ENHANCED LATE PAYMENT PENALTIES FROM HMRC

The taxman toughens up

Since HM Inland Revenue combined with HM Customs & Excise to form HM Revenue & Customs – HMRC – they have been rationalising the different rules they apply to manage all the taxes they collect for the government. Over the last two years they have carried out a major overhaul of their "powers, safeguards and deterrents" – what they can do to make sure that people are paying the right tax at the right time, and what they can do to the people who aren't.

This newsletter highlights some of the important changes that have taken place and are taking place this year. The new penalty for late filing of self assessment tax returns is particularly important – don't assume that what was acceptable in the past will be acceptable in the future.

If you are concerned about any of the possible HMRC actions raised in this newsletter, please get in touch – we are here to help.

Errors and omissions

The penalties HMRC levy for filing an incorrect return changed from 1 April 2009. We have had to get used to a new set of rules, and also the attitude of HMRC and the courts to the new legal terms. If you "exercise reasonable care" and still make a mistake, there is no penalty – but HMRC are likely to start with the attitude that a mistake has to be careless, because the return ought to be correct.

A careless error starts with a penalty of 30% of the tax which was underpaid – which you have to pay as well, with interest. If you find the error yourself and put the record straight without any prompting from HMRC, this will be mitigated down to zero. If it comes to light because HMRC ask a question – even if they don't directly find it, but reckon you disclosed it because they'd announced a visit – then the minimum penalty is 15%, even if you co-operate fully in putting the matter right.

There are higher penalties, with different levels of mitigation, for "deliberate" and "deliberate and concealed" understatements.

In an important recent change of policy, HMRC have accepted that a "pure timing error" which reverses on the next return should not be charged the full 30% penalty. An error which delays tax should be based not on the understatement in isolation, but at 5% of the understatement for a full year. So claiming input VAT one return early should give rise to a penalty of 30% of 5% of 3/12 of the mistake, not 30% of the whole thing. HMRC must be satisfied that the error is accidental and would automatically reverse on the next return.

Failure to notify

If you owe tax, it's up to you to tell HMRC – you mustn't wait for them to ask. If they come to you after you should have gone to them, there are penalties based on the tax lost (which you still have to pay anyway). As with errors, the tariff starts at 30% for a careless failure, 70% for deliberate and 100% for deliberate with concealment, and there is mitigation for unprompted disclosure and co-operation.

If you have income tax to pay and HMRC haven't asked you to submit a tax return, you are supposed to tell them by 5 October following the tax year – 5 October 2011 for the year 2010/11. You will then have to file your return and pay by the normal due date with everyone else. If you already fill in a return each year, you don't have to tell them about a new source of income – it will be covered by your form.

If you are a small, growing business that has not yet registered for VAT, you are supposed to check your turnover for the last 12 months at the end of every month – if it's more than the registration limit (currently £73,000), you are supposed to tell them within 30 days. This is a very important thing to get right, and an easy thing to get wrong if you are busy dealing with customers – if there is any chance your business might break the threshold, it's crucial to take advice to make sure you do the right thing at the right time.

Late filing

Since the start of self assessment in 1996/97, the penalty for filing a return after the deadline has been £100, which is cancelled if you have no tax to pay for the year or all your tax has already been settled. HMRC have realised that this doesn't provide enough of an incentive, so they have introduced a much harsher regime which will apply for 2010/11 returns – the ones that have to be filed on paper by 31 October 2011 or electronically by 31 January 2012.

- Being late without a reasonable excuse will incur an automatic penalty of £100, regardless of the tax liability.

- If the return is more than 3 months late, a daily automatic penalty of £10 will apply for the next 90 days (max. £900).

- If the return is more than 6 months late, a further penalty will be added: 5% of the tax outstanding or £300, whichever is more.

- And if it's still not filed after 12 months, there will be another penalty of the higher of 5% and £300.

- So a 2010/11 return which is not filed by 31 July 2012 will cost at least £1,300 (£100 + £900 + £300), even if there is no tax to pay at all. Remember, if HMRC send you a notice to file a return, you have to respond, even if there is no income or gains to report – don't just ignore it.

So if you have filed late before and either paid £100 or had the penalty refunded because the tax has been settled, don't incur a nasty shock and a nastier fine this year.

Late payment

HMRC always charge interest for late payment. They will also levy a 5% late payment penalty for settling the balance of income tax and CGT more than 30 days after 31 January – whether they have asked for the money or not. Under self assessment, you are supposed to know how much to pay, and you are supposed to make sure it is paid.

If you are six months late you will incur a further 5%, and there's another 5% for being 12 months late.

Someone who fails to file and pay will incur both these penalties and interest as well – a powerful package of HMRC "incentives".

VAT

The penalties for VAT errors and failure to notify are now the same as for self assessment. The penalties for late filing and payment are still different – and still expensive. Default surcharge will stay in place until HMRC have updated their systems to apply the new rules to VAT as well – but a surcharge of up to 15% of the tax outstanding is even worse than the income tax penalties.

Compliance checks

HMRC now have brought together all their powers to check up on taxpayers' records across all the taxes. They can visit business premises and ask for production of records as well as information and explanations of those records. Failure to co-operate, or failure to have kept adequate records, can result in penalties. If you are notified of any enquiry at all by HMRC, it is important to take the matter seriously in case an innocent-sounding question – and perhaps a careless answer, not realising all the implications – leads to a full scale investigation.

Security

Where a business collects VAT from its customers and pay it to HMRC every three months, HMRC reckon "they've got our money". If there is a risk that the business might go bust, the taxman can issue an order requiring it to deposit security for the VAT which is likely to be outstanding – which is an additional burden for a business which is already struggling with its cash flow.

This power is now being extended to PAYE liabilities, for the same reason – HMRC reckon that the tax deducted from employees' pay is "HMRC's money", not the business', and they want to make sure it's protected if the business folds. A bad payment record may lead to a security notice, and trading without complying is likely to be a criminal offence. The new law is being put on the statute book in 2011.

Supervision

In February 2011 HMRC have started a programme called "managing deliberate defaulters" (MDD). Where someone has been convicted of an offence in relation to tax, or has been charged a penalty for deliberate understatement errors in a tax return, HMRC will have the power to monitor their business closely for up to five years.

Traditionally, once you had settled up after an investigation you were left to get on with your life – while mindful that the taxman would remember you, you would not have them breathing down your neck. If someone is notified of supervision under MDD, they will be more than mindful. HMRC will be able to:

- ask for much more detailed information to be submitted with a tax return;
- ask more detailed questions about particular aspects of a tax return to build up a comprehensive picture;
- make unannounced visits to inspect the records;
- deny the use of favourable VAT schemes such as cash accounting, annual accounting and the flat rate scheme.

An order will usually last at least two years so that HMRC can be confident that the defaulter's behaviour has changed permanently.

Since April 2010, they have also had the power to publish the names of people who have been penalised in respect of deliberate errors of £25,000 or more – without a criminal prosecution, they put what they refer to as a "tax cheat" in the internet stocks on their website.

These harsh measures will not apply to someone who only makes a careless error, but their existence has to be remembered by anyone who is discussing with HMRC how and why an error occurred.

Offshore evasion

HMRC have brought in tougher penalties for people who conceal their income or gains offshore. The level of penalty depends on whether the foreign country automatically exchanges tax information with the UK (up to 100% penalty) or co-operates when asked (up to 150%) or does not exchange information at all (up to 200%). HMRC have given people with money abroad opportunities to put their affairs in order with the offer of lower penalties, and they now propose to crack down on anyone who has not taken advantage.

Disclosure opportunities

HMRC have offered "disclosure opportunities" to people with money offshore, and also to doctors and dentists and most recently plumbers. It is clear that they would rather be merciful to people who volunteer information than have to go looking. While these opportunities are principally aimed at specific categories of taxpayer or specific types of failure to disclose, principles of fairness to all taxpayers mean that others should also be able to benefit if they want to put their affairs in order. The advice is the same for anyone who has not paid the right amount of tax, it will be much more expensive and unpleasant if HMRC find them than if they turn themselves in. But it is important to take proper advice before making a disclosure – the taxpayer needs to know what to say and what information to provide, and what the likely consequences will be. Making half a disclosure is likely to be a disaster.

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