

The New Points-Based Penalty System

(Lecture B1154 – 10.11 minutes)

Introduction

In the Autumn 2017 Budget, the Chancellor announced plans to “reform the penalty system for late or missing tax returns, adopting a new points-based approach”. This was on the back of responses to consultations where most respondents indicated that they favoured a points-based model due, largely due to its comparative simplicity.

A new points-based penalty system will therefore be introduced apply to ‘regular’ returns being those filed monthly, quarterly and annually. This will replace the current system under which taxpayers who submit returns late face an instant fine (plus further penalties for prolonged delays). The new system will operate in conjunction with Making Tax Digital (MTD).

Draft legislation was originally issued for inclusion in the Finance Bill 2019 with a view to rolling-out the new system from April 2020. However, mandatory MTD for income tax reporting has since been deferred to 2021 at the earliest, and the new points-based regime has also been delayed in line with it. The legislation has accordingly been pulled from Finance Bill 2019 in order to allow HMRC “more time to consider further the communications needed for successful implementation”. The next target-date for the roll-out is April 2021.

Returns to which the new rules will apply

The draft clauses contain Tables listing the types of returns - split alphabetically into different ‘groups’ - to which the new regime will apply. There are three Tables – Table 1 for annual returns, Table 2 for quarterly returns and Table 3 for monthly returns. For example, annual self-assessment returns for income tax will fall into Table 1 Group 7. Quarterly VAT returns will fall into Table 2 Group 15.

The points-based system will initially apply to VAT returns with the system first being implemented for VAT returns filed on or after 1 April 2021 at the earliest. Income tax returns are next in the queue although no dates have yet been put forward. Corporation Tax returns will join the party ‘in due course’. This will ultimately signal the end of the flat £100 penalty for the late submission of a self-assessment return which will be abolished at “an appropriate point in the future after an appropriate notice period”. [Flat-rate penalties are something of a money-spinner for the Government with nearly 1 million taxpayers last year reportedly submitted their SA returns late. No doubt plans are afoot to replace this lost revenue.]

The new system will (eventually) apply to all returns including a variety of less high-profile returns such as those for ATED, excise duty, aggregates levy, climate change levy, IPT, landfill tax and air passenger duty. Ad-hoc or irregular returns in relation to more unpredictable transactions – for example, IHT returns, NRCGT returns Land Transaction returns for SDLT – will not be brought within the points-based system. We wait and see whether these returns will continue to be liable to the existing penalties or whether new provisions will be brought-in.

The points system

The new regime is intended to benefit those genuine law-abiding citizens who occasionally make an error of judgement or miss a deadline. These good people will typically receive the proverbial 'yellow card' but nothing more. While the penalty rates under the new regime have not been discussed, one imagines that once the yellow card has turned red, the penalty loading will be significantly heavier than it currently is, thereby increasing the punishment for those miscreants who persistently fail to meet their filing obligations.

As stated in their Policy Objective: "The government wishes to encourage compliance with regular return submission obligations but does not want to punish taxpayers who make occasional mistakes. This measure is designed to be proportionate, penalising only the small minority who persistently fall foul of the rules."

The idea of the new system is that where a regular tax return is submitted late, instead of an automatic penalty, the taxpayer will be awarded penalty points. [The draft clauses talk about HMRC 'awarding' penalty points. It's not the verb I would have chosen but if we think of this 'award' being a preferable alternative to the imposition of a fine, then we can live with it.]

An award of penalty points does not mean that a monetary penalty will be levied. A penalty will only be charged when a pre-defined points threshold has been reached. Once the accumulated points hit the magic number, a penalty will then be charged for each subsequent submission failure.

The comparison with driving-license points is obvious and like road-traffic misdemeanours, the accumulated points will be expunged after a defined period of compliance by the taxpayer.

Penalty points can be appealed and reviewed. HMRC will publish further details in due course. No penalty points will be awarded if the taxpayer has a reasonable excuse for the failure. The draft clauses helpfully tell us that insufficiency of funds and reliance on another person are not (usually) reasonable excuses, but we've heard this before.

As mentioned above, at the time of writing no penalty rates have yet been announced, but these should be forthcoming soon.

The VAT default surcharge system

As VAT is the first cab off the rank, a reminder of the current system is in order.

The default surcharge system is presently in situ for VAT. A default surcharge is a penalty levied on businesses that either submit VAT returns late or make their VAT payments late.

There is no penalty for a first offence. Instead where a return is late, the business is issued with a Surcharge Liability Notice (SLN). The SLN applies for 12 months from the end of the period of default. If VAT returns are submitted late within the SLN period, a monetary penalty will apply. This penalty starts at 2% of the VAT due for the return period, increasing to 5%, then 10% up to a maximum of 15%.

Smaller businesses with a turnover of less than £150,000 are treated more leniently and no SLN is issued on the first default. Instead HMRC issues them with a guidance letter to help with future compliance. If another default occurs within 12 months of the letter, the business will enter the surcharge liability period.

The system has been criticised and is due for overhaul. We all agree that businesses should submit their returns and pay their taxes on time, and we like the idea of system which contains sanctions to encourage compliance. However, businesses are currently being hit with massive fines in cases where the return or payment is fractionally late. The punishment often seems harsh compared to the crime.

The existing penalty regime for VAT will be carried over into the MTD for VAT regime which kicks-in from April 2019. The VAT default surcharge regime will remain in place for at least 2019/20 and 2020/21. This is despite the fact that the penalty point model seems to be much better suited to MTD than the default penalty regime that is far more administratively complex.

The new system

The current VAT default surcharge regime will be replaced by a points-based penalty system. This will apply for the late submission of VAT returns. It will not apply for late payment of VAT (new rules are being introduced here which are beyond the scope of these notes).

A business will automatically receive one penalty point every time it fails to submit a VAT return on time. Points continue to be awarded until the taxpayer reaches the statutory maximum. This is the point at which the system loses patience and starts handing-down penalties. Monetary fines will duly kick-in for subsequent failures. Whether these penalties will bite harder than the old ones under the default surcharge remains to be seen.

No further points are awarded if the accumulated penalty points have reached the statutory maximum. The maximum number of points before fines are triggered depends on the frequency of the return submission obligation. For annual returns the maximum is 2 points, for quarterly returns it is 4 points and for monthly returns it is 5 points. Businesses filing VAT returns on a quarterly basis can therefore have 4 strikes before a monetary fine is incurred. This is far more generous than the current default surcharge system where the 4th failure would usually trigger a 10% penalty (which can be horrendously expensive for large businesses).

After the maximum is reached, each late submission will attract a penalty. The draft clauses contain provisions for the imposition of penalties once the maximum number of penalty points is reached with paragraph 16(4) helpfully telling us that “The amount of a penalty under this paragraph is £[x].”

The HMRC blurb that accompanied the publication of the draft clauses and explanatory notes uses the words “fixed penalties”. Certainly £[x] seems like a fixed number. Taken at face value, this suggests that the penalty will be a set amount and will not be a percentage of the VAT due on the return. This is (potentially) very welcome news as there is no reason why the same failures by two separate businesses should be punished with hugely different fines just because one business happens to sell more stuff than the other.

Whatever the quantum of the penalty, a penalty notice must be issued which will require settlement of the penalty within 30 days. Penalties will then continue to be levied for compliance failures until the taxpayer has:

- Met all their submission obligations by the relevant deadline for 24 months; and
- Provided any outstanding submissions for the preceding 24 months.

At that stage the points total will be reset to zero and we start again with a clean sheet.

Example

ABC Ltd is a VAT registered business. Its VAT return for the quarter ended 30 April 2021 is due on 31 May 2021. The return is filed on 25 June 2021.

ABC Ltd will be liable to a penalty point. To award a penalty point, HMRC must issue a notice to ABC Ltd and state the failure in respect of which the penalty point is awarded and the group of returns for which the penalty point is awarded. Here the VAT penalty would fall into "Table 2 Group 15" being the group for quarterly VAT returns.

HMRC has 3 months to issue this notice otherwise it is out of time (the time limit is 12 months for annual returns and 1 month for monthly returns).

Any subsequent failures will attract penalty points up to a maximum of 4. Penalties will be levied for failures after that maximum is reached.

If ABC Ltd file all their quarterly VAT returns on time between 1 May 2021 and 30 April 2023, the points total will be reset to zero.

Special provisions

There are several special provisions, perhaps the most relevant one being the provision which deals with instances where a taxpayer changes the frequency of his return submissions and moves between Tables.

This could happen if a VAT registered business shifts from quarterly to annual accounting and moves from Table 2 to Table 1 (or vice versa). In this case any existing points loading would be adjusted (as otherwise the mere shifting of return frequency could either take the points total over the statutory maximum or increase the maximum giving scope for extra penalty-free failures).

For example, a business moving from quarterly to annual VAT accounting would have 2 penalty points removed from his total (and 2 added for businesses going the other way).

Late payment penalties

The points-based system deals only with the late submission of returns. Changes are also being introduced to penalties for the late payment of tax, again intended to be rolled-out for VAT from April 2021 (other taxes to follow). These will be the subject of a separate session.

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