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# The new tax penalty regime

A summary for CIOT Members of the provisions

© Nichola Ross Martin FCA

Taxation consultant and author of *Entrepreneurs' Relief: A Guide for Accountants*

This document is written as a summary of the Penalties provisions now applying to the taxes administered by HMRC. It is intended as a quick reference guide only.

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Nichola Ross Martin qualified as a Chartered Accountant in 1990. She has worked up through practice and became tax editor for a couple of leading websites. She writes on tax for various publications and sits on the ATT technical committee. In 2010 she launched [www.rossmartin.co.uk](http://www.rossmartin.co.uk) a new virtual tax resource for accountants and advisers.

## Introduction

The merger of the Inland Revenue and HM Customs brought about a review of the new department's powers and the creation of a new and unified tax penalty and compliance regime across the taxes. This regime commenced with the introduction of a new system for penalising errors in the 2007 Finance Act. New powers continue to be introduced and activated in a rolling programme of change. This note outlines the new penalty systems as it applies to direct taxes and VAT.

### Key features of the new penalty regime

- Proportionality: penalties are where practical, tax-g geared, as opposed to fixed charges.
- Tax-g geared penalties are adjusted according to the taxpayer's behaviour.
- Tax-g geared penalties are capable of suspension.
- Where a third party is responsible for an offence, it may suffer a tax-g geared penalty.

### At a glance: the main steps in calculating tax geared penalties

Step	Action	Notes
1	Quantify the potential loss of tax.	No tax-g geared penalty can apply without a loss of tax.
2	Review the situation: did the taxpayer make an error or failure despite taking reasonable care?	There is no penalty for an innocent error or failure; one made despite the taxpayer taking reasonable care over his tax affairs.
3	Was the error or failure caused by the taxpayer being careless?	Carelessness = negligence; failure to take reasonable care.
4	If the offence was caused by careless behaviour, was this accidental, deliberate or, deliberate and concealed	This step sets the maximum penalty level.
3	Was disclosure of the error or failure unprompted or prompted?	This step sets minimum penalty level.
5	Apply discounts for telling, giving and allowing.	The maximum penalty in step 4 is discounted.
6	Review penalty and any mitigating circumstances.	No penalty applies if a taxpayer has a reasonable excuse for an error or failure.
6	Request suspension.	Only applicable to penalties for errors.
7	Consider an appeal.	This will depends on the circumstances of each case and whether there are grounds for a reasonable excuse.

## Summary: new penalties for direct taxes and VAT

Penalties for:	Tax	Implementation date	Reference
<b>Error in a return or document:</b> <ul style="list-style-type: none"> <li>• Taxpayer error</li> <li>• Third party error</li> <li>• Failure to notify HMRC about an under assessment</li> </ul>	IT, CGT, PAYE, NIC, CIS, CT, VAT	Return periods starting on or after 1/4/2008 where return is due on or after 1/4/2009	S97 & Sch 24 FA 2007 SI 2008/568
<b>Failure to notify chargeability for tax purposes</b>	IT, NIC, CGT, PAYE, CIS, CT, VAT	1/4/2010	S123 & Sch 41 FA 2008 SI 2009/511
<b>Certain VAT and excise wrong doing</b>	VAT, Excise duties	1/4/2010	S123 & Sch 41 FA 2008 SI 2009/511
<b>Late filing (failure to make a return on time)</b>	IT, CGT	Returns for any tax year ending after 5 April 2010	S106 & Sch 55 FA 2009 S 26 & Sch 10 FA (No 3) 2010
	CT, PAYE, NICs, VAT	TBA	
	CIS	Transitional measures apply between April 2007 and the expected commencement on 1/10/2011	
<b>Late payment</b>	PAYE, NICs, CIS	1/4/2010	S107 & Sch 56 FA 2009
	IT, CGT, CT,	April 2011	S27 & Sch 11 FA (No 3) 2010
<b>Record keeping</b>	Direct taxes not included in a return & PAYE, NICs, CIS, IT, CGT, CT, VAT	1/4/2009	S115 & Sch 37 FA 2008
<b>Interest on late payment &amp; repayment interest</b>	PAYE, NICs, CIS, IT, CGT, CT, VAT	October 2011	S101 & 102 & Sch 53 & 54 FA 2009
<b>Increased penalties for all of the above in relation to offshore tax:</b> <ul style="list-style-type: none"> <li>• Errors in a return or document</li> <li>• Failure to notify</li> <li>• Failure to make a return</li> </ul>	IT and CGT	Expected 6/4/2011	S35 & Sch 10 FA 2010: amending Sch 24 FA 2007 Sch 41 FA 2008 Sch 55 FA 2009

## Penalties for errors

A tax-gearred penalty will apply in one of three circumstances that result in a potential loss of tax:

1. When a taxpayer makes a careless error or mistake in a tax return or document.
2. When a third party supplies false information, or deliberately withholds information in connection with another person's return or document.
3. When HMRC raises an assessment for tax and the taxpayer fails to notify HMRC that the assessment is too low.

The measures are set out in S97 and Sch 24 FA 2007.

Further amendments have followed:

- S122 and Sch 40 FA 2008 amend the rules to apply to certain third parties.
- S35 and Sch 10 FA 2010 increases the ranges of penalties in relation to the potential loss of offshore taxes.

These rules for errors are introduced in three stages across the taxes:

Tax	Commencing for:
IT, CGT, CT, PAYE, CIS and NICs (excluding Class 1A)	Return periods starting on or after 1/4/2008 where the return is due on or after 1/4/2009
Class 1 NICs, IHT, IPT, SD, PRT, ET, ED, pension schemes	Return periods starting on or after 1/4/2009 where the return is due on or after 1/4/2010
Increased penalties for offshore taxes	Expected to apply for return periods starting on or after 6/4/2011

### Error or mistake made by a taxpayer

When a taxpayer makes an error in a tax return or document and this amounts to, or leads to:

- An understatement of his liability to tax;
- A false or inflated statement of a loss by him; or
- A false or inflated claim to repayment of tax.

A penalty is charged per error.

- Each error has to be looked in isolation in order to determine its category and the behaviour that contributed to it.
- There will only be a penalty if the error could have led to a potential loss of revenue.
- Once evaluated errors may be grouped to simplify calculation.

Penalties are tax-gearred. Until 1 April 2011 there is no distinction between the rates of penalties levied for errors in relation to domestic or offshore income and gains.

- The rate of penalty that will apply is determined according to the taxpayer's underlying behaviour, as appraised at various stages between the time of the discovery of the error and its disclosure to HMRC. This may take several steps to calculate and will often require a detailed appraisal of the individual facts of each case combined with judgement as follows:
  - The first issue is to decide whether in making the error the taxpayer had been taking reasonable care over his tax affairs.
  - Where a taxpayer has made an error despite taking reasonable care any error is treated as "innocent" and so no penalty is charged.
  - Where a taxpayer is found to have not taken reasonable care (in other words he has been negligent) any error will be treated as "careless" and penalties will apply.

- A higher range of penalties will apply if the taxpayer was found to have made it deliberately or deliberately and had also made attempts to conceal it.
- Having worked out the maximum penalty according to the taxpayer's past behaviour, the minimum penalty is calculated on the basis of whether the taxpayer disclosed the error to HMRC or whether disclosure was prompted by HMRC.
- The maximum penalty is then reduced by the taxpayer's disclosure; whether he was helpful and co-operative in assisting HMRC to quantify and correct the error. The reduction is achieved by discounting the difference between the maximum and minimum penalty and deducting it from the maximum penalty.
- When a penalty is charged under the provisions of s98 of the 1970 Taxes Management Act (TMA) then no penalty is payable under Sch 24 FA 2007: any document that triggers a s98 penalty is automatically excluded from the list of documents for which penalties for inaccuracies may be charged.
- There are special rules dealing with losses and where there is no loss of tax but liability is delayed.
- A penalty may be charged where an agent has made an error, but only if the taxpayer is found not to have taken reasonable care.
- Company officers may be assessed for penalties where an inaccuracy is made deliberately. The same applies in the case of an LLP and its members.
- HMRC may suspend penalties under 'careless' behaviour for a set period.
- The taxpayer may appeal both the rate of penalties charged as well as any decision not to suspend a penalty.

#### **Calculation of penalties: potential lost revenue**

Penalties are applied to "potential lost revenue."

The normal rule is that this is the additional amount of tax due or payable as a result of correcting the error ignoring (if applicable):

- Group relief
- Close company relief for loans

When there are multiple errors, the calculation of potential lost revenue depends on the order in which they are corrected:

- Careless inaccuracies shall be taken to be corrected before deliberate inaccuracies.
- Deliberate but not concealed inaccuracies shall be taken to be corrected before deliberate and concealed inaccuracies.

#### **Potential lost revenue: losses**

If a loss is overstated, the potential lost revenue equals extra amount of tax relief received. Where the loss has not been wholly used, lost revenue is increased by 10% of the balance of the loss.

#### **Potential lost revenue: delay**

Where tax has been delayed, the lost revenue is deemed to be:

- 5% of the delayed tax for each year of the delay, or
- A percentage of the delayed tax for each period of delay of less than a year.

This does not apply to losses.

#### **Disclosure: the meaning of unprompted**

A disclosure is unprompted if it is made without the intervention of HMRC. If a disclosure is made after HMRC have given notice of an intended compliance visit into that particular area of tax, the disclosure will be treated as being prompted. However, if the disclosure relates to another area of tax, not covered by the intended visit, the disclosure will still be treated as unprompted.

#### **Disclosure quality: mitigating factors**

- The maximum penalty accords to the behaviour that is found to have produced it.
- The minimum penalty that may apply depends on whether the error is unprompted or prompted.

## Rate of penalties

Behaviour that led to error	Maximum	Unprompted (minimum)	Prompted (minimum)
Genuine mistake: despite taking reasonable care	0%	0%	0%
Careless error: the inaccuracy is due to failure to take reasonable care	30%	0%	15%
Deliberate error but not concealed: the inaccuracy is deliberate but no arrangements were made to conceal it	70%	20%	35%
Deliberate error and concealed	100%	30%	50%

From 6 April 2011 this scale of penalties will only apply to Category 1 matters, these are:

- Domestic income and gains
- Category 1 territory offshore income tax and capital gains
- Other offshore taxes

(see ***Increased penalties for offshore income and gains***, below).

The maximum penalty is reduced depending on the quality of disclosure made to HMRC as follows.

### Up to: Quality

30% for telling HMRC about it;

40% for giving HMRC reasonable help in quantifying the inaccuracy or under-assessment;

30% for allowing HMRC access to records for the purpose of ensuring that the inaccuracy or under-assessment is fully corrected.

Telling includes:

- Admitting the document was inaccurate or that there was an under-assessment.
- Disclosing the inaccuracy in full.
- Explaining how and why the inaccuracy arose.

Helping includes:

- Giving reasonable help in quantifying the inaccuracy or under-assessment.
- Positive assistance as opposed to passive acceptance or obstruction.
- Actively engaging in the work to accurately quantify the inaccuracies.
- Volunteering any information relevant to the disclosure.

Giving access includes:

- Responding positively and allowing access to all relevant documents.

Each quality factor is determined by weighing up the timing, nature and extent in relation to the disclosure.

A reduction is calculated by taking the difference between the maximum and minimum and applying the total percentage total achieved above.

*For example:*

A taxpayer makes a transposition error when entering his figures on his quarterly VAT return. This leads to a sizable tax refund. The taxpayer does not question the size of the potential refund even though it is unusual; the nature of his business is that he expects to pay VAT each quarter. The error is discovered by HMRC following an enquiry. The error is found to be attributable to the taxpayer's carelessness; any rational person would have, in the circumstances, queried a large tax refund. For the sake of the example, let us say that all things considered (and this is where each case will turn on its individual facts), the taxpayer is not judged to have made the error deliberately. On the penalty scale this provides a maximum penalty of 30% with a minimum of 15%.

Assuming that the taxpayer was reasonably helpful in disclosing the error to HMRC, once prompted, but imagine that he partially blocked access to further records before making them available, the quality discounts given could be 20%, 30% and 10%, resulting in 60% in total.

Applying 60% to  $(30\% - 15\%) = 9\%$ .

Deducting 9% from the 30% maximum produces penalties of 21%.

*For example:*

Using the example above, but the taxpayer was extremely helpful in disclosing the error, once prompted. If he is given his full quality discounts (30%, 40% and 30%) of 100%, then his penalty will be  $30\% - ((30\% - 15\%) \times 100\%) = 15\%$  the minimum penalty for a prompted disclosure.

### **Potential difficulties**

The quality factor reductions have the potential to cause some of the greatest disagreements in practice; they are estimated after gathering evidence and are the personal decision of the individuals who set them. The qualities seem to overlap; this makes discounting difficult. At some of HMRC's Learning Together events held in 2010 it was evident that participants (both HMRC and advisers) had a natural inclination to give greater reductions for quality on the basis that the initial disclosure is unprompted, than if a disclosure was prompted and the error is deliberate, or deliberate and concealed. This approach seems to be unjustified because that part of the adjustment will have been made in the previous step in the calculation in determining the appropriate minimum and maximum.

### **Special reduction: special circumstances**

On a discretionary basis HMRC may stop, suspend or forgo a penalty if there are "special circumstances".

These do not include:

- Ability to pay, or
- the fact that a potential loss of revenue from one taxpayer is balanced by a potential over-payment by another.

### **Companies and LLPs: officer's liability**

Where a penalty is payable by a company for a deliberate inaccuracy made in a return or document which was attributable to an officer of the company:

- The officer as well as the company shall be liable to pay the penalty.
- HMRC may pursue the officer for such portion of the penalty (which may be 100%) as it may specify by written notice to the officer.
- This measure does not allow HMRC to recover more than 100% of a penalty.

"Officer" in the context of a company includes:

(a) A director (including a shadow director within the meaning of section 251 of the Companies Act 2006 (c.46)).

(a) A manager.

(b) A secretary.

"Officer" in the context of an LLP means a member and also includes:

a) A director

b) A manager

c) A secretary, and

d) Any other person purporting to manage any of the company's affairs.

Para 19 Sch 24 FA 2007

## Assessment of penalties

HMRC will assess a penalty, notify the taxpayer and state in the notice a tax period in respect of which the penalty is assessed.

- An assessment will be enforced in the same way as an assessment to tax and may be combined with an assessment to tax.
- A penalty assessment must be made within the period of 12 months beginning with:
  - The end of the appeal period for the decision correcting the inaccuracy, or
  - if there is no actual tax assessment the date on which the inaccuracy is corrected.

## Suspension

HMRC may suspend all or part of a penalty for a careless inaccuracy. Notification is in writing and must specify:

- What part of the penalty is to be suspended.
- The period of suspension; not exceeding 2 years.
- The conditions of suspension to be complied with by the taxpayer.

At the end of the period of suspension, provided that HMRC is satisfied that the conditions of suspension have been complied with, the suspended penalty or part is cancelled.

If not, or the taxpayer becomes liable to another penalty during the period, the suspended penalty or part becomes payable.

*For example*

Returning to the example on the previous page, HMRC may suspend the penalty as it is attributable only to careless behaviour. They might, for example, agree to suspend it subject to there being no repetition of that sort of errors in (say) 2 years.

## Appeal

The taxpayer may appeal against a decision of HMRC:

- That a penalty is payable
- On the amount of a penalty.
- Not to suspend a penalty payable.
- Setting conditions of suspension of a penalty.

An appeal will be heard by the First-tier Tribunal. HMRC will in practice review any appeal prior to a hearing.

The Tribunal may affirm, substitute or cancel HMRC's decision if it thinks it flawed.

"Flawed" means flawed when considered in the light of the principles applicable in proceedings for judicial review.

## Partnerships

- When an error in a partnership return or document results in a loss of tax each partner will be liable for a penalty on the loss of tax attributable to his profit sharing ratio, as the partnership does not pay tax.
- Only the nominated partner may appeal a partnership penalty for errors.
- A partnership penalty that is suspended is suspended for all the partners.

## Error involving tax agents

A taxpayer is potentially liable to be penalised where a document which contains a careless inaccuracy is given to HMRC on his behalf.

A taxpayer is not liable to a penalty in respect of anything done or omitted by his agent if HMRC is satisfied that he took reasonable care to avoid inaccuracy. Para 18 Sch 24 FA 2007

Members should refer to paragraphs 3.19 to 3.26 of the CIOT's guidance in *Professional Conduct in relation to Taxation* (last issued on 4 January 2011).

### **Penalties for third party supply of false information or withholding information**

Where an inaccuracy in a taxpayer's document results in a loss of tax that is attributable to the action of a third party who has deliberately:

- Supplied false information (whether directly or indirectly) or
- Withheld relevant information;

in connection with the document and this results in a loss of tax, a penalty is calculated per document at a rate of 100% of potential lost tax.

Introduced into Sch 24 FA 2007 by s122 and Sch 40 FA 2008, this measure takes effect from 1 April 2009.

### **Failure to notify of an underassessment**

Where HMRC raises an assessment, or determination for tax and the taxpayer fails to notify HMRC within 30 days that the assessment or determination is too low, a penalty is calculated at a rate of 30% of the amount of tax under assessed.

Introduced by Sch 24 FA 2007 and amended by Sch 40 FA 2008 and s109 Sch 57 FA 2009. This measure applies to assessments from 1 April 2008 and to determinations made from 21 July 2009.

### **Failure to notify**

A new single system of penalties applies across the main taxes for failures to notify liability or chargeability to tax. Included in these provisions are penalties for certain VAT and excise wrongdoing (see next section). Both were introduced by s123 & Sch 41 FA 2008 and apply on or after 1 April 2010 as follows:

- Income Tax, Capital Gains Tax and Class 4 National Insurance contributions for the 2009-10 tax period
- Corporation Tax: accounting periods ending on or after 1 April 2009
- VAT: failures to notify liability to register which arises on or after 1 April 2010
- Other taxes and duties (not IHT and SDLT): failures where the obligation arises on or after 1 April 2010.
- These provisions do not apply to:
  - Inheritance tax
  - Stamp Duty Land Tax
  - PAYE

There are also new rules covering failure to notify for Class 2 National Insurance (for the self-employed).

### **Penalties**

A different rate of penalty applies according to:

- The period of lateness.
- The underlying behaviour that contributed to the failure.
- Whether the failure was unprompted or prompted (see the table below).

From 1 April 2011 there will be increased penalties for failures involving offshore taxes.

## Failure to notify

Penalties are calculated according to potential lost revenue. This is the tax that would, had notification not been delayed, be due on the normal due date.

- There is no penalty is due if no tax is due.
- If a person makes a full and unprompted disclosure within 12 months of first becoming liable for a failure to notify penalty, the penalty can be reduced to zero.
- There is no longer a fixed penalty for failure to notify for Class 2 NICs.

### Rate of penalties

Behaviour governing failure to notify	Maximum	Unprompted (minimum)	Prompted (minimum)
Not deliberate: notified in less than 12 months	30%	0%	10%
Not deliberate: notified in any other case		10%	20%
Deliberate, but without concealment	70%	20%	35%
Deliberate with concealment	100%	30%	50%

From 6 April 2011 increased penalties apply for failures in relation to offshore income and capital gains categories 2 and 3: see table in **Failure to notify: increased penalties for offshore income and gains, below**).

Penalties are reduced if the offence has also attracted a late payment surcharge.

There is an exception for some Excise Duty registrations where the business is required to obtain approval before they can commence trading.

If HMRC is told about the taxable activity or liability, it will allow a reduction for disclosure. This will be reduced **for:**

- 30% for telling HMRC about it;
- 40% for giving HMRC reasonable help in quantifying the inaccuracy or under-assessment;
- 30% for allowing HMRC access to records for the purpose of ensuring that the inaccuracy or under-assessment is fully corrected.

A reduction is calculated by taking the difference between the maximum and minimum and applying the total percentage total achieved above. This is done on the same basis as for penalties for errors.

## Failure to notify: certain VAT and excise wrongdoing

These measures were introduced by s123 & Sch 41 FA 2008 (as for penalties for failure to notify liability and chargeability) likewise they apply on or after 1 April 2010.

A penalty applies in respect of the potential lost revenue attributable to a failure where a person:

- Makes an unauthorised issue of an invoice showing VAT or an amount inclusive of VAT
- Misuses a product so that a higher rate of excise duty is due
- Handles goods, such as alcohol or tobacco products, that are subject to unpaid duty

Penalties are calculated on the amount of potential lost revenue the same basis as **Failure to notify** on the following scale:

<b>Behaviour governing failure to notify</b>	<b>Maximum</b>	<b>Unprompted (minimum)</b>	<b>Prompted (minimum)</b>
Not deliberate	30%	10%	20%
Deliberate, but without concealment	70%	20%	35%
Deliberate with concealment	100%	30%	50%

The maximum penalty is then to be reduced for telling, giving and allowing (as for **Failure to notify**).

#### **Appeal and mitigation: reasonable excuse**

- A tax penalty may not be charged if the taxpayer has a reasonable excuse for failing to notify chargeability within the time limits applicable, see **Appeal and reasonable excuse**, below.

## **Late Filing (failure to make returns)**

The new late filing penalty regime was introduced in Sch 55 of 2009 Finance Act but its introduction has been delayed. It applies to the following returns:

<b>Return</b>	<b>Applies from</b>	<b>Old rules apply to returns including:</b>
Self-assessment: income tax and CGT	2010/11	2009/10
Corporation tax	TBA	FY 2010
PAYE	TBA	2009/10
CIS	October 2011	2009/10 subject to transitional measures

#### **Determination of penalty when return is made**

HMRC may determine the amount of tax due in order to raise a tax geared penalty. The amount will be re-assessed when the taxpayer makes the return.

## Late filing: except CIS

Rate of penalties

Lateness	Penalty
Miss filing deadline	£100
3 months late	Daily penalty £10 per day for up to 90 days
6 months late	5% of tax due or £300, if greater
12 months late	5% or £300 if greater, unless the taxpayer is held to be deliberately withholding information that would enable HMRC to assess the tax due.
12 months or longer and the taxpayer deliberately withholds information	Based on behaviour: <ul style="list-style-type: none"><li>• Deliberate and concealed withholding 100% of tax due, or £300 if greater.</li><li>• Deliberate but not concealed 70% of tax due or £300 if greater.</li><li>• Reductions apply for prompted and unprompted disclosures and telling, giving and helping.</li></ul>

From 6 April 2011 increased penalties apply for failures in relation to offshore income and capital gains.

## Late filing: CIS returns

Lateness	Penalty
Miss filing deadline	£100
2 months	£200
6 months	5% of tax due or £300, if greater
12 months	5% or £300 will apply, unless the taxpayer is held to be deliberately withholding information that would enable HMRC To assess the tax due. Reductions apply for prompted and unprompted disclosures and telling, giving and helping
12 months or longer and the taxpayer deliberately withholds information	Based on behaviour: <ul style="list-style-type: none"><li>• Deliberate and concealed withholding 100% of tax due, or £3,000 if greater.</li><li>• Deliberate but not concealed 70% of tax due or £1,500 if greater.</li></ul>
12 months: gross paid recipients	Based on behaviour: <ul style="list-style-type: none"><li>• Deliberate and concealed withholding £3,000.</li><li>• Deliberate but not concealed £1,500.</li></ul>

- The Sch 55 FA 2009 penalty regime replaces the old (s98A TMA 1970) regime in October 2011.
- The main difference between the two regimes is that the new one places an upper limit on penalties.
- When the first CIS return is filed the total penalty for all defaults is a maximum of £3,000 and the tax geared penalties cannot apply.
- HMRC have introduced transitional measures to roll the old regime into the new regime.

### CIS: transitional measures

Transitional measures apply for new contractors who have been charged penalties since April 1997. Contractors may apply to HMRC to have any late filing penalties re-calculated under the new system. This will be a worthwhile exercise in cases where the new £3,000 cap applies.

### Appeal and mitigation: reasonable excuse

- A tax penalty may not be charged if the taxpayer has a reasonable excuse for failing to file a return on time, see **Appeal and reasonable excuse**, below.

## Late payment penalties

From 6 April 2010 HMRC may charge penalties on PAYE and NICs that is paid late.

Penalties will apply to late payments for:

- PAYE (including PAYE Settlement Agreements and determinations).
- National Insurance contributions (NICs) (including annual payments of Class 1A).
- Construction Industry Scheme (CIS) deductions.
- Student Loan deductions.

Penalties will be charged according to whether the payment is due monthly, quarterly or annually.

- Larger employers receive an automated warning letter when a payment is late. This requires no action (although the employer will need to confirm to itself that a payment was in fact late: it may need to appeal this point later). A manually generated penalty notice will be issued by HMRC for second and subsequent defaults.
- Smaller employers: as it is not possible for HMRC to generate automated warnings it will send notifications of late payment penalty charges after the end of the year.

HMRC has up to two years after the late payment occurred to issue a penalty letter.

### Calculation of late payment penalties

The amount of penalty depends on whether payment is due on a monthly or quarterly basis, or annually.

The table below shows how the monthly and quarterly penalties will be calculated:

No of times payments are late in a tax year	Penalty percentage	Amount to which penalty percentages apply
1	No penalty	Total amount that is late in the tax year (ignoring the first late payment in that tax year).
2-4	1%	
5-7	2%	
8-10	3%	
11 or more	4%	

### 5% monthly and quarterly amounts more than six months late

HMRC may charge penalties of 5% of the amount that is late on any monthly or quarterly payments:

- 5% if more than six months late.
- A further 5% if still not paid after 12 months.

## 5% Annual payments (for example Class 1A NICs and PAYE Settlement Agreements)

- HMRC may charge up to three penalties of 5% of the amount that is late, depending on the length of time that the amount is not paid in full.

% total penalty by time of payment	When paid
0%	1 - 29 days of due date
5%	30 days of due date
10%	6 months of due date
15%	12 months of due date

### Appeal and mitigation: reasonable excuse

- A tax penalty may not be charged if the taxpayer has a reasonable excuse for not making a tax payment on time, see **Appeal and reasonable excuse**, below.

## Record keeping

HMRC may specify which records should be kept and retained, and in what format, for the purpose of completion of tax returns and claims for income tax, CGT, corporation tax and VAT.

These powers were introduced in s115 and Sch 37 FA 2008 and apply from 1 April 2009.

### Retention of records

The general rule is that records should be retained for a minimum of six years subject to the following exceptions:

- PAYE and CIS records should be retained for 3 years (in addition to the current year).
- Personal tax returns cases records should be retained for 22 months from the end of the tax year to which they relate.

Sch 37 does not introduce a new penalty regime in respect of record keeping; HMRC will view a failure to keep adequate books and records as a sign of lack of care when it is linked to any errors or mistakes made by a taxpayer in a return of document.

HMRC Help sheet TH FS1 lists the records that HMRC expects taxpayers to keep and retain

<http://www.hmrc.gov.uk/factsheet/record-keeping.pdf>

## Interest on late payment and repayment interest

The new regime introduced by s101 and s102 and Sch 53 and 54 FA 2009 will harmonise interest charged across the taxes. It is due to apply from October 2011.

## Appeal and reasonable excuse

Most of the penalties referred to in this guide (with the exception of **penalties for errors**, see below) are susceptible to an appeal on the grounds of 'reasonable excuse'. No penalty shall apply where the taxpayer satisfies HMRC or the tribunal on appeal that he has a reasonable excuse for the failure.

- An failure caused by deliberate conduct would not be covered by reasonable excuse.

- Insufficiency of funds is not a reasonable excuse unless attributable to events outside the taxpayer's control.
- Where the taxpayer relies on another person to do anything, that is not a reasonable excuse unless the taxpayer took reasonable care to avoid the relevant act or failure.
- Where a taxpayer had a reasonable excuse for the relevant act or failure but the excuse has ceased; the taxpayer is expected to remedy the situation without unreasonable delay. Failing to act promptly in those circumstances will deny relief on the grounds of reasonable excuse.

There is no provision for reasonable excuse in respect of mitigation of penalties charged for errors under Sch 24 FA 2007. The cause of an error will be weighed up according to the circumstances of the case, as explained above.

## Increased penalties for offshore income and CGT

One of the latest additions to the tax penalty regime is increased tax-geared penalties in relation to offshore income and capital gains. These provisions were introduced by S35 and Sch 10 FA 2010 and they affect penalties for:

- Errors in a return or document
- Failure to notify liability or chargeability to tax
- Failure to make a return on time.

Implementation is expected to be 6 April 2011.

Increased penalties apply according to a system of categories.

### New categories for domestic and offshore income

The presence of Categories adds several new steps into the process of calculating a tax-geared penalty in relation to offences involving offshore income and CGT:

Categories are determined as follows:

Category 1	Category 2	Category 3
A domestic matter, or An offshore matter: income tax and CGT relating to a category 1 territory; or An offshore matter other than income tax or CGT.	An offshore matter: income tax and CGT relating to a category 2 territory.	An offshore matter: income tax and CGT relating to a category 3 territory.

### Which Category?

First decide whether the penalty relates to a domestic or offshore matter.

- A matter is an "offshore matter" if it relates to a potential loss of revenue that is charged on or by reference to:
  - Income arising from a source in a territory outside the UK.
  - Assets situated or held in a territory outside the UK.
  - Activities carried on wholly or mainly in a territory outside the UK.
  - Anything having effect as if it were income, assets or activities of a kind described above.
- A "domestic matter" relates to any other potential loss of revenue.

If the penalty relates to a domestic matter it is Category 1.

Where the matter is an offshore matter and it relates to income tax or CGT the appropriate category is determined by territory.

- Territories are categorised by Treasury order with regard to the quality and quantity of Tax Information Exchange Agreements that determine the level of tax transparency between a territory and the UK. For a list of the countries see **Designated Territories**, below

Where a matter is an offshore matter and it relates to a tax other than income tax or CGT it will be treated as Category 1 matter.

Where there is single failure in more than one Category in calculating a tax-geared penalty any loss of tax is apportioned on a just and reasonable basis between the relevant Categories.

### **Error or mistake (increased penalties for offshore income and CGT)**

From 6 April 2011: increased penalties apply when an errors relates to offshore income and gains arising in a territory that falls into Category 2 or 3 (see **New categories for domestic and offshore income**, above)

#### **Penalties:**

##### **Category 2**

<b>Behaviour that led to error</b>	<b>Maximum</b>	<b>Unprompted (minimum)</b>	<b>Prompted (minimum)</b>
Genuine mistake: despite taking reasonable care	0%	0%	0%
Careless error: if the inaccuracy is due to failure to take reasonable care	45%	0%	22.5%
Deliberate error but not concealed: the inaccuracy is deliberate but no arrangements made to conceal it	105%	30%	52.5%
Deliberate error and concealed	150%	45%	75%

##### **Category 3**

<b>Behaviour that led to error</b>	<b>Maximum</b>	<b>Unprompted (minimum)</b>	<b>Prompted (minimum)</b>
Genuine mistake: despite taking reasonable care	0%	0%	0%
Careless error: if the inaccuracy is due to failure to take reasonable care	60%	0%	30%
Deliberate error but not concealed: the inaccuracy is deliberate but no arrangements made to conceal it	140%	40%	70%
Deliberate error and concealed	200%	60%	100%

The maximum penalty is reduced depending on the quality of disclosure made to HMRC, see **Error or mistake made by a taxpayer**, above.

### **Failure to notify (increased penalties for offshore income and CGT)**

From 6 April 2011: increased penalties apply for failure to notify chargeability in relation to offshore income and gains. These penalties are calculated in the same way as for Category 1 territory offences (domestic and other offshore taxes) however they are increased as follows:

### Category 2 territories

Behaviour governing failure to notify	Maximum	Unprompted (minimum)	Prompted (minimum)
Not deliberate: notified in less than 12 months	45%	0%	15%
Not deliberate: notified in less than 12 months		15%	30%
Deliberate, but without concealment	105%	30%	52.5%
Deliberate with concealment	150%	45%	75%

### Category 3 territories

Behaviour governing failure to notify	Maximum	Unprompted (minimum)	Prompted (minimum)
Not deliberate: notified in less than 12 months	60%	0%	20%
Not deliberate: notified in less than 12 months		20%	40%
Deliberate, but without concealment	140%	40%	70%
Deliberate with concealment	200%	60%	100%

### Late filing (increased penalties for offshore income and CGT)

From 6 April 2011: Sch 55 FA 2009 is amended to introduce tougher penalties for Category 2 and 3 offences (those relating to offshore income and gains) as follows:

Lateness and Category	Deliberate, not concealed	Deliberate and concealed
<b>Category 2</b> 12 months or longer and the taxpayer deliberately withholds information	<ul style="list-style-type: none"> <li>105% of tax due, or £300 if greater.</li> </ul>	deliberate and concealed withholding 150% of tax due, or £300 if greater
<b>Category 3</b> 12 months or longer and the taxpayer deliberately withholds information	<ul style="list-style-type: none"> <li>140% of tax due, or £300 if greater.</li> </ul>	deliberate and concealed withholding 200% of tax due, or £300 if greater

Reductions apply for prompted and unprompted disclosures and telling, giving and helping.

## Designated Territories

It is proposed that the following territories are to be categorized by Treasury Order in 2011 as follows:

Category 1 territories	Category 3 territories
Anguilla Aruba Australia Belgium Bulgaria Canada Cayman Islands Cyprus Czech Republic Denmark (not including Faroe Islands and Greenland) Estonia Finland France Germany Greece Guernsey Hungary Ireland Isle of Man Italy Japan Korea, South Latvia Lithuania Malta Montserrat Netherlands (not including Bonaire, Sint Eustatius and Saba) New Zealand (not including Tokelau) Norway Poland Portugal Romania Slovakia Slovenia Spain Sweden United States of America (not including overseas territories and possessions)	Albania Algeria Andorra Antigua and Barbuda Armenia Bahrain Barbados Belize Bonaire, Sint Eustatius and Saba Brazil Cameroon Cape Verde Colombia Congo, Republic of the Cook Islands Costa Rica Curaçao Cuba Democratic People's Republic of Korea Dominica Dominican Republic Ecuador El Salvador Gabon Grenada Guatemala Honduras Iran Iraq Jamaica Kyrgyzstan Lebanon Macau Marshall Islands Mauritius Micronesia, Federated States of Monaco Nauru Nicaragua Niue Palau Panama Paraguay Peru Saint Kitts and Nevis Saint Lucia Saint Vincent and the Grenadines San Marino Seychelles Sint Maarten Suriname Syria Tokelau Tonga Trinidad and Tobago United Arab Emirates Uruguay