

A punishing schedule

In the second of what will be three articles on the new penalties regime and the published guidance, *Andy Wells* takes a look at the concepts of deliberate inaccuracy and potential lost revenue

In this instalment of my review of HMRC's guidance on the new penalty regime, I shall continue to use the Compliance Handbook (CH) paragraph numbers for reference. The legislation is found at *FA 2007*, Sch 24.

Overall I think this has been a good piece of work by HMRC, as the result should be to punish the most serious offences most severely, and not to punish innocent error at all. The commentary that follows should be read in that context.

Deliberate inaccuracy

The maximum and minimum penalties for deliberate inaccuracy will be 70% and 20%, respectively, of the potential lost revenue (PLR). If this involves 'concealment', these figures increase to 100% and 30%. It should be noted that in order to get to the minimum, 100% mitigation for disclosure will be needed, and in practice this looks like being tougher to achieve under the new regime. (CH82510 or the box at the top of page 29, *Tax Adviser*, June 2008 will demonstrate the significance of mitigation under the new regime.)

Concealment is dealt with at CH81160. It will occur when a document containing a deliberate inaccuracy is given to HMRC and active steps have been taken to cover it up, either before or after submission. Examples of this include things that tax advisers will instantly recognise as improper behaviour:

- creating false invoices;
- backdating documents;
- creating fictitious records of meetings that did not take place;
- wilful destruction of books and records.

These are things that could properly expose a taxpayer to prosecution.

'Deliberately withdrawing money for personal use from an incorporated business and not making any attempt to ensure it is

treated correctly for tax purposes' is described as deliberate inaccuracy in CH81150. This would not usually involve concealment, but it may do if, for example, false supplier invoices are created. Most of us would recognise that as fraud. While I would accept that it may be hard to withdraw money from a business accidentally, there are still some taxpayers, particularly in small businesses, who fail to recognise the significance of different legal personality. I am not convinced that that inevitably places them in the 'deliberate' category. Deliberately is described as 'knowingly and intentionally' giving HMRC an inaccurate document. The underlying facts will be important when categorising a behaviour, and before one gets into the debate about the quality of disclosure it will be essential to ensure that the discussion is based on the correct behaviour silo. It is hard to over-emphasise the importance of the silo cliff-edges, if that is not one mixed metaphor too many!

An example of concealment listed at CH81160 is 'invoice routing', meaning the use of offshore buying or selling companies. As this may be a perfectly legitimate activity, the example assumes that the arrangements are effectively shams. It is the production of false invoices, not reflecting the actual facts, that places this in the 'with concealment' silo. Also mentioned at CH81160 is 'describing expenditure in the business records as business related, when it is in fact private'. This can sometimes be a genuinely grey area and must surely be limited to cases in which the wrongful description of expenditure is deliberate and obvious. Although the possibility of conspiracy with a supplier is mentioned here, the inference is that this would not be essential for a deliberate inaccuracy to arise, and that no more than an incorrect entry in prime records could be considered sufficient to put this in the worst category of taxpayer behaviour. It may be arguable on the facts of a case that it is simply

an innocent error against the background of complex underlying legislation and case law. This leads me on to the question of proof.

The onus of proof is on HMRC – see CH81180. The test is the balance of probabilities, although it is acknowledged that this may be higher when a more serious behaviour is alleged. In 50:50 situations, the taxpayer is entitled to the benefit of any doubt (CH81190).

Potential lost revenue

This is a simple enough concept, but there are a few points to note. PLR is not the same as tax lost. Although it is the amount of tax due or payable as a result of correcting an inaccuracy, CH82160 states 'it is possible that there can be an amount of PLR in cases where we have not repaid any part of a repayment claimed by a person'. So it is evident that the intention is to punish, even where there is no loss to the Exchequer. CH83040 reinforces this message, referring to the situation in which 'a reduction in a loss claim does not reverse the entire loss (and there is still no tax to pay, but a penalty is nevertheless payable'.

On the other hand, at CH82250, the guidance says that 'if the overall effect of overstatements and understatement is that the tax liability is overstated when the document is submitted, there will be no PLR'. I wonder how long it will be before someone advocates the insertion of an inaccuracy creating an overstatement (which can easily be corrected subsequently), based on this part of the guidance. Of course, I would not recommend such an approach, but if taxpayers do feel unfairly burdened by penalties when they perceive that no harm has been done, it may drive some to consider whether any 'insurance' might be available. A strict reading of Schedule 24 (6) (2) might lead to the conclusion that the legislation supports this. What sub paragraph 5 of

Schedule 24 (6) does make clear is that no account shall be taken of the fact that one person's understatement may be balanced by another person's overstatement, except where this is expressly permitted by law. This is another example of how it is expected that penalties will punish behaviour without regard to the economic consequences for the Exchequer.

The example at CH82271 demonstrates that overstatements will be bottom-sliced so that any remaining understatement will be punished at the most serious level possible.

There is an example (right) of a loss carry-forward claim being disallowed following carelessness. There is no actual loss of tax, just the potential for it, since the matter has been discovered (as part of HMRC's job in monitoring filed returns) before any harm has been done. The rate of penalty applicable is set out in Schedule 24 (7) (2) (b).

Where there is no reasonable prospect of a loss being used, Schedule 24 (7) (5) should ensure that no penalty is suffered. Although the legislation clearly contemplates this possibility, the guidance, at CH82371, states that the circumstances in which this relief will apply 'will be limited'. Indeed, it is said that 'a loss will not be regarded as having no real prospect of being used simply because a person may currently have no source of income or gains that could produce a liability. It will depend on there being no reasonable prospect of such income or gains arising in the future'. That sort of comment may be indicative of a harsh approach to penalties generally, in the future.

Groups of Companies and losses carried forward (Sch. 24 (7))

(In the examples at CH82283 and 82284, the inaccuracy x SCR = PLR)

CH82342

	Profit/(loss)	Group Relief	
Co D	110,000	(110,000)	
Co E	160,000	(90,000)	(70,000)
Co F	(200,000)	200,000	
Co G	(85,000)		70,000
Agg.	(15,000)	(Loss c/fwd: Co G)	

Co D found to have Careless Inaccuracy of 40,000.

$$PLR = (£25,000 @ 21\% + £15,000 @ 10\%)$$

Finally, I should mention timing differences. Under the current regime, one often hears of cases in which HMRC seek disproportionate penalties where there is little or no real loss of tax overall, but just a timing difference. Schedule 24 (8) ensures that this should not happen any more, as the prescribed penalty is rather more reasonable. The example below is taken from the guidance at CH82391.

If one applies a disclosure discount of just 50% to a deliberate inaccuracy penalty of (70%-20)%, the penalty, expressed as a percentage of the timing difference adjustment, will be no more than 2.25%.

Prompted or unprompted?

Whether or not a disclosure is prompted will have a major bearing on the penalty. 'Unprompted' is the new way of saying 'voluntary', and it is usually going to be pretty obvious whether a disclosure comes into this category. There are examples in the guidance at CH82422, but really these are too obvious to be of assistance in interpreting the legislation. It would be helpful if the guidance could contain some borderline cases in areas of likely dispute, and this is no doubt something for HMRC's penalties team to continue to think about.

Although the benefits of a disclosure being unprompted are clear, 'getting in quickly' should be weighed against the taxpayer's ability to make a swift and full disclosure. If one fails to tick all the disclosure boxes, it seems probable that the disclosure mitigation will be very disappointing compared with the old regime. That is especially so when the maximum for disclosure still leaves the taxpayer exposed to a minimum of 20% in deliberate categories. Examples in the guidance show that 30-35% or more should not be expected to be exceptional results. More on this aspect will follow in my third and final article on this subject.

What is clear is that tax advisers do need to have a working knowledge of the subject by the time that inaccuracies on affected tax returns are discovered.

Timing Differences

CH82391

Stock valuation challenged

Under values	Y1	5000	(6 month period)
	Y2	10000	
	Y3	10000	
	Y4	10000	
	Y5	Corrected cumulative undervaluation of £35,000	
PLR	5000 X 5% X 3.5	=	875
	10000 X 5% X 3		1500
	10000 X 5% X 2		1000
	10000 X 5%		500
	Total PLR		3875

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