

## ICAEW TAX FACULTY REPRESENTATION

### TAXREP 20/11

### THE SIMPLIFICATION OF REGULATORY PENALTIES

**Comments submitted on 9 March 2011 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales on a discussion document published by HM Revenue & Customs on 31 January 2011.**

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# THE SIMPLIFICATION OF REGULATORY PENALTIES

## INTRODUCTION

1. This document sets out the comments of the Tax Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW) on the questions and proposals set out in a discussion document *Modernising Powers, Deterrents and Safeguards: The Simplification of Regulatory Penalties* published on 31 January 2011.
2. We welcome the publication of the discussion document. We appreciate that this is more in the nature of a 'pre consultation'; namely HMRC is seeking thoughts and ideas on whether reform of this area is worthwhile and whether stakeholders such as the ICAEW Tax Faculty agree that HMRC should undertake further work with the initial aim of producing a consultation document in the summer.
3. We support the principle of seeking views at an early stage in the consultation cycle and in particular before detailed proposals are worked up. This 'pre consultation' approach is one that we have recommended in the past as it provides an opportunity for expert input at the design stage and before proposals become set in stone and therefore difficult to change.
4. As this discussion document is focused on principles rather than detailed proposals, we have set out below what we believe are the key principles that should be applied to the review. We will be happy to comment on the detail when we have more specific proposals on the table.
5. We would be happy to discuss any aspect of our comments and to take part in all further consultations on this area. We also attended the meeting that HMRC held with the professional bodies on 23 February 2011 to discuss this consultation and our comments below reflect what was discussed at that meeting.
6. 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. We have applied these tenets to the proposals set out in this discussion document.

## WHO WE ARE

7. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 775,000 members worldwide.
8. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.
9. The Tax Faculty is the focus for tax within the Institute. It is responsible for technical tax submissions on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 11,000 members of the Institute who pay an additional subscription, and a free weekly newswire.

## EXECUTIVE SUMMARY

10. We agree that HMRC should undertake further work on this project and work up some more detailed proposals for formal consultation, working as needed with the OTS. The underlying policy purpose needs to be communicated clearly to stakeholders.
11. There needs to be proper time built in for the consultation process. The earliest that legislation should be enacted will be 2012 and later if initial consultation shows that particular proposals may be controversial.
12. HMRC should analyse these penalties in more detail by reference to a number of criteria.
13. It may be possible to reduce the workload by analysing similar penalties en bloc. If obsolete penalties are identified they should be repealed and where the penalties are trade specific there will need to be detailed consultation with the relevant trade and industry bodies.
14. In designing any new penalty system, there should always be a right of appeal to a Tribunal.
15. Consideration should be given to not charging penalties for a first 'offence' and including a general reasonable excuse provision. Consideration should also be given to employing techniques used in the Sch 24 FA 2007 rules on Penalties for Errors, including suspended penalties and special reductions, where appropriate.
16. There is a need to consolidate all the changes that have arisen out of the Powers Review into a new Taxes Management Act.
17. Without further analysis it is difficult to decide which of the two proposed penalty models set out in Chapter 4 would be better. In any event a 'one size fits all' penalty policy is unlikely to be the right way forward.

## GENERAL COMMENTS

### *The policy purpose*

18. The policy purpose behind this consultation is one of rationalisation and simplification. It is clear from the list of penalties in this discussion document that there must be scope for rationalisation and greater integration of the various penalties. In principle, therefore, we agree that HMRC should undertake further work on this project and work up some more detailed proposals for formal consultation.
19. We understand from the meeting we attended on 23 February that the Office for Tax Simplification (OTS) is also interested in any proposals for reform in this area. Given that the main aim of HMRC's discussion document is to rationalise and simplify the existing rules, this aligns with the OTS's agenda. We therefore encourage HMRC and OTS to work together on any proposals, thereby reducing duplication and keeping the costs of the review to a minimum. We are of course happy to assist in this process.

### *Communication*

20. As noted above we understand that the policy purpose of the reform is to simplify and rationalise the existing disparate range of penalties rather than seek to raise further revenue from levying more penalties. We support this approach. HMRC needs to make sure that this policy message is communicated clearly to stakeholders so as to reassure and encourage engagement.

### *Adequate time for consultation*

21. One of our key principles is that there should be proper time for consultation. Reform of penalty provisions will by their very nature be controversial and the consultation process should not be rushed. It may be that this work needs to be divided into a number of strands

and that the timescale for each may be different. The proposed publication of a consultation document in the summer, followed by a full consultation period, suggests that any draft legislation would not be published until the end of 2011 and would then be included in the Finance Act 2012. If the initial consultation highlights areas where reform may prove more controversial, any measures may need to be subject to further consultation and therefore the earliest they are likely to be in a Finance Bill will be 2013.

#### *Evidence base*

22. HMRC needs first to establish its evidence base to provide a sound platform on which to build any proposals for reform in the next consultation document. HMRC now needs to analyse these penalties in more detail. This should include both statistical analyses and also detailed consideration of the underlying policy reasons for the penalties. The analysis should include reference to the following points:

- 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 is the perceived deterrent effect of the penalty;
- how much revenue the penalty protects; and
- what might be the behavioural effects of any changes.

#### *Proposed approach to the consultation*

23. Given resources constraints it may not be practical or desirable to undertake this analysis for every penalty listed. HMRC should consider ways of stratifying the penalties into groups by reference to their likely function and importance, and for the less important penalties it may be enough to consider them 'en bloc' rather than individually.
24. Where it is fairly self evident that penalties are spent or otherwise moribund, then we suggest HMRC does not waste time on detailed discussions with stakeholders but instead proposes to abolish them sooner rather than later – we would be interested to know how many penalties fall into this category.
25. Many of the penalties are specialised in nature and will only apply to a small group of tax/duty payers, although within that group the penalties may be very important. Many of the penalties listed are not ones with which professional bodies such as ICAEW will be familiar: for example, there are 62 excise penalties listed. It is important that HMRC engages fully with bodies and industry groups that are likely to be affected before any decisions are made in these areas.

#### *Applying penalties: policy considerations*

26. One of the purposes of penalties is to improve compliance. We accept that a penalty may sometimes be needed in order to act as a deterrent even if, in practice, it is not often charged. However, if analysis shows that HMRC does not levy the penalties listed, then the working assumption should be that those penalties are not needed and consideration should be given to abolishing them.

27. It is important that any penalty regime is operated in a fair and proportionate way. We believe that taxpayers should always have a right of appeal to the Tribunal against any penalty levied on them and that consideration is given to including in whatever model(s) is/are adopted a 'reasonable excuse' provision.
28. For ordinarily compliant taxpayers who may sometimes fall within these penalty provisions, the mere threat of penalties may be enough to ensure that they do not let it happen again. Given that these are penalties for regulatory failures which may not be related to any loss of tax, it may be appropriate not to levy a penalty for the first 'offence' but to have a 'quarantine period', during which a penalty will only arise if the taxpayer commits a further offence within a specified period. This approach is similar to that adopted by the VAT default surcharge rules. Another more modern approach would be to adapt the suspended penalty rules in para 14 of Sch 24, FA 2007.
29. Given the wide range of taxes and duties under consideration, we do not think that one approach will fit all circumstances. We can see the case for rationalising the number and amount of flat-rate penalties. The monetary limits for many penalties were set many years ago and there may be a case for increasing penalties to an amount that they would be today if they had been linked to, say, the retail prices index. However, any uprated penalty level would then need to be tested to see if it was fair, reasonable and proportionate, and different levels may be needed to reflect the nature of the regulatory failure.
30. The advantage of monetary penalties that are 'not more than' a set amount is that it enables HMRC to apply any penalty with a degree of flexibility and discretion taking into account all the circumstances of the case; in other words to ensure that any penalty is fair and reasonable. It might be possible to express this by reference to a set amount and then have a 'special reduction' provision similar to that set out in para 11 of the penalties for errors rules in Sch 24, FA 2007.
31. There is a case for escalating penalties where there is serial and deliberate non-compliance. However, we suspect that many in this category will not be influenced by escalating penalties no matter how much they are. The danger is that escalating penalties aimed at serial and deliberate non-compliance are actually levied on taxpayers who really need more help to get it right, thus damaging the reputation of the tax system.

*The need for a new Taxes Management Act*

32. As the Powers Review project is now drawing to a close, we believe that there is a need to consolidate all the changes to the rules that have arisen out of this project into a new Taxes Management Act.

**COMMENTS ON THE SPECIFIC QUESTIONS RAISED**

*The concept – is this an area which causes difficulty or complexity and is therefore worthy of consideration?*

33. As noted above we believe that this area is worthy of further consideration with a view to simplifying and rationalising the existing penalty rules.

*The options – what are your views on the possible options we have suggested, which ones appear most suitable for further work? Can you foresee any implementation issues? Are there any other options that you think we should consider?*

34. Without further analysis it is difficult to decide which of the two proposed options set out in Chapter 4 would merit further work. As mentioned above, we are not convinced that a 'one size fits all' penalty policy would be the right way forward.

35. We suggest that before this is done more detailed work should be undertaken on the existing penalties as set out above and that, as a first step, penalties are rationalised and where possible abolished. We would expect that any final proposals may include elements of both of these penalty models.
36. We suspect that any changes to existing penalty models will require changes to HMRC's computer systems and consequently the actual implementation dates for any reformed penalties are likely to be some time after enactment. This suggests that the earliest any penalties will be charged under the new rules will be 2013 at the earliest.

*Focus – are there any particular penalties, or areas that are causing particular difficulty that you would like us to focus on?*

37. At this stage we are not aware of any particular areas or penalties on which the review should focus. If any particular areas of difficulty come to our attention we will let the HMRC team know.

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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 (see <http://www.icaew.com/en/technical/tax/tax-faculty/tax-guidance-notes?utm=widget> ).