

LOW INCOMES TAX REFORM GROUP

RESPONSE TO HMRC CONSULTATIVE DOCUMENT: MEETING THE OBLIGATIONS TO FILE RETURNS AND PAY TAX ON TIME

1. Executive summary

- 1.1 We approach this consultation from the perspective of the unrepresented individual taxpayer on a low or modest income. Thus our response is orientated towards income tax issues.
- 1.2 We challenge the view, which seems to form the basis of these proposals, that the scale of late paid tax, or late filing of returns, is such as to necessitate a major overhaul of the existing penalty regimes.
- 1.3 If additional resources are available for improving the timeliness of tax collection, they would surely be far better used in equipping either HMRC, or the voluntary sector, to provide better taxpayer education – informing taxpayers about their obligations before they arise rather than penalising them afterwards for failure to comply. The real-life examples in the Appendix illustrate this point.
- 1.4 We welcome your acknowledgment (para 4.6 et seq) that there are ways in which the existing package of support can be improved, and in paragraph 3.3 we make some observations on how effective the improvements so far carried out have been, and where more work could be done.
- 1.5 As many self-assessment taxpayers may be taken completely by surprise by the change in the paper filing deadline to 31 October, a much lighter touch will be needed for at least the first two years; or, better still, the implementation of the penalties changes should be delayed until at least April 2010.
- 1.6 Interest and penalties must be considered in tandem so that taxpayers are not over-burdened by both regimes being applied where the one is intended as mere recompense, and the other as a deterrent.
- 1.7 Your analysis of paying and filing behaviour is basically sound, but lacks any reference to disability, particularly in terms of mental incapacity in relation to tax and financial matters. Such incapacity should be accepted as a reasonable excuse, or exceptional circumstances justifying a nil penalty. A comparison of available data about a taxpayer will generally put an officer on notice that disability, or some form of mental incapacity, may be an issue.

- 1.8 In most cases we are opposed to the imposition of penalties where there is a time to pay arrangement, whether entered into before, or after, the due date. Where a taxpayer is in financial difficulties, as is normally the case where a time to pay arrangement is in place, there is little point in adding penalties to the interest they are already accruing.
- 1.9 The safeguards set out are generally comprehensive, except that the special reduction referred to in para 5.12 et seq is likely to tie the hands of officers too tightly. We would expect to see a right of appeal against a refusal of reasonable excuse.
- 1.10 We believe that low-income taxpayers need some protection where a fixed penalty would be disproportionate to the amount of tax they owe. Capping in its present form is probably not the most effective form of protection. However, if capping is to be removed, some other way should be sought of protecting those on lower incomes. This could involve capping fixed penalties by reference not to the amount of tax due, but to the level of income or profits. Alternatively, or in addition, a 'time to file' facility could be explored.
- 1.11 The benefits of alignment (para 1.2, 7.7 and passim) are exaggerated as far as most individual taxpayers are concerned. Most individuals, and certainly those on low or modest incomes, are concerned with one tax, or (at the most) two taxes. Any benefit from substituting one penalty regime for the many current regimes is likely to be undermined by the very substantial differences between penalties for different offences, and the problems of overlap.
- 1.12 The current mix of fixed penalties and tax-geared penalties in self-assessment is well understood, and reasonably effective. Of course it would be better still if nearer 100% paid in full and on time; and that goal would better be achieved by concentrating on taxpayer education and support before the event than by exacting penalties after it.
- 1.13 Regarding suspension of penalties, we remain unconvinced by the arguments you raise against them.
- 1.14 If the requirement for pre-authorisation is to be removed, daily penalties should not be imposed until the return has been outstanding for some time. In addition, the warning notice should be very clear about the circumstances in which daily penalties will be charged, for how long they will be charged, and what the taxpayer needs to do to prevent them being charged.
- 1.15 We are opposed to immediate penalties for late payment, although we have some sympathy for penalties where there is an excessive delay. But if there are to be fixed penalties immediately a payment is deemed to be late, they should be set off against any penalties incurred for late filing, or there should be a restriction on the total amount chargeable.
- 1.16 Whether someone who files or pays shortly after the due date should be treated differently from someone who files or pays later will depend upon the reason for the late filing or payment. If it is through ignorance of the system, and the taxpayer is unrepresented, then unless HMRC fully assumes the burden of guiding and informing the taxpayer there should be no penalty. There are also interactions between different penalty regimes to be considered.

- 1.17 But if the taxpayer repeatedly files or pays late once they have been informed of the due dates, they would in most cases deserve little sympathy if they were charged higher or additional penalties.
- 1.18 In general, for all but deliberate defaulters (a tiny minority) – who require ‘detering’ – penalties are likely to be counter-productive. Good taxpayer education and customer support, on the other hand, is far more likely to influence behaviour in such a way that no penalty is incurred in the first place.
- 1.19 To encourage employers to pay their in-year PAYE in full and on time, we would favour a year-end breakdown of the monthly remittances, alongside improvements in HMRC’s own internal systems of dealing with end-of-year returns and follow-up of persistent late payers.

2. Introduction

- 2.1.1 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 credit and associated welfare systems for the benefit of all those on low incomes.
- 2.1.2 The CIOT is a charity and the leading professional body in the UK concerned solely with taxation. The CIOT's primary purpose is to promote education and the 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.
- 2.1.3 We approach this consultation from the perspective of individual taxpayers on low or modest incomes. Therefore our answers and observations focus mainly on income tax self-assessment, and to a lesser extent on the PAYE obligations of small and very small businesses below the VAT threshold, including 'accidental employers' (see para 4.13.5).

3. General

- 3.1.1 We challenge the view, which seems to form the basis of these proposals, that the scale of late paid tax, or late filing of returns, is such as to necessitate a major overhaul of the existing penalty regimes.
- 3.1.2 From the data given in the consultation document (see paras 2.3, 2.13), it appears that 87% of taxpayers file their returns on time, and 85% pay their tax in full and on time. Many a commercial organisation would be well content if 85% of their customers paid their bills on time, with most of the remainder paying within a short period of the deadline. These results reinforce the generally held view that HMRC is good at its core function, which is collecting the right tax at the right time.
- 3.1.3 While the consultative document summarises the types of behaviour which lead to late filing or payment, it would be helpful to consultees to have more hard data about the causes of such non-compliance – how much is attributable to what might be described as innocent taxpayer error, how much to cash-flow problems, how much to deliberate delay, how much to HMRC error, and so forth. We have set out a few examples, from our own experience, of how penalties are applied to unrepresented taxpayers in the Appendix.
- 3.1.4 It must be borne in mind that these reforms are being discussed on the threshold of an economic downturn; a time when taxpayers may be struggling financially and in need of additional support. This may argue for delays in implementing the new system.

3.2 A better way

- 3.2.1 Much is made in chapter 9 of the additional resources needed to implement the proposals in the consultation document. If additional resources are available for improving the timeliness of tax collection, they would surely be far better used in equipping either HMRC, or the voluntary sector, to provide

better taxpayer education – informing taxpayers about their obligations before they arise rather than penalising them afterwards for failure to comply.

- 3.2.2 Your own research review (paras 3.2 et seq) shows that confusion about deadlines and due dates for payment is a frequent cause of failure to meet them. Reducing or eliminating that confusion through taxpayer education would both increase levels of compliance among those who are naturally compliant, and increase prompt payment of taxes without the need for penalties or other expensive interventions. The real-life examples in the Appendix illustrate how education and support would be more effective than penalties for many individual, unrepresented taxpayers.
- 3.2.3 Having improved education and support (we show in para 3.3 below some ways in which that could be done) HMRC could then do much to streamline their own paying and filing procedures. Again, this would make it easier for taxpayers to comply. For example, recent welcome initiatives such as the doubling of the payment-on-account threshold and the limit for 3-line accounting for small traders will undoubtedly have lightened the burden for many. We would recommend that such thresholds and limits should be increased each year in line with inflation to retain their effectiveness; not to do so imposes a further burden on taxpayers each year that the value of the threshold decreases in real terms, and represents – to that extent – a change in policy.

3.3 Quality of HMRC support (ch 4)

- 3.3.1 You list in para 4.1 ‘some of the ways in which HMRC currently supports people to file their returns and pay on time’. We welcome your acknowledgment (para 4.6 et seq) that there are ways in which the package of support can be improved, and in the following paragraphs we make some observations on the improvements you mention.
- 3.3.2 *Improving guidance and information available online and by telephone.* Both of these are important and welcome, but there must also be equally good services for those who find the telephone difficult (for instance, deaf people or those who find telephone routines confusing). Expecting taxpayers to use the phone to contact HMRC also presupposes that HMRC is easily traceable in the telephone book, which it frequently is not. While it is reasonable that people should bear the cost of complying with their tax obligations, it is important to note that the cost of telephone use (particularly 0845 numbers) falls disproportionately on those who, because they cannot afford the rental on a land line, resort to pay-as-you-go mobile phones. And while improving online services may help the 61%¹ of the population who have internet access and are competent to use it, it is useless to the remainder, a higher proportion of whom are in the lower income brackets.
- 3.3.3 *Making it easier to pay.* We welcome the improvements in flexibility of payment method, but are beginning to see disturbing signs of longer established methods, such as cheque, being discouraged in various ways. These include the ending of prepaid envelopes in which to send payment², and the wording of ‘how to pay’ guidance³ reflecting HMRC’s preference for

¹ National Statistics Office Internet Access 2007

² See <http://tinyurl.com/5bzxcw>

³ See http://www.hmrc.gov.uk/howtopay/self_assessment.htm

electronic payment. On the flipside, HMRC are making it more difficult for taxpayers to obtain a refund by cheque⁴. Whilst the security issues surrounding cheques are understood, in our experience, low-income taxpayers (particularly the older generations) still prefer them. In addition, a cheque payment is only established when it clears to HMRC's bank account, a new rule that makes it impossible for payers by cheque to ascertain just when payment is effected.

- 3.3.4 *Improving the ways HMRC engages with unrepresented taxpayers.* Little is said under this heading, so permit us to make some suggestions. The improvements you mention are in telephone and online services, but there are other ways – often preferable to low-income taxpayers on cost grounds – in which HMRC has traditionally offered help.
- 3.3.5 First, printed guidance and face-to-face advice have both suffered cutbacks in recent years. At present, the available printed guidance (eg notes to the self-assessment return, explanatory leaflets, etc) is largely aimed at people with high levels of functional literacy.
- 3.3.6 Secondly, support such as help in completing tax returns, or home visits for older or disabled people, are no longer universally available, and have suffered from the decline in numbers of enquiry centres. We know of cases where local tax office staff have referred low-income taxpayers to pro bono advice charities, because HMRC feel they can no longer give them a good enough service with the resources they have.
- 3.3.7 Thirdly, enquiry centres are themselves less accessible than they once were, with many people on lower incomes, particularly in rural areas, facing longer and more expensive journeys by public transport to get to them. That is assuming that an appointment is available at a time when the taxpayer can make the journey; and at present the appointments system can only be accessed by telephone. Where economies and resource constraints hit local offices, the unrepresented are the first to suffer because they depend almost entirely on HMRC for advice and information about the tax system.
- 3.3.8 And yet, investment in informing taxpayers about their obligations is bound to increase levels of compliance, because far more people are inclined to comply than not. At 6.16 you say that 'there is good evidence of a correlation between the SA advertising campaign and filing rates for income tax returns'. That illustrates that if people know about and understand their obligations, they are more likely to comply with them.
- 3.3.9 *More consistent time to pay arrangements.* We of course welcome the facility to pay over time where the taxpayer is in financial difficulties, and we say more below (in answer to question 2) about this.

3.4 *Forthcoming changes in filing deadlines*

- 3.4.1 You say in para 2.8 that 'forthcoming changes in filing dates are . . . taken into account.' With respect, they are not. Those compliant taxpayers who have for years filed paper returns by 31 January, particularly those who have habitually filed between 31 October and 31 January, may be taken completely by surprise when they find they have missed the new deadline of 31 October,

⁴ See <http://www.hmrc.gov.uk/sa/repay-cheque.htm>

because so little information about the change has so far emanated from HMRC. Even with a proper amount of warning, such changes take at least a couple of years to bed down properly, and assuming these proposals are likely to take effect before then, no extra flexibility is evident for those who may unknowingly have missed the paper deadline, and lack the means to file electronically by 31 January. A much lighter touch will be needed for at least the first two years; or, better still, as you have indicated in discussion, the implementation of the penalty changes must be delayed until at least April 2010.

3.5 *Interaction with interest*

3.5.1 Very little is said about this (see para 7.14). Yet the reasons for charging interest (restitution, removing a competitive advantage) overlap with the reasons for charging penalties for late payment, one of which is to 'reassure those who meet their obligations on time that those who file or pay late or not at all do not receive an unfair advantage'. If one purpose of charging interest is to ensure that other taxpayers, and the Exchequer, are not prejudiced by late payment, the need for penalties on top of interest has to be questioned.

3.5.2 In principle, we think that there are two different offences here, which must be treated separately:

- late payment – leading to interest as recompense;
- late filing of a return – leading to a penalty.

It cannot be right to conflate these two and charge both penalty and interest where only late payment is involved, except perhaps in cases of very late payment.

3.6 *Interest on penalties*

3.6.1 We understood from you that the purpose of interest was intended to be purely recompense. If so, there is no justification for continuing the practice of charging interest on penalties which did not form part of the tax liability in the first place. If the purpose of interest is solely to make good the loss to the Exchequer from not having the use of the tax due, and the purpose of penalties is to deter, then any interest charged on penalties amounts to a further deterrent, which is wholly inappropriate if the object of charging interest is solely to provide recompense.

4. *Answers to questions*

4.1.1 **Question 1.** *Do you agree with the analysis of filing and payment behaviour set out in Chapter 3? Do you have any further insight or evidence that you could share with HMRC?*

4.1.2 We are encouraged by the fact that HMRC has undertaken a review of the available research on why people do not file their returns or pay their tax on time. In general we would agree that the analysis in chapter 3 and RIA, page 5 is sound.

4.1.3 But there is one very important omission from your analysis. There are some 11 million people in the UK who are disabled within the meaning of the

Disability Discrimination Acts⁵. Of those, probably some 1.5 million have some kind of learning disability, learning difficulty or mental health problem which is likely to impede their capacity to understand or deal with their tax obligations. In addition, as people get older their capacity to deal with financial matters often diminishes, with the result that older people may well struggle to meet obligations which once they would have regarded as straightforward. Examples in the Appendix illustrate how such confusion can put older taxpayers in a difficult position, particularly where their own lack of capacity is compounded by administrative errors made by HMRC.

- 4.1.4 It is inadequate simply to categorise such people as a subset of those who 'pay or file late through confusion', as described in para 3.9. To respond to a lack of mental capacity simply by imposing penalties would be not only ineffective, but a clear breach by HMRC of its duties under section 2 of the DDA 2005.
- 4.1.5 In discussions you have indicated that a lack of mental capacity would be treated as reasonable excuse, or as exceptional circumstances justifying a nil penalty, but your difficulty is in identifying who should be treated in this way, given that a person without the mental capacity to file or pay on time is unlikely to have the mental capacity to lodge an appeal on grounds of reasonable excuse. We do appreciate the difficulty, but perhaps the answer lies in making use of data in HMRC's possession to identify who might be at risk. For example, if someone has been compliant year in and year out, then one year unaccountably fails to file or pay, that might prompt an officer to find out what had happened. Or if someone is in receipt of a disability element of tax credit, it might again put an officer on notice that their disability might be contributing to any non-compliance.
- 4.2.1 **Question 2.** *What should the relationship between time to pay and penalties be? If a taxpayer enters into a time to pay arrangement after the due date, how should they be treated? If someone fails to adhere to their time to pay arrangements how should they be treated with respect to penalties?*
- 4.2.2 This question depends very much upon the nature of the situation. The first point to make is that if a taxpayer enters voluntarily into a time to pay arrangement, it suggests that he is willing to pay but unable to pay the full amount straight away. To penalise someone for their willingness to pay seems to send quite the wrong message to that person and to others who may be minded to make a similar approach to HMRC.
- 4.2.3 Moreover, interest will usually be payable on the unpaid portion of the tax due, so the Exchequer is not actually losing any money. Even that can be inequitable as between different types of taxpayer, as we say in our response to the consultation document on interest. For example, the state pensioner in self-assessment who unexpectedly gets a tax bill will pay interest on the unpaid amount after the due date. If the pensioner were in PAYE, the liability would be coded out and no interest would be charged. We appreciate that such technical 'anomalies' may be beyond the scope of this consultation to rectify, but they do illustrate that the whole question of due dates, time to pay and issues of culpability are far from simple.
- 4.2.4 Secondly, given your acknowledgment that 'it is recognised that some taxpayers will have difficulties and may not be in a position to pay their tax on

⁵ Census 2001 and DWP Research Report No 173 (20+02)

- 4.2.5 Thirdly, one must consider what is the reason for entering into the time to pay arrangement after, rather than before, the due date. If because the taxpayer genuinely hoped to pay on time but was unable to do so, or because he did not realise the due date had passed, that would suggest disorganisation or ignorance rather than deliberate brinkmanship. Would imposing a penalty in addition to the interest already payable not be a futile and antagonistic gesture against a taxpayer who had already taken steps to make good their default?
- 4.2.6 If someone fails to adhere to their time to pay arrangement, again is this because they are in deeper financial difficulty than they at first thought, or is it that they are hoping to get away without paying? If the former, there seems little point in adding penalties to the interest they are already accruing. It is of course sensible for taxpayers in this position to contact HMRC as soon as possible to ask to vary their arrangement, and for HMRC to keep in close contact with them to support them through any difficulties. Subject to these points, we can accept that breaking a time to pay agreement would lead to penalties or at a minimum resumption of interest charges.
- 4.2.7 Imagine a taxpayer who has to pay the rent but their tax is also due. There is no question but that the rent must be paid. But a penalty is incurred for not paying the tax on time. The penalty means yet more tax is owed and debt is piled upon debt. There has to be a better way of encouraging someone in this situation to contact HMRC to arrange time to pay, and to suspend penalties in the meantime. This is an area where taxpayers could be encouraged by better publicity to apply for a time to pay arrangement – many unrepresented taxpayers have no idea that such facilities are available.
- 4.2.8 Given the above observations, we are opposed to the imposition of penalties whether the time to pay arrangement is entered into before, or after, the due date. A time to pay arrangement will generally incorporate interest and maybe some penalties, and the later it is entered into, the greater the interest. The taxpayer is therefore already paying more than they would have done had they come forward promptly. In the minority of cases where the cause of late payment is brinkmanship, penalties may be appropriate, but not in most cases where the cause is financial difficulty.
- 4.3.1 **Question 3.** *Are the safeguards for taxpayers suggested in chapter 5 adequate?*
- 4.3.2 The safeguards set out are generally comprehensive.
- 4.3.3 The special reduction referred to in para 5.12 et seq is likely to tie the hands of officers too tightly, if it can only be applied in 'extreme or exceptional circumstances'. In our response to the consultation document on penalties for failure to notify (March 2008)⁶, we strongly recommended that the special reduction should be used more widely to encourage people to come out of the informal economy. Similarly, we think that accumulation of penalties and interest could discourage people who miss due dates out of ignorance from

⁶ http://www.litr.org.uk/uploadedfiles/document/1_527_LITRG_penalties_response_0308_final.pdf

coming clean, remedying their failure and complying with their obligations in the future. At present officers have more discretion in such cases than is being allowed for in these proposals, and can use it to the longer term benefit of the Exchequer.

4.3.4 What constitutes 'reasonable excuse' is ultimately a matter for the courts, and we would expect to see a right of appeal against any refusal by HMRC to allow a plea of reasonable excuse.

4.3.5 Finally, adequate provision against double jeopardy is a vital safeguard. Where different penalty regimes apply to different behaviour patterns exhibited in the one misdemeanour, the potential for overlap is considerable. We discuss this further at para 4.9.

4.4.1 **Question 4.** *What are the advantages and disadvantages of 'capping' (where a late filing penalty is capped to the amount of tax due)? Are there any other safeguards that could be put in place that would protect vulnerable taxpayers without reducing the effectiveness of the penalty?*

4.4.2 You have set out the disadvantages of capping in paras 6.8 and 6.9, but there are also some advantages. As you point out, fixed penalties operate without regard to the taxpayer's means or culpability. Capping a fixed penalty can to some extent compensate by restricting its size to the amount of tax at stake. In that way it can mirror the tax-geared penalties higher up the scale.

4.4.3 Of course this does not work where the tax payable is considerably more than the penalty. If capping is advantageous for low-income taxpayers, it clearly works better for someone whose tax is collected through PAYE, say, and who has only a small amount left to collect at the end of the year, than for someone in self-assessment. It is an inexact tool.

4.4.4 You say that some taxpayers make an estimated payment of tax due by the filing date, then delay filing the return until much later. Others choose not to submit a return at all if they have no liability as they know the penalty will be reduced to zero.

4.4.5 These are two distinct patterns of behaviour, and you do not say what proportion of capped penalties is attributable to each, so it is difficult for us to assess the scale of the problem. If this is abuse, then it would be better to target the specific abuse; because a minority of people abuse the capping facility does not necessarily mean that the facility should be abolished for all.

4.4.6 If fixed penalties are no longer to be capped by reference to the tax due, some means must be found of protecting those who are not abusing the system and who may well perceive as unfair the charging a penalty where absolutely nothing is lost to the Exchequer. One possibility might be to cap the fixed non-filing penalty by reference to the total income or profits of the taxpayer. If this were done, it would protect taxpayers on low incomes while deterring those who might be tempted to put off filing their return because their outstanding tax liability was small after PAYE was taken into account.

4.4.7 Another possibility is to offer a 'time to file' agreement to people who are struggling in certain – perhaps exceptional – circumstances to file by the due date. Although it would involve more administration up-front, it could reduce the burden of imposing penalties and handling appeals after the filing date. It

would also develop a more co-operative relationship between HMRC and taxpayer. It would probably also be a useful mechanism where taxpayers are not yet in possession of the full facts about their income, gains or liability, and need more time to ascertain them – particularly in the case of paper filers who would otherwise face a 31 October deadline.

- 4.4.8 To summarise – we believe, as you do, that low-income taxpayers should have some protection where a fixed penalty would be disproportionate to the amount of tax they owe. Capping in its present form affords at least some protection, but is probably not the most effective, particularly when the filing date for paper filers is brought forward to 31 October (as we illustrate in example 1 in the Appendix). However, if capping by reference to the tax outstanding has been abused and it is intended to abolish it for that reason, some other way should be sought of protecting those on lower incomes. This could involve capping fixed penalties by reference not to the amount of tax due, but to the level of income or profits. Alternatively, or in addition, a ‘time to file’ facility could be explored.
- 4.5.1 **Question 5.** *Do you agree that there are benefits to alignment of penalties for failing to file a return or pay the tax owed by the due date? Are there any benefits we have missed?*
- 4.5.2 The benefits of alignment (para 1.2, 7.7 and passim) are exaggerated as far as most individual taxpayers are concerned. It may be convenient for HMRC, and indeed for some businesses, to have the one penalties regime across all taxes, but most individuals, and certainly those on low or modest incomes, are concerned with one tax, or (at the most) two taxes, and it makes no difference at all to them whether income tax is aligned with excise duties or VAT with environmental taxes. The majority of individuals with whom we have dealings are compliant by nature, and provided they know what they have to do are perfectly willing to meet their obligations. Usually it is not knowing what their obligations are that leads them into difficulties, and HMRC could do much to increase compliance rates by making information more readily accessible.
- 4.5.3 In any case, whatever benefit may be derived from substituting one penalty regime for the many currently applying to the different taxes, it is likely to be undermined by the very substantial differences between penalties for different offences, and the problems of overlap. We doubt whether the end result will be greater simplification.
- 4.6.1 **Question 6.** *How should HMRC use the tools discussed in Chapter 7 to most effectively reinforce both obligations – to file a return and to pay the tax due?*
Question 7. *How could the tools described in Chapter 7 be most effectively structured to tackle late or non filing and payment?*
- 4.6.2 Fixed penalties for failure to file on time have the advantage that they are widely understood, and effective. Capping, if retained in some form, would provide a measure of proportionality where the total tax at stake was small, or nil.
- 4.6.3 You raise some objections to the fixed penalty. You say in para 6.19 that ‘there appears to be substantial taxpayer confusion about the date on which the penalty will be imposed’. If you are referring to the rule in *Steeden v*

Carver, it is hardly surprising that many taxpayers are confused; but such confusion can be eliminated by clearer statutory rules.

- 4.6.4 However, it would be inequitable to impose the same fixed penalty for every failure, whatever the circumstances of the taxpayer (para 7.29). For example, the prospect of a £100 penalty might persuade the majority of self-assessing individual taxpayers to file on time, but it would be far too low to influence the behaviour of a multi-national enterprise. On the other hand, to impose on a self-assessing individual the same level of penalty as one would levy on a multi-national would be wholly disproportionate.
- 4.6.5 You seem in para 6.20 to cite as a disadvantage of the fixed penalty that it has led to a large number of appeals. Some of those will have been based on reasonable excuse, but how many are appeals against penalties that were wrongly issued in the first place? And why would any other system based on automated processes be any different?
- 4.6.6 Turning to late payment, in general we do not think it appropriate to charge penalties in addition to interest. The consultation document on interest makes it clear that there are two reasons for the charging of interest: to provide restitution to the Exchequer, and to remove the competitive advantage that might otherwise be gained by late payment. As we have mentioned in discussions with you, there is no need to use both penalties and interest to remove the competitive advantage; it can only be removed the once.
- 4.6.7 The use of penalties for late payment should be restricted to cases where deterrence is appropriate; for example, long (eg 12 months or more) delays in payment, particularly where deliberate. It could be seen as excessively heavy-handed to apply deterrence where payment is only a few days or even weeks late, and in any event carries interest.
- 4.6.8 The current self-assessment structure for individuals is based upon a mixture of fixed penalties, tax-gear penalties, is well understood, and – judging from the data quoted at para 2.3 that 85% pay their tax in full and on time, and most of the remainder within a few days of the deadline – is also reasonably effective. Of course it would be better if nearer 100% paid in full and on time; and from the perspective of the individual unrepresented taxpayer, as we have said above, that goal would better be achieved by concentrating on taxpayer education and support before the event than by exacting penalties after it.
- 4.6.9 Regarding suspension of penalties, we are not convinced by the arguments you raise against them (para 7.12 and 7.13). The purpose of suspension, it seems to us, is to provide greater flexibility for HMRC to respond helpfully to a taxpayer whose default is not one of wilful or deliberate evasion, but rather one of ignorance, temporary cash flow problems, or lack of organisation. In particular, charging a penalty where the taxpayer has no money to pay even the tax due, seems a pointless gesture. The object of suspension in such cases would be to get the outstanding tax paid as soon as possible, and to give the taxpayer an incentive to file or pay on time in future.
- 4.6.10 In the criminal law, the question whether a suspended prison sentence is appropriate is determined not so much by the nature of the offence as by the length of the proposed sentence. There seems little evidence that the law-abiding majority perceive it as unfair that sentences may be suspended; and if

it was thought in any one case that passing a suspended sentence would weaken the message the court wished to convey, an immediate custodial sentence would doubtless be passed instead. As for your objection that 'whilst returns may be filed on time they may not be correct and so all tax obligations would not have been met'; is it not the case that an incorrect return may attract a suspended penalty under the rules in FA 2007? And if so, why should a suspended penalty be appropriate for the incorrectness of a return, but not for its lateness?

- 4.7.1 **Question 8.** *If the requirement for pre-approval of daily penalties was removed, would the other safeguards suggested in this chapter including: a right of appeal against the penalty, internal review, and a possible limit on how large daily penalties can get be adequate to protect the taxpayer?*
- 4.7.2 To assess how effective the pre-approval of daily penalties is as a safeguard, we would need to know the grounds on which applications to impose daily penalties are currently granted or refused by the tax appeal tribunals. Certainly if the requirement for pre-approval were removed, there would need to be a right of appeal which would carry with it a right to internal review. Again, until the proposed internal review process has been fully formulated, it is difficult to assess how effective a safeguard that will prove to be. A cap on daily penalties seems a fair and reasonable protection for the taxpayer; presumably that would bear some relation to the amount of tax found to be payable.
- 4.7.3 We do, however, think that if the requirement for pre-authorisation is to be removed, daily penalties should not be imposed until the return has been outstanding for some time – at least, say, three months. In addition, as we have discussed, the warning notice should be very clear about the circumstances in which daily penalties will be charged, for how long they will be charged, and what the taxpayer needs to do to prevent them being charged.
- 4.8.1 **Question 9.** *How could HMRC ensure that the package when considered as a whole doesn't get disproportionate?*
- 4.8.2 It is necessary not only 'to consider the combined impact of separate penalty regimes for both obligations' [to pay and to file]. It is also necessary to consider the impact of interest on late payments, and the possible impact of other penalty regimes for associated failures (eg failure to notify).
- 4.8.3 The fact that the proposed new regime replicates the model of the current self-assessment penalty system, but (judging by the consultation document) is potentially harsher, could increase the likelihood that the package might become disproportionate.
- 4.8.4 As we have said earlier, we would prefer there to be no penalties on late payment until payment has been outstanding for some time. But if there are to be fixed penalties immediately a payment is deemed to be late, they should be set off against any penalties incurred for late filing. That would be consistent with ensuring that no taxpayer was penalised twice for the same misdemeanour. Alternatively, there could – as you suggest – be a restriction in the legislation on the total amount chargeable, which would have a similar effect.

- 4.9.1 **Question 10.** *Should those who file or pay shortly after the due date be treated differently from those who file their return or pay later?*
- 4.9.2 The present system allows for higher penalties the later the filing or payment. Under the new model it is proposed to bring forward tax-geared penalties for failure to file on time from 12 months to 6 months after the due date, although it seems that the amount chargeable after 6 months may be smaller than the 100% allowed under the present system after 12 months.
- 4.9.3 The answer to the question posed rather depends upon the circumstances of the taxpayer, and the reason for the late filing or payment. In practice, the unrepresented may not know, or may be confused about, the due dates, or may not realise how to ascertain them, for example if they are beginning a new trading activity. They will depend upon being told, and reminded, by HMRC when the due date is approaching, when it has passed, and (if the delay in filing or payment is lengthy) how long ago it passed. Unless HMRC take on that responsibility in all cases, it is doubtful whether a penalty should be charged at all, let alone more than one.
- 4.9.4 There are also interactions between different penalty regimes to be considered (para 7.9 et seq). Sometimes a late filing or payment may follow from a failure to notify. If a taxpayer does not notify HMRC that, for instance, they have started a business, it might be difficult for HMRC to provide the assistance necessary for that taxpayer to avoid late filing or payment. Therefore, the late filing or payment penalty should reflect the penalty for failure to notify, subject to the rule against double charging. If a penalty is charged for failure to notify, then the greater penalty should encompass the lesser, and no further penalty should be charged for the other failures. The outstanding tax will, after all, attract interest. If it is thought appropriate to reduce the penalty for failure to notify to nil, eg for disclosure within 12 months of the default, then there should be no late filing penalty, and interest on any outstanding tax should be sufficient to compensate the Exchequer for late payment.
- 4.9.5 Similarly, a late payment may follow from an incorrect return (ie the return showed the wrong amount of tax payable, and the balance is only paid once the mistake in the return is identified). In such circumstances, we expect that any penalty for late payment would be tailored to the penalty for the incorrect return. Again, there are circumstances in which a nil penalty might be charged for the incorrect return; if so, then a nil penalty should be charged for the resulting late payment, and the interest charge be relied upon to make good any loss to the Exchequer.
- 4.10.1 **Question 11.** *How should those who repeatedly file or pay late be treated?*
- 4.10.2 Those who repeatedly file or pay late once they have been informed of the due dates would not generally elicit much sympathy if they were charged higher or additional penalties. But there may be cases in which the circumstances of the particular taxpayer call for leniency (for example, mental ill health, learning disability, confusion due to age, etc).
- 4.11.1 **Question 12.** *How well do the approaches suggested in Chapter 7 balance the elements of the design principles?*

- 4.11.2 The design principles are that penalties should (a) influence behaviour, (b) be effective, and (c) be fair.
- 4.11.3 Considered in isolation, it could be argued that no penalty regime fits the design principles. If people incur a penalty, it means that their behaviour has not been influenced by the prospect of one. If a taxpayer has already defaulted (which he must do before he can incur a penalty), then the threat of the penalty has not been effective. And if a taxpayer is naturally compliant, to receive a penalty for a default they were not warned about is unlikely to seem fair.
- 4.11.4 Moreover, if a taxpayer is late in paying their tax – maybe inadvertently, or because of temporary cashflow problems – they might consider an interest charge fair enough, but balk at the imposition of a penalty in addition. In any case, if the reason for late payment is cashflow difficulties, a penalty is likely to be ineffective: if there is no money to pay the tax, there will be no money to pay the penalty.
- 4.11.5 It follows that for all but deliberate defaulters (a minority), those who require ‘detering’, penalties are likely to be counter-productive. Good taxpayer education and customer support, on the other hand, is far more likely to influence behaviour in such a way that no penalty is incurred in the first place. It is more likely to be effective, because it tends to dispel the ignorance which often causes a taxpayer to default. And few would regard as unfair a penalty imposed after due warning.
- 4.12.1 **Question 13.** *How effective are the approaches suggested for frequent filing and payment obligations in Chapter 8 likely to be in encouraging timely payment and filing? Are there alternative structures that may be more effective at encouraging on-time filing and payment?*
- 4.12.2 We are omitting this question as our concern is mainly with low-income taxpayers in PAYE or self-assessment.
- 4.13.1 **Question 14.** *HMRC would welcome views on the best way of encouraging employers to pay their in year PAYE in full and on time, without creating unreasonable burdens on employers?*
- 4.13.2 We believe that much could be achieved in encouraging employers to pay their PAYE in full and on time if HMRC improved their own internal systems in dealing with end-of-year returns and follow-up of persistent late payers.
- 4.13.3 The proposals in the consultation do mirror those discussed in the parallel consultation on interest and we would refer you to para 4.5 in our response to that consultation.
- 4.13.4 We would warn against the extended use of surcharges, as proposed in para 8.28 et seq. The evidence appears to indicate that many employers do pay shortly after the due date and if a preponderance of those are smaller employers paying late (para 8.23) this could indicate financial difficulty (e.g. do I pay the PAYE or the rent first), and surcharges are likely only to increase this financial pressure. In addition a greater burden of PAYE compliance is known to rest on smaller employers than on larger ones, and extending surcharges to this group might just increase their difficulties and solve nothing.

- 4.13.5 Monthly statements as discussed in para 8.33 may well place little additional burden on not-so-small small employers or medium sized ones, particularly those who run computerised systems. But consideration needs to be given to the impact on very small employers, or on accidental employers such as those in receipt of direct payments etc. Overall we are not in favour of a system that requires extra reports such as monthly returns.
- 4.13.6 We would not support monthly estimates of tax due (para 8.35) as this would be prejudicial to the taxpayer where there has been a downturn in business, especially if the estimate is based on last year's liability.
- 4.13.7 As we have indicated at para 4.5.2 in our response to the interest consultation, we would prefer a year-end breakdown of the monthly remittances. This would allow HMRC to take retrospective action by the use of penalties where appropriate for persistent late payers.
- 4.14.1 **Question 15.** *How well do the approaches suggested in Chapter 8 balance the elements of the design principles?*
- 4.14.2 We are omitting this question as our concern is mainly with low-income taxpayers in PAYE.

LITRG

12 September 2008

APPENDIX

Examples taken from actual TOP pensioner cases and the £100 penalty.

Example 1: Woman between 60-65 in self-assessment.

This taxpayer's spread of income gives an example of where someone on a low income could receive a penalty notice under the current 'capped' system.

- State pension £8583pa
- Occupational Pension £628pa (takes maximum K code)
- Other pensions £99pa; £224pa; £567pa – all on BR code
- Total income £10101
- Tax due £813.20
- Tax under PAYE £492
- Tax due following 31 January £321.20
- Paper tax return filed after 31 October but before 31 January
- Tax paid by 31 January

As a paper return was submitted after 31 October she might receive a penalty notice, and if she is unrepresented she might think she must find an additional £100, even though 'the right amount of tax is in charge' by the due date.

Examples 2 and 3 below – seen by a TOP adviser in recent months – illustrate that taxpayer confusion and personal problems such as health issues or responsibility to care for a family member, compounded by HMRC error, are often the reasons for non-compliance and subsequently their failure to secure appeal rights within the timescale available. These illustrate the need for taxpayer support and HMRC improvements in service rather than an alteration to the penalties regime.

Example 2

Mr W is aged 74. His only taxable income is the state pension, meaning he has to file self assessment returns. Due to a variety of health problems, he receives attendance allowance. He also has debt problems.

He told the TOP adviser that he submitted his 2006/07 tax return in September 2007, but HMRC did not receive it. He first realised this when he received a £100 penalty notice after 31 January 2008. On telephoning HMRC, he was told he could write to them within 30 days to appeal against the penalty, but he failed to do so. It was clear to the TOP adviser that Mr W was terribly confused, telling her:

'All this is so difficult when you're no longer the full ticket. Makes me panic. It's ironic that they deal with it all for you when you're young. Why don't they just stop the tax for you?'

Mr W kept no copy of the return in and no proof of postage, so disputing the penalty will be difficult to prove. In May, the TOP adviser helped him complete a duplicate 2006/07 return. In July, he received a tax calculation for 2006/07 showing nil income, nil tax liability. This is clearly wrong, as the state pension was included on the tax return.

On telephoning HMRC, the TOP adviser was told the easiest way of correcting the tax calculation was to write in with the state pension figure again. As Mr W was not confident to do this himself, the TOP adviser wrote the letter for him.

The final point to make here is that Mr W's situation only arises because DWP do not operate PAYE on his state pension, a point also made in our response to the interest consultation. HMRC's aim should be to remove such taxpayers from SA, which would in turn prevent them from being exposed to penalties.

Example 3

Mr P, 67, retired from the building trade when he was 62. The TOP adviser observed that he was perhaps not the most literate or organised person, but seemed to be doing his best to get his tax problems resolved. He cares for his sister since she had a stroke. He has been surviving on various DWP benefits and now receives the state pension and pension credit.

After retiring, Mr P kept receiving SA returns but didn't think they applied to him. He has received £200 in penalty notices for a late 2005/06 tax return.

Mr P had recently been in touch with HMRC to obtain a duplicate 05/06 tax return to complete, but the one he had been sent was for 2006/07. He had made an attempt to fill this in, but had become very confused.

The TOP adviser telephoned HMRC. They confirmed that 2005/06 was the only return outstanding and the system was flagged to show none would be required from 2006/07 onwards. HMRC's system clearly indicated that Mr P had requested a duplicate 2005/06 form but the instruction was processed incorrectly resulting in a duplicate 2006/07 form being sent out.

Looking at Mr P's income, there is likely to be no tax liability for 2005/06. Under the present capping rules, the late filing penalties should therefore be cancelled.

Clearly a taxpayer in Mr P's case needs support and assistance rather than penalties. Instead, his confusion was compounded by HMRC's administrative failure to send out the correct form when he requested a duplicate.