

Repayment interest and commercial restitution

Autumn Budget 2024 representation by the Chartered Institute of Taxation

1. Executive Summary

- 1.1. The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 20,000 members, and extensive volunteer network, in providing our response.
- 1.2. We would like to draw the government's attention to an area of unfairness, which puts businesses who are owed money by HMRC at a disadvantage with no reciprocal incentive / disadvantage to HMRC for unnecessary delay, while penalising taxpayers when they are in the position of owing HMRC money. This is due to an imbalance in repayment and late payment interest rates: The rate of interest HMRC pays taxpayers on money it owes them is much lower than the rate taxpayers are charged on money they owe to HMRC.
- 1.3. At a time when HMRC's service levels are widely recognised as being at an all-time low, the interest regime is doing little to incentivise timely repayments by HMRC, suffocating business and personal investment while monies are 'stuck' with HMRC. This hurts the ability to do business and hinders growth.
- 1.4. The government should consult on the rate and approach to repayment interest on overpaid tax. This is necessary to ensure that repayment interest provides adequate recompense for the loss of the use of the monies by the business or individual concerned, and an adequate incentive for HMRC to process repayments in a timely fashion.
- 1.5. In addition, and specifically in relation to VAT, we would urge the government to re-introduce the concept of 'commercial restitution' when levying interest on underpaid VAT, to prevent interest from being charged in circumstances where there is no loss of tax to the Exchequer. This is an anomaly which arises due to the way the tax operates rather than due to any intentional act on the part of the taxpayer.

2. About us

- 2.1. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.
- 2.2. The CIOT’s work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.
- 2.3. The CIOT draws on our members’ experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.
- 2.4. Our members have the practising title of ‘Chartered Tax Adviser’ and the designatory letters ‘CTA’, to represent the leading tax qualification.

3. Introduction

- 3.1. We are pleased to set out below our rationale for the need to review repayment interest¹, and address the inequity brought about by the late payment interest regime as it applies to VAT.²
- 3.2. Our stated objective for the tax systems include:
 - A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
 - Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
 - Greater certainty, so businesses and individuals can plan ahead with confidence.
 - A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
 - Responsive and competent tax administration, with a minimum of bureaucracy.
- 3.3. Our representation aims to deliver on the last two bullets outlined above.
- 3.4. Generally speaking, HMRC charges late payment interest at the Bank of England base rate plus 2.5%. HMRC pays repayment interest at the Bank of England base rate minus 1%, with a minimum rate of 0.5%.³
- 3.5. As such, there is typically a 3.5% differential between the late payment interest rate paid by taxpayers and the repayment interest rate paid by HMRC. For example, the current late payment interest rate is 7.5% and the current repayment interest rate is 4%. Additional financial sanctions (eg penalties or penalty interest) are also levied on the late payment of tax liabilities. While these were consulted on relatively recently (see later), they compound the unfairness between the recompense for taxpayers, and that for the Exchequer. There are no such financial sanctions on HMRC for late repayments of tax.

¹ ie on tax overpaid, tax repayable by HMRC etc.

² Finance Act 2021, section 120 and schedule 29, brought VAT within the interest regime in Finance Act 2009.

³ <https://www.gov.uk/government/publications/rates-and-allowances-hmrc-interest-rates-for-late-and-early-payments/rates-and-allowances-hmrc-interest-rates>

- 3.6. The government consulted on repayment and late payment interest generally during 2008 and 2009. This led to the introduction of new provisions within Finance Act 2009: section 101 dealing with late payment interest, and section 102 dealing with repayment interest.
- 3.7. The need (or otherwise) for differential between the rates was considered, and there were a range of views, with those in support of an equal rate stressing the importance of fairness and adequate recompense. In our own submissions, we recognised the arguments for differential interest rates, ie that interest on late payments should compensate (but no more) the Exchequer for the delayed receipt of payments rightfully due and act as a disincentive to paying late. But we also stressed the need for repayment interest to provide sufficient recompense, particularly in cases of HMRC error or delay.
- 3.8. While some of the findings from those consultations remain valid, it is right to review whether they remain appropriate some sixteen years on. Further, it would in any event be consistent with the tax policy making process⁴ to undertake a review of these changes, particularly considering the current economic and administrative climate. Many businesses and individuals have experienced financial difficulties and have required additional time to pay their tax liabilities (plus interest). Conversely, many businesses and individuals have suffered (and continue to suffer) lengthy delays in receiving repayments from HMRC.
- 3.9. While taxpayers and their advisers can submit complaints to HMRC, and seek compensation for costs caused by HMRC's mistakes or delays, there seems to be no provision to reimburse the incremental financing costs, or opportunity costs, of delays in receiving repayments. In our view, the tax system itself, without requiring the taxpayer to make a complaint, should provide adequate recompense for delays in receiving legitimate repayments or credits of tax.
- 3.10. The issue of commercial restitution arises due to the peculiarity of VAT being a tax which is charged by one entity that could be potentially reclaimable in full by another. So, even where VAT has been underdeclared, there may be no revenue loss if that VAT would have been fully reclaimable by another person had it been correctly charged. Recent changes to the interest regime for VAT mean that interest is now charged in situations where there is no revenue loss.

4. Illustrative examples

- 4.1. We have set out below some simple examples which illustrate the significant differentials that exist between the treatment of tax repayments / overpayments owed by HMRC, and late payments of tax owed by taxpayers. Amounts are rounded to the nearest £1.
- 4.2. VAT
- 4.3. From 1 January 2023, the new late filing penalty and penalty interest regime commenced for VAT. These regimes will be extended to income tax and corporation tax at a future date.
- 4.4. Company A submits its VAT return for the quarter ended 31 March 2024 on 30 April 2024, claiming a repayment of £10,000. HMRC makes some enquiries into the return but, satisfied it is correct, releases the repayment on 31 July 2024.

⁴ <https://www.gov.uk/government/publications/the-new-budget-timetable-and-the-tax-policy-making-process/the-new-budget-timetable-and-the-tax-policy-making-process>

- 4.5. In this instance, HMRC will pay repayment interest of **£99**, calculated at 4.25%⁵ of £10,000, for the period from 8 May 2024 (the day after the due date for the VAT return) to 31 July 2024.
- 4.6. This amount of interest may be wholly inadequate recompense for the delay, particularly as Company A may already have had to pay to its suppliers the VAT on its purchases in the meantime, and thus has to finance the gap between paying the supplier and obtaining the refund from HMRC. If the company's cost of capital is 9%, it is actually still at least £111 out of pocket,⁶ so the repayment interest has clearly not provided adequate recompense, even though the company has been fully compliant with its tax affairs.
- 4.7. Company B submits its VAT return for the quarter ended 31 March 2024 on 30 April 2024, showing a liability of £10,000. The company experiences cash flow difficulties, but makes the payment in full on 31 July 2024.
- 4.8. The late payment interest will be **£180**, calculated at 7.75%⁷ of £10,000, for the period from 8 May 2024 (the day after the due date for the VAT return) to 31 July 2024.
- 4.9. So, while Company A is entitled to just **£99** for receiving its repayment nearly three months late (even though it submitted an accurate return, on time), Company B is required to pay nearly twice as much interest to HMRC.
- 4.10. The position for Company B is potentially much worse, as it may also be liable to a late payment penalty if it had not (or could not) agree a time to pay (TTP) arrangement with HMRC in a timely fashion. In this case, assuming a TTP had not been agreed, the late payment penalty would comprise two elements; a first late payment penalty of **£400**, being 4% of £10,000 (the full amount remaining unpaid after 30 days),⁸ PLUS a second late penalty of **£59**, calculated daily at the equivalent of 4% per annum of £10,000 for the period from 8 June 2024 (31 days after the due date) to 31 July 2024.
- 4.11. In this case, Company B would be required to pay an additional **£639** by virtue of its late payment, **six and a half times** the amount of recompense payable by HMRC to Company A. This imbalance is plainly unfair.
- 4.12. The government intends to extend this late payment penalty regime to income tax and corporation tax, when they come into the scope of Making Tax Digital. Considering the current delays taxpayers are experiencing in receiving repayments, this is a concern.
- 4.13. Self assessment
- 4.14. Individual A submits their Self-Assessment return for the year 2021-22 on 31 January 2023, claiming a repayment of £5,000 due to the carry back of losses. HMRC do not look at the return for nine months and, after some internal checks, the repayment is made on 28 February 2024, some thirteen months after the repayment return was submitted.
- 4.15. In this instance, HMRC will pay repayment interest of approximately **£203**, calculated at rates ranging from 2.5% to 4.25%, for the period from 1 February 2023 to 28 February 2024. In the meantime, while the repayment is outstanding, Individual A is required to find the funds to make further payments to HMRC in July 2023 and January 2024.

⁵ The repayment interest rate for that period was 4.25%.

⁶ 9% cost of capital of £210, less the repayment interest of £99.

⁷ The late payment interest rate for that period was 7.75%.

⁸ Comprising 2% of the outstanding amount at day 15 plus 2% of the outstanding amount at day 30.

- 4.16. Individual B submits their return for the year 2021-22 by 31 January 2023, but fails to pay the liability due of £5,000. They pay the outstanding tax in full on 28 February 2024.
- 4.17. The late payment interest will be approximately **£388**, calculated at rates ranging from 6% to 7.75% of £5,000, for the period from 1 February 2023 to 28 February 2024.
- 4.18. So, while Individual A is entitled to just **£203** for waiting over a year to receive their repayment, Individual B is required to pay interest of **£388**, again nearly twice as much.
- 4.19. The true position for Individual B is actually much worse. Individual B will also be charged three late payment penalties of 5% each.⁹ These will add up to a total of **£750**.
- 4.20. In this case, Individual B would be required to pay an additional **£1,138** by virtue of their late payment, nearly **6 times** the amount of recompense payable by HMRC to Individual A.

5. Our recommendation on interest

- 5.1. It is now twelve years since the government consulted on its general approach to repayment and late payment interest. While the government consulted on harmonising interest rates during 2016 and 2017, the differential between the rates of repayment and late payment interest was not in scope; although we expressed our concerns at the removal of Repayment Supplement for VAT which (prior to its abolition) acted as an incentive for HMRC to issue VAT repayments timeously.
- 5.2. We suggest that the government consults on the rate and approach to repayment interest on overpaid tax. Such a consultation is necessary to ensure that repayment interest provides adequate recompense for the loss of the use of the monies by the business or individual concerned, and an adequate incentive for HMRC to process repayments in a timely fashion (and a ‘penalty’ if they do not).
- 5.3. As with late payment interest, we suggest exploring the extent this can be done in a predominantly automated fashion, and whether particular ‘triggers’ might apply additional rates or amounts of interest. For example, mistakes attributable to HMRC or other types of official error, or processing delays beyond HMRC’s funded service levels, may warrant a higher rate of repayment interest.
- 5.4. We believe that, unless something is done to bridge the gap between repayment interest and late payment interest, the inherent unfairness in the regime will continue, and it will inhibit the government’s growth agenda, conflicting with the government’s objective of providing ‘providing stability, integrity and certainty’.

6. Commercial restitution

- 6.1. Interest is generally charged on underpaid taxes in order to represent ‘commercial restitution’ ie to compensate the Exchequer when it has been deprived of an amount of tax for a period of time.

⁹ These are levied after 30 days (typically 3 March – the ‘penalty date’), five months from the penalty date, and eleven months from the penalty date.

- 6.2. It is possible for a taxpayer to underdeclare an amount of VAT due to HMRC, in circumstances where that VAT is reclaimable as input tax by a third party such as the taxpayer's customer. In such cases, there has been no loss to the Exchequer and no compensation or restitution required.
- 6.3. Under the previous interest regime (which applied to VAT return periods starting on or before 31 December 2022), this principle of commercial restitution could be applied. HMRC had discretion to apply an 'inhibit' setting on their system so that no default interest would be charged to the supplier for the underdeclared output VAT, because there had been no loss to the Exchequer.¹⁰
- 6.4. Under the present system (which applies to VAT return periods starting on or after 1 January 2023), HMRC no longer has statutory discretion to not charge interest in these circumstances, so the ability to apply the old inhibit indicator is no longer available.¹¹ So, interest is now being charged in situations where there is no net loss to the Exchequer. We do not understand this to be a deliberate policy intention and it may simply have been an oversight due to the unique position of VAT - a tax chargeable by one person that is sometimes reclaimable by another.
- 6.5. Due to the disparity in interest rates outlined above, this creates an absolute cost – a penalty in any other name – even though no tax has been lost. This statutory discretion must be reinstated as per the previous rules. It is inequitable that the Exchequer should be enriched at the expense of businesses where there is no net-loss to the Exchequer.

7. Acknowledgement of submission

- 7.1. We would be grateful if you could acknowledge safe receipt of this representation. We would welcome the opportunity to discuss the issues we have identified in more detail.

The Chartered Institute of Taxation

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¹⁰ <https://www.gov.uk/hmrc-internal-manuals/vat-default-interest/vdim3010>

¹¹ <https://www.gov.uk/hmrc-internal-manuals/compliance-handbook/ch140295>