

**Making Tax Digital – sanctions for late submission and late payment
Response from the Low Incomes Tax Reform Group (LITRG)**

1 Executive Summary

- 1.1 We welcome this further opportunity to comment on penalties reform.
- 1.2 Whichever model is chosen, HMRC need to communicate the changes to late filing penalties clearly. HMRC will also need to offer support for those who have missed an obligation. (See section 3.2)
- 1.3 We strongly recommend that application of new penalties to Making Tax Digital (MTD) is deferred for up to three years to support those making the change to the new regime. (See section 3.3)
- 1.4 Safeguards are essential, such as HMRC continuing to have the ability to cancel an obligation and any penalties associated with it (as already exists for income tax self assessment). (See paragraph 3.4.1)
- 1.5 We recommend that the principles underlying reasonable excuse claims for missing filing deadlines are completely reviewed in the light of regular filing requirements under MTD, and that factors such as technological aptitude are taken into account. (See paragraphs 3.4.2, 3.4.5 and 16.3.2)
- 1.6 None of the models as proposed caters entirely for those low-income, unrepresented taxpayers who may, for various reasons, have fallen into prolonged arrears with their tax obligations. To get those people back on the straight and narrow, we recommend that – whichever model is chosen – HMRC also have the ability to suspend penalties that have

accumulated and write them off if a taxpayer is then compliant for an agreed period. (See paragraph 3.4.6)

- 1.7 In section 4 below, in our view we are inclined to favour model A – ‘points based’ penalties, as we think this has the greatest flexibility. Within that framework, many low income, unrepresented taxpayers struggling to deal with their tax obligations may be supported to comply – particularly if combined with our immediately preceding recommendation at 1.6.
- 1.8 Also in section 4, we set out a number of points against model B – ‘regular review of compliance’. Furthermore, we explain that we think model C – ‘suspension’ has greater appeal than model B, albeit that there is insufficient flexibility to deal with certain groups of low-income, unrepresented taxpayers who may become vulnerable, indebted and in arrears with their tax obligations for various reasons.
- 1.9 We express huge concern at the lack of consultation on fixed penalty amounts and potential disproportionate/regressive impacts on the low-income population. We further strongly recommend that draft legislation is published for consultation and that efforts are made to test practicality of the new penalty model and HMRC communications alongside the MTD pilots. (See sections 3.3.2, 5, 6 and 16.2)
- 1.10 The introduction of quarterly reporting under MTD brings with it greater practical challenges and barriers to compliance than annual reporting. Thus, we recommend that HMRC have a facility for taxpayers to request additional ‘time to comply’, without penalty, if they know they will struggle to meet a deadline. (See paragraphs 8.2ff and 16.3.1)
- 1.11 We make two minor observations relating to penalty interest and would welcome the opportunity to input into further consultation on this subject. (See section 15)

2 About Us

- 2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those 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.
- 2.2 LITRG works extensively with HM Revenue & Customs (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.
- 2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT’s primary purpose is to promote education and study of the

administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

- 2.4 We note that this LITRG response comes to slightly different conclusions to the CIOT response by favouring the points-based model (but to which we recommend the addition of a suspension feature). This is due to LITRG’s focus on what may best suit low income unrepresented taxpayers, for the reasons we explain throughout this document.

3 Introduction

- 3.1 We welcome the opportunity to contribute to the ongoing process of penalty reform. Before answering the consultation questions, we make some general points.

3.2 *Communicating the new penalties regime to taxpayers*

- 3.2.1 It is important to note that whatever regime is chosen, clear communications will be necessary. For example, those engaged with self assessment at present will probably be relatively familiar with the £100 late filing penalty. Changes under the chosen model will therefore need to be communicated to taxpayers – presumably alongside their notice to file a tax return, or notice to comply with MTD. Clear communications will also be needed on an ongoing basis when a taxpayer is late complying with an obligation and has therefore taken a step along the road to incurring a penalty under the new regime.

- 3.2.2 It is also essential that HMRC’s communications offer support to get things right – for example, when notified of a point having been clocked up under model A, HMRC should outline how they can get back on track and what help is available to do so.

3.3 *Deferred application to MTD*

- 3.3.1 Paragraph 2.6 of the consultation document confirms that taxpayers will have ‘a minimum period of 12 months from when they become subject to Making Tax Digital... before the new late submission penalty comes into effect’. However, as in our previous comments to HMRC, we think a longer transition period will be necessary and would reiterate that this minimum of 12 months should be kept under close and ongoing review as part of the pilot and in the early years of MTD. By way of comparison, under real-time information (RTI) for PAYE, the smallest businesses ended up with a grace period of three years before penalties were incurred. With MTD, it should be noted that a 12-month grace period will not cover a complete MTD cycle. It would seem odd to set the penalties clock ticking for not filing the first MTD end of year submission on time when a grace period has applied to the first year’s quarterly submissions.

- 3.3.2 Ideally, the new penalties model would be developed alongside the MTD pilot period. Doing so could allow HMRC the opportunity to assess each of the different models and draw much clearer conclusions than through theoretical research alone. It would also give an opportunity to test and revise communications so that when a new penalties model is introduced, it will have already been practically tried and tested. However, the combination

of the current timetable under which MTD becomes mandatory for some from April 2018, and HMRC's intention (despite the grace period) to have new penalty rules on the statute book before that date, means that there is likely to be insufficient time for such testing to take place. This is disappointing and another reason for the MTD timetable to be relaxed.

3.4 **Review of safeguards**

- 3.4.1 We understand that HMRC's intention is to maintain existing safeguards in relation to penalties. In particular, it is clear that the ability to cancel an obligation that should never have been imposed in the first place – and so also cancel any penalties associated with it – should be carried forward into MTD, as already exists for self assessment.¹ For example, it might be the case that a person has missed MTD deadlines, but it later transpires that they could have claimed an exemption from MTD obligations. The ability to cancel the original obligation and backdate the exemption would be important to avoid penalties arising in connection with the missed deadlines.
- 3.4.2 The continuing safeguard of being able to claim reasonable excuse for missing filing obligations is essential and therefore the commitment to maintaining this noted in paragraph 2.11 of the consultation document is welcome. However, we suggest that not only *maintenance* of reasonable excuse is required but also – given the shorter timescales for compliance to be imposed by MTD and the practical issues raised as a result – the principles underlying reasonable excuse should themselves be reviewed.
- 3.4.3 For example, we have taxpayers contacting our website who often need the services of the separate charity TaxAid because they have missed self assessment deadlines and may have amassed large sums in penalties before they realise their mistake, or eventually face up to the brown envelopes and seek help. Under the current self assessment penalty regime, where daily penalties start to accrue automatically after 90 days in default, the sums involved very quickly escalate to unreasonable amounts which are disproportionate to sums owed and which are frightening for many low-income taxpayers. Indeed, once high penalties have been incurred, as in self assessment daily penalties, there is a risk that taxpayers are overwhelmed, cannot face dealing with the situation and just continue to ignore it and the penalties act as a further disincentive to compliance.
- 3.4.4 It is therefore welcome that, as we understand it, automatic daily penalties will not be a feature of the new chosen regime. However, it is concerning that whatever regime is chosen out of models A, B or C, with the advent of MTD and quarterly obligations, the typical 'bury one's head in the sand' or 'did not realise or understand what they were supposed to do' kind of taxpayer could still have amassed significant penalties by the time they take action or seek help.
- 3.4.5 While some such taxpayers may be able to demonstrate they have a reasonable excuse for failing to comply with their obligations, it may be argued that many will not if they were

¹ Section 8B TMA 1970, Withdrawal by HMRC of notice under section 8 or 8A

simply ignorant or frightened of the system. We trust HMRC will continue to take a flexible and sympathetic approach when considering reasonable excuse appeals under MTD for vulnerable taxpayers, as they have done under self assessment when it has been appropriate to do so.

- 3.4.6 Where no underlying reasonable excuse is accepted but a taxpayer is nevertheless trying to get back up to date with their tax obligations, we recommend that the penalty regime should have some flexibility to support this type of taxpayer when they do come forward. One way to do so might be to introduce a form of suspension into whichever model is chosen. We might, for example, envisage a system where many points and penalties have accrued under model A but if the taxpayer comes forward and rectifies the situation, then meets future obligations on a timely basis (ie meets certain suspension conditions), all or part of the penalty could be suspended and eventually waived.

4 Question 2.1: Which of the three penalty models proposed (A – Points-based, B – Regular review of compliance, or C – Suspension of penalties) do you consider to be the best and why?

- 4.1 We are inclined to favour model A – ‘points based’ penalties, as we think this has merit over the others for a number of reasons, specifically thinking of the low-income, unrepresented taxpayer.
- 4.2 Before discussing those merits, it might be helpful to say why we think the other two models may be less suitable.
- 4.3 Model B – ‘regular review of compliance’ has, we think, a number of points against it, as follows:
- 4.3.1 It would not be straightforward to explain to the public.
- 4.3.2 It lacks a clear link between the timing of defaults and the imposition of a penalty – in fact, particularly in the case of Fig 4.2, it could be many months before a default or series of defaults triggers a penalty at the point when the review takes place. This has two obvious disadvantages. First, it does not immediately address the negative behaviour HMRC are seeking to rectify. Thus, a taxpayer could have gone on for some time missing deadlines before any action is taken. At least with models A and C there is a clear limit on non-compliance before a penalty is issued. Second, the taxpayer could have been compliant with their affairs in the most recent period up to the time of the review, but then receive a penalty for earlier defaults. For example, with MTD quarterly reports, they might have missed three filings in year X, but then caught up with their obligations and been on time since quarter 4 of year X. To then issue them with a penalty part way through year Y on the basis of the earlier non-compliance would seem wholly counterintuitive. It may also be counter-productive when one of the aims of the penalty system is to encourage compliance.

- 4.3.3 Whatever name is given to a ‘regular review of compliance’ it is difficult to see how the public would distinguish such a process from other reviews of their affairs such as compliance checks and enquiries. This is therefore likely to cause confusion and consternation amongst taxpayers, and potentially generate fear.
- 4.3.4 It would also seem that, in order to work properly, a system like this would have to rely very much on the discretion of individual officers. This may be fine when dealing with inaccuracy penalties but when penalising lateness there needs to be greater certainty – ie the taxpayer should know that if they are late, say, four times in a row, they get a penalty of £X. It is difficult to see how such a system could be automated (which presumably would be HMRC’s desired means of administering the large part of any new penalty system, not least due to minimising costs).
- 4.4 Model C – ‘suspension’ has greater appeal than model B. Nevertheless, we think there are a number of downsides:
- 4.4.1 Though inaccuracy penalties may themselves be the subject of review in due course, it is possible that a suspension system for late filing penalties could be confused with the suspension rules already in existence for inaccuracies where there was a failure to take reasonable care.¹ As a result, ensuring taxpayers understand this model may be difficult.
- 4.4.2 Suspending a penalty for, say, 30 days – that is, effectively giving the taxpayer 30 days’ grace to fulfil their obligation, is not as flexible for taxpayers as a points-based system. Flexibility, bearing in mind quarterly reporting requirements under MTD, is preferred for the reasons we give below (see paragraph 4.5ff).
- 4.4.3 It would need really swift and effective communication between HMRC and the taxpayer, in order to explain to the taxpayer they are late, but if they submit within X days they will not receive a penalty. This is a particular concern for taxpayers who might be exempt from digital compliance – while electronic notification of a missed deadline may be sent quickly, postal delays would be a problem for those complying by other means.
- 4.4.4 Suspending penalties in this way a certain number of times before failing to suspend penalties could be considered to reinforce negative behaviour. Communications would have to be very clear that a certain missed obligation had triggered a final suspension and that the next time a penalty would occur immediately. That is, the risk is that the taxpayer will have got used to having 30 days’ grace and therefore be surprised when subsequent defaults are penalised immediately.
- 4.4.5 As noted above, this type of suspension model does not allow a taxpayer who has fallen into longer term difficulties in dealing with their tax obligations to get ‘back on track’ – see para 3.4.3ff.

¹ Schedule 24 FA 2007

- 4.5 So now we return to our view that model A – ‘points based’ is preferable. Our reasons for this are set out below:
- 4.5.1 This appears to be the most straightforward model to explain to taxpayers. It seems clear that when you miss a deadline, you collect a point; and that when those points mount up to a certain number, a penalty is incurred.
- 4.5.2 We welcome the fact that HMRC have accepted representations made by ourselves and others that points should be appealable at the time of their accrual rather than only when a penalty is levied. This is essential to establish at the time if, for instance, there was a reasonable excuse for the failure.
- 4.5.3 The points system would provide flexibility – a safety net, if you like, for those who might understandably at times fail to meet the more regular obligations to be imposed under MTD. It is much easier to plan around an annual deadline than it is a quarterly one. Life gets in the way: the taxpayer’s toddler drowns their smartphone in the bath on the eve of their MTD filing due date; one’s seasonal business is having a particularly busy period leaving little time to catch up on paperwork; a self-employed migrant has to go back to their home country where broadband services are not as readily available as they are in some parts of the UK. Not all such circumstances will constitute a reasonable excuse, but the points-based system would still provide each of these taxpayers with welcome breathing space in which to catch up with their obligations without the immediate fear of a penalty.
- 4.5.4 As noted at para 3.4.3ff, we would like to see this model coupled with a suspension condition that would allow taxpayers who have fallen into arrears the opportunity to get up to date and, provided they then remain compliant, to have penalties reduced or waived altogether.

5 Question 2.2: What are your views on the relative importance of the competing demands of fairness, simplicity and effectiveness?

- 5.1 We think all three aims are good and important. Ideally, all three would be achieved in the final model, however it is clear that there can be tensions between these demands. One area that concerns us in particular is that alignment between taxes (while potentially helpful to some who have to deal with, say, income tax for their own return, VAT returns and corporation tax for their company) should not be driven through at the expense of achieving fairness when considering the taxes individually. For instance, it is difficult to see how a fixed penalty sum could be arrived at that produces a proportionate result for a late submission for an individual and, say, a large company.

6 Question 2.3: To what extent does each of the three penalty models strike an appropriate balance between fairness, simplicity and effectiveness?

- 6.1 Fairness is difficult to comment on in relation to any of the models to the extent that no amounts of penalties are proposed in the consultation document. Penalties, so far as possible, ought to be proportionate to the default. It is difficult to see how this can be achieved if fixed amounts are to be set to apply across all taxes for all manner of default. What is proportionate (and also effective) for one taxpayer will be disproportionate for others, and also inadequate to be effective for some. We would have preferred for there to have been some public consultation on proposed amounts of penalties before proceeding to publication of draft legislation, though we understand from page 2 of the consultation document that this will not be the case.
- 6.2 We therefore recommend that draft legislation is published for consultation, as – along with the issue of the amounts of penalties – there could be points of detail that require careful consideration. Such details may be small but could be significant in terms of gauging the balance between fairness, simplicity and effectiveness.
- 6.3 We note above how model B may fail in the objective of effectiveness, as there needs to be a clear link between a failed obligation, or series of failed obligations, and a penalty being raised.

7 Question 3.1 Do you agree with these proposals for the duration of the required good compliance periods?

- 7.1 Yes, we think that linking good compliance to a number of submissions is preferable to the time period proposed in the previous consultation.
- 7.2 Our concern would be that MTD will allow for some people to file more frequently than quarterly if they so wish; but the frequency of penalties must be geared to the period within which it is compulsory to file rather than any shorter period in which taxpayers may choose to file. So if, for example, they choose to file monthly, HMRC communications would need to be clear that it is not the 'Monthly – 6 submissions' line of the table at paragraph 3.9 of the consultation document that applies but instead the 'Quarterly... – 4 submissions' line.

8 Question 3.2: Could any changes be made to the points-based penalty model to make it fairer, simpler or more effective?

- 8.1 We think the points-based penalty model offers a reasonable balance of the three aims.
- 8.2 Nevertheless, for any of the proposed models, one improvement we think that ought to be made is for HMRC to have the ability to agree that a taxpayer can have additional time to comply with an obligation. The points-based model, as argued above, in fact already has the greatest 'leeway' of the models on the table, but we would still suggest that HMRC give

thought to the following suggestion, made in response to the MTD consultations last autumn:¹

‘Time to comply’

9.9.6 One might also envisage scenarios where someone needs to make a ‘time to comply’ arrangement, rather than incur a penalty and apply for reasonable excuse for their failure. This might be for example if they need time to replace a computer that has succumbed to a virus. HMRC should have a simple process for this.

9.9.7 The consultation also refers to the UK Government’s commitment to the availability of broadband across the country as justification for why it is believed that MTD will be a success (for example, para 2.11 which refers to the Government’s support for all having access to ‘basic broadband of 2Mbps for all, which HMRC consider is a speed sufficient to send an update’). What must not be forgotten is that there may be some people who are temporarily abroad and out of range of broadband – for example a migrant to the UK who is self-employed, but who has temporarily returned to their home country for a family emergency – who may usually be able to comply, but not be able to at the time their report is due. This is obviously easier to manage and work around for an annual tax return than it is for more frequent reports. There therefore must be a concession, and the ability to apply in advance for a deferment – perhaps until they return to the UK.

9.9.8 We recommend that HMRC must have clear processes for anyone temporarily unable to comply with MTD, which should include the ability to apply for short term extension of a deadline or deferment of a filing obligation.’

- 8.3 Adopting the above would help to reinforce HMRC’s position as an approachable, customer-focused organisation. If, however, this is not thought to be practicable for reasons such as it being difficult to automate due to opening it up to abuse, or it being resource intensive if the taxpayer has to telephone to request the extension, this would reinforce our preference for model A given its greater flexibility than the other options.
- 8.4 We also recommend, as in paragraph 3.4.6 above, that the model is supplemented with a provision to suspend penalties for some taxpayers.

¹ See <http://www.litrg.org.uk/latest-news/submissions/161108-making-tax-digital> – the paragraphs quoted are from the ‘Making Tax Digital for Business, bringing business tax into the digital age’ document, but were reiterated in our ‘Tax administration’ response.

9 Question 4.1: What are your views on the timing of the review?

9.1 We offer few comments on model B, as we do not favour it for the reasons previously explained. If such a model were to be adopted, we would suggest that the review would need to take place sooner rather than later – such that the penalty is levied as close as possible to the last time of default. As described above (paragraph 4.3.2), to have a review of year X compliance some way into year Y is counterintuitive given its potential to penalise earlier defaults that have since been corrected.

10 Question 4.2: Which of the three options mentioned in paragraphs 4.5 to 4.7 above for customers within Making Tax Digital for Business do you think is the most appropriate?

10.1 As above, we do not favour this model, but of the options, that set out in para 4.7 of the consultation document ('to review compliance with the obligation to provide regular updates and the obligation to provide an end of period statement separately') would make most sense. This is on the basis that the review could then be timed so as to minimise any time lag between a default and a penalty being issued.

11 Question 4.3: Do you agree this would be a proportionate response to occasional lateness that lasted just a short time?

11.1 We agree that taxpayers should not be penalised for occasional lateness that lasts only a short time. As we have said above, we prefer model A on the basis that it allows the greatest flexibility for a taxpayer who defaults in their obligations to get back on track without the immediate threat of a penalty.

11.2 As noted at paragraph 3.4.3ff, we also think there should be flexibility to suspend penalties for those who are trying to correct previous non-compliance and to reduce or waive them if they do in fact stick to being compliant for an agreed period.

12 Question 4.4: Could any changes be made to the regular review of compliance model to make it fairer, simpler or more effective?

12.1 See previous comments.

13 Question 5.1: Do you agree that improved compliance should be recognised? Is there a better alternative for recognising it?

13.1 Yes, we agree that improved compliance most certainly should be recognised. One would not expect the 'immediate penalty' regime to continue *ad infinitum* for a taxpayer who has 'amended their ways'. To do otherwise would run contrary to the objective of fairness.

- 13.2 In addition to reintroducing suspension after a period of good compliance, HMRC could consider refunding all or part of earlier penalties charged as an additional incentive.

14 Question 5.2: Could any changes be made to the suspension model to make it fairer, simpler or more effective?

- 14.1 See our introductory comments above. A form of suspension could be introduced into whichever model is chosen in order to deliver a fair result to taxpayers who have fallen into arrears but then seek to get back on track, and also to incentivise people to do so.

15 Penalty interest

- 15.1 Though we note that no comments are specifically sought on this topic, we have two observations to make.
- 15.2 First, referring to paragraphs 6.8 and 6.9 of the consultation document discussing the leeway period before levying penalty interest, it is key that reasonable excuse provisions are maintained such that people can appeal the charge.
- 15.3 Second, as late payment interest – designed to provide commercial restitution for late payment – is to be retained and this already varies along with the Bank of England base rate, it is not at all clear why penalty interest should also be a fixed percentage *plus* the base rate. This would seem to us to involve double counting of the base rate. We illustrate this issue below by way of an example.

Example – double counting of base rate

Let us say the commercial (late payment) interest rate is base rate + 2%, and then on top there is penalty interest of base rate + 7%. The base rate is 1%.

Gerald owes £10,000 tax and he is a year late paying it. Gerald would pay:

- late payment interest at 3% – £300
- penalty interest at 8% – £800

Now, let us say the base rate jumps to 7%. Gerald would pay:

- late payment interest at 9% – £900
- penalty interest of 14% – £1,400

Gerald pays an extra 12% using the proposed model when the base rate goes up by 6%. It does not seem right that HMRC should take account of the increase in base rate twice.

16 Initial assessment of impacts, Chapter 7 of consultation document

16.1 We make two observations on the initial assessment of impacts.

16.2 *Proportionality/regressive nature of proposed penalties*

16.2.1 These penalties are for non-compliance with regular submission deadlines. The penalties are not to be tax-related, but fixed. We appreciate this is simpler, but it also discriminates against the low-income taxpayer (individual or company) who is likely to have fewer resources to comply (and, arguably, may feel less able to appeal the penalties – a problem that will only be exacerbated if costs are introduced to access the tax tribunal). We note above our concern that the amounts of fixed penalties have not been put forward for consultation and reiterate our recommendation that the legislation is consulted upon.

16.3 *Equality and other potential impacts*

16.3.1 There might be circumstances in which business owners with certain disabilities might find constant compliance with MTD obligations a trial – e.g. if they have to be in hospital, and cannot always plan their visits to coincide with filing deadlines. In theory, they should have a reasonable excuse, but there is no guarantee that HMRC will see things the same way. They might not meet criteria for exemption from MTD, nor in fact might they wish to apply for exemption if they would rather use digital filing means. As noted in paragraph 8.2 above, this is a further reason for HMRC to be able to be flexible around filing dates and agree ‘time to comply’ in some situations.

16.3.2 We are aware that there have been a number of cases with self assessment online in which the taxpayer had thought they had complied with their obligations and filed a return. But in fact it turned out that they had not pressed the final submission button, or perhaps had not realised that an error had occurred in the process so that the return was not submitted. With quarterly filing obligations, there could also be an increase in penalty points and penalties arising from people not completing all the necessary steps to make sure their report is properly filed – a question of technological aptitude rather than a straight case of lateness. As noted above at paragraph 3.4.2, HMRC ought to take into account such factors when considering application for reasonable excuse.

LITRG
9 June 2017