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HMRC Review of Powers
Penalties Reform: The Next Stage
Room 1/72
100 Parliament Street
LONDON
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3 March 2008

Our ref: CT12/TAX/TC

Dear Sirs

Penalties Reform : The Next Stage

PricewaterhouseCoopers (PwC) is grateful for the opportunity to comment on the new Consultation Document issued on 10 January 2008. We remained fully committed to being involved in all the consultations that may be issued as part of Modernising Powers process. We found it very useful to meet on 28 February to discuss the consultative documents and our comments broadly repeat the matters discussed, with some additional points of detail.

By way of general comment, we believe that the proposals for extending to all other taxes the approach enacted in Finance Act 2007 for the main taxes seems sensible and is in line with comments PwC has made in relation to previous stages of the penalties reforms. However, before we make any detailed comments that are some other points of general application. These points do not only apply to the Penalties Reform.

HMRC issued three Consultations on 10 January. Two of those are very wide-ranging and far-reaching. The sheer volume of intended changes concerns us greatly. At an operational level HMRC needs to adopt a 'business as usual' delivery but there has been massive change in recent years, starting with the IR/HM C&E merger which does not yet seem fully embedded. HMRC faces challenge with budgetary cuts, IT systems that do not work in harmony, and continued pressure on

staff morale. Yet at the same time HMRC is committing itself to fundamental changes across its whole compliance arena. The success of these changes depends on delivery; the delivery in turn depends on HMRC's people.

HMRC has a business that is populated with individuals from very differing backgrounds with very differing experiences, used to different working methods and who may have applied themselves differently over a long period of time. The individuals need to embrace the new environment that all these changes will rightly create. There is little reference within these three Consultations about how HMRC will educate, support and apply consistency across its business.

How does HMRC intend to support, train and educate across its own staff, let alone the taxpaying public and their advisers? We believe that it is essential for HMRC to publicise how it is going to address its internal training for all these fundamental changes and, if appropriate, involve the profession in assisting and supporting this massive task.

PwC also believes that HMRC need to be much clearer in terms of examples of offences and terms such as reasonable care so as to enable dialogue, clarification and better definition of these terms to be achieved. We believe that such action will support HMRC's goals and make it rather clearer what a taxpayer has to do and what is or is not acceptable.

We now set out our detailed comments on the proposals:

1. One particular point discussed at the meeting on 28 February was the required standard of proof, given the manner in which the legislation is now drafted, with the use of words such as 'deliberately supplying false information'. It is our understanding that HMRC has been advised by counsel that the civil standard of proof will apply (balance of probabilities) rather than the criminal standard (beyond reasonable doubt), but that it will be a 'higher' civil standard. We mention the point only out of concern for the fact that we fully support the need for appropriate penalties to be taken in respect of the most serious offences and we would not want the ability to take penalties to fail on account of the standard of proof point.

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2. The set of 'design principles' at paragraph 2.4 seems reasonable although words such as 'be accessible, clear and easily understood' might have been included. It is possible that these criteria are already catered for under the 'be effective' heading but these are a little mixed - for example, having a criteria of 'visible and set in statute' rather mixes two criteria. We would have 'set in statute' as a separate heading.

3. Para 2.10 comments on the review of interest on late payments. It is correct to say that this is the subject of a separate review but there is an element here that the proposals there need to be settled before the penalty regime for late notification is completed. The two inevitably overlap and if, for example, the late interest regime becomes one that builds in an element of penalty into the interest rates charged, then that should be a factor in settling whatever penalties are appropriate for late notification.

4. We do have some concerns about the comments in paragraph 3.9. If the taxpayer claims that he or she took reasonable care to ensure that the return was accurate but the agent failed to take care, how does HMRC envisage that the taxpayer could satisfy HMRC? The taxpayer and the agent could well be in dispute and the taxpayer might not be able to obtain the supporting evidence. Does HMRC propose defining ‘an agent competent’?

5. The list in Chapter 4 (and the draft legislation) of the other taxes to be covered by the new regime seems appropriate. We note that tax credits and National Minimum Wage are excluded. The omission of NMW seems on the surface to be sensible (in that the offence is against the employee, not HMRC) but one would think the penalty framework and principles should carry over. As for tax credits, again the situations are rather different (and regrettably often a mistake may be HMRC’s, not the tax credit recipient’s) but equally the principles of the new regime should carry through. These two areas need further study to understand why and how they can or cannot be aligned with the new general regime.

6. The answers to the questions posed after paragraph 4.6 seem uncontroversial:

   (1) The penalty regime should be extended as envisaged.

(2) Further guidance will be needed (see below).

(3) The benefits of aligning penalties do outweigh the difficulties and the case for this is made well in the succeeding paragraphs.

7. The heading before paragraph 4.14 is ‘Employers’ Responsibilities’. Most employers, large or small, do their best to ensure that they correctly operate the PAYE system. But mistakes occur because the system has so many rules and nuances. (For large employers the errors will hardly ever be material.) Those mistakes will almost always be innocent errors; whether or not they are spotted and put right before there is an HMRC audit could be a matter of chance. If these errors are penalised under the new system, the level of penalty is likely to be greater than under the present system but not as a result of any different behaviour. Does HMRC contemplate making any comment about this type of error?

8. Further guidance on 'reasonable care' is undoubtedly needed with some of the taxes, particularly where there will be reliance on other people. This point is acknowledged at paragraph 4.17 onwards.

9. Indeed, thinking further about the types of situation, there seem to be four broad categories of tax compliance routines covered here:

(i) A single transaction with a single return - IHT and in many cases SD/SDLT.

(ii) A single transaction requiring a single return but a case where the taxpayer is involved in submitting many returns over a relatively short period - SD/SDLT might again be examples in the context of stockbrokers or a large firm of conveyancing lawyers.

(iii) Multiple transactions which lead to a single return for a period - excise duties and perhaps IPT.

(iv) A return that covers a set period where the transactions blur into each other or it is simply a question of assessing what has gone on - PRT is an example.

It seems that the different situations might at a minimum require different guidance and, taking it a little further, might require some slightly different approaches between them as regards the reasonable care category, if only because the possibility of a suspended penalty will not always be available or logical.

8. Aligning penalty responses to different areas on employers' returns does seem sensible. Does there need to be any consideration given to situations where errors are netted off to an extent e.g. if the employer has over-deducted and paid over too much NICs but made errors on SMP, claiming too much back from HMRC?

9. The suggestion of penalties on third parties for deliberately inaccurate information seems, in principle, sensible. It does seem to need a couple of safeguards, in line with the existing para 19 Schedule 24, i.e.:

   - HMRC cannot recover more than 100% of a penalty by penalising both the taxpayer and the third party;

   - This proposal has to be in relation only to deliberate inaccuracy (the draft legislation in new paragraph 1A seems to achieve this); but

   - HMRC will need to spell out very clearly the type of situation where such a penalty might apply so that third parties are aware of the risks faced. Third parties need to understand that they could be liable for a tax where they have no access to the profit that has given rise to that tax. This is a very new type of penalty where HMRC needs to make very clear statements about its intended application so as to avoid confusion and dispel concerns,

10. There does seem merit in giving taxpayers some sort of appeal right to show that the penalty should be levied on the third party although we see this as an area fraught with potential difficulty. At the moment it seems to be at HMRC discretion as to who is penalised.

11. As for the penalty regime applying to unpaid duty on alcohol and tobacco, the framework seems sensible so the basic answer to the question after paragraph 4.21 seems to be 'yes'. Is there any interaction needed with the regime on duty stamps in any way?

12. The general answer to the summary question after paragraph 4.26 is 'yes'.

13. The changes to penalties for failure to notify are a little more difficult. It is good to see at paragraph 5.3 that HMRC acknowledge that they need to put their house in order to help taxpayers realise their obligations. The suggestion of dropping the £100 fixed penalty for late notification for Class 2 NICs is sensible. It is little understood and out of line with notification for income tax/corporation tax.

14. However, the idea of replacing the £100 penalty with a penalty geared to the income tax/NICs unpaid does seem to point the way to an element of double counting. If interest is charged on late payments and if the penalty is also geared to this, care needs to be taken to ensure that the penalty does not become disproportionate. This seems to carry through in the general framework suggested after 5.24. The framework itself seems reasonable (and of course mimics the general penalty regime) but there are a couple of oddities:

    (i) Why is it not possible to get 'no deliberate failure to notify' down to a nil penalty? That is the equivalent of a penalty for careless behaviour, which is reducible to nil.

    (ii) There is no suggestion of suspension of a penalty - probably conceptually difficult in terms of failure to notify but it does create a mismatch.

16. We are also not wholly clear how the 'unpaid tax' is calculated - the VAT that should have been charged on sales but wasn't? Or the Class 2 not due for period before registration? The penalty if tax geared could vary considerably and the potential penalty for non-deliberate failure to notify could be out of proportion.

17. A key objection to the penalties for non-deliberate behaviour is that the taxpayer could not understand or could not be expected to understand their obligations. HMRC have something

of a challenge on their hands to make sure that all taxpayers can understand easily what they are expected to do.

18. There does need to be a right of appeal to an independent tribunal at paragraph 5.25. The paragraph starts off by saying that there should be a right of appeal against the penalty and its amount: for the avoidance of doubt, it should be made clear that the tribunal will have power to vary the amount of penalty. It is not enough for the tribunal only able to say whether a penalty should be charged or not.

19. A harmonised reasonable excuse provision is appropriate. The example at paragraph 5.27 is reasonable; HMRC also needs to think through where the taxpayer can show that they tried to assess the VAT status of their supplies and got it wrong and so did not think they reached the taxable turnover threshold.

20. Finally, we have two comments on the draft legislation. The first is that in paragraph 12(4) of the draft legislation we suggest the word 'shall' should replace the word 'must' so that the sub-paragraph ends '*the aggregate of the amounts of the penalties shall not exceed 100% of the potential lost revenu*e'.

21. The second relates to the fact that in the original Schedule 24 we did not see the use of the word '*information*' otherwise than in paragraph 28(h) of Schedule 24. The word '*information*' does now appear in places in the new legislation (in one place in the schedule to paragraph 1, in paragraph 1A (third parties) and importantly in paragraph 5 (and consequentially in paragraph 9). Would it not be better if instead of the amendment to paragraph 5 '*inaccuracy*' was defined (in Part 5) to include '*an inaccuracy attributable to the supply of incorrect or false information*'? Following on from that (or alternatively in paragraph 5) would paragraph 5(1) not read better as '*attributable to the supply of incorrect or false information*'? Incorrect then links to careless inaccuracies whereas false links to deliberate inaccuracies (does false sit easily with careless?).

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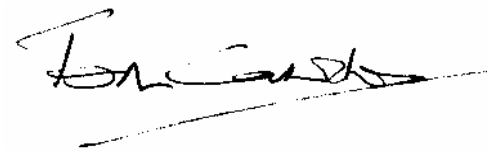
Yours faithfully



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