

## TAXREP 72/08

### MODERNISING POWERS, DETERRENTS AND SAFEGUARDS

### MEETING THE OBLIGATIONS TO FILE RETURNS AND PAY TAX ON TIME

*Memorandum submitted on 11 September 2008 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to a Consultation Document issued on 19 June 2008 by HMRC.*

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# MODERNISING POWERS, DETERRENTS AND SAFEGUARDS

## MEETING THE OBLIGATIONS TO FILE RETURNS AND PAY TAX ON TIME

### 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 on Meeting the obligations to file returns and pay tax on time, published by HMRC on 19 June 2008 (see <http://tiny.cc/M8wr0> ).
2. We would welcome the opportunity to discuss further the issues we raise with HMRC staff so we look forward to participating in the forthcoming workshop on this topic and to take part in all further consultations on this subject.
3. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Annex A. Our Ten Tenets for a Better Tax System which we use as a benchmark are summarised in Annex B.

### KEY POINT SUMMARY

4. Our key points are:
  - Nothing presented in the paper convinces us that significant changes are needed to the current penalty regime that would result in the stated objectives being better achieved.
  - For a penalty regime to be an effective deterrent to non compliance, taxpayers need to be fully aware both of their obligations and of the consequences of failing to meet those obligations. Effective and timely education, and appropriate and ongoing support, are therefore crucial.
  - The focus should be to encourage and facilitate compliance rather than punish non compliance. Wherever possible, incentives should be used rather than penalties.
  - A harmonised penalty regime for both transaction-based and profits-based taxes is unlikely to be fair and reasonable.
  - The inherent complexity of the UK taxation system means that it can be very difficult for taxpayers to understand their obligations and this makes it more difficult for them to comply.
  - Taxpayers could be better supported by HMRC in completing and filing tax returns and paying their tax on time.

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## GENERAL COMMENTS

5. Our key concern is that HMRC needs to adopt a more innovative approach to improving tax compliance. The document focuses too much on moving tax compliance further towards a 'penalty-based culture' and too little on other ways to help support and influence behaviour.

### Is change necessary?

6. The figures presented in the document (paragraphs 2.3 and 2.13) for 2006/07 indicate that 95% of returns were filed on time and 87% of tax was paid on time and that the majority of the late paid tax was 'paid within a short period'. These figures suggest that the current compliance regime is not unsatisfactory but there is room for improvement. Given this conclusion, we question whether there is a need for the existing regime to be changed.
7. The information provided about approaches used in other tax regimes is interesting but it does not include any information about how **effective** these regimes are in achieving the result of filing returns and paying tax on time. We should therefore be interested to learn what evidence is available to support the contention that changing the existing package of measures to those proposed will result in better compliance behaviour.

### Income from penalties

8. The paper does not disclose how much HMRC receives from penalties and surcharges and whether these amounts are a significant proportion of tax receipts. Given the importance of the proposals, these figures should be published.
9. In addition the figures should analyse penalties paid across the taxes and in respect of 'one off' transgressions as compared to serial non compliance.
10. There is also a lack of clarity about which is more important: the payment of tax or the making of the return. While we accept that without the return the tax cannot be quantified by HMRC, we do not think that taxpayers should be punished automatically if the right amount of tax has been paid. This would suggest that more flexibility is needed to encourage otherwise compliant taxpayers to file their tax returns on time, with penalties only applicable where there is a prolonged failure to file returns.

### Improving support

11. It should be easy for taxpayers to understand how to deal with their obligations to file returns and pay tax, and the deadlines associated with these. Feedback from our members is that taxpayers do not find it easy to understand what is required from them, how they should complete their tax returns and what are the deadlines involved. This is a particular issue for:

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- unrepresented taxpayers, who does not have agents to help guide them; and
  - taxpayers entering the system for the first time.
12. It is disappointing that Chapter 4 on taxpayer support considers only the support currently available and does not explore innovative ways to encourage compliance. The chapter is also unrealistic about the level of support and assistance for payment currently available. Many of the comments in paragraph 4.1 apply to only one tax rather than the whole range of taxes and duties and therefore are helpful only to certain taxpayers rather than all taxpayers (for example, payment methods).
  13. Members report that new clients had very often found themselves in difficulties because they did not know that they had obligations to meet, nor what those obligations were and that support and information provided by HMRC was not always adequate or appropriate to their needs (see below).
  14. There has been a move towards information only being available on the HMRC website. Whilst we support the move to electronic communication as the preferred method of delivery for the future, it means that those taxpayers who do not have access to the internet and those who are not computer literate are severely disadvantaged. We are concerned that this may compromise their tax compliance record although we have not seen any statistics on this issue. We think that more work needs to be done to understand these segments of the taxpayer population and how they might be helped.
  15. While paragraph 4.8 acknowledges that contact centre staff need improved guidance, we also think that the staff need better training, It does not address the difficulties faced by people who cannot or prefer not to use the telephone (including on cost grounds). Enquiry centres are fewer in number and are therefore less accessible to taxpayers, whilst opening hours not usually convenient for those in business or work.
  16. If HMRC were to put more resources into educating and reminding taxpayers of their obligations, and ensuring that communications with individual taxpayers are relevant to them, then HMRC would be more likely to achieve its key objective of improving compliance and the need for penalties and costs associated with dealing with them would be reduced.
  17. For example, radio advertisements exhorting people to get in touch if their circumstances change are unlikely to attract the attention of someone whose hours of work drop by a couple a week because this would not seem to be a significant change in their circumstances. However, it might mean they are no longer eligible for working tax credit. Similarly when a family is in turmoil due to a bereavement or breakdown of a relationship, calling the Tax Credits office will be low on their list of priorities but if they do not do so they risk penalties. Any advertising should focus on specific circumstances and the

types of changes that need taxpayers to take action rather than generic phrases.

18. HMRC needs to make far greater efforts to ensure that all communications and forms which it requires taxpayers to read or complete are written in plain English and are suitably focused. There have been considerable improvements over the past few years, but too often a key message is still buried at the end of a document that most taxpayers will struggle to understand. Comments need to be specific and the consequences of not taking action spelled out clearly, rather than generic comments such as 'you may be liable to penalties and interest if you do not ...'. Consequences need to be spelled out more clearly.
19. We think that one of the key reasons why taxpayers do not contact HMRC at an early stage to resolve tax payment problems is that they do not believe that they will receive a sympathetic response and a genuine willingness to work co-operatively with the taxpayer to address the issue. Taxpayers need to be confident that they will receive an appropriate response from HMRC staff with suitable training and skills who are prepared to be helpful and flexible. This may mean that more staff are needed to carry out this work but should have the advantage that fewer staff are needed to deal with long standing arrears.
20. Furthermore, the assistance provided for individuals and businesses who have had interest and penalties levied on them needs to be improved. Often such amounts are not owed but taxpayers cannot speak to anyone to resolve the matter because telephones remain unanswered or contact details given are wrong.

### **Encouraging and making it easier to pay**

21. Although there is a wide range of methods of paying tax across all taxes, payment of individual taxes is often limited to particular methods. We should like to see the range of payment methods extended to cover all taxes and contributions.
23. Most individuals budget monthly, particularly for outgoings. Making monthly payment and direct debit facilities available for saving towards tax liabilities would be attractive to some taxpayers if interest was paid on such savings. There should be more emphasis placed on putting money aside for tax. Whilst it may be right to tell the newly self-employed that they will not need to pay any tax for 18 months, if they are not encouraged to put money aside to meet the ultimate liability it will merely create a problem when the time comes for payment.
24. All taxpayers need to receive better guidance on how to calculate the amount they may be due to pay and when. This may be particularly difficult to estimate accurately for an unincorporated business but should not be a reason to avoid the issue and may mean that the proprietor will not overspend and then be unable to pay his taxes.

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25. Giving taxpayers extended times for payment of tax when paying by direct debit has been successful and is appreciated by those paying VAT. This could be extended to other taxes including self assessment (SA). However, we wish to emphasise that while some taxpayers may welcome using direct debit as a method of payment, there is reluctance by many taxpayers to use this method, given the potentially serious consequences that an error could have.
26. In the case of corporation tax payers which are not within the quarterly payment and group payment arrangements, payment by direct debit on the due date would remove the existing situation of early and late payment interest which creates work for both parties. The return would of course need to be filed by the due date or HMRC advised of the amount payable.

### **Complexity of legislation**

27. We have commented on numerous occasions that tax legislation is very complex. This in itself will hinder compliance because it makes it more difficult for people to understand their tax position and deal with it correctly.
28. Even those whose tax affairs should be straightforward may overlook issues such as, higher rates of tax may be due even where 'all' income is 'taxed at source', and may not realise that they are taxed on investment income which has been reinvested and therefore not physically received..
29. Some taxpayers understandably find the interaction of PAYE and SA difficult to understand, particularly when they have to file SA returns some years and not others. SA underpayments can sometimes be coded out through PAYE and other years not. Sometimes payments on account are needed and other years not. It is hardly surprisingly that taxpayers get confused and as a result miss deadlines..
30. Further, taxpayers who have more than one employment, or both employment and self employment income, find their tax and national insurance (NI) position very difficult to understand because they have PAYE, self assessment, and three classes of NI to deal with plus the interaction of the annual maximum calculation for NI.

### **HMRC obligations and lack of symmetry**

31. We note (paragraph 2.17) that HMRC has a number of obligations related to filing and payment including:
  - providing adequate advice and guidance on how to complete a return or make a payment
  - once a return is received either by post or electronically, to process the return quickly so the taxpayer's liability is properly recorded,
  - to minimise errors that could lead to penalties being issued incorrectly

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32. The proposed and existing penalty systems punish, sometimes severely, taxpayers who do not meet their obligations but there is little redress available to taxpayers when HMRC has not met its obligations.. For example, HMRC is obliged to process a return 'quickly' (which is not defined) but is not penalised if it does not do so. Taxpayers who file one day late must pay a penalty. This lack of symmetry is unfair to the taxpayer.
33. HMRC are only obliged to 'minimise' errors whereas taxpayers will pay tax-geared penalties if they make errors. In practice it is extremely difficult and time-consuming for taxpayers to obtain redress or compensation if HMRC makes an error, even where this error results in significant financial cost to the taxpayer (for example in the case of late repayments of tax and failing to process a claim promptly).
34. A further example is that there is no statutory obligation on HMRC to review a taxpayer's affairs and make a repayment where tax has been overpaid, for example where an individual is not within SA and has had too much deducted at source and under PAYE. However, where an individual has failed to notify HMRC of a tax liability, believing that tax has been deducted at source and under PAYE, they will incur a penalty when this is identified. We believe HMRC should have a statutory obligation to review taxpayer affairs and repay overpaid tax.

### **Early follow up**

35. Some members have suggested that implementing early and proactive follow up procedures in cases of non compliance could result in less loss of revenue. The non compliant who do not put funds aside for tax and are not chased at an early stage run the risk that by the time HMRC catch up with them, they will have racked up significant tax, interest and other liabilities which they will be unable to pay. Earlier intervention may mean that a greater amount is recovered than would be if the intervention was made at a later stage.
36. We should like HMRC to examine cases to see to what extent earlier intervention may have resulted in more of the liabilities being settled. Conversely, to what extent are amounts due but paid late proved later to be irrecoverable?

### **Education**

37. We are concerned that people do not always make the clear link between paying taxes and the provision of public services such as schools, hospitals and roads. More education is needed to strengthen this link and this should help to improve compliance. We believe that children should, as part of their citizenship education, learn about the obligation to pay taxes and the link to the provision of public services although this may increase the need for greater transparency about how taxes are spent.

## **Carrot, not stick**

38. Our members report that the carrot rather than the stick approach is more likely to influence behaviour. Wherever possible incentives should be used to encourage compliant behaviour, rather than penalties to punish non compliant behaviour. Incentives could include discounts (not necessarily large) or being able to pay slightly later. The stick approach should be used only for those who persistently fail to meet their obligations.
39. As late payment of tax already attracts interest which provides commercial restitution, penalties and surcharges for late payment are arguably inappropriate except for the serially non compliant who have the means to pay and choose not to do so. Such charges can also be disproportionate.

## **RESPONSES TO THE QUESTIONS POSED IN THE CONSULTATION DOCUMENT**

*Q 1: Do you agree with the analysis of filing and payment behaviour set out in Chapter 3? Do you have any further insight or evidence that you could share with HMRC?*

40. We generally agree that Chapter 3 properly summarises the spectrum of reasons for not filing returns and not paying tax on time. However, the underlying reasons have not been explored fully and neither has any attempt been made to quantify the number of late returns and late payments which fall into the various types of behaviour or the underlying reasons for behaviour within the categories (eg complexity, disinterest, lack of understanding, illness). Without this information it is difficult to see how a new penalties regime and support package can be targeted effectively.
41. Members asked to help taxpayers who have failed to meet their filing and payment obligations report that a significant reason for such failures is a lack of understanding of what is required coupled with an unhelpful response from HMRC. HMRC staff should remember that they work in a tax environment, are used to the terminology and understand what is required whereas taxpayers who may have very limited dealings with the tax office find the issues more difficult.
42. Asking an individual who is just setting up a business to work through numerous books of information to ascertain what he needs to do in respect of all the various taxes is unlikely to produce the desired result and may have the effect of turning someone who sets out to be compliant into someone who is overwhelmed and becomes non compliant. Similarly sending numerous tax returns for completion when a non compliant taxpayer approaches HMRC to report taxable activity can be extremely daunting. The inability to deal with the forms in the first place may have been the reason for the non compliance.

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43. HMRC need to do more to understand and address the various pressures faced by taxpayers and the difficulties they face in completing documentation. More one to one initial, and follow up, assistance may be needed to set a taxpayer on the path to good compliance. We recognise that this will require a significant up-front investment of resources but it should lead to less resources required thereafter.
44. Given that some taxpayers will inevitably at some time have difficulties filing on time due to personal or business problems, the question also arises of whether it is better for a return to be filed on time with figures which are later proved to be inaccurate or filed later with accurate figures. Which behaviour does HMRC wish to encourage or discourage?
45. It should also be noted that once a penalty has been charged, a taxpayer has no immediate incentive to file a return or pay tax. For this reason postponement of a penalty and subsequent cancellation when future filing obligations have been met for a period of time (as mentioned below) is likely to achieve more compliant behaviour in the future.

*Q2: What should the relationship between time to pay and penalties be? If a taxpayer enters into a time to pay arrangement after the due date, how should they be treated? If someone fails to adhere to their time to pay arrangements how should they be treated with respect to penalties?*

46. The paper does not examine critically whether levying surcharges and penalties results in improved collection of tax on a more timely basis. The question is fundamental to the proposals in this paper and we suggest that research should be undertaken on this issue before any changes are made to the existing rules.
47. Feedback from members suggests that although the surcharge and penalty regime may influence a minority of taxpayers, a large number believe that it is unfair and disproportionate because it penalises those who are in financial difficulties, thus exacerbating their problems rather than helping to resolve them. The approach should be to segment taxpayers between those who could pay but chose not to do so and those who would pay but are facing financial difficulties, with help provided to the latter category.
48. The availability of time to pay arrangements is not well known and the reasonableness of the arrangements seems to depend very much on the officer dealing with the case and the skill that the taxpayer, or his agent, have in negotiating with HMRC. This is not always satisfactory and on occasions will lead to arrangements breaking down simply because they were inappropriate from the outset. HMRC staff involved in negotiating time to pay arrangements need to be realistic and sympathetic. Getting the outstanding tax paid over a slightly longer period may be preferable to insisting on payment in a shorter period resulting in collapse of the business or breakdown of the arrangements. Officers need to have a consistent approach across all taxes.

49. Late payment of tax attracts interest at a commercial rate. In our view this is usually sufficient and surcharges and penalties should not be added as well as interest. These will simply worsen any financial difficulties the taxpayer is experiencing. Where the reason for non payment of tax is not lack of funds, there is a much stronger argument for charging a penalty but, in order to be fair, a penalty would also have to be charged where the reason was lack of funds. On balance and in the interests of supporting those who are in financial difficulties, we would not wish to see a penalty charged as well as interest.
50. Where time to pay arrangements have been agreed and are complied with, there should be no penalties or surcharges in respect of amounts included in such arrangements. This would encourage taxpayers to approach HMRC early when they have payment difficulties and should lessen risk of tax remaining unpaid.

*Q3: Are the safeguards for taxpayers suggested in chapter 5 adequate? What other safeguards would be appropriate?*

51. We do not believe that the safeguards being proposed are sufficient. There is considerable uncertainty as to how the 'reasonable excuse' provisions will be interpreted and the new tribunal system will inevitably be time consuming, daunting and inaccessible for many.
52. One safeguard which we should like to see is that taxpayers should never have to pay more tax than their equitable liability (for example in cases of multiple returns and out of date years where there are combinations of over- and under-payments). This principle should be enshrined in legislation.

*Q4: What are the advantages and disadvantages of "capping" (where a late filing penalty is capped to the amount of tax due)? Are there any other safeguards that could be put in place that would protect vulnerable taxpayers without reducing the effectiveness of the penalty?*

53. It is generally felt that the £100 late filing penalty for SA is too low to influence behaviour significantly, except for those to whom it would be a significant cost, typically those on lower incomes.
54. For example, a pensioner may have £150 of tax owing at the payment date and because he did not realise that he should have submitted a return; he will suffer the same £100 penalty as someone who owed £10,000 on the payment date and had deliberately not filed his return
55. There is also a lack of consistency across taxes. A company pays a £100 penalty for late filing but there is no capping and the payment of tax by the due date is irrelevant. A taxpayer with an unincorporated business with the same turnover and profits as the company who pays the tax by the due date will pay no penalty even when his return is filed late.

56. For the penalty to be more proportionate, it should perhaps be linked to income. Linking the penalty to bands, using those for micro, small, medium and large businesses, would be one way to make penalties more proportionate but whether this would influence behaviour remains to be demonstrated.
57. If the aim is to get tax paid on time wherever possible, there would appear to be merit in publicising that the late filing penalty will be reduced to nil if all tax due is paid. If the aim is to get the return in on time, there could be some merit in charging a differential rate of interest on tax owing, depending on whether the return was filed on time or not.
58. Although the self assessment late filing penalty is well known it is not always effective in deterring late filing. Take these examples. A taxpayer does not take steps to file his return on time because he knows that he is owed tax and that any penalty will be reduced to £nil under the capping provisions. He has no incentive to file his return except to obtain the repayment due and to avoid possible administrative problems if HMRC raise a penalty that then needs to be cancelled
59. Another person decides deliberately to ignore a return even though tax is owed because they know that once the return has been submitted, the Collector will start pursuing the debt and they do not have the money available to pay the tax. In this case the taxpayer may be prepared to pay the late filing penalty (plus any interest) as, in effect, it may be a relatively inexpensive way to buy time to organise finances.

*Q5: Do you agree there are benefits to alignment of penalties for failing to file a return or pay the tax owed by the due date? Are there any benefits we have missed?*

60. Whilst we agree that aligning penalties across all taxes may have some benefits, we remain unconvinced that it is the most appropriate course of action. The various taxes and duties include both transaction-based levies (VAT, Stamp Duty) and profits-based levies (CT and IT). In addition, returns are required at different intervals depending on the tax. Aligning penalties, particularly tax-linked penalties, will often penalise those dealing with transaction-based taxes because the figures may well be higher than for profits based taxes.
61. For some taxes (VAT and CIS in particular), the consequences of late filing and payment currently appear to be severe as compared with other taxes (CT and SA). We would not welcome a change to align penalties at a higher level, in particular because no evidence has been presented that this would have any effect in influencing behaviour.

*Q6: How should HMRC use the tools discussed in Chapter 7 to most effectively reinforce both obligations – to file a return and to pay the tax due?*

62. Penalties should not be regarded as a revenue raising exercise but instead encourage taxpayers to file their returns and pay their taxes on time. Given that a change in behaviour of the non compliant must be the main objective, one innovative approach HMRC could adopt would be to make penalties refundable if behaviour improves eg the returns are filed on time for next few occasions. This approach would not be dissimilar to the 'section 419 charge' levied on close companies which make loans to participators, where the amount charged is repaid when the loan is repaid.
63. Alternatively, and this could be administratively easier to manage, penalties could be suspended in the same way as is proposed for incorrect returns etc. These options have the additional advantage that they give the message that improvement is the key, rather than punishment.
64. Given that HMRC should be trying to encourage compliance, we consider that 'failure to notify' penalties give the wrong message and are neither fair nor, in many cases, proportionate. This applies particularly to persons who do not notify liability within the stated period but who, nevertheless, still file their return and pay their tax on time. It is wrong in principle to levy penalties on those who have complied with their key obligations.
65. Sometimes lack of funds means that a taxpayer cannot afford professional advice or continue to pay for an existing professional adviser and this can be the reason for non compliance. In these circumstances HMRC needs to consider how it can best help a taxpayer comply with the obligations imposed on him. Levying penalties may not be appropriate because the money applied to the penalties may be better spent on professional help with the return and thus returning the taxpayer to his previously compliant position.

*Q7: How could the tools described in Chapter 7 be most effectively structured to tackle late or non filing and payment? An illustration is provided in this chapter but there may be many alternative structures and HMRC would welcome your thoughts on this?*

66. Penalties are not an effective tool if taxpayers are not aware of when they will be payable and how they are calculated. Very often the penalty comes as an unwelcome surprise. Correspondence and literature should make it clearer what penalties may be levied and when.
67. For example, the front of the SA return states clearly the amount of the penalty for late submission and the deadlines (which is good) but it does not state the amount of or date from which a surcharge will apply ('you will be charged interest and possibly a surcharge'). Similarly Statements of Account issued in February do not clearly state on the face the potential amount of the surcharge or the date and amount of the tax which needs to be paid by to avoid a surcharge. We recommend that a statement should be added such as:

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68. You owe £[total amount outstanding]. Interest is being charged at [enter rate] p.a. on this amount. This will be £[enter amount] per week. In addition, if you do not pay at least £[enter amount for tax year still outstanding] by 28 February you will be charged a surcharge of £[enter actual amount]. If you pay part of the £[amount], the surcharge will be reduced.

*Q8: If the requirement for pre approval of daily penalties was removed, would the other safeguards suggested in this chapter including: a right of appeal against the penalty, internal review, and a possible limit on how large daily penalties can get be adequate to protect the taxpayer?*

69. Daily penalties are a weapon of last resort and should only be used in cases of serious non-compliance and only where taxpayers have been given every opportunity to submit returns but have not done so. We are concerned about the proposal to start charging these without prior approval. Parliament legislated that daily penalties require approval for a reason: to safeguard the taxpayer. The fact that it is expensive to enforce is not an acceptable reason to dispense with the existing safeguard. The procedures required reinforce the fact that Parliament intended this to be a last resort.
70. If prior approval was no longer required, we are concerned that there may be inconsistencies in the way that the daily penalties are used and the timing of their application, depending on factors which should be irrelevant such as work load in the relevant tax office and of the officer dealing with the case, the views of the officer himself, and so on.
71. If daily penalties are to be applied without prior approval, then they should apply only from a fixed pre-set date after the transgression, for example one year, and they should be widely publicised and be mitigable in cases where there is reasonable excuse for the delay.
72. We should also like to see officers making more attempts in a variety of different ways to ascertain the reason for a delay in submitting returns. It would save both parties time and costs if this was established as early as possible. It may be for specific reasons which can be addressed and dealt with, for example, because correspondence is being sent to the wrong address, the taxpayer has a long term illness or there is a business failure. It is human nature to ignore notices at times of crisis and in these circumstances entering into early dialogue with the taxpayer rather than simply sending notices should be encouraged, to the benefit of both parties.

*Q9: How could HMRC ensure that the package when considered as a whole doesn't get disproportionate?*

73. One existing example of a penalty being disproportionate is the penalty for the late filing of a partnership self assessment return. It is our view that there is no justification for this penalty being linked to the number of partners in the partnership, who may also suffer a personal penalty in respect of their own

returns if the partnership return is late. We suggest that any penalty for late partnership returns should be treated in the same way as a late corporation tax return.

74. As previously stated, we are not convinced that penalties are always an effective way to encourage compliance and on that basis any penalty package is likely to be disproportionate. We have also stated that penalties and surcharges should not be applied as well as interest.

*Q10: Should those who file or pay shortly after the due date be treated differently from those who file their return or pay later.*

75. A deadline should be a deadline with consequences clearly spelled out. There would seem to be no compelling reason for P35 returns and CT600 returns to have a seven day period of grace during which no penalty will arise and not to have the same for other returns also.
76. Encouraging future compliance should be key, so we recommend a warning in the same way with VAT and CIS. The first transgression should be treated with a 'light touch' but future ones subject to increased penalties. For the reasons set out above we would like to see more research on the issue of how escalating penalties influence behaviour.
77. Again, when the amount of penalty which may be charged is not clearly spelled out, taxpayers may not realise the financial effect of missing a deadline.

*Q11: How should those who repeatedly file or pay late be treated?*

78. It has been suggested that a more effective deterrent than monetary penalties would be to 'name and shame' those who do not comply with their obligations. Arguably this is likely to be a more powerful tool in influencing behaviour than a fine but we are concerned about the risks of error in such an approach.
79. An alternative approach would be to publish details of settlements reached and those involved. This could also be useful way to highlight in financial terms the consequences of failing to comply with one's obligations and addresses the need to demonstrate to compliant taxpayers that HMRC is dealing with non compliant taxpayers and also acts as a warning to those who are not yet compliant.
80. We also believe that, in the interests of setting an example to the population at large, there could be merits in using the criminal code more in cases of deliberate avoidance of tax and falsification of accounts and documents, rather than the current approach of penalties rather than prosecution. However, the cost effectiveness of this would need assessing.
81. Apart from this we consider that the existing penalties and sanctions work well to deal with those who do not comply.

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*Q12: How well do the approaches suggested in Chapter 7 balance the elements of the design principles?*

82. The approaches set out do not offer sufficient safeguards to the taxpayer and would not appear to offer any advantages over existing provisions. We should prefer an approach which is more of a carrot than a stick with more incentives to reward compliant behaviour rather than increasing punishments for non compliance, which may make the situation worse.

*Q13: How effective are the approaches suggested for frequent filing and payment obligations in Chapter 8 likely to be in encouraging timely payment and filing? Are there alternative structures that may be more effective at encouraging on time filing and payment?*

83. The comments made elsewhere apply equally to frequent filing and payment obligations but there should be a higher 'tolerance level' before penalties are applied.. This would take into account the more onerous requirement to file or to pay frequently and therefore the higher chance of failures occurring as compared with persons required to file less frequently.

*Q14: HMRC would welcome views on the best way of encouraging employers to pay their in year PAYE in full and on time, without creating unreasonable burdens on employers.*

84. We should like to see an analysis of how much PAYE is paid late (as opposed to the number of schemes paying late) and how much is still outstanding after given periods eg a week, a month etc. It should then be possible to consider how best to target those paying the most tax late. If the amounts being paid late are small and by only a short time it would be better to put resources elsewhere because the existing regime works well enough.
85. Employers could be charged interest when they pay their in year PAYE late. While this would not necessarily encourage payment on time, the employer would not obtain such an advantage from paying late as at present. The interest would be easy to quantify provided that the payment made in respect of any month is the correct amount due. For this to work, any deliberate underpayment would have to be penalised and HMRC would need to be able to check that the amount is correct using its visit powers to review and audit the figures. This arrangement would be preferable to the alternative which would be requiring employers to make returns more frequently.
86. HMRC should also consider risk profiling PAYE schemes and looking for irregular payment patterns and following up on unusual items. This may be particularly useful to identify schemes where employers deliberately underpay in-year payments but then settle the full amount owing before interest is due. Such an approach should identify employers who are obtaining an unfair competitive advantage over competitors by not paying the correct amount of PAYE on time.

*Q15: How well do the approaches suggested in Chapter 8 balance the elements of the design principles?*

87. We are concerned that the approaches being suggested do not take into account a frequent reason for late payment – lack of funds. If there is no money to pay a liability, tax geared penalties will, as mentioned above, exacerbate the problem.
88. What evidence is available to support the view that the VAT surcharge regime has influenced behaviour? Has anyone considered whether, where there is a lack of funds, to avoid surcharges VAT is paid rather than PAYE or CT/SA tax, which do not attract a penalty or surcharge?

AW  
11.09.08

## ICAEW AND THE TAX FACULTY: WHO WE ARE

1. The Institute of Chartered Accountants in England and Wales (ICAEW) is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.
2. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department for Business, Enterprise and Regulatory Reform through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.
3. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 10,000 members of the ICAEW who pay an additional subscription.
4. To find out more about the Tax Faculty and ICAEW including how to become a member, please call us on 020 7920 8646 or email us at [taxfac@icaew.com](mailto:taxfac@icaew.com) or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.

## 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.co.uk/index.cfm?route=128518>.