Low Incomes Tax Reform Group.

A voice for the unrepresented.

Reform of behavioural penalties
Response from the Low Incomes Tax Reform Group (LITRG)

1. Executive Summary

1.1. We welcome HMRC's continued engagement on penalties as part of the Tax Administration Framework Review. We agree with the aim of simplifying the penalty system, and are pleased to note that HMRC aim to minimise any detrimental impact on perceived fairness. Although it may be difficult to balance these objectives, we think it is possible and important to do so.

1.2. There have been recent consultations on new ways of tackling non-compliance and the better use of improved third-party data. Careful consideration should be given to the extent to which taxpayers can rely on HMRC guidance and tools as well as how these areas will interact with the reform of behavioural penalties.

1.3. LITRG has concerns about the concepts of 'reasonable excuse' and 'reasonable care'. Currently we understand there can be a lack of consistency in the way these are applied by HMRC. Detailed consideration needs to be given to the policy, operations and guidance for these two key safeguards.

1.4. We recommend that the minimum 10% penalties should be removed for both inaccuracies disclosed after three years and failures to notify disclosed after 12 months for non-deliberate behaviour. The minimum 10% penalty for inaccuracies disclosed after three years does not have a basis in statute, which we do not think is appropriate as a matter of principle. Conceptually, it also seems somewhat odd that the timing would affect the level of inaccuracy and failure to notify penalties – indeed we think it can lead to situations that can damage trust in HMRC.

1.5. We think the suggestions regarding the simplification of penalty reductions for unprompted disclosure and in particular the quality of disclosure are reasonable. It is difficult to distinguish between the existing categories of telling and helping, so it makes sense to combine the two into one type of reduction. We wonder whether the set percentage reduction for unprompted disclosure could be greater than that proposed. With regards to the distinction between unprompted and prompted disclosure, careful consideration needs to be given as to how this fits in with HMRC's increasing use of one to many campaigns, which involve different types of nudges and prompts.

CHARTERED INSTITUTE OF TAXATION
30 Monck Street, Westminster, London, SW1P 2AP

REGISTERED AS A CHARITY NO 1037771

Tel: +44 (0)20 7340 0550
E-mail: litrg@ciot.org.uk

Web: www.litrg.org.uk

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1.6. If HMRC wish to adopt higher penalties for deliberate behaviour and repeated instances of deliberate behaviour, it is essential that they raise awareness of this. Otherwise, the higher penalties cannot act as a deterrent. Penalty reductions for coming forward voluntarily and quality of disclosure arguably have as big a role in incentivising compliance as penalty escalation. We are not sure that penalty escalation is appropriate for inaccuracy penalties, as the compliance failure is not linked to taking action by a particular deadline.

1.7. We agree that penalties for offshore non-compliance could be simplified. Where behaviour is not deliberate, we do not think there is justification for different penalty ranges for different territories. The current system makes no allowance for those coming to the UK who have income sources in their home country, and may simply be unaware of the need to tell HMRC about their foreign income.

1.8. We think that penalty suspension could be used in a wider range of circumstances, for example, where there is a failure to meet a recurring obligation. Of the two approaches discussed in the consultation document, we prefer the second, whereby HMRC would issue a 'caution' in case of the first inaccuracy or failure. We think this approach could help to build trust in HMRC and might be simpler to administer.

1.9. We do not support the idea of an alternative model for penalties that would not be behaviour-based. We think a behaviour-based penalty regime provides an important safeguard for unrepresented taxpayers.

1.10. We would not expect non-financial sanctions to be in point for unrepresented taxpayers who cannot afford to pay for professional tax advice. However, we note the following general points: for a sanction, financial or non-financial, to act effectively as a deterrent, it must be widely known about before someone takes a decision as to whether or not to comply; as a matter of principle there should be a clear link between the non-financial sanction and the non-compliance; HMRC must consider the consequential effects of proposed sanctions.

1.11. In respect of all the proposals discussed in the consultation, it is essential that HMRC give careful thought as to how they will raise awareness of them at a time when non-compliance can be deterred or caught at an early stage.

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 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. Introduction

3.1. We welcome HMRC's continued engagement on penalties as part of the Tax Administration Framework Review. We agree with the principles identified in the 2012 Powers Review[1] and the broader objectives of the Tax Administration Framework Review as they apply in the context of penalties.[2] 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. However, HMRC also wish to minimise any detrimental impact on perceived fairness, which could risk undermining trust in HMRC and the tax system.[3] It is not easy to balance these objectives, but we think it is possible to make improvements to the current system that can meet these goals. We focus our comments on the position of unrepresented taxpayers who are unable to pay for professional advice.

3.2. We previously submitted a response to HMRC's consultation on new ways to tackle non-compliance, for which HMRC have now published a summary of responses.[4] HMRC indicate in the summary of responses that they will take forward for further consideration both the reform of revenue

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[1] The Review identified principles that affect statutory obligations, safeguards and sanctions. The final group of principles, for sanctions, is applicable to this consultation. The Review identified that sanctions for non-compliance should be: set in statute, clear and publicised, proportionate to the offence, used consistently, and effective in deterring non-compliance and returning the non-compliant to compliance: https://publications.parliament.uk/pa/ld201719/ldselect/ldeconaf/242/24205.htm

[2] The consultation said that a revised tax administration framework should: provide certainty and appropriate safeguards for taxpayers, be flexible enough to adapt to changing circumstances and enable targeted support for taxpayers, support HMRC's aim to make it easy to get tax right and hard to get it wrong, help build trust in a tax system that is recognised as fair and even-handed, be as simple and transparent as possible, help reduce the cost for taxpayers of meeting their obligations and drive down the costs to the Exchequer: https://www.gov.uk/government/calls-for-evidence/call-for-evidence-the-tax-administration-framework-supporting-a-21st-century-tax-system

[3] See sections four and five of the report "Analysis of the drivers of trust in HMRC", published 28 May 2025, for more information on the link between perceived fairness and trust: https://www.gov.uk/government/publications/analysis-of-the-drivers-of-trust-in-hmrc

[4] The summary of responses is available on GOV.UK at https://www.gov.uk/government/consultations/the-tax-administration-framework-review-new-ways-to-tackle-non-compliance/outcome/the-tax-administration-framework-review-new-ways-to-tackle-non-compliance-summary-of-responses

correction powers and approaches to taxpayer self-correction. HMRC should consider how any changes to the inaccuracy penalty regime interact with the outcomes from that previous consultation. For example, to what extent should the onus be on HMRC to take opportunities to use revenue correction notices rather than issuing an inaccuracy penalty?

3.3. HMRC have also been consulting on the better use of improved third-party data.[5] As HMRC make greater use of third-party data and pre-population, there is a broader question as to whether the balance of responsibilities is correct and we have encouraged HMRC to consider a consultation exploring this important issue further. If accuracy and notification do remain the responsibility of taxpayers, even where third-party data is available to HMRC, it is essential that HMRC ensure taxpayers are aware of their responsibilities. Trust in HMRC will suffer if taxpayers are penalised because it is not clear that they need to check the accuracy of pre-populated third-party data, or if the taxpayer believes there is no need to notify HMRC about a source of income because HMRC already know about it from shared third-party data.

3.4. An important part of ensuring that behavioural penalties are fair is the question of the extent to which a taxpayer can rely on HMRC's guidance and tools on GOV.UK and on data provided by a third party. In either case, if the taxpayer places reliance on the guidance or assumes third-party data is correct, but this leads to them incurring an inaccuracy or failure to notify penalty, this will also damage trust in HMRC and the tax system.

3.5. Two key areas of interest for LITRG with regards to penalties are the concepts of 'reasonable care' and 'reasonable excuse'. We would like HMRC to give detailed consideration to policy, operations and guidance for these two key safeguards. In particular, we think that a taxpayer should not face a penalty for inaccuracy if they can prove that they followed HMRC advice (and thereby made an error despite taking reasonable care), for example, by retaining a copy of webchat advice. We think that this idea is possibly alluded to in the compliance handbook.[6] But ideally HMRC should openly adopt this as a rule of thumb and make it clear in the general guidance on GOV.UK.[7] This would also serve to drive up HMRC standards of guidance and advice.

3.6. HMRC's guidance on GOV.UK[8] is now wider than it ever has been on reasonable excuse. This says HMRC should treat each case on its own merits and, in addition to the facts surrounding the

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[5] The most recent consultation closed on 21 May 2025: https://www.gov.uk/government/consultations/better-use-of-new-and-improved-third-party-data

[6] Compliance Handbook 81131: Penalties for Inaccuracies: Types of inaccuracy: Inaccuracy despite taking reasonable care no penalty due – Examples: https://www.gov.uk/hmrc-internal-manuals/compliance-handbook/ch81131

[7] The Australian Taxation Office publishes guidance that helpfully and transparently sets out the different levels of protection the taxpayer has when using its advice and guidance at: https://www.ato.gov.au/about-ato/ato-advice-and-guidance/how-our-advice-and-guidance-protects-you

[8] Taxpayer guidance at https://www.gov.uk/tax-appeals/reasonable-excuses; guidance in the Compliance Handbook starts at CH160000 https://www.gov.uk/hmrc-internal-manuals/compliance-handbook/ch160000 and includes guidance on case law that cites the Upper Tribunal's comments in the case of Christine Perrin

asserted excuse, take into account the experience, ability and background of the individual. However, it is not clear that HMRC apply their own guidance consistently. Given the existence of economic abuse and rogue agents, we think it is important that HMRC take steps to ensure their interpretation of reasonable excuse (and reasonable care) takes such aspects into account alongside the factors mentioned in their guidance. For example, it does not seem fair that a taxpayer should be penalised for an inaccuracy that has been created by a rogue agent, when many taxpayers are simply not in a position to assess the competence and trustworthiness of an agent or the accuracy of tax data submitted to HMRC on their behalf.

4. Q.1: What are your views on removing the minimum 10% penalties for: 1. Inaccuracies disclosed after 3 years; 2. Failures to notify disclosed after 12 months for non-deliberate behaviour?

4.1. In our experience, from working with TaxAid and Tax Help for Older People, penalties do not necessarily play a role in a taxpayer's decision as to whether to come forward. There may be other reasons, perhaps not directly related to tax, for wishing to put their tax affairs in order – for example due to life changes, because they need to plan for the future or for peace of mind. Or they may only recently have become aware of the inaccuracy or failure to notify, even if the issue has been ongoing for a number of years. For example, a taxpayer may have fallen into non-compliance because of illness (physical or mental health) or because of having to be a carer for a family member. Once they have either recovered or made adjustments to their life such that they are better able to cope, they may return to a position where they are able to think about other things, including tax, and take steps to resolve their tax position or put right any non-compliance. This is illustrated well by a query on an MSE forum from 2022.[9]

4.2. Conceptually, it seems somewhat odd that the timing of disclosure would affect the level of penalties. If a taxpayer makes a disclosure to HMRC as soon as they become aware of a non-deliberate inaccuracy, it seems strange that the penalties might be greater just because they took longer to become aware of the problem. Indeed, the fact that a taxpayer may face a higher penalty simply because they were not aware of an inaccuracy for more than three years may be viewed as unfair. It is these types of situations that are perceived as unfair that damage trust in HMRC. By way of example, we have recently come across a case where a taxpayer aged over 80 years old was accumulating late filing penalties because they were not aware that they were receiving notices to file – the notices were digital and going to the Personal Tax Account and the taxpayer was unaware of them.

4.3. We think therefore that the minimum 10% penalties should be removed in both cases.

[2018] UKUT156 [TC] at CH160950 https://www.gov.uk/hmrc-internal-manuals/compliance-handbook/ch160950

[9] See the initial query on the MSE forum at https://forums.moneysavingexpert.com/discussion/6335098/appealing-self-assessment-late-penalty

4.4. It is our understanding that the minimum 10% penalty for inaccuracies disclosed after three years does not have a basis in statute. We do not think it is appropriate to adopt non-statutory positions in relation to penalties – penalties should be clear in statute as a matter of principle.

4.5. Given that these minimum 10% inaccuracy penalties do not have a statutory basis, there is a question as to whether taxpayers, particularly those who are not represented, are even aware of them until the penalty is imposed. They do not feature in the main GOV.UK guidance.[10] If taxpayers are not aware of the minimum penalty rates, it is unlikely that they are either deterring them from coming forward if the inaccuracy is over three years old or encouraging them to come forward earlier if they are able.

4.6. There is a statutory basis for the minimum 10% failure to notify penalties where this is disclosed 12 months or more after the tax becomes due. Removal of this minimum penalty would align the regime with that for inaccuracy penalties, representing a simplification.

4.7. Most cases of unfairness surrounding failure to notify penalties occur when the taxpayer was not aware of the requirement but is not able to successfully claim they had a reasonable excuse.[11] In most of these cases the taxpayer discloses as soon as they become aware of the failure and the underpayment of tax. It seems strange to charge different penalties for the most recent tax year, where the failure is the same as for earlier years. There would still be an incentive to disclose promptly, because of the reduction for unprompted disclosure and the penal rate of interest that applies to late paid tax.

4.8. The penalty for failure to notify is based on potential lost revenue. This means that if there is no potential lost revenue, there is no penalty. So, the consequences for many unrepresented taxpayers for not notifying HMRC (or not notifying HMRC on time), in cases where no tax is at stake, are nil. Given HMRC's general stance that ignorance of the law is not a reasonable excuse (acknowledging HMRC's re-write of their internal guidance on this point), this provides a useful safety net for low-income, unrepresented taxpayers. We think it is important that this safeguard is preserved.

4.9. We would also note an anomaly that arises in respect of the current lack of alignment between the regimes for failure to notify and inaccuracy penalties. We can compare two taxpayers, one in self assessment and one not, who fail to disclose a source of foreign income in, say 2022/23, because they do not realise it is taxable in the UK. This can be the case with foreign pensions – because the pension is often taxed overseas, the taxpayer does not think they need to tell HMRC about it. However, technically, foreign pensions are generally taxable in the UK under the relevant double taxation treaty, rather than taxable overseas with a foreign tax credit given in the UK. The taxpayer

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[10] They are referred to briefly, as an option, in compliance factsheet 7A: https://www.gov.uk/government/publications/compliance-checks-penalties-for-inaccuracies-in-returns-or-documents-ccfs7a/compliance-checks-for-penalties-of-inaccuracies-in-returns-or-documents-ccfs7a-factsheet

[11] This is partly because reasonable excuse is not just related to the question of penalties but also the number of assessable years – an inability to access reasonable excuse can mean a jump in years under assessment from 4 to as many as 20: https://www.gov.uk/hmrc-internal-manuals/compliance-handbook/ch51300

in self assessment can make an unprompted disclosure. This will be treated as an inaccuracy, because their self assessment for 2022/23 was incorrect. This means they can have their penalty reduced to nil. The taxpayer that is not in self assessment can also make an unprompted disclosure. But this will be treated as a failure to notify. If they make the disclosure more than 12 months after the tax became due, they can only get their penalty reduced to 10%.[12] This seems unfair. One could argue that the taxpayer who is within self assessment should face the higher penalty, as they will have received nudges to consider whether they needed to report any foreign income while completing their self assessment tax return. The taxpayer who is not within self assessment has received no such nudge. Moreover, the taxpayer outside self assessment faces an assessment window of 20 years, whereas the taxpayer within self assessment only faces an assessment window of 12 years for careless inaccuracies.[13]

5. Q.2: What are your views on the ways in which HMRC could: 1. Simplify penalty reductions for unprompted disclosure; 2. Simplify penalty reductions for the quality of disclosure?

5.1. We wonder if the proposed weightings of penalty reductions strike the right balance? For example, should there be a greater reduction, for example, 50% for making an unprompted disclosure, since HMRC would otherwise not know about the tax liability. We think it would be worth HMRC exploring how the current level of reductions for unprompted disclosure affects taxpayer behaviour, if they have not already done so.

5.2. Consideration may need to be given to the interaction of HMRC's use of one to many campaigns with the distinction between prompted and unprompted disclosures. There are different types of one to many campaign. Whether a taxpayer response to a one to many communication counts as unprompted or prompted depends on the nature of the campaign. Additional clarity would be welcome in this area.

5.3. The suggestions regarding the simplification of penalty reductions for the quality of disclosure are reasonable. It is difficult to distinguish between the existing categories of telling and helping, so it makes sense to combine the two into one type of reduction. It may even make sense to combine all three existing categories of telling, helping and giving access, into one overarching reduction for co-operation.

5.4. HMRC could also do more to publicise the possible reductions in penalties, as this might encourage some taxpayers to come forward voluntarily.

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[12] 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)).

[13] The assessment window is 12 years because it relates to offshore non-compliance. The divergence is even greater where the case involves onshore non-compliance: 20 years compared to only six years.

5.5. We have a concern that unrepresented taxpayers find it difficult to self assess penalties, for example in respect of the digital disclosure service. In our view, it is not appropriate for taxpayers to have to self assess penalties. We do not think it is wise for unrepresented taxpayers to use the digital disclosure service at all in its current form. There is no clear demarcation between the various options for the behaviour that led to the error or omission. This means it is possible they will choose the wrong option and potentially incriminate themselves. The risk of an unrepresented taxpayer making an incorrect disclosure is already high; having to self assess penalties without a proper understanding of the regime and safeguards exacerbates this.

5.6. We recommend that HMRC look at data that sets out the penalty levels when taxpayers self assess their own penalties as opposed to when HMRC assess them. They should also look at data setting out the level of penalties raised on different types of taxpayer – unrepresented versus represented. We are concerned that the imbalance of power between HMRC and the taxpayer may mean that unrepresented taxpayers face higher penalties than those that have representation.

6. Q.3: With reference to the existing inaccuracy and failure to notify penalty ranges, what would you consider to be proportionate and appropriate penalty rates for both deliberate behaviour and repeated instances of deliberate behaviour? Which factors should be considered when applying these?

6.1. In general, we are in favour of a penalty regime that treats occasional non-compliance differently from repeated non-compliance, in particular where the repeated non-compliance is deliberate. However, where there is a genuine reasonable excuse for the non-compliance, it should not affect how subsequent non-compliance is treated.

6.2. We note that it can be difficult to determine or prove if a failure to notify or inaccuracy is deliberate. Concealment may be a factor that indicates deliberate behaviour. We think it may be worth exploring whether a single category of deliberate behaviour could cover both the current categories – deliberate but not concealed / deliberate and concealed. HMRC could also work on providing a clearer framework or set of hallmarks that indicate deliberate behaviour.

6.3. We are concerned that there can be a mindset in HMRC that all taxpayer behaviour is deliberate. If the two current categories of deliberate behaviour are merged into one, we hope that unconscious bias will not lead to unrepresented taxpayers facing penalties for deliberate behaviour or repeated instances of deliberate behaviour, when this is not the case.

6.4. We think it would be worth exploring the possibility of resetting the position in respect of these higher penalties, particularly in light of HMRC's one to many activities. People do change, and following a one to many campaign or a compliance check, a taxpayer may effectively start over. It would seem a shame to then raise tougher penalties on them for an inadvertent error once they have established a new pattern of behaviour, as this could damage trust in the tax system and HMRC.

6.5. If HMRC wish to adopt higher penalties for deliberate behaviour and repeated instances of deliberate behaviour, it is essential that they raise awareness of this. Otherwise, the higher penalties cannot act as a deterrent.

6.6. In terms of factors to consider, HMRC need to think about what the approach will be if they find many errors at the same time – should this be treated as one error or repeated errors? In cases of historic non-compliance, HMRC also need to consider their approach. For example, if someone is within self assessment and has failed to declare a source of income for say three years in a row, but discloses it all at the same time, should HMRC treat that as one error or three separate errors? In this context, we do not think escalation of penalties works well in cases of historic non-compliance, because if all penalties are charged at once, the taxpayer has no chance to respond to one level of penalty before the next applies. Another factor to consider is whether a deliberate failure or inaccuracy in one type of tax return should have any bearing on a subsequent failure or inaccuracy in a different type of tax return.

6.7. Penalty reductions for coming forward voluntarily and quality of disclosure arguably have as big a role in incentivising compliance as penalty escalation. In our view, penalty escalation is not appropriate for inaccuracies, as the obligation is not linked to taking action by a particular deadline. We think escalation of penalties are most effective where they incentivise compliance with a deadline before higher, successive penalties apply. Taxpayers should always have the chance to respond to one level of penalty before the next one is charged.

7. Q.4: How could penalties for offshore non-compliance be simplified whilst still acting as an effective deterrent?

7.1. We agree that this area of penalties could do with simplification. The fact that territorial categories affect the penalty ranges, in addition to behaviour, can make them challenging to navigate and understand for unrepresented taxpayers, especially if they are trying to make an offshore disclosure.[14]

7.2. The different levels of penalty for different territories may be justified if a taxpayer acts deliberately and has chosen to hide offshore income in a country that is not co-operative with the UK. For non-deliberate errors or failures to notify, there is no justification for assessing the penalty according to the nature of the territory, as this has not played a role in the taxpayer's behaviour.

7.3. In particular, the current regime does not allow for those coming to the UK having income in their home country, which is entirely natural – should a taxpayer who happens to originate from a category 3 country face more severe penalties than a taxpayer who happens to come from a category 1 country, if their circumstances are otherwise identical?

[14] The compliance factsheet is quite difficult to follow, interspersing general penalties for offshore non-compliance with information on the requirement to correct: https://www.gov.uk/government/publications/compliance-checks-penalties-for-income-tax-and-capital-gains-tax-for-offshore-matters-ccfs17/compliance-checks-penalties-for-offshore-non-compliance-ccfs17

7.4. The regime catches out taxpayers, particularly the unrepresented, who are simply not aware that they have to pay UK tax on their overseas income (see our example in respect of foreign pensions in paragraph 4.9). There are a number of factors that feed into this – their residency status, their domicile status (historically), the type of income, whether there is a double taxation treaty and if so, what the treatment is under it, the availability of UK allowances etc. The current regime does not seem to respond to these complexities in the context of ordinary taxpayers, as opposed to say, hardened tax avoiders. One option might be for there to be a de minimis for all taxpayers with a UK tax liability on offshore income, such that if the tax at stake is below a certain threshold, no penalty applies.[15] This would reduce the burden for the taxpayer, but it would also provide an administrative saving for HMRC.

7.5. Moreover, unless taxpayers are aware of the offshore penalty regime upfront, which is unlikely to be the case, the current regime is not acting as an effective deterrent.

8. Q.5: How could HMRC simplify penalty suspension while retaining an effective prompt to taxpayers to address the source of the inaccuracy?

8.1. Currently, the ability to suspend a penalty is only available in the case of a penalty for a careless inaccuracy. However, suspension could arguably be useful in a broader range of circumstances, such as a failure to meet any recurring obligation.

8.2. For recurring obligations, we prefer the second approach set out in the consultation – the use of a caution. This chimes with a suggestion in our 2024 submission,[16] where we noted that we would prefer an approach whereby HMRC issue a warning letter in the case of a first failure or error. This would not be quite the same as a suspension, because HMRC would not issue a penalty at all in respect of the first failure or error. They would only issue a penalty in respect of a future failure or error. This would also have the advantage of aligning more closely with the points-based system that is being introduced under penalty reform for income tax filing penalties.[17]

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[15] A comparison can be drawn with SEISS 4 and SEISS 5 grants, where taxpayers had to repay some or all of their grants if they amended their tax returns for tax years 2016/17 to 2019/20 inclusive and this meant they were no longer entitled to the grant amounts they had received. HMRC said that if the taxpayer had to pay back £100 or less for each grant then they did not need to pay back anything. See our guidance at https://www.litrg.org.uk/working/self-employment/calculating-self-employed-profits/self-employment-income-support-scheme-seiss#16

[16] See paragraphs 4.30 ff.: https://www.litrg.org.uk/submissions/tax-administration-framework-review-enquiry-and-assessment-powers-penalties-safeguards-litrg

[17] Under the points-based system, if a taxpayer misses a filing obligation, they receive a penalty point. This serves as a warning. It is only if they miss future obligations of the same type that they receive additional penalty points and eventually a financial penalty.

8.3. This approach would have a significant advantage in terms of building trust in HMRC and the tax system, since it would help avoid situations where taxpayers receive penalties for obligations they did not realise existed or with which they did not realise they had not complied. In addition, it would help avoid the perception of unfairness that arises when a taxpayer has tried to contact HMRC for help, or has managed to access online or telephone guidance from HMRC, but either through a failure to get through on the telephone or an error in the guidance from HMRC, has made an error in their tax affairs and is faced with a penalty.

8.4. The approach that uses a warning letter (or 'caution' as described in the consultation document) would help to avoid the difficulty of determining suspension conditions for the obligation in question. It would also open up the use of the warning letter approach to a wider set of circumstances, including what may seem like one-off obligations, such as failure to notify. This would also help to address the misalignment between the failure to notify and inaccuracy penalty regimes, which, as we noted above (see paragraph 4.9) favours taxpayers who are within self assessment over those who are not. This point is especially relevant to unrepresented taxpayers within PAYE who make a disclosure of an income source that they did not realise was taxable.

8.5. We think it would still also be worth exploring the first option – automatically suspending penalties without conditions. We would suggest alignment with the two-year period under penalty reform for income tax and VAT (after which penalty points can be cancelled) if this is pursued.

8.6. We think automatic suspension would be an improvement on the current system. This is because it is not clear whether HMRC currently consider suspension in all cases where it might apply. This means that there can be perceived inconsistencies in the treatment of taxpayers, as the availability of suspension may depend on whether the taxpayer, or their agent, asks about it. As a result, unrepresented taxpayers are more likely to miss out, if they are either not aware of the option and / or are unable to articulate suitable suspension conditions, because they lack experience and knowledge of what conditions HMRC would typically accept.

8.7. Also, it would remove the issue of HMRC having to determine whether the taxpayer has met the suspension conditions at the end of the suspension period. This can be difficult for HMRC to determine and can also affect trust in the tax system if the taxpayer disagrees with HMRC, since they are not able to appeal the decision. The fact that a taxpayer does not have the ability to appeal is problematic.

8.8. However, as the CIOT note in their response (see section 8), automatic suspension could be problematic, for the reasons the CIOT has explained. It would also be more complex to implement and operate than a caution.

8.9. With either approach, there is a question as to whether the taxpayer understands what behaviour they need to change or error they need to correct going forward. So, reforms in relation to suspension of penalties or warnings need to be coupled with an educational approach. So, one option might be that to avoid a penalty, a taxpayer has to join a webinar say to educate themselves on the topic. Having completed a webinar, the taxpayer would not be able to claim ignorance if they make the same mistake in future. This type of approach might be less feasible where a taxpayer is digitally excluded.

9. Q.6: What do you see as the opportunities and challenges of this approach? Do you think that a new legislative model would be preferable to simplifying existing penalties, as outlined in Chapter 3? If so, how could any potential transitional costs be minimised?

9.1. We support the overall objective of simplification, but this should be done so as to minimise the introduction of any unfairness, which might undermine trust in the tax system. We appreciate that there are practical difficulties in determining the underlying behaviour and intentions behind non-compliance. However, the fact that some penalties are behaviour-based offers an important safeguard 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.

9.2. While we appreciate that an approach that broadly bases penalties purely on co-operation and history of non-compliance might 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.

9.3. We agree that it might be possible to simplify the categories of behaviour. We think one of the most important points when considering behaviour is whether it was deliberate or non-deliberate. So, for example, we think it would be possible to treat all deliberate behaviour as one, regardless of whether it is concealed or not. Similarly, all non-deliberate behaviour could be treated equally. We note that the alternative model set out in the consultation paper focuses on this distinction.

9.4. Where we differ from the alternative model set out in the consultation paper is that we do not think a penalty is necessary for non-deliberate inaccuracies and failures to notify.[18] There are arguably other incentives (rather than the stick of a penalty) that encourage taxpayers to take care over their tax affairs. In particular, HMRC could focus on the taxpayer message that it is important to get your tax affairs right to ensure you pay the right amount – this could highlight claiming allowances and reliefs to ensure you do not pay too much tax, but also the importance of avoiding a later tax bill and interest if HMRC find you have not paid enough tax.

9.5. We appreciate that HMRC may view penalties as appropriate, as set out in the alternative model. On the basis that penalties are retained for non-deliberate behaviour, we think the idea that a first mistake results only in a warning rather than a financial penalty is worth taking forward. This could be rolled into the existing penalty framework or form part of an alternative model.

9.6. The proposed alternative model merges current failure to notify and inaccuracy penalties. It also removes consideration of behaviour (other than deliberate versus non-deliberate). The current time limits that apply in terms of how many years a taxpayer must disclose depend on behaviour and also differ between the failure to notify and inaccuracy penalty regimes. So, a redesign would need to consider carefully what assessment time limits should apply.

[18] See our comments at paragraph 4.23 ff in our response to the 2024 consultation: https://www.litrg.org.uk/submissions/tax-administration-framework-review-enquiry-and-assessment-powers-penalties-safeguards-litrg

10. Q.7: What is your view on HMRC's use of tougher non-financial sanctions to deter and respond to deliberate and repeated non-compliance and to promote future compliance?

10.1. In general, we would not expect these sanctions to be in point for unrepresented taxpayers who cannot afford to pay for professional tax advice.

10.2. We take the opportunity to make some general observations. In order for a sanction, financial or non-financial, to act effectively as a deterrent, it must be widely known about before someone takes a decision as to whether or not to comply. It is not clear how high the level of awareness is of existing non-financial sanctions, such as the publication of details of deliberate defaulters. So, as with financial penalties, if HMRC choose to make use of tougher non-financial sanctions to deter serious non-compliance, it is essential that they give careful thought as to how they will raise awareness of them at a time at which non-compliance can be deterred or caught at an early stage.

10.3. There should be clear parameters as to when HMRC can make use of tougher non-financial sanctions. We think that as a matter of principle there should be a clear link between the non-financial sanction and the non-compliance.

10.4. The consultation mentions the possibility of HMRC having the power to remove someone's passport or driving licence. We do not think it would be appropriate for HMRC to be able to do this in the vast majority of cases, as this might mean the person is without a form of identification or ability to work. This could prevent them accessing banking services for example or earning a living. If HMRC explore other forms of non-financial sanction, it is important that they consider the consequential effects of proposed sanctions – this might be difficult to do comprehensively. However, it will be essential, as otherwise HMRC could face legal challenges, based on proportionality, consistency and human rights.

10.5. One option might be for HMRC to share data with regulators, subject to data protection laws.

10.6. In terms of ideas to promote future compliance, we recommend HMRC consider:

- offering tax incentives,
- finding ways of simplifying compliance, for example by introducing the withholding of tax in the gig economy,
- creating campaigns to promote tax and bring tax into people's day to day lives and even
- introducing some kind of 'two ticks' recognition programme to give compliant taxpayers/businesses important leverage.

Of course, the key to compliant taxpayers is ensuring they have tax morality – which is why we have mentioned trust in the system throughout our submission. We are pleased to see the recent report on drivers of trust in HMRC,[19] and hope that the research outcomes will prove useful to HMRC. We are happy to discuss our ideas in more detail if that would be helpful.

[19] https://www.gov.uk/government/publications/analysis-of-the-drivers-of-trust-in-hmrc

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