



MAKING TAX DIGITAL: INTEREST HARMONISATION AND SANCTIONS FOR LATE PAYMENT

Issued 1 March 2018

ICAEW welcomes the opportunity to comment on the [Making Tax Digital: interest harmonisation and sanctions for late payment](#) consultation published by HM Revenue & Customs on 1 December 2017.

This response of 1 March 2018 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world.

We attended a meeting with the relevant HMRC and HM Treasury staff to discuss these provisions. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

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MAJOR POINTS

1. ICAEW is in agreement with the three principles (recompense, fairness and simplicity) set out to remove inconsistencies in the way interest is charged and paid.
2. We agree with the proposals for aligning interest for corporation tax and VAT with the current rules for income tax as set out in the consultation document.
3. ICAEW does not agree with the proposals for late payment penalties. The hybrid model proposed is unnecessarily complex and is unlikely to be an effective deterrent. We recommend that late payment penalties be based on an interest-type calculation only.
4. We consider that 15 days is far too short a period in which to agree time to pay. We recommend that no late payment penalties should be charged where payment is made or time to pay is agreed within 30 days of the due date.
5. Members are concerned about the way in which HMRC systems allocate payments, sometimes to the detriment of taxpayers, and these issues also need to be addressed, separately from consultation proposals. It is not clear how allocations are made and how interest is calculated. We recommend that HMRC explores options for providing much clearer information for taxpayers and agents on how payments have been allocated and interest has been calculated.

GENERAL POINTS

Proposed hybrid model for late payment penalties

6. This consultation document proposes a hybrid model for late payment penalties that includes an element charged at a percentage of the tax due and an element charged in an interest-type calculation. The previous proposal for late payment penalties to be based on an interest-type calculation only is much less complex and is our recommended option. The current proposal will be poorly understood by taxpayers and, therefore, will not provide the required incentive to make full payment as quickly as possible. Cliff edge penalties where tax is unpaid at a certain date can be unfair and should be avoided when designing new penalties. We provide further detail below in our responses to consultation questions seven to nine.

Time period to agree time to pay

7. 15 days is far too short a period in which to agree time to pay with HMRC. As well as personal and administrative factors the taxpayer may need time to take advice, to arrange financing or to negotiate the arrangement with HMRC. Paper tax returns are not usually processed within 15 days; the taxpayers online statement may not be updated until well after the due date and they are unlikely to have received a paper statement. There could be an impact on HMRC workloads if agreements have to be made within such a short period. We are not aware of any evidence that taxpayers abuse the current 30-day period before income tax self assessment late payment penalties are charged and there would appear to be no good reason for this period to be shortened. The proposal to reduce the penalty by 50% if payment is made or time to pay is agreed from day 16 to day 30 adds further complexity and, for the reasons already given, is highly unlikely to provide the desired incentive. We provide further detail below in our responses to consultation questions seven to nine.

Taxpayer awareness of penalties

8. Penalties are only effective if taxpayers are aware of and understand them. There is very little information on [gov.uk](https://www.gov.uk) on the income tax self assessment late payment and submission penalty regimes, although there is fuller guidance for corporation tax and VAT. HMRC does not specifically warn taxpayers that they are about to incur a late payment penalty in time for them to take action to avoid that penalty. Late payment penalties are very poorly understood by most taxpayers and therefore have little impact as a deterrent. We recommend that HMRC undertakes to improve the communication of the penalty rules, particularly if changes are made. Similarly, the [information on agreeing time to pay](#) is too brief, with the information gap being filled, by those who can find them, by guides published by tax charities and some professional bodies. We would be pleased to work with HMRC on improving communications of the penalty rules.

Allocation of payments

9. Members have reported significant concerns about how HMRC systems allocate payments. In Appendix 1, we set out some examples of where the allocation rules work unfairly, to the detriment of the taxpayer, as they can result in interest being charged when, overall, there are no amounts due to HMRC. We recommend that HMRC resolves the issues with allocation and offset of payments and other processing issues as a separate matter but certainly before introducing penalty interest.
10. Where a taxpayer has several debts a debtor is entitled to allocate a payment at the time of payment. Paying the exact amount of a specific debt constitutes allocation to that debt. If the debtor does not allocate the payment, the creditor can do so. If neither allocates, the payment is set against the earliest debt. Unfortunately HMRC systems seem to ignore steps one and two and allocate every payment against the earliest debt even when the payment is clearly intended to be allocated against a later one. Where a person pays their tax by the due date the earliest debt is generally interest on the previous payment. Currently, most taxpayers put up with the misallocation, but very few people are going to put up with having to pay penalty interest solely because HMRC has misallocated the payment of a specific debt.

Interest charge calculations

11. Checking interest charges is currently very difficult, particularly for unrepresented taxpayers, as interest is not added to tax accounts at regular intervals and HMRC online systems and documents are not currently designed to give clarity on interest charges. There is considerable scope for HMRC to use digital tax accounts to make these charges more transparent, ie, for it to be possible for taxpayers and their agents to 'drill down' to obtain the full details of how the interest charge has been calculated. We recommend that HMRC explores options to make it much easier for taxpayers and their agents to check interest charges. We believe that this is essential if the interest charges levied are to be accepted by the public.

Online and paper statements

12. HMRC statements (paper and online) do not make it clear how payments have been allocated and are extremely difficult to follow. There is considerable scope for improvement in how payment and liability information is displayed online and in paper statements.
13. Consideration must be given to the transition as the new system is being implemented. Statements containing liabilities, payments, penalties and interest charges under both

the old and new systems will be difficult, and in many cases almost impossible, to understand.

Interaction with late submission and notification penalties

14. It is important that late payment penalties are considered in conjunction with late submission penalties and late notification penalties; taxpayers see penalties as being part of one penalty system.

RESPONSES TO SPECIFIC QUESTIONS

Question 1: Do you agree that in-year QIPs should continue to attract differential interest rates?

15. We agree that differential interest rates should continue to apply to QIPs.
16. We note that interest on corporation tax is deductible, whereas interest on income tax is not. This difference has not been acknowledged in the consultation document.

Question 2: Do you agree the way interest is charged for CT satisfactorily mirrors the rules in Finance Act 2009?

17. We agree that the way interest is charged for corporation tax satisfactorily mirrors the rules in FA 2009.

Question 3

18. Not applicable.

Question 4: Do the proposals for interest for VAT on late payment of a return reasonably reflect the FA 2009 rules?

19. We agree that the proposals for interest on late payment of VAT reasonably reflect the FA 2009 rules.

Question 5: Are the proposals for VAT regarding interest on assessments and amendments sensible?

20. We agree that the proposals for interest on VAT assessments and amendments are sensible.

Question 6: Do the proposals for interest on a delayed payment of a repayment VAT return reflect the right balance between recompense for customers and the protection of public monies?

21. We agree that the proposals strike the right balance, save in one respect. A taxpayer might submit a valid repayment claim incorporating a method of determining the use to which input tax is made in making taxable supplies, for example under partial exemption rules. In our experience such claims can lead to HMRC officer queries and such enquiries can remain open for weeks, and in some cases months, whilst the facts are gathered and alternative methods of use explored. Such delays are not generally as a result of the taxpayer, who is naturally anxious to provide information to HMRC so as to facilitate early repayment of VAT. We suggest that a cap should be placed on the period of time that such reasonable enquiries remain open during which period any interest will not accrue to the taxpayer.

Question 7: Do the proposals for late payment penalties strike the right balance between fairness for those that pay on time and provide a reasonable time for those that need to arrange payment? and

Question 8: Do you think these general rules provide the correct balance between protecting those that pay on time and encouraging those that do not? and

Question 9: Do the proposed rules provide the correct balance between protecting those that pay on time and encouraging and supporting those that do not?

22. We do not agree that the proposals for late payment penalties strike the right balance or meet the objectives set out.
23. The analogy of a parking ticket penalty which is often reduced if paid within the first 14 days, see para 5.20, is not a valid comparison. A parking penalty notice is physically issued to the car owner and the 14 day reduced penalty period runs from the date of that notice. A taxpayer is not issued with a similar notice or payment reminder for missing a tax payment date.
24. The hybrid model with two elements is unnecessarily complex, will be poorly understood by taxpayers and therefore will not provide the required incentive to make full payment as quickly as possible. Cliff edge penalties where tax is unpaid at a certain date can create unfairness and should be avoided when designing new penalties. We recommend that late payment penalties be based on an interest type calculation only.
25. We consider that 15 days is far too short a period in which to agree time to pay. As well as personal and administrative factors, the taxpayer may need time to take advice, to arrange financing or to negotiate the arrangement with HMRC. There could be an impact on HMRC workloads if agreements have to be made within such a short period. We are not aware of any evidence that taxpayers abuse the current 30-day period before income tax self assessment late payment penalties are charged and there would appear to be no good reason for this period to be shortened.
26. The proposal to reduce the penalty by 50% if payment is made or time to pay is agreed from day 16 to day 30 adds further complexity and would not provide the desired incentives. We recommend that no late payment penalties should be charged where payment is made or time to pay is agreed within 30 days of the due date.
27. The proposals would penalise heavily those who are unable to agree a formal payment arrangement with HMRC and are likely to merely exacerbate their financial difficulties without incentivising them to make whatever informal payments they can. We recommend that HMRC should be given more discretion to waive late payment penalties in hardship cases.
28. We understand that the term 'penalty interest' and indeed the word interest will not be used to describe late payment penalties, even though an element may be charged in an interest-type calculation. This is a helpful change as the terminology in the previous consultation documents gave rise to considerable confusion.
29. Although not stated in the document, we understand that the interest-type element of the penalty would cease to accrue if and when a payment arrangement (or payment) is made. We support this change as it would mean that there would be a continuing incentive for taxpayers to contact HMRC to make a payment arrangement, even after the initial 15/30 days have elapsed.
30. Late payment penalties should be calculated, charged and notified on a monthly basis so that the taxpayer is alerted to the charges, rather than finding them imposed when they do pay the debt, which may be some considerable time later.
31. We welcome the proposal that the base rate will not be included in the calculation of late payment penalties as this creates the perception of a double charge as the base rate is included in calculating the rate of restitution interest.

Question 10: We believe that late payment penalties should apply from the payment due date. What difficulties, if any, could you see with this?

32. We agree that late payment penalties should apply from the payment due date but only if there is a 30-day period in which to pay or reach a time to pay agreement with no penalty being charged.

Question 11: Are there any other specific circumstances that should be accounted for?

33. We are not aware of other specific circumstances that should be accounted for.

APPENDIX 1

Specific examples of issues with allocations and interest calculations under current rules which should be reconsidered when drafting the new framework.

34. **Corporation tax offsetting under and over payments.** The corporation tax interest rules do not properly offset under and overpayments between periods, as the actual payment date is routinely lost when transferring an overpayment in one period, against an underpayment in another. We note that the original date can only be retained where an entire payment is allocated; part allocations inevitably bring the date forward to the transfer date. This causes interest to be both charged and credited despite no net liability being due, with a resulting net interest charge.
35. **Corporation tax loss carry backs.** The corporation tax interest rules do not deal correctly with loss carry-backs as the loss carry-back is treated, for interest purposes, as a payment credit for the earlier period, arising on the normal due date for that earlier period (much later where quarterly instalment payments (QIPs) are involved). The loss carry-back should reduce the prior year liability for both tax and interest.
36. **IR35 cases.** When a company is found liable to pay IR35 tax, it will almost always also be due a corporation tax rebate, as the deemed payment and associated secondary national insurance are allowed for corporation tax purposes, s139, Corporation Tax Act 2009. Also, if sufficient dividends were paid by the company to put the director into the higher rate tax bracket, a rebate is due under s58, Income Tax (Earnings and Pensions) Act 2003. IR35 inquiries usually take several years to settle and HMRC will charge interest at the rate for overdue payments (currently 2.75%, and 3% through most of those years) on the IR35 taxes, while only paying it at the rate for overpaid tax (0.5%) on the offsets. Given the current difficulties in this area, both with the amount of time involved in agreeing cases and the fact that the corporation tax offset will usually come to round about half the total IR35 bill, the tax involved can be substantial. HMRC should be able to backdate the offsets, so that interest is charged at the overdue tax rate only on the net balance. Normally, where self assessment is involved, HMRC will apply the 'Common Period Rules' (see <https://www.gov.uk/hmrc-internal-manuals/debt-management-and-banking/dmbm401070>). Although the Common Period Rules specify when HMRC has to make offsets, there does not appear to be any legislation which prevents HMRC from making offsets more widely whenever they think it appropriate to do so. This power should be clarified as part of this interest harmonisation process.