Low Incomes Tax Reform Group
A voice for the unrepresented

Making Tax Digital: Tax Administration
HM Revenue & Customs (HMRC) consultation document
Response from the Low Incomes Tax Reform Group (LITRG)

1 Introduction

1.1 LITRG welcomes the opportunity to comment on all the Making Tax Digital (MTD) consultations issued on 15 August 2016.

1.2 This consultation response should be read in conjunction with our responses to the other consultations on MTD.

1.3 We begin though with some general comments on the MTD policy.

2 Making Tax Digital programme

2.1 We generally support the HMRC digital strategy and recognise that many benefits may be possible in the digital world. We are though hugely concerned that much of the detail of the MTD programme is still to be considered and finalised, and as a result implementation of MTD for unincorporated businesses from April 2018 is totally unrealistic and unachievable in the timescale.

2.2 The current timetable does not allow sufficient time for:

- HMRC to properly publicise and educate the public about MTD;
- businesses to prepare for these very significant changes, both in terms of practical impacts and the additional costs which will result;

- the software – which is crucial to the success of MTD – to be anything like fully developed and tested.

2.3 We strongly urge HMRC to delay the commencement of MTD until the design has been completed and fully tested. This should substantially reduce the massive risk of the project going seriously wrong with the damage done to HMRC reputation but also the inevitable 'teething problems' that will without doubt occur. A more relaxed introduction will therefore lessen the chances of the public quickly losing faith in the system, reduce the chance of naturally compliant taxpayers making mistakes due to having to rush into unfamiliar territory, and protect HMRC from reputational damage.

2.4 We do not support the principle of mandating MTD and are wholly opposed to this approach. If we compare it to self assessment (SA) online filing which has been very successful without being mandatory, we can see that if a product is good and beneficial, taxpayers will naturally migrate to it. Mandation is very likely to have the opposite effect to that which it is intended to foster: instead of increasing tax receipts, it may act as a disincentive to businesses to trade legitimately and encourage some into the hidden economy.

2.5 Many businesses with low incomes will find it extremely difficult to comply with the requirements of MTD for a number of reasons, being cost, extra administrative time, lack of IT knowledge, and lack of financial literacy. To make the system work as smoothly as possible, we would strongly recommend that the exemption level is raised very substantially above the proposed limit of £10,000 annual turnover. In our view we consider that the exemption limit should initially be set at an amount equivalent to the current VAT registration threshold. This should at least mean that MTD for business will be more successful from the outset as potentially problematic traders will be below the exemption limit. In turn, fewer resources will be required to provide digital and perhaps financial support to those who will need assistance. This should result in a much smaller group than would otherwise be the case. But if MTD is as good as HMRC promise, traders will almost certainly wish to join it voluntarily.

2.6 The success of the MTD programme depends heavily on the use of good software. It is the responsibility of Government to provide free software where it is a requirement to have software to be able to comply with legal obligations. In respect of MTD HMRC should ideally provide good, free software to small businesses. Relying on commercial businesses to make free software available is, in our view, fraught with very significant problems and is wholly unsatisfactory. Free software provided from commercial sources will have only limited functionality, thus those unable to afford upgraded packages could be excluded from many of the purported benefits of MTD and free software providers will constantly be bombarding their customers with update requests.

2.7 Finally, there will always be some taxpayers who are digitally excluded for a variety of reasons such as lack of broadband due to remote location, or age, or disability. The service and support available to this group of taxpayers must be of at least the same level as that

available to digitally enabled taxpayers. Regretfully, the detail of what this support will likely be has not yet been made clear.

3 Tax administration: Executive Summary

3.1 We agree with a number of the proposals in relation to checking a taxpayer's tax position, such as replicating the current self assessment enquiry powers in respect of the End of Year (EoY) declaration, and replicating the approach for determinations, corrections and information powers. It is crucially important though that current safeguards are, as a minimum, fully maintained. Additional safeguards will almost certainly be required in relation to data security and privacy.

3.2 HMRC should take the opportunity presented by MTD to reinforce the dividing lines between the enquiry and discovery processes, which have become blurred lately. In addition, HMRC need to take very considerable care and act sensitively in how they approach apparent discrepancies, whether between taxpayer and third party information provided to HMRC, or between figures provided by the taxpayer in their quarterly updates and their EoY declaration.

3.3 We strongly recommend that the same three-year period of freedom from penalties be applied to those small and micro-businesses who come within the scope of MTD as was applied at the start of the real time information (RTI) regime.

3.4 We agree with the five design principles for penalties, but in terms of the design of the specific points system, we think that penalty points should expire after 24 months. In addition, far more should be done to cater for those whose failure to comply is due to vulnerability.

3.5 We think that the introduction of a quarterly filing regime with much shorter deadlines than the current SA system brings with it the need for much more flexibility around those deadlines. While one may be able to make plans to get an annual tax return in on time within a nine-month window, it is much more likely that a short term and unforeseen inconvenience (such as a broken smartphone) might prevent a taxpayer from meeting a deadline under MTD. We think that taxpayers ought to have a simple route to ask for a short extension of the deadline, or waiver of a penalty point, in such situations.

3.6 We recommend that there is a full review of the scope of 'special reduction' and call for decision-making on reasonable excuse claims to be more closely aligned with cases decided by the First-tier Tribunal (FTT).

3.7 We strongly recommend that penalty points should be appealable at the time of issue, rather than when they have caused a penalty to be charged. Otherwise, we think there is a serious risk that justice will be denied to many unrepresented and/or vulnerable taxpayers.

3.8 Our comments on late payment penalty proposals include a recommendation that HMRC do more for vulnerable taxpayers who find themselves in debt. Adding to their burden with

ever-increasing penalties does little to aid recovery of tax. Instead, efforts should be made to contact taxpayers before penalties mount up and seek to agree time to pay arrangements, with provision for penalties to be suspended provided that the payment schedule is adhered to.

4 About Us

4.1 The 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 on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.

4.2 LITRG works extensively with HMRC and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

4.3 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.

5 General comments

5.1 We welcome the opportunity to respond to this consultation on tax administration. Our response concentrates on the potential effects on taxpayers on low incomes and other vulnerable groups whom we seek to represent.

5.2 We note that the aims of MTD include to reduce the levels of non-compliance, errors, late submissions and late payments etc. We would expect this to be supported by evidence of current performance and goals set for improvement. Such evidence would provide a basis for assessing the value of introducing MTD and its long-term effectiveness.

5.3 Additionally, compliance data relevant to different groups of individuals (for example, by protected characteristics) and different types or sizes of businesses, plus data on the current means of filing, would demonstrate HMRC Equality Act duties while highlighting risk areas for non-compliance by volume, value and such characteristics. This would then assist MTD design to mitigate risk and improve performance.

5.4 ***Inaccuracy penalties – initial comments***

5.4.1 Paragraph 3.10 of the consultation document invites initial comments on inaccuracy penalties, on which we make here a general point about pre-population. Whether a person

is 'vulnerable' or not, pre-populated figures on a return or other document, particularly if they emanate from government, are highly likely to induce a sense that if the pre-populated figures conflict with other data in the person's possession, the pre-populated figures must be right (because they are from an authoritative source) and the other data must be wrong. It will be difficult to justify penalising a person who takes that approach (in the instance where this results in an inaccurate submission) given that it will be prompted by a wish to be as accurate as possible, and a belief that following the government-provided figures will best achieve that aim. It is hardly due to deliberate error, or even carelessness – rather the reverse.

5.4.2 Another point relevant to inaccuracy penalties is that many people find it easier to check accurately when a document is in printed form rather than on a screen. Any inaccuracy penalty regime needs to recognise and allow for the difficulty many will experience in checking figures on a screen, particularly a small smartphone screen, without access to a printer.

Finally, we believe that HMRC might need to take a relaxed view to inaccuracy penalties as MTD beds in. There will no doubt be those who have been mandated to keep their records digitally and file quarterly updates, and who do their best to use the software that will be available but nonetheless make mistakes. If inaccuracies are discovered on a future compliance check, HMRC will need to give them credit for their efforts and support them to correct what has gone wrong and get it right in future rather than penalise them for mistakes made in the transition.

6 Question 2.1: Do you agree that compliance legislation should be amended to replicate current enquiry powers into the Self Assessment return to the End of Year declaration?

Question 2.2: Do you agree that current HMRC and customer safeguards should also be maintained?

Question 2.3: Are there any other options for preserving HMRC's current enquiry powers in MTD?

6.1 It seems sensible that compliance legislation should be amended to apply current SA enquiry powers to the EoY declaration, and that existing safeguards should be maintained. We believe also that further customer safeguards will be necessary to protect privacy and security when accessing taxpayers' software in order to enquire into digital records, and Your Charter (https://www.gov.uk/government/publications/your-charter/your-charter) should be reviewed with that in mind, as well as any other updating necessary in the light of MTD.

6.2 The opportunity should be taken to reinforce the dividing lines between the enquiry and discovery processes which have become blurred lately. After the 12 month enquiry window (from the date of submission or amendment of the EoY declaration) the taxpayer should have confidence that the submission will not be enquired into except in the limited

circumstances in which a discovery assessment may be made, in particular that HMRC could not reasonably be expected to have become aware during the enquiry period of the loss of tax, or the loss of tax was brought about carelessly or deliberately by the taxpayer. There have been occasions in the past where communications from HMRC have looked like an attempt to secure a 'second bite at the cherry' even though the conditions for discovery have not been strictly fulfilled.

6.3 The use of nudges and prompts should reduce the number of occasions on which an enquiry is called for, as taxpayers will be encouraged to check and verify the information as they input it. But there are times when a taxpayer may justifiably override a prompt or nudge, and the mere fact of having done so should not of itself constitute a risk factor giving rise to an enquiry. For example, if prompts are designed to pick up on 'usual items', and one update does not include such an item, the prompt might ask the taxpayer to check whether there is a figure to include. The fact that there is no such figure to include in that particular update should not automatically increase the risk of an enquiry. This could occur with both costs and income, particularly if there is more than one income stream within a business – for example, a business that normally includes both 'turnover' and 'other income' might return no 'other income' in a particular quarter.

6.4 Additional taxpayer safeguards will be required to reflect the unfamiliarity of many individuals with the digital world, and the ease with which digital information can fall into the wrong hands. In addition, HMRC's right of access to taxpayers' digital records should be counterbalanced by robust safeguards. Given the prevalence of fraudulent activity in the digital sphere, particularly when fraudsters plausibly impersonate HMRC, the Department must take on a consumer protection role and not simply leave it up to the taxpayer to distinguish between the genuine HMRC approach and the exact, or near-exact, copy. HMRC must be particularly sensitive to the dangers to which the taxpayer may be subject in giving direct access to his/her computer. The taxpayer must have a right to compensation where an action or omission by HMRC has facilitated unauthorised access to digital records. We are dealing here with a very different world from paper records, access to which can be more tightly controlled.

6.5 Paragraph 2.19 of the consultation document states, 'We propose that the scope of any enquiry should include all aspects of the [taxpayer's] affairs that are currently required in the return.' While we trust that requiring both a digital return and a traditional SA return will be the exception rather than the rule during the transition, it seems sensible that there should be a unified enquiry process covering both. We do however foresee a difficulty where quarterly updates (which may not be the subject of an enquiry but access to which may be required in enquiring into the EoY declaration) contain different information from the adjusted figures in the EoY declaration itself or the SA return. Compliance teams may notice the difference, assume it is a discrepancy, and substitute the figure given by the quarterly update if that is higher. Similar problems arise already where, for example, RTI figures are different from those submitted on annual declarations for tax credits, which may be for perfectly legitimate reasons. There may also be a similar risk of issues arising where VAT figures do not match the quarterly updates.

7 Question 2.4: Do you agree with the proposed approach to replicate HMRC's compliance powers for determinations, corrections, information powers and discovery assessments?

Question 2.5: Do you have any other comments on how compliance powers need to change to transition to MTD?

7.1 Again, this seems a sensible approach; current safeguards must also be retained. However, paragraph 2.22 of the consultation document incorrectly states the law: under Taxes Management Act (TMA) 1970, section 28C, the taxpayer can displace a determination by submitting a return up to three years after the filing date, or 12 months after the determination if that is later (s 28C(4)). There is also no mention at paragraph 2.22 of special relief, which allows HMRC in certain circumstances to substitute the right amount of tax due for the amount that has become due and payable under a determination that has become final (TMA 1970, para 3A, Sch 1AB). That is an important safeguard which must be retained.

7.2 HMRC's 'best of judgment' assessments have on occasion been rightly criticised for being 'unreasonably excessive' (see, for example, *James Ronaldson Scott v HMRC Commissioners* [2015] UKFTT 420 (TC)). Under MTD, HMRC will have better access to taxpayers' digital records and should therefore be able to avoid such wild guesses. We expect that determinations issued to taxpayers who have given HMRC regular updates (even if they have failed to convert them into EoY declarations) will be based upon the information so provided, which should enable officers to exercise better judgment than hitherto.

7.3 Paragraph 2.23 states that HMRC can correct 'obvious errors' which might be simple and arithmetical or 'they might be information HMRC can see is incorrect based on other information'. As we have observed at paragraphs 6.3 and 6.5 above, the danger of this approach is that there may be a good reason for the apparent discrepancy, or information provided by a third party (such as a bank) to HMRC may be incorrect (or incorrectly attributed to the taxpayer), and care should be taken not to substitute an incorrect figure for a correct one, particularly where figures returned in the quarterly updates are different from those contained in the EoY declaration.

7.4 Paragraph 2.28 of the consultation refers to the possible need for transitional provisions to ensure that information discovered in MTD can inform discovery assessments relating to previous SA periods. MTD will mean HMRC have much more information at their disposal than previously. This can of course be helpful in assessing a taxpayer's position, however, it is important that information is used appropriately. Care needs to be taken not to leap to incorrect conclusions in respect of previous SA periods based on MTD information.

8 Question 3.1: Do you agree that 12 months is an appropriate length of time to allow [taxpayers] to become familiar with the new obligations before the new penalty regime comes into effect?

8.1 No.

8.2 It is clearly right to suspend the operation of any penalty regime until taxpayers have had an opportunity to get used to the major changes that MTD will bring. The question relates to how long a time scale that should be. HMRC would do well to learn from their own experience with RTI, when a light-touch penalty regime of substantial duration did no harm to the efficient operation of the new system. Some taxpayers – mainly new employers, and those with fewer than 50 employees – had three years in which to adjust before being subject to late filing penalties, and there were further relaxations for employers with under ten employees. Compared with the introduction of RTI, the current proposal of a mere 12 months familiarisation period seems remarkably ungenerous. This is particularly the case since 12 months will not even give taxpayers the opportunity to experience a full MTD cycle, with the EoY declaration only being due nine months after the year-end, according to current proposals.

8.3 In addition, taxpayers will have to adjust to a variety of new obligations under MTD, including quarterly updating, the possibility of different accounting bases and different accounting periods. The self-employed, in particular, may also be adjusting to keeping their records online and learning how to use new software and hardware.

8.4 We therefore strongly recommend that the same three-year period of freedom from penalties be applied to those small and micro-businesses who come within the scope of MTD as was applied at the start of the RTI regime.

9 Question 3.2: Do you agree that the period to wipe the slate clean should be 24 months? If not what other period would be appropriate?

9.1 We agree that there should be such a 'rehabilitation' period, and 24 months is not unreasonable.

9.2 But we recommend there should also be a limit on the length of time penalty points can sit on a taxpayer's account. For example, a taxpayer is issued with one penalty point in June 2018, and then is compliant for a time; they are then issued with another point in July 2019, and again they are compliant thereafter. The first point should be removed from the taxpayer's account in June 2020, and the second point should be removed in July 2021. In effect, points should 'expire' 24 months after they have been received, whether or not they have contributed to an actual penalty during that time. This is more just, in that it should be clear from the outset how long a 'punishment' should endure. This is also comparable to other systems, such as for driving offences, where points expire after a specified period.

10 Question 3.3: We invite views on the design principles outlined for the points-based penalty. For example, do you consider there are any further elements to build in to this basic model?

10.1 The five design principles are, in summary: (1) designed from the customer perspective, primarily to encourage compliance and prevent non-compliance, (2) proportionate to the offence, taking into account past behaviour, (3) applied fairly, so that compliant customers are in a better position than non-compliant ones, (4) provide a credible threat, and (5) applying a consistent and standardised approach.

10.2 The principles for the new late submission penalty – no penalty for a first offence, drawing taxpayers' attention to their failure and giving them the opportunity to avoid a penalty, and taking account of their history of compliance – go part of the way to correcting the disproportionate and unfair aspects of the present late-filing penalty regime. Paragraphs 3.17 and 3.18 of the consultation suggest that the amount of the penalty will be graded according to culpability, with a tax-geared penalty for deliberate failure to make a submission, and this should help alleviate the current situation where the amount of the penalty bears no relation to the tax at stake.

10.3 However, more should be done to cater for those whose failure is due to vulnerability: the previously compliant individual who over time becomes non-compliant because of the onset of illness, disability or old age; the individual who suffers periodic episodes of mental ill-health during which they are unable to deal with their affairs; the taxpayer who suffers a bereavement or family breakdown and is temporarily disabled from handling day-to-day paperwork; the itinerant taxpayer who cannot file online from abroad; the PAYE employee who is self-employed for a few weeks and penalised for not meeting his filing obligations, even though he is on PAYE throughout.[1]

10.4 Another potential source of injustice is the penalty levied on taxpayers who do all that is required of them, but because they do not fully understand the digital systems fail to complete the filing process. Historically there have been tens, probably hundreds, of thousands of SA filers who complete 95 per cent of the filing process but do not press the final 'submit' button, thereby incurring a late-filing penalty when they genuinely think they have done everything they need to do. We understand that this is less of a problem now, since the system is supposed to give a prompt that the return has not yet been filed (if appropriate), when the taxpayer exits the online system. One hopes that with more sophisticated systems there will be nudges and prompts to guide filers through all the necessary steps. But there is also the wider question of how fair and proportionate a penalty system can be that makes no distinction between a mechanical failure due to unfamiliarity with IT systems, and a negligent or deliberate failure to file on time. In our view a

[1] Our concern here is taxpayers who are employed throughout a tax year and whose only previous experience of the tax system is the PAYE system; for a few weeks during a tax year they also have a self-employment, which they should report to HMRC. They fail to comply in respect of their filing obligations, however. Given they are in the PAYE system (meaning that it is relatively easy for HMRC to recoup any underpaid tax), the key issue is the filing obligation. We raise for consideration here the idea that perhaps employees in this position should be treated a bit more leniently, particularly given they are more likely to be unaware of SA obligations.

mechanical failure should not attract a penalty, or a penalty point; it can be perfectly well prevented by showing the taxpayer how it should be done, with clear instructions combined with nudges, prompts, etc.

10.5 We also take the view that a failure to submit on time owing to an IT failure (whether in relation to IT products or services belonging to HMRC, the taxpayer or a third party provider) or an unreliable connection should not be penalised at all, not even with a penalty point. There will be occasions when the taxpayer realises in advance that they will be unable to submit on time, because of the HMRC system, third party system or the taxpayer's IT equipment not working, and this is through no fault of their own. In such instances, it should be possible to apply for a reasonable excuse in advance, such that the system does not issue an automatic penalty point. By way of example, a taxpayer may be due to submit a quarterly update by 31 March. They try to make a submission on 15 March, because they are going on holiday for three weeks the following day (so there will be no further entries to include in the update). However, either due to a fault or planned downtime, the HMRC system is not able to accept the taxpayer's information on 15 March. The taxpayer is therefore unable to submit their quarterly update until after their return from holiday in April. It would not be appropriate for a penalty point to be issued in such a case.

HMRC may argue that if a taxpayer knows they may have a problem meeting a deadline, they should always be able to plan around it. That is not always the case, as shown in the example above of HMRC systems not working; but equally it may be down to myriad other reasons. A further example might be that a taxpayer is due to file a quarterly return next week, but their smartphone – their means of compliance with MTD – is stolen or broken. In that event, again, a taxpayer should have the ability to ask in advance for their deadline to be extended, or a penalty point waived. HMRC would no doubt wish to ensure that compliance takes place within a reasonable period of whatever event prevents the taxpayer from doing so on time, but it should be possible to devise a simple process to ask for 'time to comply'. This is also discussed at paragraphs 9.9.6-9.9.8 in the section on exemptions in our response to the consultation 'Making Tax Digital: Bringing business tax into the digital age'.

10.6 In addition, we recommend that, as with RTI, a few days' grace is built into each submission deadline so that submissions made within that period of grace will not incur a penalty point or a penalty. This is particularly important in the early years of the new scheme.

10.7 Finally, we repeat two recommendations from our response to the consultation document on penalties issued in February 2015:

1) A full review of the scope of 'special reduction' is called for: in particular whether it should be extended to cases where late filing is due to a taxpayer's vulnerability, and the resulting penalty is disproportionate to the tax at stake; whether special reduction can be used to mitigate the 'strict application of the penalty law' when it produces a result that is 'contrary to the clear compliance intention of that penalty law' in a wider category of cases than at present; and whether HMRC officers actually do consider special reduction in all cases that they are required to.

2) Decision-making on reasonable excuse claims should be more closely aligned with cases decided by the FTT and HMRC's own statutory review teams. This might, for example, involve rewriting the official guidance on reasonable excuse to take account of FTT decisions at a more detailed level. It is notable that every year, the Tax Assurance Commissioner reports that statutory review teams vary or overturn well over half of the penalty decisions that come before them, which hardly speaks well of the quality of decision-making in HMRC on such matters.

11 Question 3.4: At what stage for each of these different submission frequencies should points generate a penalty?

11.1 We have no particular views on this. We merely observe that if the objective is to reduce the number of penalties charged, the models at paragraphs 3.19ff, 3.27 and 3.29ff might cause them to increase, at least as far as income tax is concerned. Currently there is one filing obligation a year, whereas under the new system there may be five (potentially more if a taxpayer chooses to submit updates more frequently than quarterly): four quarterly updates and one EoY declaration. If a penalty is to be charged after incurring four penalty points, that could lead to more than one penalty a year under the new system. In addition, it may be that low-income, self-employed, universal credit (UC) claimants are more likely to opt for monthly reporting to HMRC (given the need for monthly updating for UC), and therefore it might disproportionately affect this group. We do recognise, however, that if people respond to the accrual of penalty points by correcting the failure, the chance of them incurring a penalty will be diminished (paragraphs 6.7 and 6.8 of the consultation refer).

11.2 We think more consideration needs to be given to how this model will work for someone who wants to update more frequently than quarterly under MTD, but therefore updates on a less regimented/irregular basis, say every two months, or sometimes two monthly, sometimes every month. Will taxpayers have to nominate how frequently they will provide updates to HMRC in advance?

11.3 We note that the Digital Tax Account (DTA) will display the penalty point total for a taxpayer. It is important to ensure that there is also a non-digital means of letting taxpayers know their running points total and of notifying them when they incur a new penalty point. There will be taxpayers who find themselves unable to access their DTA through illness, disability, and also due to more prosaic problems, such as failure of equipment, or failing to keep payments up on their mobile phone contract. As noted at 2.7, it is also important that the level of support and assistance available to those who are unable to engage digitally is at least equivalent to that provided for the digitally enabled. There should also be a clearly defined process setting out at what point HMRC should use a non-digital channel if it becomes apparent that a taxpayer has ceased to engage digitally. Indications that a taxpayer has become digitally excluded might include the fact that they cease to make their regular updates or cease to access their DTA, particularly when they have previously been compliant.

12 Question 3.5: We would welcome comments on whether existing penalties are sufficient to support compliance with occasional filing obligations. If not, what more is needed?

12.1 We have no comment to offer.

13 Question 3.6: Do you agree that, in principle, a single points total that covers all of the customer's submission obligations is the right approach?

13.1 Yes.

13.2 We have a concern about how this would work in relation to partnerships, and in particular whether actions of the nominated partner could affect the penalty position of the other partners and vice versa.

14 Question 3.7: Do you agree that the proposal outlined in paragraphs 3.25 to 3.28 is the right way to operate a single points total? If not, what alternative would you suggest that ensures the design of the penalty is kept simple?

14.1 To the extent that the proposal accords with the principle set out in question 3.6 above, we agree. But we have reservations about the frequency with which penalties arise under this model, or the number of penalty points that should accrue before a penalty is charged. We are inclined to the view that four penalty points is too few, given such a pattern would probably lead to the imposition of a greater number of penalties than at present.

15 Question 3.8: We welcome views on whether the escalator model wold be a more effective way of aligning with the five principles described in paragraph 3.2.

15.1 In our view the escalator model as set out at paragraph 3.31 would be complex and unwieldy, difficult for taxpayers to understand or keep track of, and only repeat the sterile and unsatisfactory accumulation of penalties to little or no purpose that happens now with SA. If a submission deadline is repeatedly missed while other subsequent deadlines are met, the appropriate response should be a reminder and an offer of assistance in case there is a systematic fault. An extra penalty point would do nothing to resolve the problem and would only exacerbate whatever difficulties were causing the failure.

15.2 It should be possible to 'design out' repeated failures by arranging the software so that, if (for example) the Q1 submission had been missed, the Q2 submission would report on both Q2 and Q1. Intelligent software should be able to spot that a reporting obligation had been missed and prompt the taxpayer accordingly: "Do you want to report your Q1 summary at the same time?" There would then be no need for an escalator model.

15.3 In any case, even if all four quarterly updates are missed, that should be redeemable by a prompt and accurate EoY declaration and the following year should begin with a clean slate.

16 Question 3.9: Do you agree that a fixed penalty is appropriate?

Question 3.10: Should the amount of fixed penalty reflect the size of a business?

16.1 We have no objection to a fixed penalty provided the amount is not disproportionate to the amount of tax at stake. We believe it was a mistake to abandon the capping of fixed penalties by the amount of tax due, and recommend that some similar mechanism should be reinstated in the new regime; or at least to ensure that 'special reduction' is used in cases where penalties are disproportionate to the ultimate risk of loss to the Exchequer resulting from the taxpayer's failure.

16.2 Provided that unrepresented taxpayers who owe little or no tax are protected in that way, we have no particular views on whether the fixed penalty should increase in proportion with the size of a business. In order to do this, HMRC will have to define how they determine 'size' for this purpose, whether by looking at one or several factors, such as turnover, profits, net assets, number of employees, etc. We agree that it is in the interests of the taxpaying community that any penalty charged to a business of substance should be such as to take away any economic advantage that business may gain by being non-compliant.

16.3 A fixed penalty without adequate provision for mitigation or remission risks being unfair and disproportionate, contrary to the design principles in paragraph 3.2. Please see paragraph 10.8 of this response.

16.4 When notifications or warning letters are issued as penalty points are accrued, they should be clear about what the recipients have to do and what help is available, including any reasonable adjustments for the digitally assisted population.

16.5 In, as we read it, dismissing the idea that educating taxpayers about their obligations could be key to improving compliance, paragraph 3.35 of the consultation effectively disengages HMRC from any responsibility for advising or educating the taxpayer on how the new MTD system will work. If HMRC take that attitude, those who cannot afford professional advice, or who are confused or uncertain about their obligations will continue to receive the same treatment as those who are deliberately non-compliant, which is one of the unfairnesses inherent in the present system that we were hoping the revised penalty regime would steer clear of. It is an approach which focuses more on the convenience of the administrator than the needs of the customer, and makes it difficult to take seriously any claim by HMRC to be a customer-focused organisation. If speed awareness courses help to reduce offending by motorists, we see no reason why tax awareness courses should not have the same effect on non-compliant taxpayers, particularly where non-compliance is due to ignorance rather than brinkmanship – and even more so at a time when the tax system is about to change out of all recognition. We strongly recommend that this stance be reconsidered.

17 Question 3.11: Do you agree that points should only become appealable when they have caused a penalty to be charged?

17.1 No. Points should be appealable at the time they are incurred. This should be a full right of appeal to the Tax Tribunal. If HMRC are confident in their decision-making abilities, this should not lead to the Tribunal Service being overwhelmed with appeals for the award of points (which in itself may not give rise to a penalty being charged).

17.2 If a penalty point is issued because, for example, of an IT failure, or because the taxpayer has a reasonable excuse for non-submission, then it is entirely appropriate that the taxpayer should have the right to appeal against it at the time of issue. Otherwise penalty points will simply accrue until a penalty is charged, at which point any appeal should focus on whatever defects there may or may not be in the charging of the penalty, not on whether or not a penalty point should have been issued in some previous period. Justice delayed is justice denied.

17.3 We also think it would be simpler to allow appeals at the time. Otherwise there are risks of evidence being mislaid or destroyed, or taxpayers forgetting that they had a valid reason to appeal a particular point. This would be a particular issue if HMRC pursue the approach suggested at paragraph 3.20 f., which could mean that points sit on a taxpayer's record for several years – see our response to question 3.2 above. This would also mean that the penalty system becomes more of a potential revenue-raiser rather than a tool to encourage compliance.

17.4 In addition, taxpayers often find dealing with their taxation obligations to be stressful. Denying a taxpayer the right to appeal the imposition of points is denying them peace of mind, particularly if they have a reasonable excuse for the failure. For vulnerable taxpayers, such as those with a mental illness or physical disability, being unable to appeal at the time of issue of a penalty point could be particularly detrimental.

17.5 Furthermore, it is not unknown for HMRC to issue penalties in error. It would be unconscionable for a taxpayer to be unable to challenge an erroneous penalty point.

18 Question 4.1: Do you agree that 14 days is an appropriate length of time to allow customers to either pay in full, or make arrangements to do so before penalty interest is charged?

18.1 We agree that a period of grace should be allowed, but would regard a 30 day period as more appropriate than the 14 days proposed. See also our answer to question 4.4 below.

18.2 Where the taxpayer asks for time to pay before the due date, but HMRC have not yet agreed the terms before the period of grace has expired, we believe that penalty interest should not be triggered before the time to pay arrangement has been concluded – provided the taxpayer does not delay unreasonably in providing any information requested. It would be

unconscionable to charge penalty interest if the taxpayer had made a timely request, but HMRC had not concluded the arrangement before the period of grace was up.

19 Question 4.2: Do you think that charging penalty interest is the right sanction for non-compliance with payment obligations?

Question 4.3: Are there any other commercial models that might be appropriate for us to consider?

19.1 We agree that charging penalty interest is an appropriate and proportionate sanction for late payment. In contrast with a fixed penalty, it allows the severity of the sanction to vary according to the amount of tax outstanding, and the length of the delay in payment.

20 Question 4.4: We invite views on the design principles outlined for penalty interest. For example, do you consider there are any further elements to build into this proposal?

20.1 There will be a transitional period during which many people may not be comfortable with paying online. Simply being able to go online and use social media apps, or send and respond to emails, etc. does not necessarily mean that one has the skills to do online banking. Such taxpayers should either be allowed longer, or permitted to pay by an alternative method. Some have valid concerns about the security aspects of committing details of their bank account and other personal financial matters to the internet, and are uncertain about how to make payment securely. Their concerns should be respected.

21 Question 4.5: Does model 1 or model 2 best meet the government's objective of providing a fair and proportionate response to late payment of tax?

21.1 We favour model 1. We see no need for model 2; given that compound interest will be building up on the original and accumulated debt, we think doubling and trebling the interest rate at regular intervals could soon breach the government's design principle of proportionality. Besides, the greater the late payment penalty, the more difficult it will be for the debtor to secure funds to pay both the principal debt and penalty interest – and the greater the probability that HMRC will experience the problem of irrecoverable debt, as happens now with SA penalties.

21.2 In cases where a second or third late payment penalty becomes due we would urge HMRC to consider intervention before issuing the penalty to try to establish whether there might be mitigating circumstances that could constitute a reasonable excuse in due course. If the taxpayer cannot pay the principal sum due for valid reasons, there is little point in adding further late payment penalties which may cause severe stress and anxiety. In this instance, we would urge that HMRC aim to agree a time to pay arrangement if possible and to suspend any further penalty provided that the taxpayer sticks to that payment schedule. In

some cases, such as bereavement for example, it may even be necessary to suspend collection altogether until such time as the reasonable excuse has passed.

22 Question 4.6: Do you agree that the timing of late payment penalties should change to reflect the frequency of payment due dates?

22.1 Yes, to the extent that penalty interest should be charged with reference to due dates for the tax in question. That said, we do not see the necessity for charging additional penalty interest 60 days after the due date when another payment of VAT will fall due shortly thereafter, presenting an opportunity to add a further interest charge for any VAT that remains outstanding from the earlier quarter. A three-monthly charge of VAT penalty interest balances with the six-monthly charge for income tax and we do not see the need for greater frequency.

23 Question 4.7: We invite views on the design principles outlined for late payment sanctions. For example, do you consider there are any further elements to build into these proposals?

23.1 Please see our answers to question 4.4.

24 Question 4.8: Which proposal best meets the design principles?

24.1 Model 1, for the reasons set out in our answer to question 4.5. In addition, model 2 arguably aims to raise revenues, rather than simply encourage compliance.

25 Question 5.1: Should the current interest rules for income tax and Class 4 NICs continue to apply in MTD?

25.1 Yes.

26 Question 5.2: Do you have any initial comments about aligning interest rules cross taxes?

26.1 We have no initial comments, other than that alignment is generally a welcome simplification, but if there is a good reason for any difference between taxes then it might be undesirable to force them into alignment simply for the sake of it.

27 Question 6.1: Please provide details of how the proposed administrative changes will affect you, including details of any one-off and ongoing costs or savings.

27.1 N/A.

28 Question 6.2: Do these administrative proposals have a significant or disproportionate impact on groups with legally protected characteristics, as recognised in the Equalities Act 2010?

28.1 We repeat our observations in response to question 3.3. Although the risk of people accruing enough penalty points to merit an actual penalty will diminish if they take note of the nudges and prompts sent to them, there always will be those for whom no amount of nudging or prompting will be effective – not because they will not comply, but because they cannot. Many in this group are likely to be people with protected characteristics under the Equality Act 2010 – old age and disability in particular – and the impact of any penalty regime on them could be disproportionate if reasonable adjustments are not made (such as a sensible attitude to reasonable excuse appeals and the scope of special reduction). Where penalty points are incurred because of unfamiliarity with digital processes, HMRC will be bound to offer what help they can through digital assistance schemes. Although some within these groups will qualify for exemption from MTD, they will not become exempt from all tax compliance obligations, and HMRC's current penalty regime for late filing and payment operates significantly to their disadvantage because there is so little scope for reasonable adjustments. Under the proposed new regime there is more scope, provided full use is made of reasonable excuse and special reduction, and taxpayers are clearly and routinely notified of their appeal rights.

LITRG
7 November 2016