

Clearer, but more complex

In the first of two articles, *Andy Wells* takes a look at the new penalty regime and HMRC's guidance



The legislation governing the new penalty regime for IT, CGT, CT, PAYE, NIC and VAT was enacted in *FA 2007*, Sch 24. It applies to return periods starting on or after 1 April 2008, when the return is due for filing on or after 1 April 2009 (apart from a couple of exceptions in relation to VAT). As April 2009 still feels a long way off, practitioners may be forgiven if they have not read the legislation. Guidance was published on HMRC's website on 1 April 2008. References to the Guidance in this article will use the Compliance Handbook (CH) paragraph numbers, which are also used on the website.

There was a lot of consultation on the legislation and guidance, and the CIOT has participated fully. Objectives were stated to include:

- making the system fairer;
- making the system clearer for taxpayers;
- encouraging a return to compliance;
- recognising compliance history;
- 'To help those who try to comply and come down hard on those who don't'

All of that is perfectly reasonable. Overall, the new regime will be much fairer.

The current regime is well known to tax practitioners and the three mitigation factors are to be found in IR 160 (see box below).

Practitioners will be aware that, currently, HMRC do often seek penalties for mistakes on a tax return even though they may seem innocent. It is quite common to see 10 to 15% being paid. On the other hand, in a case of suspected fraud, an investigations specialist is often able to negotiate a civil settlement in which the penalty does not exceed 30%.

So, in practice, there is sometimes little difference between the penalties for extremely different types of behaviour. HMRC's own statistics, presented at one of the consultation workshops, bear this out.

That is hardly fair. The new regime will increase penalties for the more serious offences, while eliminating them in cases of 'mistake despite taking reasonable care'.

The new rules are somewhat formulaic and to that extent are clearer, although there is still considerable room for discretion, and therefore negotiation. I have some concerns about how disclosure mitigation will be applied after April 2009. The Guidance tends to suggest that full mitigation, where (and to the extent that) this could be available, may be hard to obtain in practice. I will cover this in my second article, but for now I will concentrate on 'taking reasonable care'.

While clearer, the penalty formula under the new regime is more complex. Simplicity was not itself a key objective. The formula is set out at CH 82510. I have provided an alternative interpretation in the box on p 29.

It can be seen that behaviour is key. There are four categories of behaviour, of increasing seriousness:

- Mistake despite taking reasonable care.
- Failure to take reasonable care.
- Deliberate understatement.
- Deliberate understatement with concealment.

The new regime creates a series of 'cliff-edges' between behaviours, as illustrated diagrammatically on p 29.

In contrast to the IR 160 regime, if your behaviour should fall into the wrong category, no amount of co-operation, however fulsome, will be capable of fully mitigating the penalty. Consequently there will be scope for considerable dispute over the appropriate category of behaviour in any particular case.

It is to be hoped that inspectors at the 'coal-face' will apply a light touch when it is

'Old' penalty mitigation factors per IR 160

Disclosure	up to 30% *
Co-operation	up to 40%
Seriousness ('size and gravity')	up to 40%

Total up to 110%

* In cases of prompted (non-voluntary) disclosure, the maximum is just 20%

Penalty calculations under FA 2007, Sch 24 (CH 82510)

- Establish the 'behaviour' leading to Potential Lost Revenue (PLR) and calculate the PLR.
- Establish the maximum penalty for the behaviour.
- Establish the minimum penalty for the behaviour.
- Calculate the maximum reduction for disclosure (b-c).
- Agree the quality of the disclosure, expressed as a percentage.
- Calculate the actual disclosure reduction (d x e).
- Calculate the penalty percentage (b-f).
- Calculate the penalty (PLR x g).

needed. The sceptical among you will not be confident of this, but HMRC have already embarked on an extensive internal training programme, and Mark Leech (the 'Penalties Tsar'), who is leading HMRC's penalties implementation initiative, has already given the profession a certain amount of reassurance in this respect.

A key area of potential dispute will be over the question of whether a taxpayer has taken reasonable care. If he has, there will be no penalty. In considering this, different standards will apply to different taxpayers (see CH 81120). Obviously a sub-contractor is not required to maintain the same sort of records as Barratt Homes Plc. More complex or unusual transactions will require greater care.

That all makes sense.

Reasonably-held views of the law will not be regarded as careless, although there is always room for disagreement over that word 'reasonable'. If the taxpayer has any doubts, it will be advisable to clearly flag the situation with HMRC before the return is filed, and make detailed notes of any advice received, as taxpayers will not be held responsible for inaccurate advice provided by HMRC (when based on full and accurate disclosures of fact, that is). Simple typographical errors, in isolation, are unlikely to be considered careless when the result is not obviously odd – see CH 81130.

Of great significance to tax practitioners is the acknowledgement, at CH 84540, that a taxpayer will have taken reasonable care when a tax agent who is 'trained and competent for the task in hand' has been given all relevant information; has given advice that has been fully and properly implemented; and the taxpayer has checked the return to the extent possible (for example, spotting the complete absence of a major transaction). The implication is that if one of these factors is not present, reasonable care may not have been taken, despite the use of a tax agent. Members of the CIOT may recognise this as an opportunity to differentiate their practices from the unqualified.

At CH81140 the Guidance likens 'failure to take reasonable care' to negligence, citing the case of *Blyth v Birmingham Waterworks*. Someone once said: 'When is a mistake negligent? – When it is a tax mistake!' But now we have guidance that confirms that the test is 'Would a prudent and reasonable person have done that?' Repeated inaccuracies by the same taxpayer will be an indicator,

but by the same token, so will a previously unblemished compliance history. The Guidance does state: 'People do make mistakes – we do not expect perfection.' I welcome this public acknowledgement that to err is human, but I do wonder how often it will prove necessary to quote this part of the guidance at the coal-face.

There are three further points to make about carelessness.

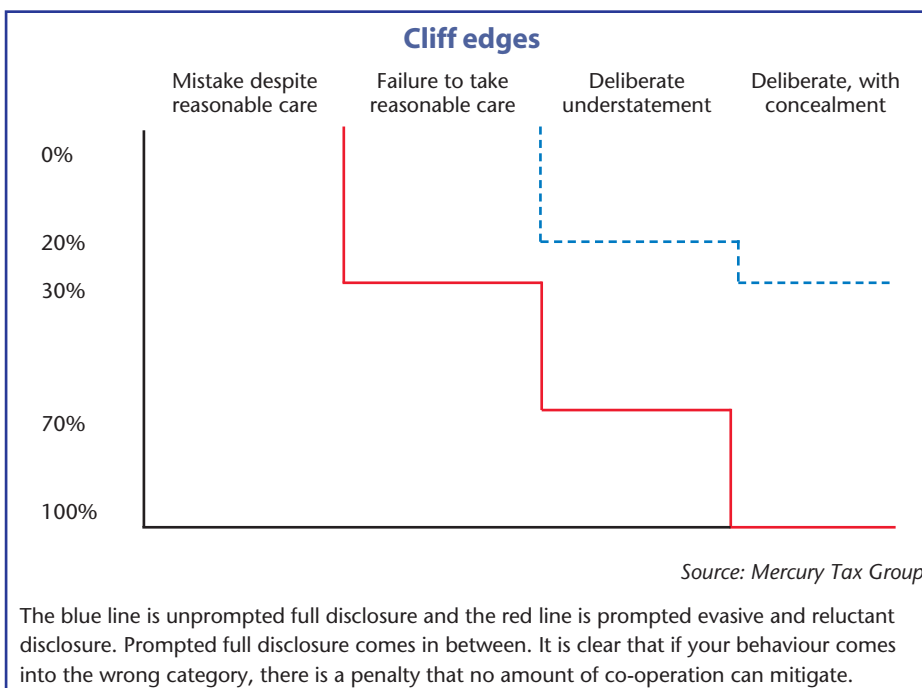
First, a non-careless inaccuracy, later discovered by the taxpayer, 'will be treated as careless if not corrected' (CH 81080). I am not sure how HMRC will be able to show that a taxpayer has discovered an error without correcting it. If he has, however, it seems to me that the failure to correct must be deliberate!

Second, it should be noted that failure to notify HMRC that an assessment is understated within 30 days will be regarded as careless (CH 81090). This is explicitly stated and contrasts with the long-held view that a taxpayer is not obliged to appeal an under-assessment, albeit this has been of less significance since the introduction of self-assessment.

Third, as set out at CH 81141, there will be a significant change in attitude towards the VAT voluntary disclosure regime. Unless the de-minimis limit comes into play, correcting an error in a later VAT return will not count as disclosure. HMRC dislike a casual approach to VAT return inaccuracies, and it appears that penalties can be expected next year, where none would currently arise.

I believe the guidance will prove to be work-in-progress. Many of the examples given so far are really much too obvious to be of assistance in interpreting the legislation, which, after all, is the whole point of guidance. There is little point in telling us that someone who 'has no structured system for making sure that his records are accurate' has not taken reasonable care (Paul, in example 1 at CH 81142).

This new regime is going to change things significantly. As is usually the case with change, there is an opportunity for the well-prepared practitioner. In a subsequent issue of *Tax Adviser* I shall consider the Guidance in relation to deliberate understatements, PLR, disclosure behaviours, suspension of penalties and appeals.



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