



## THE SIMPLIFICATION OF REGULATORY PENALTIES

**Comments submitted in October 2011 by the Tax Faculty of the Institute of Chartered Accountants in England & Wales to HM Revenue & Customs in response to the consultation document *Modernising Powers, Deterrents and Safeguards: The Simplification of Regulatory Penalties* issued on 17 June 2011.**

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## INTRODUCTION

1. In this document we present the comments of the Tax Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW) on the consultation document *Modernising Powers, Deterrents and Safeguards: The Simplification of Regulatory Penalties* (the condoc) issued by HM Revenue & Customs (HMRC) on 17 June 2011.
2. We are pleased to have the opportunity to respond to this consultation. We would be happy to discuss any aspect of our comments and to take part in all further consultations on this area.
3. The Tax Faculty commented on the earlier (January 2011) discussion document on this topic in TAXREP 20/11 (published in March 2011).
4. Information about the Tax Faculty and the ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's ten tenets for a better tax system, by which we benchmark proposals to change the tax system.

## WHO WE ARE

5. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
6. In the region of 43,000 ICAEW individual members are in practice. 12,000 firms, ranging from the 'Big 4' to sole practitioners, are authorised by ICAEW to practice.
7. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
8. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including *TAXline*, a monthly journal sent to more than 8,000 members, a referral scheme and a weekly tax newswire sent to over 18,000 registered users.

## GENERAL COMMENTS

9. We welcome the proposal to reform the system of regulatory penalties and broadly support the principles set out in this condoc. Our comments on the specific questions for consultation are set out below. Many of the general comments in our response to the initial stage of this consultation (TAXREP 20/11) are also relevant in relation to the current consultation.
10. In TAXREP 20/11 we said that HMRC needs to analyse the regulatory penalties in more detail in order to establish the evidence base on which to build detailed proposals for reform. We trust that HMRC will carry out such an analysis before proceeding to the next stage in consultation after the current condoc. This analysis should include consideration of the following points:

- the underlying policy reasons for the penalty;
  - the frequency with which the penalty is charged;
  - the actual amount of the penalty charged;
  - whether the penalties charged are actually collected;
  - the processes and admin burdens HMRC incurs in levying the particular penalty;
  - the likely costs for stakeholders (tax and duty payers, agents etc) in dealing with the penalty;
  - what the perceived deterrent effect of the penalty is;
  - how much revenue the penalty protects; and
  - what might be the behavioural effects of any changes.
11. 'Regulatory penalties' cover a broad range of very different penalties. Reform of these penalties will require (to quote from para 1.16 of the condoc) 'a tailored approach, grouping penalties together in a number of sets'. We do not see how the alternative approach set out in para 1.16, 'an overarching penalty model encompassing all requirements in the tax system', will produce a fair or proportionate system.

## **RESPONSES TO SPECIFIC QUESTIONS**

### **Q1: Do you agree that these six principles are the correct ones to apply to this work?**

12. We agree that these are the correct design principles.
13. With regard to principle 1 – that penalties should influence behaviour – it is important that people be aware of their obligations, otherwise the penalties will not be a deterrent but merely a punishment. This is particularly important in the case of many of the regulatory penalties, where the compliance obligation may be little known or something a person is unlikely to encounter frequently. If HMRC considers a compliance obligation is necessary, it must take steps to publicise it to those likely to be affected.
14. Principle 2 – that penalties should be proportionate – is an important one. The aim of a financial penalty should be to encourage compliance and eliminate any benefits of non-compliance. Regulatory penalties need to be proportionate to the financial or other consequences of the failure to comply.
15. To ensure that penalties are proportionate, HMRC will need to do a considerable amount of detailed comparative work before making detailed proposals at the next stage of this consultation. The list of penalties in Annex B to the January 2011 condoc shows inconsistency among penalty levels for similar failures.
16. Simplification – principle 4 – should take into account that regulatory penalties cover a broad range of very different penalties. The aim should not be to simplify by applying a 'one size fits all' approach. Different categories of penalties will require different rules, though within these categories the rules should be rationalised and made consistent.
17. We support the intention – principle 6 – to repeal penalties where appropriate. As stated in para 2.6, HMRC should consider not just the penalty but also whether the obligation itself has become obsolete or unnecessary. There is no point having a penalty, intended as a deterrent, where the obligation no longer exists.

### **Q2: In principle, do you think that it would be sensible to aim for one aligned penalty where obligations can be 'grouped' together?**

18. Yes, we agree with this approach.

19. It should be borne in mind when grouping obligations that although the obligations may be similar – eg the failure to keep records – they may affect different classes of taxpayer. Imposing the same maximum penalty and other sanctions on (say) an individual taxpayer and a large business may not be fair or proportionate.

**Q3: How should a model for regulatory penalties tackle different types of breaches? Is there merit in applying no penalty for a first offence?**

20. We think there is considerable merit in applying no penalty for a first offence, but this may not be appropriate for all types of regulatory penalty. For example, it will undermine the deterrent effect where the obligation itself is likely to be a one-off.
21. Rather than having an across-the-board rule of no penalty for a first offence, it may be better to use different ways of achieving the result. The method used would depend on the nature of the obligation and of the penalty. Options include:
- No penalty for a first offence.
  - No penalty to be charged where the taxpayer has a reasonable excuse or has taken reasonable care.
  - HMRC to have discretion whether to charge a penalty, depending on the circumstances.
  - A system of suspended penalties, where there are recurring obligations.
22. Where there are continuing or recurrent breaches, it may be appropriate to apply increased levels of penalty. This could be done after a warning letter but no penalty for a first offence, and taking into account any reasonable excuse.

**Q4: Bearing in mind the roles of regulatory penalties discussed in the previous chapter, how can penalties be geared to ensure that they are proportionate to the impact of the regulatory failure? Is the Schedule 36 model of a Tribunal-imposed penalty attractive?**

23. A tax-geared penalty may be appropriate where the tax lost or other impact of failing to comply can be easily quantified, though such a penalty should take into account whether the taxpayer has taken reasonable care.
24. We agree that daily penalties are probably not appropriate. Any penalties for continued failure to comply need to be on the basis that the person is fully aware of the obligation, and should not be charged if the person has a reasonable excuse and/or has taken reasonable care.
25. We cannot see the benefits of a tribunal-imposed penalty for regulatory failures, which would simply create administrative burdens for all parties. There should however be a right of appeal to a tribunal for all penalties, with the tribunal able to vary the penalty as well as confirm or cancel it.

**Q5: Is the notion of penalties which reflect behaviour applicable to a model for regulatory penalties?**

26. Yes, for some classes of regulatory penalty a regime which takes taxpayer behaviour into account may be appropriate.
27. In reforming the regulatory penalty rules, HMRC should take the opportunity to replace the term 'fraudulent or negligent' conduct with terminology in line with that used in the other new penalty regimes.
28. In determining what is careless behaviour in the context of regulatory penalties, the rules should take into account whether the person could reasonably have been expected to know about the obligation in the first place.

**Q6: Should reductions for disclosure be considered as a feature of a regulatory penalties model?**

29. Yes, for some classes of regulatory penalty it would be a good idea to give reductions for disclosure, as this will encourage people to come forward and comply with their obligations.

**Q7: Do you agree that there should be some form of revalorisation power in a new model?**

30. We can see the argument for including such a power in the legislation, so that it is there if needed. We would like to reserve judgement on this proposal until we have more details of the proposed new regulatory penalty regime (or regimes).
31. There would need to be controls on the use of such a power. If the levels are increased the penalties must remain fair and proportionate, and we can envisage that unless all penalties are increased consistently with one another, the regime could become over-complicated and disproportionate. This should not be done without proper consultation and parliamentary scrutiny.

**Q8: What types of non-financial sanction could work in this penalty context?**

32. We would first make the point that as well as sanctions, HMRC can encourage compliance with regulatory obligations by making people aware of them, and by providing information and support in order to help people comply.
33. For a first failure to comply, it may be effective for HMRC to issue a warning letter about the requirements and the penalties of non-compliance. This non-financial sanction would be accompanied by either waiver of the penalty, or suspension of the penalty subject to future compliance (different methods may be appropriate for different types of regulatory obligation).
34. We note the suggestion that penalties might be reduced to early payment. We have some reservations about this. Firstly, it is not a feature of the other new penalty regimes introduced by the Powers Review, and it would seem inconsistent to introduce it just for regulatory penalties. Secondly, it means that those who have the means to settle early will get a reduced penalty whereas those with financial difficulties will not, which does not seem fair or proportionate.

**Q9: How do you think these features should apply to a regulatory penalty regime? Are there any other features that a regulatory penalties model should include?**

35. We have no further comments.

**Q10: Should the concept of reasonable excuse be applied to regulatory penalties? Should it be for all penalties, or for specific types?**

36. We agree that the concepts of both reasonable excuse and reasonable care should form part of the regulatory penalty regime.

**Q11: Do you agree that any reasonable excuse provision should be aligned with the existing meaning elsewhere in penalties legislation?**

37. Yes, we agree that the reasonable excuse provision should be aligned with equivalent provisions in other penalties legislation.
38. However, HMRC should be realistic in its interpretation of what constitutes a reasonable excuse for the breach of a regulatory obligation. It is conceivable that a person might be

genuinely unaware of an obligation, especially an obscure or one-off obligation, and could not reasonably be expected to know about it unless HMRC had notified them or it or had publicised it clearly. In our view this would be a reasonable excuse provided the failure e

**Q12: Do you agree that rights of review and appeal should be aligned across regulatory penalties?**

39. Yes, we do agree. There should be the right to an internal review and the right of appeal in respect of all penalties.

**Q13: Are there any other safeguards from the new penalties (or elsewhere) that you would like to see included in the regulatory penalties framework?**

40. We have already noted that HMRC must ensure that taxpayers are aware of their regulatory obligations and take this into account in establishing whether there is a reasonable excuse for failure to comply.
41. We trust that once the revised regulatory penalty regime (or regimes) has been agreed upon, HMRC will publish its draft staff guidance on the operation of the regime for consultation.

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## **APPENDIX 1**

### **THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM**

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99.