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# HMRC consultation document

# Making Tax Digital - sanctions for late submission and late payment

# Response by the Chartered Institute of Taxation

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|  | Introduction |
|  | This consultation sets out the Government’s proposals for new late submission penalties and provides an update on the plan to penalise late payment by penalty interest. |
|  | As an educational charity, our primary purpose is to promote education in 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. |
|  | The CIOT responded to ‘Making Tax Digital: Tax Administration’ on 7 November 2016[[1]](#footnote-1) and ‘HMRC Penalties – a discussion document’ on 11 May 2015[[2]](#footnote-2) and we were heavily involved in the HM Revenue and Customs (HMRC) Powers Review which ran from 2005 to 2012. Many of the current penalties came into existence as a result of that very comprehensive review of HMRC Powers. We should not lose sight of the principles that underscored the previous review, learn from that experience and build on what has so far been achieved. |
|  | The Government’s aim is to introduce a late submission penalty model for the new filing obligations that will be introduced by Making Tax Digital (MTD). Such a model should be consistent with the five principles set out in ‘HMRC Penalties: a Discussion Document’. Throughout this response we will be referring to these principles to test whether HMRC’s proposals are consistent with them or not. The five principles are:     1. The penalty regime should be designed from the customer perspective, primarily to encourage compliance and prevent non-compliance. Penalties are not to be applied with the objective of raising revenues. 2. Penalties should be proportionate to the offence and may take into account past behaviour. 3. Penalties must be applied fairly, ensuring that compliant customers are (and are seen to be) in a better position than the non-compliant. 4. Penalties must provide a credible threat. If there is a penalty, we must have the operational capability and capacity to raise it accurately, and if we raise it, we must be able to collect it in a cost-efficient manner. 5. Customers should see a consistent and standardised approach. Variations will be those necessary to take into account customer behaviours and particular taxes. |
|  | We broadly support HMRC’s five penalty principles. In our response to HMRC’s 2015 consultation document on penalties[[3]](#footnote-3) we gave our views on each of the five principles and also suggested two further principles that we believe should apply. These were–   * that penalties must always be subject to a right of appeal. There must be a visible, clear and easily accessible right of appeal against the imposition of a penalty; * that penalties must be kept as simple as possible, so that they and the policy intention behind them are easily understandable to the ordinary taxpayer. |

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|  | **Executive summary**  **The Penalty Models** |
|  | Of the three models discussed in the consultation document, on balance, we prefer Model C – ‘Suspension of penalties’ because it sets conditions which would encourage the submission of late filings to avoid a penalty (principle 1). In our view, the other models will not do this as effectively. We also think it is relatively easy to understand. |
|  | We think that Model A – ‘Points based’ also has some attractions. It will provide the taxpayer with a ‘warning’ that they need to work at improving their compliance in order to avoid a monetary penalty, but there is a risk that, without penalties having a 'shelf life' there could be a significant length of time between getting a point and getting a penalty. This could reduce the effectiveness of the model (principle 4). |
|  | Attached to this submission are two spreadsheets with our suggestions for how the suspension model and points based model might look. We also attach two flowcharts showing how our proposed cumulative suspension model would operate. We discuss this in more detail below. |
|  | We would be pleased to have the opportunity to meet with HMRC to discuss our suggestions in more detail. |
|  | We do not favour Model B – ‘Regular review of compliance’ because the taxpayer will not know until sometime after their initial failure what the consequences will be of that and other failures as the review is not being done in real time. |
|  | Not knowing how the penalty regime will operate when a taxpayer has multiple MTD filings within a particular tax (eg because a taxpayer has one or more self-employed businesses and/or a let property) has made it harder to comment. For the avoidance of any doubt, our view is that it would more closely respect the five penalty principles if the different filing obligations were kept separate for penalty purposes; in effect as if they were separate taxes. |
|  | Some of our comments on the various penalty models are inevitably made without a full understanding and appreciation of how the MTD software might work since it is currently still in the development and testing phase. Our comments are made with the intention that they might influence how the software will eventually work in practice in order to support an effective penalty regime. |
|  | The consultation document does not consider the size of the penalty and we understand that no public consultation will take place on this aspect. Ideally, a simple penalty system is needed and that would be a fixed penalty at the start, even if this means forgoing a little fairness to get simplicity. We would suggest that £100 is a good starting point. The consultation is also silent on whether there will be any repeat or escalation of penalties for continued non-compliance. Therefore it is not clear how the penalty model will deal with continued failures to submit information. |
|  | Agents must be able to see their individual clients’ compliance history and penalty record, whichever penalty model is chosen. Furthermore, agents must be able to appeal on their clients’ behalf against penalties and penalty points that have been issued to their clients. Where the appeal process is digital by default, agents must also be able to appeal by digital means. |
|  | We recommend that draft legislation is published for consultation, particularly as this may contain the details about the amount of the penalty, as well as how the penalty system will operate. |
|  | The CIOT would be happy to work collaboratively with HMRC on the development of whatever penalty model is chosen. |
|  | We note that this response comes to slightly different conclusions to the response by our Low Incomes Tax Reform Group (LITRG). Their response favours the point based model whereas we are favouring the suspension based model. This is due to LITRG’s focus on what may best suit low income unrepresented taxpayers, for the reasons they explain throughout their document.  **General comments about the MTD Penalty Regime** |
|  | We would encourage HMRC to standardise the penalty regime as much and as quickly as possible (penalty principle 5), whilst ensuring adequate communication to taxpayers of the changes and that adequate time is allowed for taxpayers to understand the changes. Having a variety of different regimes is currently confusing, so a genuine move towards consistency, for both MTD and non-MTD taxes, would be welcome. |
|  | We agree that taxpayers must be given a minimum period of 12 months from when they become subject to MTD for Business filing obligations in order that they can become familiar with their new obligations before the new penalty regime takes effect. However, we would argue that this should apply on a tax by tax basis, because there might be different filing dates for the different taxes (ie if they are not aligned) or because understanding and dealing with (say) VAT obligations is different to understanding and dealing with (say) Income Tax obligations. In particular, it would also be consistent with the approach that penalties will be applied on a tax by tax basis, and therefore help prevent confusion. |
|  | While we acknowledge that the smallest businesses have been given an extra year to ready themselves for MTD, HMRC should remain open minded to giving all taxpayers more than 12 months to become familiar with their new MTD filing obligations before penalties apply. If penalties are introduced too soon it could undermine the whole system. The pilots should provide valuable data for HMRC about the capability and reliability of the MTD software, and also insight into taxpayer behaviour in coping with the new regime’s filing obligations. The three year deferral for real time information for PAYE (RTI) penalties for small businesses shows the benefits of a flexible approach. |
|  | However, given that much of the third party software is not yet available or fully developed, let alone agents then having time to set up their own processes, the proposed timetable for introducing mandatory reporting under MTD from April 2018 onwards and HMRC’s intention to have the new penalty rules on the statute book by April 2018 risks there being insufficient time for thorough testing to take place. The deferral of the roll-out of the pilots (due to the General Election) adds to our concerns. HMRC should keep the timetable under constant review and not hesitate to defer mandation and/or the introduction of penalties, if necessary, so as to give MTD and the associated penalty regime the best chance of success, with a high level of taxpayer compliance, once it goes ‘live’. |
|  | In order for the system to operate fairly, it will be imperative once any penalty-free transitional period has finished that penalties are visible to taxpayers (and agents) and cannot accumulate without the taxpayer becoming aware of them. This has happened in the past with some CIS and PAYE penalties. We also note that, in some areas, current legislation penalises continued late filing of returns irrespective of whether any tax is due. This perceived lack of fairness with the current system means that it may not provide the most suitable model for repeat penalties. |
|  | Communication methods need to be reviewed as part of the digital approach.[[4]](#footnote-4) With the move to digital personal tax accounts, HMRC need to consider in particular how to communicate effectively with taxpayers to ensure they know when and why they might need to log into their accounts. Taxpayers receive so many emails from many sources that it is often difficult to distinguish what is important/ time sensitive and what is not. Other means of communication should be considered as well. |
|  | There is also the serious ongoing problem of cyber security as well as ‘phishing‘ emails and texts purporting to be from HMRC. Many people ignore messages from HMRC because they think they are fraudulent or spam. Where penalties are involved, time is clearly of the essence as the taxpayer will need to log into their account and take action within a relatively short space of time. How the message is worded and presented is therefore going to be a key part of HMRC’s communications strategy in order that compliance can be encouraged and non-compliance prevented (principle 1). |
|  | Once in their digital tax account, information regarding penalties must be easy to locate. We trust HMRC will be doing a substantial amount of user testing in this area to ensure the digital tax account operates successfully when it comes to both:   * messaging taxpayers and presenting information about their penalties; and * communicating that information through APIs to their agents, where the taxpayer is represented. |
|  | Making taxpayers aware of their changing obligations and a new penalty regime will be essential to a successful roll-out of MTD. Providing clear, concise and timely HMRC guidance will be vital. Educating taxpayers, advisers and HMRC staff will, we believe, be crucial in preventing non-compliance and error. We are concerned about reports of widespread lack of awareness of MTD amongst taxpayers and suggest this needs to be addressed as a matter of urgency. |
|  | It is essential that existing safeguards are protected in relation to penalties. The ability to claim a reasonable excuse for failing to meet a filing obligation should be maintained. It may also be an opportunity to review and update the existing principles underlying ‘reasonable excuse’, particularly since filing obligations under MTD will become more frequent and the timescales much shorter, giving little time to right issues such as an IT downtime before a deadline. We would particularly encourage HMRC to consider publishing details of what might constitute a reasonable excuse around IT/ internet problems, considering the increasing level of electronic submissions required. |
|  | We think that whichever model is chosen, the facility for the taxpayer to alert HMRC BEFORE the filing deadline that they are going to fail to meet the deadline, as they can do for SA, and have a reasonable excuse for that failure, should be considered. This could avoid the need for HMRC to issue a penalty/penalty point or suspension, and for the taxpayer and HMRC to have to spend time dealing with the consequences of that. However, any such option should be simple and straightforward and not create confusion over the operation of the penalty regime itself. |

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|  | **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?** |
|  | As mentioned above, on balance, we prefer Model C – ‘Suspension of penalties’ because it sets conditions that would encourage the submission of late filings to avoid a penalty. In our view, the other models will not do this as effectively. We also think it is relatively easy to understand. |
|  | We think that Model A – ‘Points based’ also has some attractions. It will provide the taxpayer with a ‘warning’ that they need to work at improving their compliance in order to avoid a monetary penalty, but there is a risk that, without penalties having a 'shelf life' there could be a significant length of time between getting a point and getting a penalty. This could make it more difficult for a taxpayer to understand and keep track of their position and therefore reduce the effectiveness of the model (principle 4). |
|  | We do not favour Model B – ‘Regular review of compliance’. The taxpayer will not know until sometime after their initial failure what the consequences will be of that and other failures as the review is not being done in real time. This seems like a missed opportunity to make the best use of information at or near the time that HMRC become aware of it. The delay in using the information will lead to uncertainty for taxpayers, and is less likely to encourage a change in behaviour (principle 1). |

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|  | **Question 2.2 What are your views on the relative importance of the competing demands of fairness, simplicity and effectiveness?** |
|  | Fairness, simplicity and effectiveness are all desirable objectives for a penalty system. However, we recognise that the competing demands of fairness, simplicity and effectiveness will often be in tension, weighing against each other. In our view, the objective must be to create a primarily simple system that is also fair, and finally effective, that encourages and drives taxpayer compliance (principle 1) in order that MTD submissions are delivered on time with minimal intervention from HMRC. |
|  | The system must be simple enough for taxpayers to understand what they need to do to comply and hence what they need to do to avoid being penalised. A simple system has the potential to be a very effective system for this reason. It should be as fair as is possible, and be seen to be fair, but there is little point in creating a system that is fair but which is so complex that it becomes ineffective because no one understands it. A balance is required. |

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|  | **Question 2.3 To what extent does each of the three penalty models strike an appropriate balance between fairness, simplicity and effectiveness?** |
|  | We agree with the proposal that the model chosen will operate for each tax regime separately, at least at first. This strikes us as being the simplest option. |
|  | Whichever model is chosen, we think that there will have to be some kind of penalty ‘cap’ together with additional means of tackling persistent non-compliance. Just continuing to issue penalties will clearly not be the answer where there is continual and persistent failures to submit information on time/at all, especially if the reason for failure is common across the taxes. The consultation document does not address this point and concentrates only on initial penalties. We note that the current penalty legislation may not provide the most suitable model for subsequent penalties as it is not always fair, for example, it allows for a minimum penalty of £1,600 for filing a return more than one year late, even if there is no tax liability at all. |
|  | We think the suspension model will be simpler for taxpayers to understand than the other models. It has the advantage of directly linking the late submission to the conditions, which, if met, will avoid the penalty. The cumulative version proposed also has similarities to the VAT Default Surcharge regime, which, while criticised by some in relation to the amount of the penalty, is a logical and well-understood regime. In our view this is more likely to encourage compliance, and at the same time penalise non-compliance (principle 1), and be a proportionate response to the offence of late filing (principle 2). |
|  | We think the points based model is theoretically a good idea but that it could in practice be complicated for taxpayers to understand, and keep track of. There are also difficulties in devising an appropriate mechanism for resetting points to zero, so as positively to encourage compliance without being seen as rewarding non-compliance. In this regard we do not understand why the ‘shelf life’ option has been dropped. If this model is left on the table we think that the decision on shelf life should be reconsidered because it is already a familiar concept (in driving licences for example) and would therefore aid its understanding. |
|  | Points based model |
|  | Our spreadsheets show how HMRC’s points based model might work for both quarterly and annual submissions. We have used a cumulative approach because it can track current behaviour and make sure the compliant taxpayer is in a better position than a non-compliant taxpayer (principle 3). However, as the spreadsheet illustrates, the lack of a ‘shelf life’ for points is a serious limitation in the model being proposed by HMRC and should be reconsidered – see below.  Quarterly submissions – a missed deadline attracts a penalty point, but the fourth point attracts an actual penalty. The taxpayer needs to then file the next four submissions on time to re-set the clock. If the taxpayer fails to file the next four submissions on time they will receive an automatic penalty for each failure.  Annual submissions – a missed deadline attracts a penalty point but a second failure attracts an actual penalty. The taxpayer needs to file the next two submissions on time to re-set the clock. If the taxpayer fails to file the next two submissions on time they will receive an automatic penalty for each failure. |
|  | Further specific concerns we have with the points model are:   * The version proposed is awarding one point for every failure. It is unclear how the model will work with taxpayers who have multiple filing obligations, such as for a sole trade and a rental business, per tax, and who will be exposed to a higher number of penalties than a taxpayer with fewer filing obligations. We are of the view that four penalty points leading to a penalty is too few, given the frequency with which penalties could arise if this model does not take into account that some taxpayers will have multiple filing obligations per tax and that these are cumulative over the years (thus undermining principles 2, 3 & 4). * We would suggest, therefore, that HMRC apply penalties per obligation (eg one set of points for each trading business, and another set of points for each property business). It seems inevitable that a taxpayer will be exposed to more penalties the more filings they have to do, but by keeping them separate at least this might give them more chance to become compliant and hence avoid penalties, for example in a situation where someone has a business and a rental property for which they use an agent, they might be at risk of missing a deadline if the rental agent is slow in producing the information they need, but be in full control themselves of their self-employed submissions. * Devising a model that does not keep different filings separate could be much harder as well because it would have to be flexible enough to work for taxpayers with various numbers of sole trades and let property businesses, as well as those with just one sole trade or one let property. * It is also unclear how the points based model will encourage submission of each individual update within a certain time period (principle 1). Indeed, once a submission is late and has accrued a penalty point, there is no stimulus to file that submission, unlike under the suspended penalties approach. * We think therefore there will have to be some kind of ‘escalation’ or repeat penalty built into the model to encourage compliance, particularly within the annual submission model. * In the last consultation, which explored the expiration of penalty points, we said that we agreed that a sustained period of compliance should result in penalty points being nullified but that we favoured penalty points having an expiry date (like points on a driving licence). We do not understand why this ‘shelf life’ idea for points has now been scrapped in the current consultation document. In our spreadsheet we illustrate the impact of points not having a shelf life. A taxpayer with only occasional non-compliance (example 4) could incur a financial penalty after missing 4 out of 16 deadlines, and never manage to re-set the clock whereas a taxpayer with a very poor compliance record (example 5) who misses 8 out of the same 16 deadline, would receive no financial penalty and does reset the clock. * Ignoring the end of year report, it therefore appears that someone with four straight quarterly failures, and so clearly non-compliant will get one penalty. Someone who is late once a year will, after four years of basically 75% compliance, get the same penalty. That doesn’t seem to be that fair; oddly it does not put them in a better position than the first person (principle 3) nor take account of past behaviour (principle 2). HMRC should reconsider its decision on this issue, or explain why this decision complies with its penalty principles. * The proposal to allow the recording of the reason for a failure to submit at the time a point is issued is welcome, and is something we recommended during the last consultation. We assume this will be done digitally, and non-digital options will also be available for the digitally excluded. Even so, this creates complexity and additional burdens on taxpayers (compared to the other models) simply because they have to ‘do’ something else on top of filing their regular submissions. This will also create burdens on HMRC. Presumably they will need to automate this ‘appealing’ of the point otherwise how will HMRC cope with the undoubted deluge of appeals they will get under the points system. We are concerned, therefore, about the resource implications of the penalty model (principle 4). |
|  | Suspension model |
|  | The suspension model, on the other hand, will, in our opinion, be simpler to understand and administer, and produce a fairer and more effective result. |
|  | Our spreadsheets and two flowcharts show how two slightly different suspension models might work for both quarterly and annual submissions. The models we have designed are both different to the one in Chapter 4 of the consultation document. One looks at each year separately and one is a cumulative model. The two flowcharts we have prepared are based on the cumulative model.  **Yearly approach**  The advantage of a yearly approach is that it is very simple to explain and understand. A line is drawn after a set period and the clock then starts again. The reset period for a taxpayer with annual submission obligations could be, say, three years. Starting each year/three year period with a clean sheet would keep giving every taxpayer the same opportunity to become, and stay, compliant, without their penalty history hanging over them for year on year. However, we recognise that this simplicity has the potential consequence of not putting compliant taxpayers in a better position than the non-compliant (principle 3) if everyone’s clock is reset at the same point regardless of their pattern of compliance in the previous period, or take account of past behaviour beyond the year/three years in question (principle 2).  Our suggested model raises a penalty on the second failure to meet the suspension condition so does not allow excessive non-compliance.  Quarterly submissions – a missed deadline attracts a suspension with conditions to file the update by a specified date. If the taxpayer meets the conditions, they have one further suspension opportunity within the year. If the suspension conditions for the first missed deadline are not met a penalty is not imposed at that stage, but a penalty will be imposed if the suspension conditions are not met on the second occasion that the deadline is missed.  After two suspension opportunities have been given, the next missed deadline attracts an automatic penalty. The clock is reset at the end of the year.  Annual submissions – as above, but the clock is reset after the third submission.  **Cumulative approach**  The advantage of a cumulative approach is that it tracks current behaviour, takes into account past behaviour (principle 2) and makes sure the compliant taxpayer is in a better position than a non-compliant taxpayer (principle 3). The cumulative approach does add a little more complexity, but as noted above has similarities with the VAT Default Surcharge regime, which is currently understood by many businesses and their advisers.  Quarterly submissions – a missed deadline attracts a suspension with conditions to file the update by a specified date. If the taxpayer meets the conditions, they are put on 12 months’ ‘probation’ but with one further suspension opportunity in that period. If they miss one further deadline within the 12 months and meet the suspension conditions they will not get a penalty but they will have to submit the next four updates on time to avoid an automatic penalty and to re-set the clock.  The first time that a taxpayer misses the suspension conditions they do not get a penalty, but are put on 12 months’ ‘probation’ without any further suspension opportunity. If they miss a further deadline within the 12 months they will get an automatic penalty. They need four consecutive submissions on time to re-set the clock. If not, they will continue to get an automatic penalty every time they miss a deadline.  Annual submissions – as above, but the ‘probation’ period is 2 years and so the taxpayer needs to file two consecutive submissions on time to re-set the clock. |
|  | Further points about these models:   * It will be easier for taxpayers to understand and will encourage better compliance because it will focus on each individual failure and set conditions for that failure to be rectified (principle 1). These conditions could be clearly set out in legislation, guidance and any suspended penalty notice, and should make it more effective than the points based model. * An automatic suspension method will make it quick and simple for HMRC to administer and does not involve any subjective analysis of the taxpayer’s reason for missing a deadline (principle 5). This will avoid the problems we see in the suspension model for inaccuracy penalties, ie suspension not being offered when it might have been appropriate, arguments over whether the conditions for suspension of the penalty have been met and so on. * Like the points based model, it is unclear how HMRC’s proposed suspension model will work with taxpayers who have multiple filing obligations per tax, and who will be exposed to a higher number of penalties than a taxpayer with fewer filing obligations. We recommended that the regimes are operated on a per-obligation basis (see our comments above). * Again, like the points based model, we think there will have to be some kind of ‘escalation’ or repeat penalty built into the model to encourage compliance where suspension conditions are not met, or suspension is not available; particularly within the annual submission model. |
|  | Regular review of compliance |
|  | As mentioned above, we are not in favour of the ‘regular review of compliance’ model. We explain our concerns about this model in more detail in paragraphs 8 to 11 below. |

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|  | **Question 3.1 Points Model**  **Do you agree with these proposals for the duration of the required good compliance periods?** |
|  | It seems reasonable to require two sequential submissions to be made on time to reset the points total to zero where there is an annual submission frequency. |
|  | Similarly, it seems reasonable to require four sequential submissions to be made on time to reset the points total to zero where there is a quarterly submission frequency. What remains unclear is how the annual end of year submission fits with this, because there are effectively five (and possibly even six) submissions per year for a taxpayer within MTD for Business, not four. |
|  | It is also unclear how this would model would work where a taxpayer has multiple quarterly filing obligations, and who is therefore exposed to greater penalties if the same model operates for 8, 12 or more obligations a year. Our suggestion above helps combat this. |
|  | There is a danger that penalties would become too onerous if there was the risk that a taxpayer with multiple filing obligations around a certain date could receive multiple points/ penalties even though the same reason for late filing would potentially apply to all the obligations. This could be perceived as very unfair and could end up undermining the system. It could lose its purpose of being a credible threat (principle 4) and be seen as a disproportionate response by HMRC (principle 2). Again, our suggestion to treat different filing obligations separately will help mitigate such a problem. |
|  | In any event, it will be crucial that the information provided by HMRC is clear and understandable to avoid confusion and misunderstandings arising as to which point/ penalty applies to which filing obligations. |

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|  | **Question 3.2 Points Model**  **Could any changes be made to the points-based penalty model to make it fairer, simpler or more effective?** |
|  | We make the following comments referring to Fig 3.1:   * By taking a chronological approach this example combines two different tax years (Year 1 and Year 2). This appears to be the most logical approach to take (rather than to treat each year in isolation) because of the more regular updating that is required under MTD for Business and because it more closely tracks ongoing behaviour. * It is not entirely clear what will happen if a submission is not made before the next update is due, or whether the MTD software will allow a submission of a later update before an earlier one has been submitted. * If the intention is that quarterly updates will be cumulative, as in RTI, (so Q1 = Q1, Q2 = Q1 + Q2 etc.), then our assumption is that if Q1 is not submitted at all, but Q2 is submitted, that will effectively mean that Q1 has been submitted, albeit late, at the time when Q2 is submitted (so long as the data for both Q1 and Q2 has been input into the software). * It would be very confusing if it was possible to submit later ‘standalone’ updates without having submitted earlier ones. Indeed, the penalty system should positively encourage the submission of earlier updates before, if not with, later ones. We do not think the points based model does this, as there is no immediate incentive to submit (for example) the Year 2 Quarter 1 update when the deadline has been missed. * Under this model, subject to understanding better how the MTD software will work, there does not appear to be any difference in the taxpayer’s penalty point position between getting a late submission in by a certain time, or much later, or not at all, ie there is no ‘escalation’ of penalties in the current model. We suggest that there will need to be further points/ penalties imposed the longer the submission remains outstanding, similar to the present penalty system for Self-Assessment. * The points tally does not grow once the penalty level has been reached (eg four points for quarterly submissions). It seems then that a fixed penalty (say £100) would apply for each subsequent failure. That fixed penalty does not reflect the taxpayer’s continuing (bad) behaviour if they are just exposed to the same £100 penalty. It might be better for the points to continue to accrue, and if 5 points are reached, the penalty is (say) £200, then £300 if 6 points are reached and so on. That would be more likely to prevent non-compliance (principle 1) and take into account past behaviour (principle 2). * Since the taxpayer can appeal or make representations to HMRC when they receive a penalty point, it is possible that an appeal could still be unresolved by the time that an actual penalty is issued (or further penalty points awarded). The system will need to be able to deal with this situation, so that the actual penalty (or penalty point) is either temporarily suspended or refundable once the appeal has been determined. |
|  | We make the following comments referring to Fig 3.2:   * This example illustrates that the points based model is easier to understand when applied to a taxpayer with annual filing obligations, because there is no combining of tax years, and submissions are further apart. * It seems reasonable to require two sequential submissions to be made on time to reset the points total to zero. However, this model does not differentiate between taxpayers who file their return a day late and those that file their return several months late. This seems unfair and ineffective as a deterrent. * It is unclear whether this model will encourage the submission of an outstanding return or not, and whether there should be an escalation of penalties depending on how late the submission is. |
|  | Communication is key to the success of the model. We encourage HMRC to work with the software developers to ensure that MTD software will prompt businesses when an update is due so they don’t miss the deadline. If they do miss it, they should be quickly notified about the penalty point and the consequences of receiving the point should be fully explained. The taxpayer must be notified regarding what is needed to bring their tax affairs back into compliance and avoid further points and/ or an actual monetary penalty. |
|  | Similarly, it should be made easy for the taxpayer (or their agent) to appeal a penalty and/or penalty point. Non-digital alternatives should be provided for the digitally excluded. |

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|  | **Question 4.1 Regular Review of Compliance Model**  **What are your views on the timing of the review?** |
|  | As already mentioned, we do not favour Model B because the review is not operating in ‘real time’, but is instead looking backwards at the taxpayer’s compliance history. This is too late to change the taxpayer’s behaviour during that period and less likely to encourage compliance and prevent non-compliance (principle 1) than the other models. Our subsequent comments should be read in this light. |

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|  | **Question 4.2 Regular Review of Compliance Model**  **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?** |
|  | Fig 4.1 seems a better approach than Fig 4.2 because it is focussing on ongoing behaviour rather than on specific accounting periods/ years. |
|  | In Fig 4.1, it needs to be clear which quarters for which year fall into each 12 month period of review. The illustration refers to the ‘deadline’ for quarters 1 to 4, ie the proposals is that this will be 30 days after the end of each quarter, but if the review takes place at the end of quarter 4 (say), this would pick up the deadline date for quarter 4 of the previous year. |
|  | Fig 4.2 keeps each tax year separate and provides time for the extent of each lateness to be taken into account, but on the downside it means that the review is taking place a long time after the date of the filing obligations and is not looking at ongoing behaviour as much as Fig 4.1. |
|  | It is unclear how the outcomes of each period’s review would affect future reviews or influence future decisions (principles 1 and 3). |
|  | We agree with HMRC’s suggestion at paragraph 4.2 of the consultation document that they would need to notify the taxpayer each time they were late to ensure that any penalty chargeable at the time of the review did not come as a surprise, and to provide the taxpayer with the opportunity to tell HMRC if they have a reasonable excuse for the failure. |
|  | The third option explained in paragraph 4.7 of the consultation document sounds complicated. We do not think this option should be pursued. |

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|  | **Question 4.3 Regular Review of Compliance Model**  **Do you agree this would be a proportionate response to occasional lateness that lasted just a short time?** |
|  | Yes. |

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|  | **Question 4.4 Regular Review of Compliance Model**  **Could any changes be made to the regular review of compliance model to make it fairer, simpler or more effective?** |
|  | The term ‘regular review of compliance’ sounds very much like existing terminology that is used to describe formal tax enquiries and compliance checks, so we would suggest that if this model is selected it is given a different name to avoid misunderstandings. |

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|  | **Question 5.1 Suspension Model**  **Do you agree that improved compliance should be recognised?**  **Is there a better alternative for recognising it?** |
|  | Yes, we like the suspension model for that very reason, that improved compliance is recognised. The automatic setting of conditions should positively encourage and recognise compliance and prevent and penalise non-compliance (principle 1). |
|  | We agree that the model must operate automatically and reliably, so that (as is illustrated in Fig 5.1) a first and second failure (for example) will always receive an automatic suspension with consistent automatic conditions (principle 5). This is easy to understand and provides certainty for taxpayers, so they will know and understand the consequences of non-compliance. |
|  | One of the main issues will be the length of the ‘specified time’ in which to submit the outstanding submission and whether that length of time is adequate. It should be viewed from the taxpayer’s perspective so that when they receive the notification there is still sufficient time in which to comply. How the message is worded and presented is therefore going to be a key part of HMRC’s communications strategy in order that the taxpayer will know that they only have a certain period of time to take action. We recommend that when a person first subscribes to MTD they are provided with various types of guidance, one element of which might be details of the penalty regime so they can familiarise themselves with their obligations. |
|  | An automatic and consistent suspension model will presumably be relatively easy for HMRC to administer digitally. There is no need for either HMRC or the taxpayer to keep track of ‘points’. |
|  | However, the suspension model portrayed in the consultation document is in some respects harsher than the points model in that the taxpayer will receive a penalty as soon as they fail to meet the suspension condition (albeit that the conditions set will have provided further time to comply); there is no flexibility in the illustration in Fig 5.1 to allow a couple of defaults before charging the penalty unlike with the points model – we think this should be changed. As mentioned above, we have tried to devise a fair suspension model, which allows for additional suspension opportunities (see attached spreadsheets and flowcharts). |
|  | Another possibility would be to allow the smallest (to be defined) businesses an additional suspension opportunity, before they enter the ‘probation’ period, rather like what happens now with the VAT default surcharge. |
|  | The suspension model keeps the issue of the penalty closer to the time of the original failure than the other models. This makes it easy to understand and provides a credible threat (principle 4). |

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|  | **Question 5.2 Suspension Model**  **Could any changes be made to the suspension model to make it fairer, simpler or more effective?** |
|  | The taxpayer will continue to receive automatic penalties without the chance of suspension unless the ‘clock’ can be reset to zero at some point in the future. The issue is how to determine what will be regarded as a ‘sustained period of compliance’. As with the points based model, this should vary depending upon the frequency of submissions. It would also be logical and fair to tie it into the taxpayer’s compliance history (principles 2 & 3), but in a consistent and standardised way that can be automated (principle 5). |
|  | One option, which we suggest in our examples, is to have a cumulative model which does not look at accounting periods or tax years separately. For the taxpayer making quarterly submissions, we have suggested four consecutive submissions on time would be a reasonable number. For annual submissions, two consecutive submissions seems reasonable. Another option, as discussed above, is to reset the clock after each year (where updates are quarterly) or every three years (for annual submissions). |
|  | To avoid confusion, we would recommend that this suspension model is clearly differentiated from the suspension model that is currently in place for inaccuracy penalties. Perhaps it could be referred to by a different name, such as ‘penalty deferment’ or ‘penalty postponement’ or ‘automatic suspension’. |
|  | **Comments on the proposals for penalty Interest** |
|  | We are disappointed that HMRC have not proposed any further specific questions on penalty interest. We note however that views are welcome on the proposals. |
|  | We would encourage HMRC to take time to develop a regime that applies across ALL taxes, not just MTD ones. The due dates for tax under MTD are not changing, so there is no need to rush in a halfway-house new regime. |
|  | *Date from which penalty interest would be calculated* – we agree that the original proposal of 14 days is too short. In our view, a period of around 28/ 30 days is more reasonable. This would acknowledge that there will always be factors that could lead to inadvertent late payment (such as workloads, holidays, and postal delays), and also give more time for time to pay arrangements to be put in place where necessary. Normal late payment interest could apply as normal in the interim period. |
|  | HMRC recognise at paragraph 6.9 of the consultation document that they need to balance any grace period with the practical effect that this broadly shifts the payment date. A suggestion could be (say) a 28/ 30 day grace period for first default, then 14 days thereafter. Or some similar mechanism which gives a longer period for one-off failures to pay, but a shorter/ no period for subsequent ones. Consideration could be given to linking these periods to the suspension periods if that penalty model is chosen, to promote consistency between the two. |
|  | *The rate of interest* – we note that there is ‘double counting’ in the proposal at paragraph 6.12 of the consultation document, in that the Bank of England base rate is already factored into late payment interest. Therefore it would be unreasonable for the rate of penalty interest to factor in the Bank of England base rate as well. |
|  | At paragraph 6.10 of the consultation document, HMRC state that a debt owed to HMRC should not be a lower priority than amounts owed to other creditors. Similarly, in our view, debts due to HMRC should not be a *higher* priority either[[5]](#footnote-5). The risk with the introduction of penalty interest is that they will become a higher priority than amounts owed to other creditors unless the penalty interest rate is set at a level equivalent to statutory interest or lower. We suggest that the legality of going down any one route should be fully explored with relevant specialists before decisions are taken. |
|  | We would encourage HMRC to consider taking steps to pay interest (even penalty interest) to taxpayers if HMRC themselves have failed to make repayments within certain periods of time. The repayment supplement regime on delayed VAT repayments (a flat 5% of the VAT reclaimed) is a good incentive for HMRC to process repayments promptly. This would help level the playing field between monies owed *to* HMRC, and monies owed *by* HMRC. It is reasonable to assume that the penalty principles should encourage good compliance by HMRC, as well as by taxpayers. |
|  | The proposals for a system of penalty interest generally seem to us to be simpler and more understandable than the current late payment penalty system. |

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|  | **Acknowledgement of submission** |
|  | 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. |

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|  | **The Chartered Institute of Taxation** |
|  | The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. 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. 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.  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. The CIOT’s comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.  The CIOT’s 18,000 members have the practising title of ‘Chartered Tax Adviser’ and the designatory letters ‘CTA’, to represent the leading tax qualification. |

The Chartered Institute of Taxation

9 June 2017

1. Making Tax Digital: Tax Administration – CIOT comments <https://www.tax.org.uk/system/files_force/file_uploads/161107%20MTD%20-%20Tax%20Administration%20-%20CIOT%20comments.pdf?download=1> [↑](#footnote-ref-1)
2. HMRC Penalties – a discussion document – CIOT comments <https://www.tax.org.uk/system/files_force/file_uploads/150511%20HMRC%20Penalties%20-%20a%20discussion%20document%20-%20CIOT%20comments.pdf?download=1> [↑](#footnote-ref-2)
3. See paragraph 6 of our response document <https://www.tax.org.uk/system/files_force/file_uploads/150511%20HMRC%20Penalties%20-%20a%20discussion%20document%20-%20CIOT%20comments.pdf?download=1> [↑](#footnote-ref-3)
4. See the OECD’s ‘Technologies for Better Tax Administration A Practical Guide for Revenue Bodes’ May 2016 <http://www.oecd.org/publications/technologies-for-better-tax-administration-9789264256439-en.htm> [↑](#footnote-ref-4)
5. HMRC lost its status as a preferred creditor in 2003 following the implementation of Section 251 Enterprise Act 2002. The majority of unsecured creditors, including HMRC, now rank equally as non-preferential ordinary unsecured creditors, in insolvency proceedings. [↑](#footnote-ref-5)