Modernising Powers, Deterrents and Safeguards:

The Simplification of Regulatory Penalties

Consultation document
Publication date: 17th June 2011
Closing date for comments: 9th September 2011
Subject of this consultation: This is the first consultation (of two) on the final stage of the Review of Powers’ reforms of penalties in the tax system.

Scope of this consultation: This consultation covers all penalties that have not previously been considered by the Review of Powers. It includes penalties relating to all the taxes and duties administered by HMRC, along with a small number of non-tax penalties, but excludes certain specific penalties from scope (see para 1.10). This consultation considers and seeks views on the design principles and design features of a new penalty framework.

Previous Review of Powers work has looked at penalties for inaccuracies in returns, failure to notify, late filing and payment. For the purposes of this document the remaining penalties are termed ‘regulatory’ penalties.

Who should read this: Persons subject to administrative requirements under the tax system, their advisors, and groups representing taxpayers and other interested parties.

Duration: 17th June 2011 to 9th September 2011

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How to respond: As above

Additional ways to be involved: HMRC will be inviting representative bodies and other interested parties to meet with the Review of Powers team and discuss the issues raised in the consultation document.

After the consultation: A full response document will be published. HMRC will prepare a further consultation with detailed proposals for a new penalty framework.

Getting to this stage: The Review of Powers, Deterrents and Safeguards was set up to provide a modernised framework of law and practice for HMRC appropriate to the merged Department’s tasks and which allows those tasks to be carried out effectively and efficiently.

Since 2007 the Review of Powers has brought alignment and modernisation across the main penalties for inaccuracies in returns, failure to notify and late filing and payment. The Review is now looking at whether there is scope to modernise or align the remaining large number of disparate penalties.

Previous engagement: A discussion document was published in January 2011. This provided a high-level overview of the issue and sought views about the value of further work. Responses generally agreed that there was scope for simplification and there was a range of views about what a new model should look like and what features it should have. A summary of responses can be found at Annex B
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On request this document can be produced in Welsh and alternative formats including large print, audio and Braille formats
1. Introduction

1.1 Since 2005, the Review of Powers, Deterrents and Safeguards (the Review of Powers) has been undertaking a programme to review, align and modernise HMRC’s legislative powers and safeguards. This programme includes new cross-tax penalty frameworks for inaccuracies in documents, failures to notify and failures to file a return or pay on time\(^1\).

1.2 Penalties for failure to comply with information requests from HMRC have also largely been modernised\(^2\) and this work is proposed to be completed by the reforms to data gathering powers which form part of the Finance Bill currently before Parliament\(^3\).

1.3 Once this work has been completed, the UK tax regime will be supported by a modernised and aligned administrative framework with common design principles. The treatment of the same non-compliance for different taxes and duties will no longer attract differing sanctions under the law, except in those rare occasions where it makes sense to do otherwise. Safeguards will be present, clear and consistent.

1.4 There remain over 300 civil penalties which have not yet been considered by the Review of Powers. These penalties – which we have called “regulatory penalties” for the purposes of this consultation – underpin the tax system in a variety of ways. They support administrative rules which encourage smooth and efficient tax administration. They protect third parties who want to get their tax affairs right. They prevent non-compliance and serious fraud.

1.5 “Regulatory penalties” may in fact be a slightly misleading term. Tax and regulation are different levers on behaviour. These penalties do not support regulation in the traditional sense, but support the tax system. However, the term has in recent years fallen into common use among those interested in the work of the Review of Powers, and, despite it not being a completely accurate description, it is one which this consultation will continue to use for the sake of clarity and continuity.

1.6 Tax and tax administration are not within scope of the various methods the Government has put in place for reducing the stock and flow of regulation on business but are instead covered by the New Approach to Tax Policy Making. The use of the term “regulatory penalties” in this consultation is a convenient shorthand for the disparate penalties used in the different tax regimes to support the administration of the tax system. This does not mean they are “regulation” rather than “tax administration”.

1.7 In January, HMRC published a high-level discussion document to gauge support for the simplification of regulatory penalties\(^4\). Responses were broadly positive, with most respondents welcoming an opportunity to address an extensive and complex aspect of tax administration. A summary of the responses received as part of this discussion can be found at Annex B.

1.8 Most thought that it was a good idea to review HMRC's remaining penalties with a view to simplification. However there were different views on the options and the necessary features of a simplified regime, with several respondents suggesting that taxpayer groups

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\(^{1}\) Schedule 24, Finance Act (FA) 2007, Schedule 41 to FA 2008 and Schedule 55 to FA 2009 respectively
\(^{2}\) In Schedule 36 to FA 2008
\(^{3}\) Clause 86 of, and Schedules 24 and 25 to, Finance (No. 3) Bill 2010-11
\(^{4}\) 'The Simplification of Regulatory Penalties', was published on 31st January 2011 for six weeks. It asked whether there would be any benefit in considering whether simplification could be achieved for HMRC’s regulatory penalties. (http://www.hmrc.gov.uk/consultations/index.htm)
are quite distinct from each other and require their own separate penalty regimes. (The Construction Industry Scheme was cited as an example.)

1.9 Following the end of the discussion period, Ministers asked HMRC to commence a review of regulatory penalties with a view to exploring options for modernisation, alignment and simplification. Given the range of responses received, this consultation looks at high level concepts and features. It asks respondents to consider how a new model, or models, should work, specifically in relation to how different types of penalties should be treated, and whether it is necessary to consider the different roles of the penalties when designing a new model.

1.10 This consultation does not consider the penalties associated with the disclosure of tax avoidance schemes, penalties available under Money Laundering Regulations, penalties supporting the tax credits system, penalties for failure to comply with National Minimum Wage requirements, or penalties relating to statutory payments such as sick and maternity pay.

A new framework for regulatory penalties

1.11 This document looks to establish the design principles which should be applied to the reform of regulatory penalties, and to examine possible features of a new model, or models. Chapter 2 discusses the proposed principles which will underpin this review and asks if they are correct.

1.12 Respondents to the discussion document offered differing views on the shape that a model for regulatory penalties should take. The new penalties legislation contains a number of design features that were developed through consultation. It therefore seems sensible to examine these design features, and to seek views on whether and how they should be introduced in a new regulatory penalty framework. This is considered in Chapter 4.

1.13 This document sets out:

- Chapter 2: the design principles underpinning the simplification of regulatory penalties
- Chapter 3: the role of regulatory penalties in the tax system
- Chapter 4: the different features that can make up a penalty regime, and asks for views on how they should be applied to this work
- Chapter 5: the safeguards that could apply
- Chapter 6: the current evaluation of impacts

1.14 This document does not propose what a new framework should look like. This is a stage one consultation, within the new Tax Consultation Framework, which looks to establish objectives and explore options for change. Once design principles have been established, and views on the desirability of various design features have been obtained, HMRC will draw up detailed proposals for reform. These proposals will then be subject to a further full public consultation and, in line with the new approach to tax policy making, any necessary legislation will be published in draft for consultation.

1.15 There would be no additional burdens for the compliant as a result of this work. There would be no change in what is necessary to meet the obligations even if penalties are aligned, and there could be benefits for taxpayers if HMRC are able to repeal any obligations and penalties.

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5 under s98C Taxes Management Act 1970
6 The consultation, Modernising Customs and Excise Law, which is published this summer considers issues around some of the Customs penalties
1.16 HMRC hold no preconceptions of what a new regulatory penalty framework may look like. It may be one that an overarching penalty model encompassing all requirements in the tax system would be appropriate, or it may be that a more tailored approach, grouping penalties together in a number of common sets, is preferable. It is likely that the next consultation will look at each option, and while questions on which is the more suitable approach are more relevant to that consultation, any early views on which should be favoured are welcome at any stage.
2. Design Principles

2.1 The Review of Powers, Deterrents and Safeguards aims to provide an improved and consistent framework of powers and safeguards, overseeing a programme of legislative, administrative and operational change.

2.2 As part of its work to modernise and align the legal framework of tax administration the Review of Powers has applied a number of design principles. These have helped interested parties to evaluate the proposals.

**HMRC must support those who seek to comply and come down hard on those who seek an unfair advantage through non-compliance**

**Powers and statutory obligations must be:**
- set within a clear statutory framework;
- easily understood (by taxpayers, their agents and HMRC staff);
- straightforward to comply with;
- proportionate to what HMRC staff need to do to protect the Exchequer from the risk assessed;
- consistently applied; and
- effective in providing information which is needed for HMRC officers to assess risk, discover and deal with non-compliance.

**Safeguards for taxpayers must be:**
- clear, publicised and accessible;
- effective;
- supportive of human rights; and
- responsive to the nature and purpose of particular powers and sanctions.

**Sanctions for non-compliance must be:**
- set in statute;
- clear and publicised;
- proportionate to the offence;
- used consistently; and
- effective in deterring non-compliance and returning the non-compliant to compliance.

**Simplification and repeal**

2.3 This consultation considers the reform of regulatory penalties themselves rather than the obligations they underpin. However, there may be some instances where it is clear that the obligation is obsolete or deficient, and where repeal may be appropriate.
2.4 The current system of over 300 penalties is complex and difficult for the lay person to understand. Although strictly, some of these are the same penalty for a different offence (the section 9 FA 1994 penalties for excise regulatory offences, for example), this complexity is unhelpful.

2.5 An effective deterrent must be clear and comprehensible to the affected person; if it is not, the person will not be aware of the consequences of non-compliance, and thus cannot be effectively deterred from failing to comply with their obligations.

2.6 HMRC approach this review with a preference for simplification where possible; looking to address this complexity through repeal and alignment. Where a penalty – and perhaps an associated obligation – is obsolete, has fallen out of general use, or is ineffective, there will be a presumption towards repealing it.

External Reviews

2.7 Two external reviews are relevant when considering the design principles applicable to regulatory penalties. Both the Hampton\(^7\) and Macrory\(^8\) reviews considered which rules should underpin a regime of regulatory control. Although they were not looking at the regulation and management of tax they provide some overarching concepts that may be applicable here.

2.8 The Hampton review found that weak incentives, such as low financial penalties, reduce the willingness of businesses to be compliant. It concluded that the aim for a regulatory framework should be a broad range of flexible, proportionate sanctions that can be applied in cases of non-compliance at an earlier stage than criminal prosecution.

2.9 The Macrory Review provided six key principles for developing sanctioning regimes for regulatory non-compliance. Those most applicable here aim to

- change the behaviour of the offender;
- eliminate any financial gain or benefit from non-compliance;
- be proportionate to the nature of the offence and the harm caused; and
- deter future non-compliance

Design Principles for Regulatory Penalties

2.10 The values behind both the Hampton and Macrory recommendations are reflected in the Powers design principles that have been specifically applied to the development of penalty regimes. These state that an effective penalty regime must:

1. Influence behaviour,
2. Be fair and proportionate, and
3. Be effective and set out in legislation

2.11 Whilst these principles remain applicable for the work on regulatory penalties it would seem appropriate to add further principles reflecting the intention behind the work. In addition to the focus on simplification, there must also be an emphasis on deliverability of any proposals and minimisation of cost to both HMRC and customers. It is critical that any

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\(^7\) March 2005: Hampton Review - Reducing administrative burdens: effective inspection and enforcement

new penalty framework can be implemented in practice. It is therefore suggested that the principles below are included for this work:

4 Simplification, where sensible
5 Change that is deliverable
6 Repeal where appropriate

**Question 1:** Do you agree that these are these six principles are the correct ones to apply to this work?
3. Role of Regulatory Penalties

3.1 There are over 300 penalties which have not yet been modernised by the Review of Powers\(^9\). These penalties support legislation which imposes an administrative requirement on someone. Failure to comply with that requirement renders the person liable to a regulatory penalty. So the purpose of the regulatory penalty is to encourage compliance. They are clearly a disparate set, but in general they underpin the assessment and collection of tax. In most cases there will not be a direct impact on the amount of tax due.

3.2 Regulatory penalties cover a number of different types of failure:

- ‘One off’ breaches: failures that concern a discrete event, such as failing to inform HMRC of a change of circumstance, which in some cases may be repeated;
- ‘Ongoing’ breaches: where the breach continues until rectified such as failing to provide information when required; or
- ‘Regular or recurring’ breaches: where the obligation recurs at regular intervals providing the opportunity for multiple breaches, such as the filing requirement for filing an EC Sales list.

3.3 Respondents to the discussion document recognised that these legal obligations have different purposes within the tax regime. They suggested that a new model may need to take those differences into account.

3.4 This chapter therefore considers, and seeks views upon, the roles that obligations - and the associated penalties – play in the administration of tax and related matters. A better understanding of this role will help to inform the design of a new penalty framework.

The purpose of regulatory penalties

3.5 HMRC has identified a number of generic purposes served by these requirements in tax administration. This list may not be exhaustive, and single requirements are in practice likely to fall into more than one category. In each of the examples, “P” is the party subject to the requirement.

Allow HMRC to check P’s tax position

Record preservation requirements are classic examples of such rules. If the taxpayer does not meet the requirement to preserve the underlying business records on which a tax return is based, it can be more difficult for HMRC to check whether the information in that return is correct.

Allow HMRC to check a third party’s tax position

Such rules preserve HMRC’s ability to check tax positions which rely upon a third party to do something. This could be a requirement to send information to HMRC (e.g. the requirement to notify a settlement with non-resident trustees)\(^10\), or a requirement to give information to another person which substantiates their tax position (e.g. the giving of

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\(^9\) A full list of the penalties was provided in the Annex to the discussion document published in January, and available at [http://www.hmrc.gov.uk/consultations/index.htm](http://www.hmrc.gov.uk/consultations/index.htm); an updated list will be published alongside a future consultation

\(^10\) Paragraph 24(3) of Schedule 5 to FA 1996
certificates under the Enterprise Investment Scheme\textsuperscript{11}). In either case, this information is material to the tax position of a third party.

\textit{Help third parties to get their own tax affairs right}

Some requirements placed upon \(P\) in order to help third parties to get their own tax affairs right. Requirements in this field include the example cited in the last section regarding EIS certificates; the requirement helps the taxpayer (\textit{i.e.} the person receiving the certificate) to get their affairs right, as well as allowing HMRC to check the tax position.

The failure to comply with such rules can lead to an accidental under- or over-statement of tax elsewhere. It can also lead to greater costs of tax administration, for HMRC and for the taxpayer. There is, of course, a link to the above category of making it easier to check a third party’s tax position.

\textit{Enable \(P\) to get their own tax returns/payments right}

The tax system places some explicit requirements on taxpayers to ensure that they are able to complete returns and make payments. Record keeping requirements are examples of such rules: while record preservation requirements mean HMRC can return to a taxpayer to check whether their tax position is correct, record keeping rules allow the taxpayer to calculate that tax position in the first place.

\textit{Prevent conduct that can facilitate evasion or fraud}

Some conduct, while not itself representing the evasion of tax, can nevertheless encourage, facilitate or otherwise support evasion or fraud by another party. The restrictions on the use of red diesel, and the accompanying penalty\textsuperscript{12} are examples of this conduct. In that example, \(P\)’s use of red diesel encourages the person producing it to evade the relevant excise duty.

\textit{Allow for efficient tax administration}

The tax system imposes some requirements which serve the purpose of allowing for more efficient tax administration. One example is the requirement to file some returns electronically. Without the requirement, information may be received at the wrong time, in the wrong format, and/or in a fashion which generates extra costs.

\textbf{Analysis of the existing regulatory penalties, and common features}

3.6 Given the sheer number and variety of regulatory penalties, it is difficult to comprehensively analyse how they are currently used. We have, however, identified over 50 obligations where the penalties have not been recently issued, or are issued very rarely.

3.7 Infrequent use may not in itself mean that a penalty provision is unnecessary. The penalty may be a perfect deterrent, the mere threat of it acting to ward off any non-compliance. Or it may be an important aspect of a highly specialised system that need only seldom be used – but which has a large impact when it is.

3.8 However, HMRC have approached this review with the intention of repealing any penalty which is no longer necessary. As the review continues, we will explore the reasons why some penalties are used infrequently and, should no firm reason for keeping them be found, there will be a presumption towards repeal.

3.9 Again respondents recognised that different regimes currently have different penalties where failure to meet an obligation have a similar outcome, and that can create unwelcome uncertainty and distortion. For these obligations that have common features a

\textsuperscript{11} s207 Income Tax Act 2007
\textsuperscript{12} Requirement: section 10(3) of the Hydrocarbon Oil Duties Act 1979; penalty: section 9 FA 1994
simplified model could look to provide aligned penalties for similar obligations, to provide consistency of penalty. Some of these possible 'groupings' are discussed below.

**Penalties for inaccuracies in a document given to another person, or failure to provide a document where required to do so**

3.10 There are a number of penalties for giving an incorrect document to another person, or for failing to provide a document when required. Schedule 24 to Finance Act 2007 aligned penalties for errors in taxpayer documents given to HMRC, and Paragraph 1A of that Schedule introduced penalties on third parties where they are responsible for an error in a person's return.

3.11 Paragraph 1A's use could be extended to cover all relevant circumstances, and views would be welcome on such an approach, but there are weaknesses in reliance upon this provision. Errors in a document given to a third party are less likely to bring a direct benefit to the party subject to the requirement, as there would usually not be a direct impact upon their own tax affairs. The error may not find its way through to an inaccuracy in the third party’s return: they may have to find other means of determining their correct tax position.

3.12 There may be merit in a new aligned treatment for such inaccuracies where the fault is less serious or administrative in nature and the Schedule 24 Paragraph 1A remedy is unavailable or inappropriate.

**Penalties for inaccuracies in documents given to HMRC regarding the affairs of another, and the failure to provide such documents**

3.13 There are also various penalties relating to documents given to HMRC which relate to the affairs of another. For example, there are penalties for failing to inform HMRC where a professional has assisted in the formation of a settlement with offshore trustees.

3.14 As with the other categories here, a variety of sanctions are currently in place. Some include concepts no longer used in the rest of penalties legislation, such as fraudulent or negligent conduct.

3.15 Where a document given to HMRC contains an inaccuracy, or where that document is not supplied at all when it should have been, and the document concerns the person’s own tax affairs, there could be one aligned set of rules to determine the correct sanction.

**Penalties for failure to keep or preserve records**

3.16 There are 13 penalties for either failing to keep records (i.e. to record data salient to taxation, such as sales) or failing to preserve records (i.e. to maintain these records for a stipulated period of time).

3.17 The sanctions for failure vary depending upon the tax regime affected. For VAT, section 69 of the Value Added Tax Act 1994 provides the obligations and penalties, whilst record keeping penalties for direct tax are contained in section 12B of the Taxes Management Act 1970.

3.18 The record keeping and record preservation requirements themselves are outside the scope of this review.

**Question 2: In principle, do you think that it would be sensible to aim for one aligned penalty where obligations can be ‘grouped’ together?**
4. Possible design features

4.1 This chapter looks at various features that a penalty regime can have and asks for views on how they could, or should, work within a simplified regulatory penalty model. Responses to the discussion document made it clear that any attempt at simplification should not itself unintentionally create complexity. HMRC would, therefore, appreciate views not only on what features should apply, but also any thoughts on which features are the highest priority for inclusion in a simplified system, and how such features could work in practice.

Types of Penalties – how should a model for regulatory penalties tackle different types of breaches?

4.2 As mentioned in Chapter 3, there are three different types of failure: one-off (possibly with a repeat offence), ongoing, and regular/recurring. When considering the development of a simplified model we need to determine whether these different types need to be treated differently.

4.3 It does not seem unduly complex for one-off and repeat offences to be treated in a similar manner – a penalty, £x, is applicable for each occurrence. The question here is whether there should be a progressive increase in the penalty applied where there are recurring breaches. Should a new model treat these breaches as linked events or as individual one-off breaches? Should repeat offences be met with increasing sanctions?

4.4 If they are treated as linked events, a model could provide for an ability to increase the penalty where a failure is repeated within a set period.

4.5 A more difficult issue may be how to treat ongoing breaches, where the failure itself does not recur, but rather the initial failure continues. It would seem logical that where the penalty attached to the initial failure has not made the taxpayer remedy the problem HMRC need access to a further sanction to encourage taxpayers to fulfil their obligation quickly.

4.6 Schedule 36 to FA 2008 provides for daily penalties to address on-going failures. Given the low value of most regulatory penalties, daily penalties would similarly need to be quite low value to remain proportionate, and therefore may not be an efficient mechanism. Other options are to increase the initial penalty by a set amount for every set period that the failure continues to go unrectified, e.g. for every month the penalty increases by 25%, or to treat the passing of each set period as a new failure and therefore a new penalty would be applied. Again this opens considerations as to whether a cap should apply, and if so at what level.

4.7 It was suggested during the discussion period that HMRC should consider applying no penalty for the first offence. This could apply to all offences or only to some (one-off offences, less serious offences, or those where there has been disclosure, perhaps). Some of the relevant concepts are discussed elsewhere in this chapter, but views on the general concept of a nil penalty for the first offence are encouraged.

Question 3: How should a model for regulatory penalties tackle different types of breaches? Is there merit in applying no penalty for the first offence?
Impact - How can penalties be geared to ensure that they are proportionate to the impact of the failure?

4.8 The previous chapter set out the different roles that administrative requirements – and thus the regulatory penalties that underpin them – play in ensuring the effective operation of the tax system.

4.9 As the Macrory Review concluded, an effective penalty takes account of the impact of the non-compliance. This could mean taking account of the benefit which the party liable to the penalty gains from failing to comply, or taking account of the wider impact on society of the non-compliance.

4.10 With the new penalties for errors, failure to notify, etc., this is straightforward. The benefit gained by the taxpayer for an error (if it is in their favour, which it may not be) will result in a quantitative tax benefit to them. The penalty can thus be geared to that amount. This is also an excellent proxy for the impact on society, as the amount of tax lost is an amount which the Exchequer has foregone. Gearing the penalty to the tax thus has the effect of linking to the benefit to the taxpayer and the impact on society.

4.11 With penalties for failure to comply with information notices, the picture is rather different. Penalties are generally fixed; they are mechanical in nature. However, if there is a loss of tax, a tribunal may impose a penalty that is appropriate and linked to that loss of tax. This is a novel way of allowing for a geared penalty where the circumstances merit one. The requirement for the Tribunal to set the penalty ensures that these circumstances must be exceptional.

4.12 Regulatory penalties are more difficult. As the previous chapter showed, they serve a wide range of purposes. A simple tax gearing approach would not be appropriate: not all requirements have a direct link to an amount of tax, and in some cases where an amount is available it would be disproportionate to gear to it. (For example, penalising the failure to notify HMRC of the appointment of a fiscal representative for the purposes of Air Passenger Duty in proportion to the total amount of APD chargeable on the airline may be disproportionate.).

4.13 There are a number of proxies for impact which could be used:

- Potential lost revenue – for example, where a failure means that the return of another person is incorrect, the penalty could be geared against that amount.

- Administrative burden – for example, linking the penalty amount to the additional expenditure incurred by HMRC in rectifying a wrong, or which the person would have incurred by complying correctly.

- A general scale – many existing regulatory penalties are not geared to any sum related to the breach, but have been set in accordance with general penalty norms (e.g. the proliferation of £300 and £250 fixed penalties).

4.14 It is clear that some failures will have greater consequences than others. Failure to meet requirements aimed at reducing the cost of administration may have a lower impact than failing to comply with an anti-fraud provision, for example (although this may not always be the case). Views are welcomed on whether and how the role of the penalty could be used in determining the overall impact of a breach.

4.15 Some existing penalties use a mixed model. For example, excise penalties under section 9 of FA 1994 allowed for a £250 fixed penalty or a tax geared penalty of 5% of the duty at stake, or a daily penalty.
Question 4: Bearing in mind the roles of regulatory penalties discussed in the previous chapter, how can penalties be geared to ensure they are proportionate to the impact of the failure? Is the Schedule 36 model of a Tribunal-imposed penalty attractive?

Deliberate Behaviour - is the notion of penalties which reflect behaviour applicable to a model for regulatory penalties?

4.16 The new penalties regimes all include the concept of ‘non-deliberate’ and ‘deliberate’ behaviour.

4.17 HMRC’s strategy is to firmly tackle those who intentionally avoid complying with their obligations. In line with that the new regimes look to the behaviour of the taxpayer. If the failure to comply with the obligation is found to be deliberate the amount of the penalty (which is based on the tax loss) is increased.

4.18 Of the regulatory penalties within scope, fewer than 5% look to the behaviour of the taxpayer to determine the appropriate level of penalty. In those cases where they do – all from direct tax law – the behaviour referred to is ‘fraudulent or negligent’ conduct.

4.19 If the deliberate concept were to form part of a regulatory penalties model there are two basic options for including it. The first is to provide the power, either to HMRC or a tribunal, to increase any penalty where there is proven to be deliberate non-compliance. This would have the benefit of reflecting the approach taken in the other new penalty regimes, and HMRC’s commitment to come down hard on those who are deliberately failing to meet their obligations. Although it would be a change for the vast majority of the penalties, many of them do not naturally fit with an evaluation of behaviour, and therefore it may actually only be used in a very small number of cases.

4.20 The second option is to provide for an increased penalty only in relation to the penalties that currently refer to fraudulent or negligent conduct. This would reduce the amount of change and recognise the different nature of the majority of regulatory penalties. However it may mean that those who have deliberately failed to comply with certain obligations face the same penalty as those who failed to take care. It would also restrict such a sanction to direct tax.

Question 5: Is the notion of penalties which reflect behaviour applicable to a model for regulatory penalties?

Disclosure – should reductions for disclosure be a feature of a regulatory penalties model?

4.21 The new penalties frameworks for inaccuracies and failures allow for reductions for disclosure. Disclosure is defined as a taxpayer telling, helping and allowing access to HMRC in respect of an inaccuracy or failure. Different levels of reduction can be obtained depending upon the quality of the disclosure, and whether it was prompted or unprompted. The more mechanistic new penalties – penalties for failure to comply with an information notice under Schedule 36 – by contrast do not offer such reductions.

4.22 Reductions for disclosure are not typically present in regulatory penalties legislation. This does not mean disclosure is never recognised; in practice, a penalty may not be charged or, in the case of penalties which are of a value “not exceeding” a prescribed amount, the amount may be reduced in recognition of co-operation.
4.23 Disclosure reductions act as an incentive for a person to correct any problems with their affairs and to encourage future compliance. They should also help the speedy resolution of investigations, protecting resources for HMRC and for the investigated party. So where HMRC announces its intention to look into the systems that a business has in place to comply with its requirements, it should help the process if the business brings problems to HMRC’s attention, rather than waiting for them to be discovered.

4.24 However, introducing a consideration of disclosure may itself introduce complexity into the penalty process by giving the parties something to dispute. Furthermore, with some requirements it may be difficult to differentiate between a prompted and unprompted disclosure. In others, it may be impossible to disclose. For example, how could a person disclose that they had filed a return on paper when the requirement was to do it electronically? How would such a disclosure help resolve the problem?

4.25 There needs to be caution against introducing new bureaucracy into some of these matters. If a requirement is briefly breached and swiftly remedied in an excise warehouse, for example, would it be proportionate to expect the business to make an unprompted disclosure to HMRC in the hope of reducing or eliminating the penalty?

4.26 There are clearly some merits to including incentives for disclosure, but there are also downsides, and risks of increased complexity.

Question 6: Should reductions for disclosure be considered as a feature of a regulatory penalties model?

Revalorisation - should there be a revalorisation provision in the penalty model?

4.27 Many of the penalties within scope of this review are fixed or “not exceeding” penalties. A defined amount is specified in the legislation. This approach obviously has strengths. It is clear from the law what level of penalty Parliament intended to impose, and treatment can be consistent within that. However, as time passes, the real value of these fixed amounts reduces.

4.28 Some penalties have revalorisation mechanisms built into the legislation, but many do not. It is resource-intensive to revalorise by primary legislation, so this is rarely done. Even where mechanisms are present, they are not always used.

4.29 Revalorisation can play an important part in ensuring that a penalty retains its deterrent effect as the value of money changes. More detailed proposals on a revalorisation mechanism will form part of the next consultation.

Question 7: Do you agree that there should be some form of revalorisation power in a new model?

Other sanctions

4.30 In response to the last discussion document it was suggested that HMRC should be looking at non-financial penalties and other incentives to encourage compliance. The example that was given was reductions for early payment of penalties, similar to the way in which some penalties for parking infringements are operated. Any further ideas would be welcome, as would views on the potential costs of implementation.

Question 8: What types of non-financial sanction could work in this penalty context? Question 9: How do you think these features should apply to a regulatory penalty regime? Are there any other features that a regulatory penalties model should include?
5. Safeguards

5.1 One of the main problems with the current array of regulatory penalties is the lack of consistency in the provision of safeguards. All penalties carry a right of appeal to an independent tribunal, but some have features which might be described as interim or early stage safeguards. Just as it is important to have a comprehensible deterrent in order to have an impact, it is important that taxpayers have a comprehensible and consistent set of safeguards.

5.2 In the existing legislation, some safeguards may be best described as implicit. For example, some of the “not exceeding” penalties may never be charged, or may be charged at lower rates, if a person can prove that they did not intend to fail to comply, if it were unavoidable, or if they did so for a good reason. But this is generally left up to the discretion of the officer and the guidance set out by HMRC.

5.3 The Review of Powers has consistently sought to set out safeguards that are strong, accessible, and give customers clear assurance in the law itself.

5.4 This chapter discusses the possible application of the safeguards implemented in other aspects of the Review of Powers to the field of regulatory penalties. Again, it does not set out to discuss the safeguards around the obligations themselves.

Reasonable care and reasonable excuse

5.5 “Reasonable care” is a concept introduced into tax administration through the new penalties for inaccuracies. If a taxpayer has taken reasonable care with their tax affairs, they can rest assured that no penalty may be charged on any mistakes that they may have inadvertently made.

5.6 Some requirements – for example giving HMRC documents or statements with a material inaccuracy in relation to CIS gross-payment\textsuperscript{13} or incorrect tax relief certificates\textsuperscript{14} – involve doing something where an inaccuracy could be met with a penalty. In these cases, there may be an argument for ensuring that a new penalty system would apply no penalty where the person has taken reasonable care with their affairs in relation to the requirement.

5.7 On the other hand, it may be that the detailed investigation and discussion needed to determine whether reasonable care has been taken is disproportionate in these cases. Although consideration of a failure is likely to be shorter and less detailed than a tax investigation.

5.8 A balance may need to be struck between the introduction of a new legislative safeguard and the desire to simplify the system.

5.9 “Reasonable excuse” is a long standing concept and has been used to apply to failures, rather than inaccuracies. It thus could have broader application in regulatory penalties, for example providing protection where obligations to provide information are missed.

Question 10: Should the concept of reasonable excuse be applied to regulatory penalties? Should it be for all penalties, or for specific types?

\textsuperscript{13} s72 Finance Act 2004
\textsuperscript{14} s348(9) Income Tax Act 2007
5.10 If this concept were to be introduced for regulatory penalties, our preference would be to align with a meaning of reasonable excuse already present in penalties legislation.

**Question 11:** Do you agree that any reasonable excuse provision should be aligned with the existing meaning elsewhere in penalties legislation?

*Reviews and Appeals – should a regulatory penalties model provide one appeal provision covering all penalties?*

5.11 Common rights of review and appeal were introduced for all the new penalties. HMRC’s intention is to continue this approach and to provide for aligned review and appeal rights for regulatory penalties. A single, simplified approach should make safeguards more easy to understand and thus to use for the penalised party.

5.12 There are some administrative issues with aligning these review and appeal rights, some arising because there are different process routes for different taxes. HMRC is considering these administrative issues and will formulate detailed proposals for consultation.

**Question 12:** Do you agree that rights of review and appeal should be aligned across regulatory penalties?

**Question 13:** Are there any other safeguards from the new penalties (or elsewhere) that you would like to see included in the regulatory penalties framework?
6. Impact

6.1 As this is a first stage consultation the impact of any changes in this area are not yet quantifiable. Much will depend on the options that emerge from responses to this consultation.

6.2 HMRC will continue working to identify impacts throughout the policy development process, specifically looking for how any changes could affect different groups. We would welcome views on any possible impacts under the headings below.

Summary of Impacts

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<tr>
<td>Exchequer impact (£m)</td>
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<td>The initial assumption is that there will be a negligible exchequer impact across all years. No new penalties are proposed, but rather a simplification, and perhaps revalorisation. This estimate will be refined as we better understand the potential scope for changes to these penalties.</td>
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<tr>
<td>Economic impact</td>
<td>None anticipated.</td>
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<tr>
<td>Impact on individuals and households</td>
<td>The impact on individuals requires further analysis, but there should be no direct impact on compliant individuals and householders as penalties are only applicable where there has been a failure to comply with the obligations.</td>
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<td>Equalities impact</td>
<td>As the policy work is at an early stage there needs to be further work on the equalities impacts, and this will continue throughout the policy development process. We will be seeking views or information from representative bodies on whether any of the features considered could potentially have an equalities impact.</td>
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<td>Impact on businesses and Civil Society groups</td>
<td>There should be no direct impact on compliant businesses as these penalties only affect those who fail to comply with their obligations. Depending on the options that are taken forward there may be some one-off costs for businesses getting used to the new legislation, and possibly on third sector groups who provide advice. As with the other impacts we are seeking views from respondents on this, particular any evidence from previous changes.</td>
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<td>Operational impact (£m) – HMRC</td>
<td>There will be some implementation and, possibly, IT costs if changes are taken forward. As options are developed, we will track and consider the size of those implementation costs.</td>
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<td>Other impacts</td>
<td>In particular we will be doing further work on any impact on small firms as part of the policy development process. We will specifically be looking to engage with small firms and their representative groups to discuss the issues in this consultation and determine what areas could see an impact on small firms, and how that could be mitigated as options are developed.</td>
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6.3 Although we are not in a position to give details on the use of the penalties at this stage we can give an indication of the numbers of penalties that fall within the different tax and duties regimes. We would appreciate any views on the different impacts that these
<table>
<thead>
<tr>
<th>Tax Regime</th>
<th>Approximate Number of Penalties</th>
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<tbody>
<tr>
<td>Aggregates</td>
<td>5</td>
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<tr>
<td>Any Tax Matter</td>
<td>2</td>
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<tr>
<td>Capital Gains Tax</td>
<td>25</td>
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<tr>
<td>Child Trust Fund</td>
<td>1</td>
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<tr>
<td>CIS</td>
<td>5</td>
</tr>
<tr>
<td>Climate Change Levy</td>
<td>7</td>
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<tr>
<td>Corporation Tax</td>
<td>25</td>
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<td>Customs</td>
<td>65</td>
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<td>Excise</td>
<td>62</td>
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<tr>
<td>Income Tax</td>
<td>75</td>
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<tr>
<td>Inheritance Tax</td>
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<td>Insurance Premium Tax</td>
<td>8</td>
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<td>Landfill Tax</td>
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<tr>
<td>Petroleum Revenue Tax</td>
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<tr>
<td>Stamp Duty</td>
<td>10</td>
</tr>
<tr>
<td>VAT</td>
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</table>

**Evaluation and Monitoring:** HMRC’s use of any revised penalties would be monitored through information captured within its operational and accounting systems.
7. Summary of Consultation Questions

Question 1: Do you agree that these are these six principles are the correct ones to apply to this work?

Question 2: In principle, do you think that it would be sensible to aim for one aligned penalty where obligations can be ‘grouped’ together?

Question 3: how should a model for regulatory penalties tackle different types of breaches?

Question 4: Bearing in mind the roles of regulatory penalties discussed in the previous chapter, how can penalties be geared to ensure that they are proportionate to the impact of the regulatory failure? Is the Schedule 36 model of a Tribunal-imposed penalty attractive?

Question 5: is the notion of penalties which reflect behaviour applicable to a model for regulatory penalties?

Question 6: should reductions for disclosure be considered as a feature of a regulatory penalties model?

Question 7: Do you agree that there should be some form of revalorisation power in a new model?

Question 8: What types of non-financial sanction could work in this penalty context?

Question 9: How do you think these features should apply to a regulatory penalty regime? Are there any other features that a regulatory penalties model should include?

Question 10: Should the concept of reasonable excuse be applied to regulatory penalties? Should it be for all penalties, or for specific types?

Question 11: Do you agree that any reasonable excuse provision should be aligned with the existing meaning elsewhere in penalties legislation?

Question 12: Do you agree that rights of review and appeal should be aligned across regulatory penalties?

Question 13: Are there any other safeguards from the new penalties (or elsewhere) that you would like to see included in the regulatory penalties framework?
8. The Consultation Process

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

Stage 1  Setting out objectives and identifying options.
Stage 2  Determining the best option and developing a framework for implementation including detailed policy design.
Stage 3  Drafting legislation to effect the proposed change.
Stage 4  Implementing and monitoring the change.
Stage 5  Reviewing and evaluating the change.

This consultation is taking place during stage 1 of the process. The purpose of the consultation is to seek views on the policy design and any suitable possible alternatives for reform.

How to respond

A summary of the questions in this consultation is included at chapter 7.

Responses should be sent by 9th September 2011, by e-mail to Powers.review-of-hmrc@hmrc.gsi.gov.uk or by post to: Review of Powers, Room 1.72, 100 Parliament Street, London, SW1A 2BQ

Telephone enquiries: 0207 147 0096 (from a text phone prefix this number with 18001)

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from the HMRC Internet site at http://www.hmrc.gov.uk/consultations/index.htm. All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).
HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

**The Consultation Code of Practice**

This consultation is being conducted in accordance with the Code of Practice on Consultation. A copy of the Code of Practice criteria and a contact for any comments on the consultation process can be found in Annex A.
Annex A: The Code of Practice on Consultation

About the consultation process

This consultation is being conducted in accordance with the Code of Practice on Consultation.

The consultation criteria

1. When to consult - Formal consultation should take place at a stage when there is scope to influence the policy outcome.

2. Duration of consultation exercises - Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.

3. Clarity of scope and impact - Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.

4. Accessibility of consultation exercise - Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.

5. The burden of consultation - Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees’ buy-in to the process is to be obtained.

6. Responsiveness of consultation exercises - Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.

7. Capacity to consult - Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

If you feel that this consultation does not satisfy these criteria, or if you have any complaints or comments about the process, please contact:

Richard Bowyer, Consultation Coordinator, Better Regulation and Policy Team, H M Revenue & Customs, Room 3E13, 100 Parliament Street, London, SWA 2BQ

020 7147 0062 or e-mail hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk
Annex B – Summary of responses to the Discussion Document

The discussion document was published in January 2011, with a six week window for comment. HMRC met with a range of representative bodies, and received 17 written responses. A list of respondents is below.

Do you agree that it is sensible to consider the use and effectiveness of these penalties?
Most respondents agreed that this is a sensible time to consider the use and effectiveness of regulatory penalties, with a view to making the system simpler, fairer and more effective. Any review would be an opportune time to look at and perhaps revalorise flat rate penalties which were set many years ago, keeping the findings of the Hampton review in mind.

A key concern was that care would have to be taken to avoid over-complicating the penalty regime under the title of simplification. HMRC will need to look closely at how current penalties are being used: what impact they are having on non-compliant behaviour; what penalty level is being set where there is a maximum; what penalties are no longer necessary.

Fixed Penalties
There was consensus of opinion that penalties with no link to tax liability are often required to maintain compliance with the administration of the regime. Fixed penalties are more relevant to such situations. However while fixed penalties have the benefit of certainty and ease of operation, there is a risk of disproportionate impacts on differing populations of taxpayer, especially in relation to business taxes.

A Single Provision
Many respondents felt that a system providing for discretion allows a proportionate response when dealing with different sizes of business. It was also suggested that it may have a greater likelihood of affecting how people respond to meeting the criteria to avoid being penalised because where there appears to be an opportunity to influence the level of any penalty even having it reduced to nil or suspended, taxpayers are probably going to be more willing to take steps to meet the criteria. However some respondents were keen on a reduction in discretionary penalties as they reduce certainty and can encourage inconsistency.

Model
It was clear that respondents felt that the different purposes of administrative requirements would need to influence the development of a new model or models. For example it was suggested that where the failure has a direct impact on tax liability the VAT model could be followed. Where the penalty is for other failures i.e. those not relating to a tax return or payment, it could be based upon a fixed penalty, similarly incremented, depending upon the number of defaults in a prescribed period.
This is a difficult area and careful thought would need to be given to ensure that the correct balance between individual taxpayers and businesses (especially large businesses) is achieved.

Most respondents were very clear that there would need to be significant thought given to the different roles of regulatory penalties, and how that should be reflected in a new model. They were concerned that HMRC should not think ‘one size will fit all’.
# Respondents to Discussion Document

## Written Responses

- Alan Powell Associates
- Association of Chartered and Certified Accountants
- Baker Tilly Tax and Accounting Ltd
- Barrettine Group
- British Beer and Pub Association
- Forum of Private Business
- Grant Thornton UK LLP
- Institute of Chartered Accountants in England and Wales
- Institute of Chartered Accountants of Scotland
- Ministry of Justice
- Prudential Plc
- Try Lunn & Co
- VAT Practitioners Group
- Warehousing Association
- Welsh Assembly Government
- World Duty Free

## Meeting Attendees

- Association of Accounting Technicians
- Association of Taxation Technicians
- Chartered Institute of Taxation
- Deloitte
- Institute of Chartered Accountants in England and Wales
- Institute of Chartered Accountants of Scotland
- Institute of Indirect Taxation