



Making Tax Digital
Sanctions for late submission and late payment

7 June 2017

About ICAS

1. The following submission has been prepared by the ICAS Tax Board. The ICAS Tax Board, with its five technical Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 board and committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.
2. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members in the many complex issues and decisions involved in tax and financial system design, and to point out operational practicalities.

General comments

3. ICAS welcomes the opportunity to respond to the HMRC consultation 'Making Tax Digital - Sanctions for late submission and late payment', issued by HMRC on 20 March 2017.
4. ICAS supports the five objectives of late submission penalties as set out at para 2.4 of the consultation: encouraging compliance rather than raising revenue, proportionality, fairness, provision of a credible threat and consistency. HMRC must also be able to raise penalties accurately and collect them in cost-efficient manner.
5. As the proposed system will be entirely new, and Making Tax Digital (MTD) brings new compliance obligations, there needs to be a major publicity campaign before the introduction of the new regime.
6. If the MTD timetable is adjusted to allow for a full pilot to take place before introduction (ie to cover 4 quarterly returns and the end of year return), the proposed 12-month light touch approach to penalties may be sufficient. This delay in implementation was recommended by the Treasury Select Committee and the House of Lords Economic Affairs Committee.
7. If the new MTD regime proceeds on the rushed timetable currently proposed, starting in April 2018, then 12 months is too short. A light touch period of 24-36 months would be more appropriate to allow for the fact that there will have been insufficient time to fix teething problems with making tax digital, leading to inadvertent failures to comply.
8. A history of penalty points issued should be visible on the Business Tax Account. This is particularly necessary for disorganised taxpayers. Alerts should be given when issue of a financial penalty is approaching.
9. Maintenance of compliance history is important as part of encouraging client compliance. It will also provide some evidence of behavioural responses to penalties and flag cases where taxpayers are playing the system.
10. It is right that an appeal process should be available on the issue of a penalty point, not just when a financial penalty is actually charged.

Penalty interest

11. Penalty interest is mentioned in section 6 of the consultation, though there are no formal consultation questions on this. The comments here are made in view of the close interaction of late payment and late submission penalties.
12. ICAS agrees that penalty interest would be a fairer and more proportionate response than a fixed rate penalty. Late payment penalties should be based on the amount of tax unpaid by the due date.

13. It is appropriate for Time to Pay agreements to be excluded from any penalty interest provisions. This mirrors current policy in respect of late payment penalties.
14. Time to Pay guidance should be clear and prominent. It should include details on how and when to apply, the conditions and circumstances in which it is made available, and whether separate arrangements are needed for each tax.
15. As an ongoing, and therefore incremental, interest charge replaces a 5% late payment penalty, a policy of arranging Time to Pay in advance of the due date is reasonable. Commercial interest, rather than a punitive rate of interest is appropriate once Time to Pay has been agreed.
16. Charging penalty interest using a figure of 8% plus Bank of England base rate (as per statutory interest for late payment of commercial debts) is too high.
17. Given publicity for, and the opportunity to arrange, Time to Pay in advance of the due date, a punitive rate of interest is not unreasonable, after the due date.

Specific questions

Question 2.1 Which of the three penalty models proposed (A - Points-based, B - Regular review of compliance, or C – Suspension of penalties) do you consider to be the best and why?

18. A mixture of models A and C is recommended. Approach B, regular review, seems to have little to recommend it.
19. Model A has significant advantages. It is easily understood and the ability to reset the penalty clock to zero after a period of compliance is an incentive to address compliance failures.
20. The points approach means that there would be warnings and time to make improvements before a penalty is actually imposed. This model provides a form of suspension but without the subjective element (which has caused some problems with the operation of the current suspension regime).
21. It would be appropriate that no penalty points would be awarded where there is a reasonable excuse.
22. The use of suspended penalties can also be an effective motivation and compliance tool which should be used more widely. This is an attractive part of Model C, but the all or nothing aspect, and lack of build-up renders it less effective. There is very little time for a taxpayer to modify their behaviour - only a short window for one specific late return.
23. Combining models A and C would result in an effective compliance model. This would also take into account the different needs and motivations of different taxpayers and sizes of business.
24. Suspending penalties: some taxpayers may not react until a financial penalty is issued. This is likely to be particularly true for smaller businesses. This may be linked to a lower awareness and understanding of the tax regime. For this group, suspension of penalties is an effective motivator. Charging penalties would be perceived as unfair.
25. For other taxpayers, the Model A approach may provide an effective incentive, as well as giving time to change their behaviour.
26. An approach which combined model A with wide use of suspension for a first financial penalty charge, might tackle both groups.
27. Motivational impact of separate or combined penalty points. There would be difficulties with combining penalty points for different taxes under model A.

28. For example, it would be possible to be in CIS, VAT and CT or IT at the same time. Different staff teams or even different tax agents could be involved for different taxes. It would be an ineffective compliance tool and a potential disincentive if, for example, the VAT team usually filed on time, but due to three late CIS returns, received a penalty for a single late VAT submission.
29. Penalty points for different taxes should be kept separate.
30. Model B seems too far from real-time. An annual review carried out within two months of submission date leaves a lot of slack (para 4.4). The overlap of reviewing year one submissions when three year 2 submissions have already been made is confusing. The automatic issue of immediate penalty points under Model A provides more clarity.
31. Model B also suggests linking review periods for indirect and direct taxes. This is unsatisfactory. Many different factors are at work. For indirect taxes, cashflow, or uncertainty about specific transactions may be a significant factor.

Question 2.2 What are your views on the relative importance of the competing demands of fairness, simplicity and effectiveness?

32. A penalty system should be designed to tackle two different categories of 'offender': those who are disorganised / chaotic and those who deliberately 'play the system'. In terms of fairness, the fact that the system needs to deal with distinctly different groups with different motivations must be borne in mind.
33. Paragraph 2.4 states that 'penalties are not to be applied with the object of raising revenues'. The aim is to encourage compliant behaviour and to remove any financial advantage from non-compliance.
34. Simplicity and fairness tend to be aligned. Only where a system is simple to understand is it likely to be perceived as fair. Fairness encourages compliance as it is straightforward to identify the behavioural patterns that are rewarded.
35. Effectiveness is assisted by simplicity and fairness. Voluntary compliance is assisted where a system is understood and its objectives agreed.
36. Effectiveness is however wider than fairness and simplicity. To be effective, penalties need to be credible (para 2.4 point 4). Credibility is related to the potential lost revenue, the taxpayer's ability to pay and the likelihood of collection.
37. Effectiveness is also related to the taxpayer group targeted by the compliance activity. Is the taxpayer just chaotic or is non-compliance a deliberate decision?
38. It is noted that tax geared penalties are to be retained for 'deliberate' non-submission. Per 3.38 of Making Tax Digital: Tax administration consultation issued on 15 August 2016, a "tax-geared penalty for a deliberate failure would be calculated as a percentage of the tax that would have been due if the submission had been made".
39. This suggests that the primary target for the penalty models outlined is the disorganised taxpayer, rather than the 'deliberate' avoider.
40. In consequence, simplicity and fairness must be key objectives. This has consequences for system design.
41. There could be perceived unfairness if penalties applied to ATED returns where eligibility for a relief meant that there would never be any tax due.
42. Having fixed penalties can be seen as unfair and may lead to collection / recovery problems, where the financial penalty is not proportionate to the taxpayer's means. This suggests that mitigation should be available to reduce financial penalties where income is low. Consideration should also be given to behaviour.

43. While having one regime for all taxes achieves a degree of simplicity, it also creates a very significant number of potential penalty occasions. If these are combined, it is likely to obscure different compliance history for different taxes.
44. There should be adequate systems in place to remove penalties [across all taxes] due to ill health or other difficulties; and a simple method for taxpayers to alert HMRC where a crisis has occurred.

Question 2.3 To what extent does each of the three penalty models strike an appropriate balance between fairness, simplicity and effectiveness?

45. Model A is simple, clear and fair. It includes many of the advantages of suspension without including the subjective element which has caused problems with the present suspension regime. The points approach means that there would be warnings and time to make improvements before a penalty is actually imposed.
46. Model B – regular review, seems the most complex. The complexity potentially makes it less fair – as taxpayers struggle to understand their obligations and what they need to do to comply.
47. Model C is simple, but seems somewhat arbitrary. Missing a single episode – failing to comply with one submission within a set time frame – can lead to a financial penalty. This unfairness and lack of build-up renders it less effective. As compared to Model A, it appears as if a single action, rather than a pattern of behaviour, leads to a penalty.
48. Hence, a combination of models A and C would appear the most effective.

Question 3.1 Do you agree with these proposals for the duration of the required good compliance periods?

49. Relating the reset period to the frequency of submissions is sensible. Reset periods of two submissions for annual returns (24 months), four submissions for quarterly submissions (12 months) and six submissions for monthly submissions (6 months) is reasonable.
50. There are unanswered questions. What happens if compliance does not improve? Do penalty points accumulate for ever? If non-compliance is long-term, could there be a more effective intervention, such as a business records check? Do financial penalties remain at the same level? How soon would 'deliberate' error, tax geared penalties kick in?

Question 3.2 Could any changes be made to the points-based penalty model to make it fairer, simpler or more effective?

51. As mentioned above, suspension of financial penalties would improve model A.

Question 4.1 What are your views on the timing of the review?

52. If this method were chosen, the pattern shown at fig 4.2 seems preferable.

Question 4.2 Which of the three options mentioned in paragraphs 4.5 to 4.7 above for customers within Making Tax Digital for Business do you think is the most appropriate?

53. If this model applied, the option at para 4.6 would be preferable, with 4.5 second choice. The approach at 4.7 is not recommended.

Question 4.3 Do you agree this would be a proportionate response to occasional lateness that lasted just a short time?

54. If this model applied, the approach suggested of permitting a 30-day window for submission is sensible. It is also reasonable that this facility be withdrawn if late submission becomes habitual.

Question 4.4 Could any changes be made to the regular review of compliance model to make it fairer, simpler or more effective?

55. It is hard to see how this model could work effectively. The extended time period for review, and the lack of immediate connection between individual failures and a financial penalty make this model difficult to follow.

Question 5.1 Do you agree that improved compliance should be recognised? Is there a better alternative for recognising it?

56. The principle of suspending penalties is excellent in terms of motivation. For the reasons outlined in the response to question 2.1 above, we consider that a penalty points system, combined with a suspension option for financial penalties, offers the clearest, most effective approach.

Question 5.2 Could any changes be made to the suspension model to make it fairer, simpler or more effective?

57. It is unclear how repeated suspension would work. Our experience, particularly around VAT penalties, suggests that reality kicks in when a financial penalty is raised; but that effective compliance is enhanced by one-off suspension.
58. Where suspension is repeatedly sought, it suggests that more significant compliance intervention is needed. Penalty points can assist here by providing a balance between carrot and stick.