

The new penalties regime

Further to the merger of HM Customs and Excise and the Inland Revenue, HMRC have been operating several different penalty regimes, dependent on which tax has been misdeclared. Under new legislation coming into force in 2009, these are replaced by a single penalties regime which will apply to payment errors in income tax, corporation tax, NIC, PAYE and VAT. From a VAT perspective, the biggest change is that misdeclaration penalties are no longer triggered by a financial point, but rather by the nature of the inaccuracy. Genuine mistakes will no longer be penalised, as long as reasonable care has been taken.

As a result of these changes there are now four categories of error in payment:

1. Mistakes or misinterpretations in fact or law, when reasonable care has been taken will not be liable to any penalty.
2. Failure to take reasonable care ('careless action') will be subject to a penalty of 30 percent of the potential revenue loss to HMRC.
3. Where the underpayment (or over-claim) is due to deliberate action on behalf of the taxpayer, but no attempt has been made to hide this action ('deliberate but not concealed') the evasion is liable to a penalty of 70 percent of the revenue loss.
4. Where the taxpayer has both deliberately created an inaccuracy and taken action to hide the behaviour from the tax authorities such as falsifying documentation ('deliberate and concealed') the penalty will be 100 percent of the loss of revenue.

The penalty for failing to notify HMRC of a mistake in a formal assessment, where HMRC think that the taxpayer should have recognised such a mistake will be 30 percent of the revenue loss.

In addition where an error has led to tax being paid later than it should have been there will now be a penalty. The penalty amount will be 30 percent and will be charged on the potential lost revenue, which is calculated in accordance with a special formula, namely 5 percent per annum or part annum of the error amount. This will be in addition to and not instead of default interest.

Various degrees of mitigation of the penalties are available where the taxpayer makes a full disclosure whether at HMRC's prompting or by way of an unprompted voluntary disclosure. Under the current legislation, no penalty is normally applied where a mistake is made in one period but a compensating mistake for the same transaction(s) is made on the following return. There is also a 'period of grace' during which a penalty will not normally be imposed. This period extends from the end of an accounting period to the due date for filing the VAT return for the following period. These concessions were brought in following business' concerns regarding the harshness of the current penalty regime as originally introduced in 1990. The easements were never enacted in statute but were announced by way of a Budget Notice as introducing some flexibility to the way in which HMRC administer the regime.

In addition there is a new suspension regime which will enable HMRC to suspend any penalties for no longer than two years where HMRC believe that this will encourage a business to return to compliance. Failure to apply with the conditions as laid out can result in all suspension terms being cancelled with the result that the penalties will then become payable in full.

As usual there is an appeal process for taxpayers and it is expected that there will be an increase in litigation as the new regime comes on line. HMRC believe such cases will be helpful in providing further definition and guidance around reasonable care and the other operational aspects of this new regime.