of trying to contact the taxpayer first (such as those mentioned in paragraph 4.57 above).

Reform opportunity O: regular uprating of fixed penalties

4.60 We accept there may be a case for uprating of fixed penalties, to maintain their value in real terms over time. If amounts are uprated, then we recommend that they are kept to a round number. Of course, if the penalty is made wholly proportional to a person's income or tax liability (with no de minimis), then this would not be necessary.

4.61 However, changing the amount too frequently would be a challenge on awareness and simplicity grounds. In addition, in order to maintain trust and perceived fairness in the system, the government should also uprate other aspects of the tax system which are in the taxpayer's favour.[30]

4.62 In any case, it is not just the amount of the penalty which influences behaviour, but also simply the fact that any penalty at all is charged – leading to a perceived 'black mark' on a taxpayer's record and the feeling that they have raised their risk profile in HMRC's eyes.

Reform opportunity P: transparency

4.63 We agree that penalties are more likely to provide a more effective deterrent when they are seen to be applied and enforced, and we think that HMRC being more transparent about the penalties they charge may help with this. Publication of statistics may be of limited benefit without corresponding awareness-raising activity, as the general public may be unlikely to look at them. Nevertheless we think it would be useful in informing the broader stakeholder and public debate on taxpayer compliance.

4.64 We do not agree that publication of penalty statistics would risk increasing non-compliance because it might 'normalise' the behaviour. That might be the case for missed obligations which have no financial consequence to the individual, but we do not think that taxpayers will be more willing to

[30] See page 27 of our December 2020 paper, *A better deal for the low-income taxpayer*

risk (or knowingly suffer) a penalty just because of the knowledge of how many others have been charged them.

4.65 Publication of statistics on penalty appeals and review decisions can have also have a broader benefit: it provides a measure for external parties to judge quality of HMRC initial decision-making. This can in turn provide an additional incentive for that decision making to be as fair as possible. However, we do acknowledge that additional information may come to light during the appeal process, so this statistic cannot be used as a definitive indicator of poor HMRC decision-making at the first stage.

5 Safeguards

5.1 Safeguards are essential in order to promote fairness of treatment, consistency of approach, and underlying trust in the system.

5.2 However, as highlighted in the call for evidence, the tax system does not currently have a system of safeguards that are, in themselves, entirely consistent. This can go some way to undermine their effectiveness. We are therefore supportive of HMRC's commitment to review and improve the current suite of taxpayer safeguards.

5.3 Our views on this matter are focused largely on the usability and accessibility of safeguards for taxpayers who are on lower incomes and/or are typically unrepresented by an agent. Taxpayers should not be disadvantaged due to their personal financial position, and taxpayer rights should be accessible for all.

5.4 Currently, we suspect that these safeguards are out of reach for many and are likely to remain so. This is particularly the case for taxpayers who have very little understanding of the tax system and do not have an agent to guide them, or may have language barriers or other difficulties that prevent them from fully understanding the process. Where this is the case, safeguards are not likely to be effective.

5.5 The access and uptake of safeguards could be improved by increased proactivity from HMRC in explaining and offering the options to taxpayers, and simplifying the overall process of appeals. These themes are key in our overall response to the reform opportunities set out in the call for evidence.

5.6 In addition, we would implore HMRC to consider a review of how cases are managed 'on the ground' before these safeguards become relevant. By this, we mean we would like to see HMRC take steps to ensure a consistent approach to 'minor' administrative matters where it would not, at any rate, be cost effective to pursue unless absolutely necessary.

5.7 For example, where late filing penalties are applied, we have heard anecdotally of inconsistent approaches to reasonable excuse appeals by HMRC staff.[31] We have heard that some caseworkers may accept a reasonable excuse appeal by phone, whereas others might not. Similarly, some might accept a reasonable excuse based on a particular set of facts, whereas another taxpayer could have their appeal refused with a very similar fact pattern. These inconsistencies are not widely known or shared and so there is likely some unfairness and inconsistency endemic in the system. Though we appreciate that HMRC have recently updated their Compliance Handbook guidance on reasonable excuse to try and address this, it would appear that some 'frontline' inconsistencies remain. Addressing these could go some way to preventing certain cases from requiring escalation in the first place, providing a better overall experience for taxpayers..

5.8 It is also important that taxpayers who have extra support needs are able to access the Extra Support Team. There appears to be an increasing shift from HMRC identifying cases where there is an extra support need to taxpayers needing to self-identify their eligibility to access this service. This particularly became apparent during the closure of the self assessment helpline. If eligible taxpayers are missing out on this essential extra support, then it would seem even more likely that their access to safeguards is undermined.

5.9 Finally, access to taxpayer safeguards might also be improved by ensuring the frontline tax charities are adequately funded to assist low-income taxpayers with appeals.

5.10 We now comment on HMRC's specific reform opportunities identified within the call for evidence.

Reform opportunity Q: aligning how appeals are made

General comments

5.11 We have concerns that taxpayers may be facing inconsistent levels of service when it comes to appealing a tax decision. In line with our comments at paragraphs 5.6 and 5.7, we have heard anecdotally that HMRC caseworkers take inconsistent approaches when dealing with formal appeals – particularly in cases where the taxpayer might be outside of the 30-day time limit. Taxpayers themselves might not be aware that they are facing inconsistent treatment, so have no way to hold HMRC to account. While this might not directly form part of this review, it is still an important point to bear in mind.

Different appeal processes

5.12 The call for evidence highlights that differing appeal processes apply for direct and indirect taxes, and HMRC accept that this may cause confusion for taxpayers.

5.13 For our target population, the making of a simple appeal can be challenging enough. The unrepresented taxpayer might feel intimidated at the prospect of challenging a decision made by HMRC, worrying that their own lack of knowledge might hinder the prospect of success, even if they

[31] Frontline tax charities such as TaxAid and Tax Help for Older People might be able to provide helpful insight on specific inconsistencies they have encountered.

do have grounds to appeal. Any added confusion caused by inconsistencies in the overall appeal system is unhelpful. On that basis, exploring ways to make the appeal process as user-friendly as possible is welcome.

5.14 To that end, we are supportive of HMRC giving further consideration to the alignment between the differing appeal processes for direct and indirect taxes.

5.15 We cannot provide specific evidence of taxpayers becoming confused by the fact that there are two separate sets of rules. This may present more of an issue for agents who are advising the taxpayers on a range of tax matters, rather than taxpayers themselves.

5.16 However, it seems likely that an unrepresented taxpayer is facing a dispute covering both direct and indirect taxes, both of which require an appeal to be lodged, the differences in appeal procedure will cause confusion and add stress to an already difficult situation..

5.17 We think it would be helpful to examine the original reasons for the differences in approach and consider whether these are still valid as part of considering a unified appeals process going forward. However, would generally encourage HMRC to adopt the most straightforward approach, or indeed consider a hybrid approach if each process of appeal has its own distinct merits.

5.18 It is noted in the call for evidence that adopting the indirect tax approach could be simpler for taxpayers to understand and lead to swifter dispute resolution, but at the potential risk of more cases going to Tribunal. We cannot comment on this likelihood of Tribunal cases increasing, but we are generally supportive of any system that is simpler for taxpayers to understand.

5.19 We would, however, be disappointed with any outcome that makes an appeal to Tribunal a condition of accessing Alternative Dispute Resolution (ADR). We understand this is currently a feature of the indirect tax approach to appeals. As already mentioned, an appeal to the Tribunal is unlikely to be a course of action that unrepresented taxpayers will feel confident to proceed with. We discuss this further under the considerations for reform opportunity S: improving access to ADR and statutory review.

5.20 In summary, we are broadly supportive that alignment of the appeals process across all taxes be explored in more detail. This should be done with input from those who have practical experience of leading taxpayers through the appeals process. However, any review must keep the taxpayer as the most important stakeholder in any rebuilt appeals system. A guiding principle should be the accessibility and ease of understanding for those taxpayers who are facing a dispute without the assistance of an agent.

Reform opportunity R: aligning payment requirements

5.21 The call for evidence notes that the direct and indirect tax regimes also have differing payment requirements for matters under dispute. Direct tax liabilities relating to a dispute can be postponed until the matter is settled whereas, for indirect taxes, the payment of the disputed liability is required before the Tribunal will hear a taxpayer's appeal (other than in cases where financial hardship is accepted).

5.22 We are broadly in favour of unifying the payment requirements across direct and indirect taxes. We cannot offer insight on the practicalities or merits of each method on a detailed basis, as we do not provide practical assistance to taxpayers. However, generally speaking we would favour an approach where payment can be postponed until such time as the outcome is determined.

5.23 Requiring payment upfront is likely to worsen the accessibility of safeguard options for taxpayers, who will consequently face a cashflow disadvantage from the outset. This could directly impact their ability to successfully challenge a dispute, undermining the entire framework of taxpayer safeguards.[32]

5.24 While we appreciate the indirect tax approach does allow for the suspension of disputed tax in cases where hardship is demonstrated, this would appear to add a further administrative burden at an already stressful time for the taxpayer, as the taxpayer is expected to set out the reasons that the hardship would be caused. Our preference would therefore be for all taxes to follow the current direct tax approach, whereby all taxpayers are entitled to make an application for postponement, even where hardship is not necessarily in point.

5.25 That said, postponement itself is still another administrative hurdle for the taxpayer, and could benefit from a wider review as regards it accessibility. In particular, we are concerned that the requirement for the taxpayer to independently calculate the 'overcharged tax' could be a potential barrier to accessing this important safeguard, particularly for unrepresented taxpayers who might know that something is 'wrong', but not feel confident to quantify it. We look at further possible areas for review under paragraphs 5.28 et seq.

5.26 We do not necessarily object to wider the application of postponement across all taxes being subject to the existing flexibilities afforded to HMRC, allowing them to refuse a postponement application in certain circumstances, with onward referral to the Tribunal to decide if postponement should be granted – but this should be used sparingly.

5.27 It is worth adding that HMRC charges late payment interest at a rate currently set at 7.75% per annum. Given that this has increased significantly in recent years due to the overall increase in the Bank of England base rate, this may act as a deterrent to those who may be simply trying to defer payment without any genuine prospect of success. This also would seem to be adequate recompense to the Exchequer in the event that the tax liability is ultimately upheld.

Postponement – further thoughts

5.28 On the subject of postponement, it seems appropriate to highlight the recent First-tier Tribunal case of *Benjamin Erridge v HMRC.*[33] While this case was focused on undeclared high income child benefit charges and associated penalties (the outcome of which was, incidentally, found largely in favour of

[32] For instance, a taxpayer might not usually have an appointed agent, but may choose to appoint one in a tax dispute scenario. Requiring tax payment upfront might mean the taxpayer is unable to access valuable advice that may assist their case.

[33] [2024] UKFTT 276 (TC)

the taxpayer), it is the separate matter of postponement that provides for particularly disappointing reading.

5.29 In this case, it appears that the taxpayer (who had dyslexia and reading difficulties) did not exercise his right to apply for postponement of the tax liability while the matter was under appeal. Further, as we understand it, HMRC also sought to enforce upfront payment of the disputed penalties, despite it being the published position that penalties are not enforced during appeal.[34]

5.30 As such, this taxpayer was pursued by external debt collectors to recover the tax and penalties before the appeal had been heard. His request for a time to pay arrangement was rejected. Placed under pressure to raise the full sum as soon as possible, the taxpayer sold his family home at a discounted price within 2 weeks to pay the sum, which was, at any rate, eventually decided by the courts not to be fully due.[35] The Tribunal noted that the pressure put on Mr Erridge to settle immediately had cost him needless 'financial loss and distress'.

5.31 The case of Benjamin Erridge appears to expose a weakness in the current system of postponement for direct tax liabilities. While it is not entirely clear why Mr Erridge or his representative did not apply to postpone the disputed tax liability, it seems likely that he did not fully understand that this option was available. To prevent such unfortunate cases arising in the future, we would encourage HMRC to undertake a review of how postponements are offered and implemented. The case also raises some wider questions about how HMRC ensure taxpayers get the support they need and ensure that taxpayers are not put under undue pressure that causes distress, especially when other options are available.

5.32 Some possibilities (which might have specifically prevented the outcome in the case of Mr Erridge) include:

- A more robust approach to communicating the option of postponement. This should be particularly important in cases where external debt collection agencies have been engaged. Before such agencies are able to approach the taxpayer, HMRC should take steps to speak to the taxpayer to explain their options verbally, which may in turn alert them to any additional needs that the taxpayer might have, including where it might be appropriate to involve the Extra Support Team. Clearly one would hope that such additional needs would have already been identified earlier in the process, but the case of Mr Erridge highlights that this *perhaps* cannot be guaranteed.[36]

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[34] See https://www.gov.uk/tax-appeals/delay-payment. HMRC says that penalties are not payable while an appeal is ongoing, for both direct and indirect tax purposes.

[35] Overall, the assessments were reduced significantly and the associated penalties quashed altogether on grounds of reasonable excuse.

[36] It is not clear from the case write-up whether HMRC were aware that he had additional needs, due to dyslexia and reading difficulties.

- At the other end of the scale, one option for HMRC to consider would be moving to a system of automatic postponement in respect of a tax matters under appeal. Any move to automatic postponement would require careful communication of the potential exposure to late payment interest, and taxpayers must be made fully aware that they can 'opt-out' of the postponement and choose to pay the disputed tax up front if they wish. Taxpayers opting out of postponement must be assured that the appropriate amount would be repaid to them in the event that their appeal is upheld.

5.33 Moving to a default basis of postponement would, by extension, require HMRC to reconsider how the disputed tax liability is computed. As already discussed in paragraph 5.25, we do have concerns that the current system – whereby the taxpayer must calculate the 'overcharged' tax to be postponed (subject to HMRC agreement)– is unhelpful and intimidating, particularly for the unrepresented taxpayer. Even if automatic postponement is not considered viable, we would still urge HMRC to consider the appropriateness of asking taxpayers calculate their own postponement figure.

5.34 It might be preferable for taxpayers to have the option to ask HMRC to provide them with a proposed postponement figure, which the taxpayer is able to dispute if necessary. We appreciate achieving this outcome might be challenging.

Reform opportunity S: improving access to ADR and statutory review

5.35 The call for evidence expresses HMRC's aspirations to increase the taxpayer take-up of statutory reviews and ADR.

5.36 We fully appreciate the importance of ADR and statutory review as means of resolution without litigation. Given the costs involved in taking a case to Tribunal, particularly if tax counsel is appointed, these are likely to be the most accessible methods upon which the middle and lower-income population can rely.

5.37 In addition, ADR and statutory review can lead to a swifter resolution of matters. However, it is our view that the option to proceed to Tribunal must still be within reach for those with limited financial means.

5.38 We note that HMRC has undertaken external research on the Statutory Review Process and that it has highlighted a lack of taxpayer awareness.[37] We very much hope that this will galvanise HMRC's efforts to improve awareness and accessibility of taking a route to resolution which does not involve the Tribunal. We find it concerning that HMRC do not already consistently seek to make taxpayers aware of their full range of options.[38] This is an obvious area for improvement, and we fully support HMRC's aspirations to improve awareness and take up of these safeguards.

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[37] https://www.gov.uk/government/publications/statutory-review-process

[38] As noted, the Statutory Review Process report indicates that some taxpayers were not aware that statutory review was available and/or was not offered to them.

5.39 In order to improve access and encourage take-up of statutory reviews and ADR, HMRC should provide timely and clear information about the options, written specifically with the unrepresented taxpayer in mind. This information should be provided as early as possible in the process, and further assistance should be available (independent from the caseworker dealing with the dispute) should the taxpayer have any concerns or queries about the options available to them. This might come in the form of a dedicated helpline where a taxpayer can speak to an HMRC adviser who can talk them through their options and answer any questions.

5.40 We note that it has been reported in the tax press[39] that cases have been handled internally by HMRC by caseworkers without the relevant technical understanding. We would urge HMRC to ensure that any cases put forward for statutory review or ADR would always be dealt with personnel with the relevant technical expertise appropriate for the case. We discuss this further under reform opportunity T: mandating statutory reviews in some cases.

5.41 While we do support the increased promotion of ADR and statutory review, there can be great value in the public (and independent) nature of Tribunal judgements, so we would be concerned to see this option effectively discouraged in cases where it might be appropriate. Matters being decided by the courts are an essential further element of the tax legal framework and help develop the law and provide future clarity for the wider taxpaying population. Findings at Tribunal can produce an ongoing legacy and set of principles that taxpayers (and HMRC) can continue to use and rely upon for many years to come.[40] Clearly a decision made by the courts is only binding when reached at Upper Tribunal level or above, but even judgements at First-tier Tribunal can provide useful external scrutiny and wider understanding on areas of the law that perhaps lack clarity. The same cannot be said for disputes dealt with via ADR or statutory review, and there is perhaps a risk that inconsistent decisions might prevail internally without external scrutiny.

Reform opportunity T: mandating statutory reviews in some cases

5.42 The call for evidence indicates that around 14% of appeals notified to the First-tier Tribunal in 2022/23 related to late payment and late filing surcharges and penalties. Consequently, HMRC are considering whether it might be appropriate to mandate statutory reviews in such cases, or in cases where the facts are simple and the tax under dispute is less than £10,000.

5.43 We are not necessarily opposed to the idea of mandating statutory reviews in simpler and/or lower value cases, and appreciate that this could go some way to ease pressure on the Tribunal system.

5.44 However, we would urge HMRC to ensure that it has sufficient internal resource available to effectively cope with an increased statutory review caseload. In particular, it is essential that reviews are only undertaken by a person with technical expertise relevant to the matter under dispute, to

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[39] See *Misleading information from HMRC* (September 2023), Keith Gordon, Taxation Magazine: https://www.taxation.co.uk/articles/misleading-information-from-hmrc-137981

[40] For example, the case of *Mallalieu v Drummond*, concerning the tax deductibility of certain clothing, has become very well-known and is equally relevant to lower income taxpayers.

ensure as far as possible that the correct outcome is arrived at. We have heard anecdotally that statutory reviews have, on occasion, been undertaken by HMRC staff who are not specialists in the area under dispute.[41] This puts trust in the process at risk and undermines the usefulness of statutory reviews.

5.45 If the relevant technical staff cannot be guaranteed at a particular time, then it may be appropriate to consider extending the timeframe associated with conducting statutory reviews. Although we would prefer taxpayers to receive the outcome of any review as swiftly as possible, this should not come at the expense of having the right person undertake the review. One necessary safeguard here is for the taxpayer to be able to object to an extended timeframe and thus retain the right to be able to pursue their case to the Tribunal without excessive delay.

5.46 Further, despite this being an HMRC internal review, there must some sort of demonstrable independence built into the statutory review process. If such reviews are to be mandated, it will be even more important that taxpayers are able to rely on their case being given the 'fresh pair of eyes' that it deserves. Such assurances might include the strict enforcement that the reviewing officer:

- must have no prior knowledge of or involvement with the case,
- must not have any contact with the original caseworker while the review is undertaken, and
- must provide a critique of the arguments put forward by both parties and fully seek to explain these in a way that the taxpayer can understand.[42]

5.47 In summary, taxpayers must be assured this process is robustly fair, and not merely a tactical move to uphold the original decision and 'wear down' a taxpayer's resolve. This could be *perceived* as an obstruction to taxpayer justice, even if that is not the reality, so reassurances must be carefully built into the process.

5.48 Though we agree that statutory review can be a more cost-effective route than the Tribunal for simpler cases, such as those relating to late filing and late payment penalties and other administrative matters, we once again echo the comments above (see paragraph 5.41) about the valuable role that the Tribunal does still have in providing a public airing of issues that might impact a larger number of taxpayers.

5.49 All in all, for lower income, unrepresented taxpayers, appealing to the Tribunal is very unlikely to be their preferred course of action due to the time, cost, complexity, and perhaps 'mental resilience' required in doing so. However, it must always remain an option and should not be actively

[41] Including at discussions taking place within the safeguards workshop on 16 April 2024.

[42] Ensuring taxpayer understanding will sometimes require a tailored approach. While correspondence should always aim to be clearly written and understandable, this is vital if the taxpayer is not represented and especially if HMRC is aware of any individual needs. In such cases, the reviewing officer might need to provide a more accessible 'plain English' analysis or other tailored correspondence/communications.

discouraged or made harder to access, even where statutory reviews are mandated in the first instance.

Reform opportunity U: withdrawing the option of statutory reviews in certain cases

5.50 While we understand HMRC's concerns that some taxpayers might seek to 'exploit' safeguards in order to prolong matters and delay the inevitable requirement to settle a tax charge, we feel this is unlikely to apply to the majority of taxpayers. Our experience of taxpayers who are in a tax dispute with HMRC suggests that, for the most part, they are worried, they find the experience stressful, and overall would like to have matters concluded so they can move on with their life. However, this should not be at the expense of receiving a correct or fair outcome.

5.51 It would be useful if HMRC could seek out data or provide their own evidence of how many (and what kinds of) taxpayer disputes are suspected to be unduly 'strung out' by the taxpayer simply to defer the eventual liability.

5.52 To preserve equality for all taxpayers facing a dispute, it is our strong preference that the option of statutory reviews is maintained in all cases. Removing the possibility of a statutory review for a certain subset of taxpayer could go against the 'treating you fairly' principle within the HMRC Charter.[43]

Reform opportunity V: Digital administration

5.53 We are supportive of HMRC's continued drive to digital administration and fully appreciate the mutual benefits this can have for HMRC and the taxpayer alike.

5.54 That said, non-digital options must be maintained for those who are digitally excluded, and we hope that HMRC will at all times refer to its own internal Digital Inclusion Strategy when developing new digital solutions in this area. We have urged HMRC to publish this strategy externally.

5.55 To be clear, any non-digital alternative must be easily identified by the taxpayer and should be set out in full in any correspondence the taxpayer receives (perhaps by way of a separate factsheet[44] or similar). It is not sufficient for taxpayers to be directed to online information, as some simply do not have internet access.

5.56 If a wider-reaching digital appeal process is launched then, at least initially, we would urge HMRC to maintain a non-digital system that continues alongside it (for all customers, not just those who are specifically digitally excluded or digitally unconfident). It has been seen that effective digital options rarely have optimal effectiveness in their early iterations, and taxpayers must have continued access to a reliable method of dealing with their appeal.

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[43] https://www.gov.uk/government/publications/hmrc-charter/the-hmrc-charter

[44] All communications to taxpayers must be written in plain English, be easy to follow, unambiguous and logically laid out. It should be taken as the default approach that any taxpayer may not be in a position to pay for advice and therefore will be seeking to understand their options as a layperson.

5.57 In due course, we do not think it is unreasonable for HMRC to work towards a 'digital by default' appeals system for those who are digitally able. However, it is our recommendation that any digital appeals process is extensively tried, tested, and allowed to 'bed in' before any restrictions of access to non-digital methods are put in place. It is our view that if digital systems are good, people will naturally gravitate towards them as the easiest way of doing things.

5.58 To reiterate the point already made under reform opportunity F (paragraphs 3.59 et seq), a guiding principle for HMRC when moving to greater use of digital services and communications should be to ensure that all obligations under HMRC's Charter,[45] as well as the HMRC principles of support for taxpayers who need extra help,[46] are properly met.

5.59 In addition, the CIOT and ATT have jointly published their 'seven principles of tax digitalisation' which sets a helpful benchmark for the creation and improvement of digital tax services.[47]

5.60 As a final comment, LITRG have previously provided input to the Ministry of Justice as regards their online process for appealing to the Tax Tribunal, in the context of assisted digital.[48] It seems sensible that any digital appeals system within HMRC should be similar to the digital journey faced when appealing to the Tribunal. The Ministry of Justice might also be well placed to share their learnings and experience with HMRC of digitalising such a process.

LITRG
7 May 2024

[45] https://www.gov.uk/government/publications/hmrc-charter/the-hmrc-charter

[46] https://www.gov.uk/government/publications/hmrc-charter/hmrcs-principles-of-support-for-customers-who-need-extra-help

[47] See the CIOT's press release dated 24 April 2024: https://www.tax.org.uk/tax-bodies-publish-principles-of-digitalisation-as-hmrc-launch-new-round-of-testing

[48] Comments submitted 31 October 2016: https://www.litrg.org.uk/submissions/transforming-our-justice-system-assisted-digital