

Penalty mitigation – errors (Lecture P1310 – 16.08 minutes)

This article considers the mitigation, or the reduction for disclosure, that may be available in relation to the penalties that may be charged when a taxpayer has submitted a return or document containing an error to HMRC. It will not cover the mechanics of the penalty calculation but will consider some of the practical considerations for advisers dealing with a case where these penalties are, or may be, charged by HMRC.

Overview

The relevant penalty rules, at Schedule 24, Finance Act 2007, apply to Capital Gains Tax, Construction Industry Scheme, Corporation Tax, Income Tax (including Self-Assessment), NIC (Classes 1 and 4), Pay As You Earn, and VAT, for returns or documents that were due to be sent to HMRC on or after 1 April 2009, and relate to a tax period beginning on or after 1 April 2008. The rules were extended to cover other taxes administered by HMRC for returns or documents that were due to be sent to HMRC on or after 1 April 2010 and relate to a tax period beginning on or after 1 April 2009.

For earlier periods, a different set of rules apply, but they are not considered in this session. In addition, this session does not consider the increased penalties that can apply where the penalty relates to income or an asset that is held outside of the UK, or the special rules relating to documents connected to avoidance arrangements.

It is not sufficient for there to be an error in a return or document submitted to HMRC for a penalty to be charged. There must also be an underpayment of tax or a misrepresentation of the tax liability arising from the error (this can include an excessive over-repayment claim, or excessive loss claim). When there has been an underpayment of tax, etc, you need to determine the appropriate penalty, if any, by considering the relevant culpability.

HMRC have produced a factsheet, CC/FS7a, which covers penalties for inaccuracies in returns and documents. The factsheet can be accessed from the link on the following page, <https://www.gov.uk/government/publications/compliance-checks-penalties-for-inaccuracies-in-returns-or-documents-ccfs7a>

The categories of behaviour

There are four categories to consider:

1. Reasonable care - not defined, and the words take their ordinary meaning. Each case must be determined by the facts, and the client's circumstances. What is accepted as being reasonable care for one taxpayer may not apply to another.
2. Careless – where the inaccuracy is due to failure by the taxpayer to “take reasonable care”.
3. Deliberate but not concealed –where the inaccuracy is deliberate on the taxpayer's part but the taxpayer does not make arrangements to conceal it.
4. Deliberate and concealed –where the inaccuracy is deliberate on the taxpayer's part and the taxpayer makes arrangements to conceal it. This includes by submitting false evidence in support of an inaccurate figure.

Advisers should note that, absent an admission by the client, the onus is on HMRC to demonstrate, on the balance of probabilities, that the client's behaviour was deliberate.

In addition, advisers need to be aware that an inaccuracy in a document given by the client to HMRC, which was not careless or deliberate on the client's part when given to HMRC, will be treated as careless if the client discovers the inaccuracy at a later time and did not take reasonable steps to inform HMRC.

Where HMRC accepts that a client has taken reasonable care, they do not charge a penalty. Thereafter, the level of penalty that HMRC can charge increases as you progress to the more serious categories of culpability. In addition, non-financial sanctions may also apply where the client falls in either of the deliberate categories.

When considering the appropriate category of behaviour for an inaccuracy, advisers need to establish all material facts – this can include consideration of any health (physical or mental) issues that impacted on the client, any relevant personal circumstances, what records the client has maintained, and what advice was obtained.

Unprompted v prompted

The next consideration, where appropriate, is to establish whether the disclosure was unprompted or prompted. This determines the minimum penalty percentage that HMRC can charge. There is a statutory definition (Para 9(2), Schedule 24, Finance Act 2007) of when a disclosure is unprompted. The legislation states that a disclosure will be "unprompted" if it is "made at a time when the person making it has no reason to believe that HMRC have discovered or are about to discover the inaccuracy...". Otherwise, the disclosure is "prompted".

Advisers need to establish the facts, to determine whether their client's disclosure is unprompted, including copies of any correspondence from HMRC. It is an important position to determine, because of the impact on the penalty that HMRC can charge. Can you establish that the client has made an earlier notification to HMRC of the problem, for example?

Where HMRC have started an enquiry into a client's affairs, it may still be possible to argue that a client has made an unprompted disclosure, although this would usually need to be where the disclosure area is unrelated to the purpose of the enquiry.

HMRC officers are told to reserve judgment as to whether a disclosure is unprompted or prompted until the end of their compliance check. This is because new evidence can emerge over the course of the investigation. Advisers should take a similarly cautious approach, until all available documentation, and information, has been obtained.

The quality of disclosure

The level of co-operation demonstrated by the client, deemed the quality of disclosure, determines the amount of reduction that applies to the penalty. The greater the co-operation given by the client, the greater will be the reduction applied to the penalty. This breaks down to three areas – telling, helping and giving. Each of these areas is considered in relation to their respective timing, nature and extent.

Practical considerations

The right time to consider penalties is at the start of an enquiry, not at the end. Advisers should inform the client about the potential penalties that can be charged and give appropriate advice. The actions of the adviser can impact on the level of penalty that is charged, so they should avoid any delay in their communications with HMRC.

The penalty is applied to the potential lost revenue ("PLR"), usually this is the amount of tax that has been underpaid. Advisers should consider whether the PLR has been correctly calculated, and whether there is any justification for its reduction.

Advisers should ensure that they, and HMRC, consider each inaccuracy separately. Different categories of behaviour may apply, with the relevant penalties applied. There can be a tendency for inaccuracies to be treated as one, and this should be avoided. A key part of this is the need, and ability, to make an objective assessment of the client's culpability, and to issue appropriate advice to the client. This is a scenario that I often come across in practice, with an acceptance by the adviser that they are too close to the client to make the necessary assessment.

When considering penalties, it is important to establish all relevant facts, and gather supporting documents, which will help the adviser to make the objective assessment noted above.

Advisers should consider obtaining specialist advice (ideally before approaching HMRC) where they have any concerns, either about the client's case, or their ability to make an objective assessment. The adviser should establish whether there are any special circumstances, such that a special reduction can be applied to the penalty. Where the adviser and client cannot agree the penalty with HMRC, the client can use the appeal process (covered in other sessions).

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