

**Making Tax Digital: interest harmonisation and sanctions for late payment
Response by the Chartered Institute of Taxation**

1 Introduction

1.1 HM Revenue and Customs' (HMRC's) consultation document is seeking views on:

- Aligning late paid and repayment interest for VAT with similar rules for Income Tax and Corporation Tax which will enable a common set of rules to apply across these regimes.
- Introducing a new model for charging penalties on late payments to help address the current diverse late payment penalty models, promote positive behavioural change, and facilitate the opportunity to apply this same model across other regimes at some point in the future.

1.2 The Chartered Institute of Taxation (CIOT) welcomes the opportunity to comment on the proposals.

1.3 As an educational charity, our primary purpose is to promote education in taxation. One of the key aims of the CIOT is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

1.4 Our response draws on our stated objectives for the tax system, which include a legislative process which translates policy intentions into statute accurately and effectively, without unintended consequences. The tax system should provide greater simplicity and clarity, so people can understand how much tax they should be paying and why, and greater certainty, so businesses and individuals can plan ahead with confidence. It is important that there is a fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented), and responsive and competent tax administration, with a minimum of bureaucracy.

2 Executive summary

- 2.1 We agree with the broad principles for a good penalty regime set out by HMRC in the consultation document; that it should be:
- Fair
 - Effective in supporting good compliance
 - Simple to understand and operate
- 2.2 We agree with the proposal to enable a common set of rules for late payment interest and repayment interest to apply across Income Tax Self-Assessment, Corporation Tax and VAT. This will make the system simpler and clearer, and help taxpayers better comply with their obligations.
- 2.3 We are concerned that the proposals to remove Repayment Supplement for late payment by HMRC of VAT refunds will be detrimental to businesses. We are also surprised that, at the same time, HMRC is proposing a similar model to penalise late payment by taxpayers. Either a regime with a 'penalty' at the end of a defined period meets the above principles, or it does not. It must work both ways.
- 2.4 We have some concerns with the 'hybrid' penalty model proposed in the consultation document. In our view, 15 days is not a long enough period to enable the taxpayer to take the appropriate action to avoid a penalty and should be extended to 30 days. The model is also complex and HMRC will need to explain how it works clearly to taxpayers in order that they understand what they need to do to minimise their exposure to penalties and the consequences of not meeting their payment obligations.
- 2.5 It will be important that the eventual late payment model chosen links consistently and fairly with the penalty points model which is being proposed for late filing of returns.
- 2.6 It is not clear from the consultation paper from what date the proposed changes to the rules on interest and late payment penalties would take effect. Equally, for VAT purposes, it is not clear whether the existing Default Surcharge would continue to apply to late filing of VAT returns. While it is not essential that the proposals are brought in at the same time as Making Tax Digital for Business (MTDfB), and in fact there is unlikely to be enough time for that to happen especially with VAT¹, it would make sense to streamline the introduction of the changes as far as is possible rather than bringing them in in a piecemeal fashion. Previous experience has shown that changes brought in over several years² can cause confusion for taxpayers and advisers alike.

3 Question 1. Do you agree that in-year quarterly instalment payments (QIPs) should continue to attract differential interest rates?

- 3.1 We agree that the differential interest rates should be maintained for QIPs.

¹ On the current timetable MTD for VAT will start in April 2019. The government has committed that it will not widen the scope of MTD for Business beyond VAT before April 2020 at the earliest.

² Following HMRC's Powers Review, which ran from 2005 – 2012, changes were introduced over several years. <http://webarchive.nationalarchives.gov.uk/http://www.hmrc.gov.uk/about/powers-appeal.htm> We know from our members that this piecemeal approach to implementing significant changes to the tax system caused confusion.

- 3.2 The lower rate of interest for corporation tax quarterly instalment payments (see SI 1989/1297 reg3ZA), and indeed the difference between that rate and the 'normal' rate (see SI 1989/1297 reg3A), was extensively discussed in the period leading up to Budget Day 2000. In essence, the differential interest rate reflects the fact that the corporation tax quarterly instalment payments are in-period estimates paid in advance. The eventual tax liability will be based on the final results of the current tax year, which will not be known until much later and may depend on events that happen after the instalments are made. We think the same considerations have continued to apply ever since. In fact, the need for the lower QIPs rate will become even more important for very large companies for accounting periods beginning on or after 1 April 2019, when the quarterly instalment dates will each be brought forward by 4 months, see SI 2017/1072.
- 3.3 The principle of fairness for a good penalty system (see paragraph 2.1 of the consultation document) would suggest that other estimated in-year / in-period tax instalments should similarly attract differential interest rates, particularly where tax is paid during the period in which the tax liability arises and before the final liability for the period is known. Estimated payments on account are made for other taxes in certain circumstances^[1]. HMRC should explore whether differential interest rates would be appropriate in these other circumstances.

4 Questions 2 & 3 – Do you agree the way interest is charged for Corporation Tax satisfactorily mirrors the rules contained in Finance Act 2009? If you do not agree, please explain why.

- 4.1 We agree the way interest is at present charged on underpaid and overpaid corporation tax (TMA 1970 s87A and TA 1988 s826) is close enough to the Finance Act 2009 equivalents.
- 4.2 Apart from a few small exceptions, there is currently no penalty for a failure to pay corporation tax on time (although interest on unpaid tax will be due), because the unified penalty code for failures to pay tax on time has never been extended to corporation tax despite expectations that it would be. The changes proposed by this consultation will therefore need to be adequately communicated to corporation tax payers before they start to be subjected to late payment penalties for the first time.

**5 Question 4 – Do the proposals for interest for VAT on late payment of a return reasonably reflect the Finance Act 2009 rules?
Question 5 – Are the proposals for VAT regarding interest on assessments and amendments sensible?
Question 6 – Do the proposals for interest on a delayed payment of a repayment VAT return reflect the right balance between recompense for customers and the protection of public monies?**

^[1] Payments on account of income tax are made based on the amount of the self-assessment tax liability for the preceding year. These payments on account are made in two equal instalments on or before 31 January in the year of assessment; and 31 July next following.

Payments on account of their quarterly VAT liability are made by VAT-registered businesses with a VAT liability of £2.3 million or more in a period of 12 months or less. These payments are made at the end of the second and third months of each VAT quarter in advance of their quarterly VAT returns. A balancing payment for the quarter, that is the quarterly liability less the payments on account made, is then made with the VAT return.

- 5.1 We agree that the proposals for interest on late payment of a VAT return appear to reflect the Finance Act 2009 rules, and that the proposals regarding interest on assessments and amendments appear reasonable.
- 5.2 However, regarding the changes proposed to repayment supplement, we are extremely concerned that the current incentive (ie Repayment Supplement) for HMRC to make timely repayments will be removed under the new system.
- 5.3 Whilst the current Repayment Supplement regime may be something of a blunt tool, it provides restitution to the taxpayer where HMRC has failed to progress enquiries into repayment returns promptly.
- 5.4 It is vital that HMRC process repayments promptly, as VAT is an integral part of a business's cash flow. If a business is claiming a VAT repayment, that is typically because it has been charged VAT by a third party, and quite likely paid out that VAT ie the business is 'out of pocket' by the amount of the VAT it has incurred. The business has to finance that amount of VAT, from the date it paid its supplier, until it receives the repayment from HMRC.
- 5.5 A business's cost of finance / capital (or even the opportunity cost of being deprived of monies) is likely to be much higher than 0.5% (the proposed interest rate). Businesses must already wait until at least a month after the end of their VAT return period before receiving a repayment, and any further delays, without adequate recompense, is unfair and clearly contrary to one of HMRC's key principles.
- 5.6 We would encourage HMRC to consider how this unfairness might be overcome. For example, HMRC could be required to pay penalty interest for making a late repayment, in a similar way to the proposals set out in paragraphs 5.24 to 5.26 of the consultation.
- 5.7 We note that the proposed new model for interest on late payment of tax has remarkable similarities with Repayment Supplement ie a 5% penalty for late payment after 30 days. Why is the late payment model appropriate, but Repayment Supplement not?

6 Question 7 – Do the proposals for late payment penalties strike the right balance between fairness for those that pay on time and provide a reasonable time for those that need it to arrange payment?

- 6.1 We are not convinced that the proposals for late payment penalties strike the right balance between fairness for those that pay on time or provide a reasonable time for those that need to arrange payment.
- 6.2 Whilst broadly supporting the idea of a late payment penalty as proposed, we think that applying it after 15 days is too soon, even with a 50% reduction, especially as late payment interest will be accruing as normal from the due date. We think 30 days is a more appropriate period of time. In general, this is the length of time allowed under current rules before a first penalty is charged for late payment and is generally well understood and accepted. A longer period would also provide:
 - Sufficient time for HMRC to identify taxpayers who have not paid their tax on time, notify such taxpayers of the penalty consequences of paying their tax

late and allow time for such notices to be received, read and acted upon by taxpayers.

- Time for taxpayers to accommodate factors that could lead to inadvertent late payment after 15 days, such as workloads, holidays and postal delays.
- Time for taxpayers to seek and obtain finance from other sources, particularly where a business has unexpected cashflow issues (eg due to a large customer paying late) at short notice before the official payment due date.
- Taxpayers (and HMRC) with more time to negotiate and agree a Time To Pay (TTP) arrangement without risk of a penalty being imposed.

6.3 We understand why charging a reduced penalty if payment is made in the first 15 days could provide an incentive for taxpayers to settle what they owe or agree a TTP arrangement during that 15 day period, but if the process is not streamlined or efficient enough to make it workable within that short time period then the incentive effect will be reduced.

6.4 An alternative suggestion could be (say) a 30 day initial 'grace' period, then 15 days thereafter for the 50% reduction and 15 days thereafter for the full penalty to apply.

6.5 Notwithstanding our concerns about the time periods proposed, we agree in principle with the proposal that late payment penalties will not be applied where a TTP arrangement is in place before or shortly after the due date. For this to be effective, HMRC must ensure that they provide taxpayers with adequate information and assistance to enable them to negotiate TTP arrangements quickly and easily in order that their exposure to penalties can be minimised. The necessary resources and guidance must be made available to HMRC staff so that they can ensure that they provide a consistent approach to all TTP requests and that they can accommodate requests from taxpayers within the timescales to ensure penalties are minimised.

6.6 It is not clear from the consultation document what the penalty position would be if a TTP arrangement was in the middle of being negotiated at the 15 day or 30 day point and therefore not 'in place' at that time. In practice, for example, where a specific debt management department within HMRC cannot immediately agree an arrangement (ie because the debt is considered 'large') and are required to refer the case to a specific debt management team, time delays are experienced by clients / agents waiting for a call back from HMRC as often direct contact details will not be provided to the agent. Further delays typically occur where information is required by HMRC to consider fully a request for a TTP arrangement and there is no facility for that debt management department within HMRC to receive information by fax or email. The 15 day period suggested is too short a timescale for posted information to be received and considered by the relevant debt case worker within HMRC. It is apparent that not all cases are straightforward enough to be agreed quickly, so providing some flexibility around what is meant by 'put in place' seems appropriate, particularly if the delay in agreeing it was due to factors outside the taxpayer's control, such as a late request by HMRC for further information or administrative / processing delays or staffing problems at HMRC's end.

6.7 Arguably, a better approach (which would remove the need to consider the time needed by HMRC's teams) where a taxpayer requests time to pay would be to stipulate that they should get no penalties if the approach was made to HMRC before the payment due date or, if later, within the 15 (or 30) day period following the due date, and the TTP arrangement is ultimately agreed and they meet the instalment payments. This would incentivise taxpayers to ask for help before the deadline and

do everything they can to meet the payment instalments on time – which is in both parties' best interests.

- 6.8 We assume that if the taxpayer breaks the TTP agreement, then the intention is that they would become liable to any penalties that would have been charged if there had been no agreement. This is reasonable, although taxpayers should have the opportunity to renegotiate an extended TTP agreement if the breach arises due to unforeseen circumstances.
- 6.9 Where a TTP arrangement is refused by HMRC, there should be mechanism to appeal the decision, considering the impact a refusal might have on penalties, and for the penalties to be suspended during the appeal process.
- 6.10 We fully support the retention of the current rules on appealing penalties and reasonable excuse.

7 Question 8 – Do you think these general rules provide the correct balance between protecting those that pay on time and encouraging and supporting those that do not?

- 7.1 The 'hybrid' penalty model proposed of an element charged as a percentage of the tax due (for tax paid up to 30 days late) and an element charged in a penalty interest-type calculation (where paid more than 30 days late) adds complexity to the proposals.
- 7.2 Although the proposals will reduce (but not remove entirely) the 'cliff edges' we have under the current late payment penalty system, we can foresee that charges, being a mixture of interest, penalties and penalty interest, could mount up rapidly under the proposed 'hybrid' model. The 30 day 'cliff edge' will be of particular significance because at that date both the 5% penalty will apply and penalty interest will start to run.
- 7.3 HMRC must ensure that they encourage and support taxpayers in paying their tax on time and keeping their exposure to penalties to a minimum, by providing timely information to taxpayers to help them understand the consequences of paying their tax late, when the different charges will apply and how they will be calculated. A late payment penalty system will not be perceived as fair if taxpayers are not able to understand their obligations and the consequences of not complying with them sufficiently well to know how they can minimise their risk of incurring penalties.
- 7.4 We agree with HMRC's proposal to exclude the base rate in calculating late payment penalties. In our view, including the base rate in both the calculation for late payment interest and late payment penalty interest would have amounted to 'double counting'.
- 7.5 We note that it is intended that late payment penalty interest will only be calculated and become payable after the debt has been paid in full. In order to increase transparency and understanding, we think that HMRC should contact the taxpayer at regular intervals to demand payment of the overdue amount and at the same time tell them exactly what their penalty interest liability is at that point in time, as well as the amount of late payment penalties they have also incurred. It should not be assumed that telling a taxpayer merely that penalty interest is accruing on unpaid tax at x% per annum will be readily understood. Providing an actual figure for the penalty interest that has already accrued as well would, in our opinion, have a stronger effect

on either encouraging payment or incentivising the taxpayer to come forward to negotiate a TTP arrangement with HMRC.

- 7.6 Presumably, part-payments would reduce the amount of late payment penalty interest, ie penalty interest should only be charged on the actual amount outstanding – not the original liability.

8 Question 9 – Do the proposed rules provide the correct balance between protecting those that pay on time and encouraging and supporting those that do not?

Question 10 – We believe that late payment penalties should apply from the payment due date. What difficulties, if any, could you see with this?

- 8.1 From the brief explanation in paragraphs 5.27 to 5.29 of the consultation document, it appears that it is proposed to continue the current legislation for late payment of tax where returns are filed late or no notice was issued. Under current legislation, generally speaking, penalties for late paid tax apply only to amounts which the taxpayer knew to be due, for example amounts under a self-assessment or an HMRC assessment. That seems a sensible approach.
- 8.2 However, there is an exception to this. If a taxpayer files a return late, then late payment penalties apply from 31 January after the year of assessment, so the penalties apply if payment is made more than 30 days after 31 January, even though the taxpayer has no quantified tax assessment to pay. It appears the government propose to charge the new 5% penalty, and the new late payment interest, from that date also. In cases such as this - where tax is paid late and the associated tax return is also filed late - the interaction of the proposed new late payment penalties with the new model for late filing penalties will need to be considered to ensure that together the penalties applying are consistent, proportionate and fair.
- 8.3 It is not clear how the proposals in paragraphs 5.28 to 5.29 will ‘replicate the situation of a person who had complied with their obligations to make a return’, since a person who has displaced a determination / prime assessment by filing a late tax return will not have had the same opportunity to seek and negotiate a TTP arrangement with HMRC (and therefore obtain a reduction in late payment penalties) as the person who has complied with their filing obligations.
- 8.4 We strongly disagree with the proposal in paragraph 5.30 to charge late payment penalties from the due date where the tax is due by amendment without providing any ‘grace’ period for taxpayers to avoid a penalty or obtain a 50% automatic penalty reduction. The current penalty regime in Finance Act 2009 Schedule 56 provides that where an amendment or correction is made to a return, either by the taxpayer or by HMRC, late payment penalties on the extra tax on the amendment do not apply until 30 days after the date the amount of extra tax becomes due and payable³. It is not clear why the current 30 day period should be removed from the new model in its entirety. No explanation for this very significant change is given. We think such a change would significantly increase the number of late payment penalties, discussions about whether the taxpayer has a reasonable excuse and appeals. The

³ For the most part, the relevant legislation is TMA 1970 s59B(6) (payment date for discovery assessments), TMA 1970 Sch3ZA (payment dates for amendments and corrections) and FA 2009 Sch56 para1 Table items 19, 23 and 24 (penalty dates).

cost to both taxpayers and HMRC would be considerable. In our view, the 30 day 'grace' period permitted by the current rules should be retained.

- 8.5 Paragraph 5.31 indicates that late payment penalties would apply to accelerated payment notices (APNs). The penalty regime applicable to APNs is in Finance Act 2014. It is unclear whether HMRC are intending to replace the current APN penalty regime or not. Whatever the intention, there should be no double counting of penalties.

9 Question 11 – Are there any other specific circumstances that should be accounted for?

- 9.1 Under current rules, HMRC may reduce or stay a penalty or agree a compromise in relation to proceedings for a penalty if they think it right to do so because of special circumstances. Reduction in special circumstances should continue to be available whatever new late payment penalty model is chosen.
- 9.2 Where a late payment penalty is incurred currently, HMRC will raise an assessment to collect it. The notice of assessment must state the period in respect of which the penalty is assessed. The penalty is then payable within 30 days beginning with the date of the assessment. We would suggest that the same assessing rules should apply to whichever model is chosen.

10 Acknowledgement of submission

- 10.1 We would be grateful if you could acknowledge safe receipt of this submission and ensure that the CIOT is included in the List of Respondents when any outcome of the consultation is published.

11 The Chartered Institute of Taxation

- 11.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 18,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation
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