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Follower Notices and Penalties – HMRC Consultation

Response 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 19,000 members, and extensive volunteer network, in providing our response.

1.2 In general we agree with the proposals in the consultation document, in the absence of HMRC following the House of Lords' recommendations[1]. We are aware that the high level of the current follower notice (FN) penalty (50%) can act as a disincentive for a taxpayer to continue with their appeal even if they consider that their case has a strong chance of success.

1.3 However, even at a penalty level of 30% we would anticipate that the same issues will remain and that it will still act as a disincentive for a taxpayer who considers they have a strong case to continue with their appeal. In other words, it does not overcome the fundamental problem with the FN penalty regime which is that it puts pressure on a taxpayer not to exercise their legal rights.

1.4 HMRC's proposal to introduce a 30% / 20% penalty structure seems to us like a 'fudge' when what is actually needed is a more radical overhaul to overcome the rule of law problems presented by how the FN regime is formulated.

1.5 In paragraph 5 we consider some alternative options which might help to achieve a better balance between the objective of FNs to discourage further litigation of points already settled with the rights of taxpayers to continue a genuine dispute.

[1] 'The Powers of HMRC: Treating Taxpayers Fairly' – December 2018 report by the House of Lords Economic Affairs Committee. Its recommendations were that the FN legislation be amended to include a right of appeal to the tax tribunal and that the FN penalty regime be abolished - see paras 94 and 104.

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 This consultation[2] is seeking comments on proposed changes to penalties for failing to take corrective action in response to a FN. It is proposing to reduce the standard rate of the penalty from 50% to 30%, but to maintain the higher rate for those taxpayers whose cases are without merit and whose continued refusal to settle with HMRC is deemed to be time wasting. The purpose behind the proposal to reduce the standard rate of the penalty to 30% is to provide a more genuine choice to those taxpayers who believe their own case is different and has a strong chance of success and who wish to continue to pursue their appeal, instead of taking corrective action. Draft legislation has been published alongside the consultation document.

3.2 The CIOT's stated objectives for the tax system relevant to this consultation 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).

4 Q1. Do you agree that reducing the penalty rate would better balance the objective of FNs to discourage further litigation of points already settled with the rights of taxpayers to continue genuine disputes?

[2] https://www.gov.uk/government/consultations/follower-notices-and-penalties

4.1 Yes, in general we agree with this, in the absence of HMRC following the House of Lords' recommendations. We are aware that the high level of the current penalty (50%) can act as a disincentive for a taxpayer to continue with their appeal even if they consider that their case has a strong chance of success.

4.2 The behaviour being penalised by the FN regime at the point a penalty is appealed is (i) a taxpayer taking a different view to HMRC on a particular point and (ii) deciding to appeal to the tribunal. That is fundamentally contrary to the rule of law - whether the penalty is 10%, 30% or 50%. It is hugely problematic for the Executive to pressurise persons into not exercising their legal right to access the courts simply because the Executive thinks those persons are not being reasonable. When we commented on the draft legislation that introduced the FN penalty provisions[3] that are now in Finance Act 2014 s 208 to s 214, we said that we anticipated that the measure would effectively mean a taxpayer would be prevented from pursuing their case any further even if they genuinely believed that their case was different, and that this could not have been the intention of the legislation so we are pleased that HMRC are consulting again on this. However, we are disappointed that the consultation is not considering broader points such as the lack of appeal rights against the issue of the FN itself.

4.3 We agree in principle (in the absence of HMRC following the House of Lords' recommendations) with the proposal to reduce the standard penalty to 30% and appreciate that HMRC are trying to find an appropriate balance. However, even at a penalty level of 30% we would anticipate that the same issues will remain and that it will still act as a disincentive for a taxpayer who considers they have a strong case to continue with their appeal. In other words, it does not overcome the fundamental problem with the FN penalty regime which is that it puts pressure on a taxpayer not to exercise their legal rights.

4.4 The consultation document notes at paragraph 2.8 that 30% is the same as the maximum penalty for a careless inaccuracy on a tax return but it does not make it clear that this is in addition to the FN penalty[4]. In addition, many errors involving tax avoidance are now automatically presumed to be careless[5]. Put together a 60% penalty will be a substantial deterrent against avoidance (albeit they can be mitigated for the quality of disclosure / co-operation). If the level of the standard FN penalty is reduced to 30%, the existing reduction available for co-operation which can reduce the penalty to 10% should be maintained.

5 Q2. Do you have any further suggestions to better achieve this balance?

5.1 Providing a formal right of appeal against the FN would help but, for the reasons explained in para 2.6 of the consultation document, HMRC do not consider that this is a viable option, and so it is not being consulted on as part of this consultation. This is unfortunate, because, as we said at the time the original legislation was being introduced[6], although we support in principle the concept of follower cases (where the facts of a case are the same or very similar to an already decided judicial ruling and the taxpayer has declined to concede in their own case), the way of achieving it should not be to take away a taxpayer's normal safeguards and rights of appeal and to give HMRC almost unprecedented executive powers to decide who falls within the mischief they intend to deal with. This simply does not fit with a fair and balanced legal system. Indeed, the House of

[3] Draft Finance Bill 2014 Tax Avoidance Schemes – CIOT comments para 4.15: see here.
[4] Para 12(2A) Sch 24 Finance Act 2007
[5] Para 3A Sch 24 Finance Act 2007
[6] Draft Finance Bill 2014 Tax Avoidance Schemes – CIOT comments at paras 2.4 and 4.14: see here.

Lords in its December 2018 report on HMRC's Powers[7] recommended that the FN legislation be amended to include a right of appeal to the tax tribunal.

5.2 Another option is for HMRC to consider reducing the standard FN penalty to a figure below 30%, perhaps to 25%, which may provide less of a disincentive for a taxpayer who considers they have a genuinely different case to continue with their appeal, but is still at a reasonably high level to encourage a taxpayer whose case is on all fours with the scheme defeated in another person's litigation to take the appropriate corrective action and settle their own case with HMRC, particular with the threat of the new 20% penalty on top.

5.3 Another option could be that the FN does not apply an immediate penalty, but rather puts the taxpayer on notice that if they do not succeed in the Tribunal, and if the Tribunal issues a cost order under Tribunal rule 10(1)(b) on the basis that the taxpayer has acted unreasonably in bringing the proceedings (NB not conducting – see para 7.5 below), then they will be liable for a x% penalty. This should perhaps put the taxpayer on notice as well that HMRC will be applying for such a costs order in the litigation should it go ahead. Then, instead, what is penalised is behaviour which is objectively unreasonable (proceeding unreasonably) rather than behaviour which is not unreasonable (disagreeing with HMRC and seeking resolution of the dispute from the Tribunal).

5.4 A further option is whether the 30% penalty could be mitigated down not only to 10% (for co-operation) but potentially to zero if a Tribunal ultimately agrees that the case was nonetheless a meritorious one. By 'meritorious' we do not mean that the taxpayer wins their case (because if they win then there is no tax and therefore no penalty[8]). Rather it means that the Tribunal issues a statement at the end of the case that, although the taxpayer has lost, they had an arguable case and that it was reasonable in all the circumstances (or similar wording) for them to have appealed the matter (despite the precedent case being against them). The idea is that this would be a relatively high hurdle for the taxpayer to meet, so in most cases there would still be a 30% penalty (mitigable to 10% for co-operation). But in cases where the Tribunal considered that the taxpayer was justified in taking the case then, even if they lose it (on a technicality, for instance), there is the prospect of reducing the penalty to nil. That would create a nice balance because:

- in most cases the penalty would be 30%
- increased to 50% if the Tribunal strikes out or says it was wholly unmeritorious
- decreased to 0% if the Tribunal says that the case was entirely meritorious (just not won).

5.5 The FN regime can be confusing to taxpayers. Sometimes a taxpayer appeals against an assessment or enquiry closure notice in respect of an avoidance arrangement on several grounds and this can lead to confusion about how to deal with a FN where there are other grounds for their appeal unrelated to the avoidance arrangement. In the case of *Broomfield*[9] HMRC conceded that where a taxpayer has independent grounds of appeal not connected to the FN, HMRC may not stop those from being litigated. HMRC could make this clearer in their communications and guidance, so that the taxpayer understands better how to respond to the FN if

[7] 'The Powers of HMRC: Treating Taxpayers Fairly' – December 2018 report by the House of Lords Economic Affairs Committee at para 94.

[8] See HMRC's follower notices and accelerated payments guidance at para 16.1.4. If a person is successful in the substantive litigation the penalty will be discharged as it is a tax-geared penalty and there will be no disputed tax to form the basis of the penalty.

[9] R (on the application of Broomfield and others) v Revenue and Customs Commissioners [2018] STC 1790) para 6 – see here.

they want to continue their appeal on those other grounds and how it fits with the 'reasonable in all the circumstances' appeal ground[10] referred to in para 1.10 of the consultation document.

6 Q3. How effective do you believe a further penalty would be as a deterrent to timewasting litigation of avoidance schemes?

6.1 A further penalty may be effective because it is a further cost that the taxpayer risks incurring if they choose not to take corrective action following the issue of the FN, so it is likely to be a key factor in their decision whether or not to take corrective action. If the taxpayer's conduct is unreasonable then HMRC can already ask the Tribunal for a costs order (albeit these are relatively rare in practice), so the two together may be particularly effective.

6.2 We should be wary of mission creep. HMRC might consider introducing tax-related penalties in other cases of timewasting, over and above costs. That would tilt the balance further in HMRC's favour and encourage petty procedural arguments which would be counterproductive.

6.3 We think that there is also an argument that dropping the penalty to 30% will be enough to act as an effective deterrent without the need to create a further 20% penalty. This links to our previous comments in answer to Q2 regarding whether the 30% / 20% penalty split achieves the appropriate balance.

6.4 The change to the FN penalty regime and how the two penalties work needs to be clearly communicated in HMRC's letters and guidance so a taxpayer who receives a FN can make an informed choice whether to take corrective action or not.

7 Q4. Are the suggested criteria the correct ones to adopt? Do you have any further suggested criteria to apply?

7.1 The criteria suggested in paragraph 2.10 (and in draft clauses 208A(5) and (6)) are that the highest rate of FN penalty could apply, for example:

- if the tax tribunal or court strikes out a taxpayer's appeal on the grounds either that it has no reasonable prospect of success or that there is an abuse of process (clause 208A (5)); or
- if the tax tribunal or court makes a statement that the taxpayer has acted unreasonably in bringing or conducting the proceedings. This statement could be made at the Tribunal's or court's volition or on application from HMRC (clause 208A (6)).

7.2 We agree with the principle of making the further 20% penalty judged by reference to decisions by the tribunal or court, rather than HMRC's discretion.

7.3 We suggest that the strike-out criterion could be reworded to ensure a greater link between the FN and the strike-out, as follows:

> 'if the tax tribunal or court strikes out a taxpayer's appeal on the grounds either that it has no reasonable prospect of success (**in view of the relevant judicial ruling**) or that there is an abuse of process'.

[10] S214(3)(d) Finance Act 2014

7.4 We understand that the Tribunals do not always like strike out applications, instead preferring often to have a single substantive hearing. If, as a result of these proposals becoming law, HMRC increase the number of strike out applications, this could create resource issues for the Tribunals service.

7.5 Instead of creating new criteria for the 20% penalty, another option might be to mirror the unreasonable conduct rule (Tribunal rule 10(1)(b) – reproduced below) under which a costs order may be sought but without mirroring the 'conducting' element of the test, as there seems little point is pegging the further 20% penalty to that limb of the test.

> '10(1) The Tribunal may only make an order in respect of costs — (b) if the Tribunal considers that a party or their representative has acted unreasonably in bringing, defending or conducting the proceedings'.

8 Q5. Are these the correct conditions to apply before such a further penalty can be issued? If not, what other criteria do you suggest?

8.1 The FN should be validly issued (not just issued).

9 Q6. Do you believe the further penalty should be reducible to reflect further cooperation by the recipient of a FN? If so, what factors should be taken into account?

9.1 Yes, we think the further penalty should be reducible and one factor that could be taken into account is helping to quantify the tax due, as well as the other types of cooperation already recognised in HMRC's guidance[11].

10 Q7. Would these grounds of appeal provide sufficient safeguards for taxpayers incurring this penalty? Are there any other appeal grounds you think should be applicable?

10.1 Yes.

11 Acknowledgement of submission

11.1 We would be grateful if you could acknowledge safe receipt of this submission and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

The Chartered Institute of Taxation

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[11] HMRC Compliance checks series – CC/FS30a Tax avoidance schemes – penalties for follower notices - see here.