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Surcharges and Penalties in UK Tax Law

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Abstract

This paper reviews the tax penalties' regime in the UK, in the context of a general anti-evasion policy. It argues that the global economic crisis has had a significant impact in the UK surcharges and penalties system, intensifying the process initiated before, towards a much tougher regime. This new approach can be explained party on the basis of traditional considerations, such of deterrence and punishment; there is the suspicion, however, that it may be also based on other considerations, namely as an additional source of revenue, or as compensatory measure for the revenue lost through fraud. It concludes that tax penalties whose ratio is no longer (solely) deterrence are disproportionate, and as such, contrary to EU law, and the ECHR.

Introduction

Within the UK two levels of government are responsible for collecting tax, namely central government – Her Majesty's Revenue and Customs (HMRC) – and local government. The three most important taxes in the UK are Personal Income Tax, Value Added Tax (VAT), and Corporation Tax. Personal Income Tax still collects the highest percentage of UK revenue, followed by VAT, and finally, at a much lower percentage, Corporate Income Tax.[1] Dependency on taxes for government expenditure is high, as taxes constitute the main resource of government revenue, at around 93% of total UK governmental receipts.[2] It is unsurprising therefore, that the UK applies a complex system of surcharges and penalties to ensure compliance. The ratio of such surcharges and penalties has traditionally been two-fold: they have a deterrent element, namely ensuring that taxpayers are aware of the consequences of non-compliance and thus will endeavour to make the correct tax payment, or will endeavour to do so in the future; and there is a punishment element, which acts of guarantor of equity and fairness amongst taxpayers, ensuring everyone pays their due share of tax.[3]

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[1] G. Maffini et al, *Business Tax: The Coalition Years*, Report of the Oxford University Centre for Business Taxation, 2015, at 19.

[2] T. Pope and B. Roantree, *A Survey of the UK Tax System*, IFS Briefing Note BN09, November 2014, at 5.

[3] J. Davison, "The new VAT penalty regime" (2009) *VAT Digest* 3.

Reportedly motivated by institutional changes, and partially by the need to intensify the deterrence element, and to encourage further compliance, the UK has witnessed over the last decade a clear toughening of the surcharges and penalties regime. Developments since 2008/2009, however, particular in terms of the size of penalties, and instances of third party liability, seem to indicate that legislative amendments to the penalty system are not solely the result of those factors; rather, the tendency towards strengthening of the penalty system seems to be partially attributable to the effects of the global economic crisis, and its impact on public finance concerns.

This report is divided into seven sections, namely: taxpayers and third party duties (1); definition and categorisation of different types of surcharges (2); surcharges regarding third parties (3); legal protection of the taxpayer/third parties (4); deductibility of surcharges (5); numbers and development (6); and effectiveness (7).

1. Taxpayer and Third Parties' Duties

In this section, taxpayers' obligations to contribute towards a successful tax assessment procedure will be determined. A brief definition of tax assessment procedure will be undertaken first, followed by a description of taxpayers' duties regarding tax assessment procedures, tax control and supervision, tax collection procedures, and tax disclosure obligations.

1.1 Tax Assessment Procedures and General Duties

Personal Income Tax

Pay-As-You-Earn

A Pay-As-You-Earn (PAYE) scheme is a withholding tax, deducted from each income payment by the employers, who are responsible for remitting it to the government. PAYE is required on all payments of salary or other compensations. As of 2014-2015, taxpayers are not obliged to pay income tax if they earn less than £10,000 per year. The amount of PAYE is deducted from pay cheques, on the basis of a tax code supplied by HM Revenue and Customs (HMRC).

PAYE was introduced in 1944 during the Second World War.[4] Its main purpose was to make it as simple as possible for taxpayers to make a payment, whilst not being too

[4] S. James, "Self- assessment for income tax" (1994) *British Tax Review* 3, 206.

complicated for the Inland Revenue to manage.[5] The PAYE scheme allowing the exact amount of tax to be collected throughout the tax year, doing away with taxpayers' obligation to file for untaxed income or return overpayments. Under the PAYE system used by the UK it is operated on a cumulative basis throughout the year where earning and tax payment are recorded in the tax year to date. Cumulative basis means that, when calculating tax due in each week or month, employers have to consider the whole income earned in that tax year, and tax paid so far; tax due is then calculated, and deducted from the employees' paycheques; the system also offers, however, a repayment during the tax year, where taxpayers' income falls below the tax threshold..[6] These features have the significant advantage of making the system more accurate than non-cumulative withholding systems; although maintaining accuracy has become harder as increasingly complicated tax regulations have been introduced.[7]

In order to improve accuracy levels, and decrease compliance and administrative costs in the long-term, in 2012 HMRC began the phased introduction of Real Time Information (RTI). Under the new RTI, information about tax, and other deductions under the PAYE system, is transmitted to HMRC by the employer every time employees are paid, rather than at the end of the tax year, or when employees start or leave a job. Since April 2014 all employers have been required to report in real time.[8] This, which relies on technology developments, is been hailed as a great improvement of the PAYE system, and one which will allow in the long term employers to be removed from the tax collection process.[9]

Self-assessment

Self-assessment is the system whereby, as the name suggests, that the taxpayers assess themselves. Whilst usually the PAYE withholding tax system is applied for personal income tax, the system only works well for taxpayers with relatively simple income. Self-assessment came into force in the 1997, in what was regarded as the most fundamental reform of personal tax administration in about 50 years;[10] It was intended to deal with the self-employed and those with complex affairs, but in practice it also

[5] The Inland Revenue was merged with HM Customs and Excise to form HM Revenue and Customs on 18 April 2005.
[6] T. Pope and B. Roantree, n. 2 above, at 7-10.
[7] S. James, "Self-assessment for income tax" (1994) *British Tax Review* 3, 206.
[8] HMRC, *Real Time Information (RTI): Improving the Operation of Pay As You Earn (PAYE)*, Policy Paper, December 2014; available at:< https://www.gov.uk/government/publications/real-time-information-improving-the-operation-of-pay-as-you-earn
[9] T. Pope and B. Roantree, n. 2 above, at 11.
[10] Inland Revenue, Press Release, 16 March 1993. See also S. Green, "Self-assessment: a new era for United Kingdom' taxpayers, but what about the costs?" (1996) *British Tax Review* 2, 107-119.

applies to taxpayers' whose tax liability cannot be wholly discharged through PAYE – such as those on state retirement pension.[11]Taxpayers on self-assessment are required to file a tax return by a specific date, reporting on income received and tax due, for the previous tax year.[12] Statistically, only 20% of total taxpayers approximately are required to file annual tax returns at present;[13] the great majority of taxpayers have their tax liability worked out correctly through the operation of the PAYE system, so there is no need for them to file returns.[14] Nevertheless, research indicates that UK tax administrative costs are high, and can be as much as three times those in the US.[15] In order to reduce these administrative costs, as well as compliance costs, HMRC has introduced an online filing system since 2009, and one of its main goals is the increase the amount of taxpayers filing online tax returns.[16]

Corporation (Income) Tax

Corporation tax was introduced in the UK in 1965,[17] by which time many other industrialised countries had already had a separate tax on companies for many years.[18] In 1996, a self-assessment system was put in place for Corporation Tax, which means essentially that corporations have full responsibility for making their tax assessment and payments.[19] The deadline to register for Corporation Tax is three months after starting a limited company.[20]

In the last years, the has been progressively moving towards a territorial system, so that as it stands UK based companies is obliged to pay Corporation Tax on all their UK

[11] R. Williamson and I. Young, "UK National Report" in P. Pistone and P. Baker (eds.), *Practical protection of taxpayers' fundamental rights*, IFA Cahiers de Droit Fiscal International 2015, vol. 2.
[12] Taxes Management Act ("TMA") 1970, ss. 8, 8A, 9, 12AA, 12AB.
[13] R. Williamson and I. Young, n. 13 above.
[14] I. Wallschutzky and C. Sandford, "Self-assessment of income tax: lessons from Australia" (1994) *British Tax Review* 3, 215.
[15] S. James, n. 7 at 206.
[16] A. Lymer et al, "Filing by internet in the UK: the barriers to the adoption of filing self-assessment tax returns by internet" (2005) *British Tax Review* 5, 544-556; A. Plager, "Online filing: the aftermath" (2009) *Taxation* 4194, 162-163; and S. Banyard, "Online filing is the goal" (2008) *Tax Adviser*, 22-23.
[17] Finance Act ("FA") 1965.
[18] D. Stopforth and A. Goodacre, "The birth of UK corporation tax – the official view" (2015) *British Tax Review* 2, 189-223.
[19] FA 1998, Sch 18, para 7. J. Tiley and G. Loutzenhiser, *Advanced Topics in Revenue Law* (Oxford: Hart Publishing 2013), at 33.
[20] Ibid.

profits, and some of its non-UK profits, whilst non-resident companies are responsible for paying tax on profits from their UK activities.[21]

Corporation Tax is charged on the taxable profits during the financial year,[22] which is between 1 April and31 March. Although the rates are set for the financial year, assessments are made by reference to accounting periods; where corporations' accounting periods are not in synchrony with the government's financial year, profits are apportioned. Large corporations – those that exceeded the upper limit for small profits relief by GBP £1.5 million – are allowed to pay tax in instalments, on a quarterly basis. .[23]

Value Added Tax (VAT)

VAT was first introduced in the UK in 1973, following the country's accession to the European Economic Community (EEC). Since 2011 the standard VAT rate in the UK is 20%.; although a significant percentage of consumption is subject to either a reduced rate of 5%, or a 0% rate. Whilst VAT is a consumption tax, and thus its costs are meant to be borne by consumers, remittance of the tax to government rest with VAT registered businesses, namely the sellers.

Under the VAT Act 1994, the VAT registration threshold currently stands at £81,000 turnover; however, businesses below the threshold can still voluntarily register for the tax. Additionally, for businesses with less than £150,000 per annum of turnover, a Flat Rate Scheme applies, whereby businesses are allowed to pay a fixed percentage of the turnover every three months. For those falling into the main VAT system, VAT returns are usually due every three months, and they must be submitted even if no sales or purchases have been made during that period.

1.2 Duties regarding Clarification, Examination and Supervision Procedures

In 2008, the rules on record keeping were broadly aligned for all taxes; these rules also enable HMRC to shorten the period for keeping records.[24]

Personal income tax

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[21] For an overview of this evolution see M. Gammie, "Taxing corporate profits in a global economy" (2013) *British Tax Review* 1, 42-58; and C. Sanger, "Corporate tax road map" (2011) *British Tax Review* 1, 2-10.
[22] Corporation Tax Act ("CA") 2009, s 2(1).
[23] CA (Instalment Payments) Regulations, reg 3(1).
[24] FA s115 and sch. 37; for an analysis see F. Lagerberg, "Finance Act notes: new information, etc, powers – section 113 and schedule 36; sections 114 and schedule 37 and section 117" (2008) *British Tax Review* 5, 503-508.

Under the PAYE system, employers must keep records of amounts paid to employees, including tax deductions made. Records must be kept for at least 3 years from the end of the tax year they relate to. If the employer fails to do so, HMRC may estimate the tax owes and set a fine.[25] As regards taxpayers subject to self-assessment, they too are obliged to keep records of all the information needed for filling tax returns. These records must be kept for at least 22 months after the end of the tax year, or 15 months where tax returns were sent after the deadline. There are no specific rules regarding how records should be kept, And in particular, they could be kept in both paper and digital forms, so long as they are accurate, complete, and readable. HMRC is entitled to make enquiries for a period of 12 months after tax return has been submitted, requesting any information in the taxpayer's power or possession,[26] in what is usually called the "enquiry window".[27] With this investigation the Revenue has right to call for

Corporation (Income) Tax

Corporations also have a duty to keep company, tax, and accounting records. Company records include: details of directors, shareholders and company secretaries; the results of any shareholder votes and resolutions; promises for the company to repay loans at a specific date in the future ('debentures') and who they must be paid back to; promises the company makes for payments if something goes wrong and it's the company's fault ('indemnities'); transactions when someone buys shares in the company; and loans or mortgages secured against the company's assets. Accounting records include money received and spent by the company; details of assets owned by the company; debts the company owes or is owed; stock the company owns at the end of the financial year; the stocktaking used to work out the stock figure; all goods bought and sold including details of sellers and buyers; other financial records, information and calculations that needed to complete the company's tax return; and records of money transactions. All aforementioned documents must be kept for at least 6 years after the end of the financial year.

VAT

[25] J. Tiley and G. Loutzenhiser, n. 27, at 92.
[26] J. Tiley and G. ,Loutzenhiser, *Revenue Law* ,Seventh Edition (Oxford: Hart Publishing, 2012), at 68.
[27] TMA 1970, S9A.

VAT registered businesses are obliged to keep VAT records and accounts for at least 6 years.[28] Similarly to records for personal income tax, these records can be kept in paper or electronic forms, so long as they are accurate, complete, and readable. Whilst any business can be subject to a VAT inspection, their frequency will depend on the size and complexity of the business, and on whether the businesses has submitted a late or incorrect VAT returns before.

1.3 Duties regarding Tax Collection

Like in most countries, tax collection, or remittance, in the UK rests primarily with third parties, i.e. not those who pay – or are supposed to pay – the tax. This is the case for the vast majority of personal income tax, namely that collected via PAYE; as well as for all indirect taxes, in particular VAT and excise duties. This means in practice that the majority of revenue is collected via third parties, such as employers, or sellers.[29]

Personal income Tax

Insofar as personal income tax is concerned, Tax collection rests with different people, depending on which system taxpayers fall into to..

Collection of personal income tax under PAYE Scheme rests on employers, not the taxable person (employee); employers are required to operate a PAYE system, as part of their payroll, unless none of the employees is paid £111 or more per week. Employers are obliged to deduct income tax from payments made to employees, and both payments and deductions must be reported to HMRC. Payment to HMRC is normally due every month, except where the employer expects to pay less than £1,500 a month for all its employees, in which case they can arrange to pay quarterly.

On the contrary, personal income taxpayers who fall under the self-assessment regime are responsible for making payments directly for any tax owed.

Corporation (Income) Tax

[28] HMRC, *VAT Notice 700/21: Keeping VAT records*, available at: https://www.gov.uk/government/publications/vat-notice-70021-keeping-vat-records/vat-notice-70021-keeping-vat-records

[29] HMRC, *Tax and NICs Receipts: Information and Analysis*, July 2015, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/440627/May15_Receipts_Bulletin_v2_Corrected_Tax_Credits.pdf

Businesses subject to corporation tax are obliged to pay their own tax. For companies with taxable profits up to £1.5 million, tax must be paid within 9 months and 1 day after the end of accounting period; for companies with taxable profits above £1.5 million, tax may be paid in instalments.

VAT

VAT-registered businesses have a duty to pay the VAT collected on their outputs, by the deadline shown on VAT return; deadlines are different depending on which type of payment system (Annual Accounting Scheme and payments on account) is used.

1.4 Duties regarding Disclosure of Tax Avoidance Schemes (DOTAS)

The duty to disclose tax avoidance schemes, known as DOTAS was introduced in 2004,[30] and has been amended several times since.[31] A further toughening of the scheme was announced at UK Budget 2014, with new legislation expected to be approved in the FA 2015.[32] Its rules comprise both primary and secondary legislation; the latter encompassing provision for the disclosure to HMRC of certain "arrangements" (the descriptions regulations) and also prescription as to the information to be provided to HMRC in relation to such "arrangements" (the information regulations).[33] The stated aim is to provide early information to HMRC about tax avoidance schemes and their users,[34] but disclosure of a tax arrangement has in theory no tax effects on the taxpayer's position; neither the requirement to disclose, nor indeed, disclosure itself, in any way affect the validity of a scheme in the eyes of the law.[35] In practice, however, a disclosed tax arrangement may be rendered ineffective by Parliament, possibly with retrospective effect,[36] and as of 2012, HMRC stated that DOTAS had informed over 60

[30] FA 2004, s309 to s319.
[31] FA 2007, s108; FA2008, s116 abd Sch38; and FA2010, s56 and Sch17. On these changes, see amongst others R. Bland, "Finance Act notes: disclosure of tax avoidance schemes – section 108" (2007) *British Tax Review* 5, 584-589.
[32] HMRC and HM Treasury, *Overview of Legislation in Draft*, 10 December 2014. See also P. Sukhraj, "AS2014: Penalties under GAAR and strengthening DOTAS" (2014) *Accountancy Live*, 4 December 2014.
[33] L Oats and D Salter, "Notes on Finance Acts: section 56 and schedule 17 of the Finance Act 2010: disclosure of tax avoidance schemes" (2010) *British Tax Review* 5, 458-463
[34] HMRC, *Disclosure of Tax Avoidance Schemes: Guidance*, 14 May 2014, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/341960/dotas-guidance.pdf
[35] M. Devereux, J. Freedman, and J. Vella, "The Disclosure Of Tax Avoidance Schemes Regime" in *Review of DOTAS and the tax avoidance landscape*, Report for the National Audit Office, 2012, available at: http://www.sbs.ox.ac.uk/ideas-impact/tax/publications/reports
[36] HMRC, *Disclosure of Tax Avoidance Schemes: Guidance*, n. 46 above, at 18.

new anti-avoidance legislative measures.

Whilst usually referred to just as DOTAS, there are in reality two different disclosure regimes, one for income taxes, and another one for VAT.

Income Taxes

DOTAS requires promoters of tax avoidance schemes – the person who designs or markets the scheme – and users of tax avoidance scheme – usually the promoter's client – to provide information to HMRC about schemes within 5 days of being made available or implemented.[37] The duty to disclose the information falls only on a single promoter; other promoters will be excused from the disclosure requirement, where other promoter satisfies the disclosure requirement.[38] Schemes that are required to be notified to HMRC are those that meet the three following criteria: it must yield or be expected to yield a tax advantage; a main benefit of the transaction must be the achievement of such a tax advantage; and the transaction must fall within certain regulatory descriptions. What constitutes a "tax advantage" for the purpose of DOTAS includes the following:

(a) relief or increased relief from tax,

(b) repayment or increased repayment of tax,

(c) avoidance or reduction of a charge to tax or an assessment to tax,

(d) avoidance of a possible assessment to tax,

(e) deferral of a payment of tax or advancement of a repayment of tax, and

(f) avoidance of an obligation to deduct or account for tax.

VAT

Under the FA 2004, any taxable person – i.e. the person that is, or is liable to be, registered for VAT in the UK – who is party to a notifiable scheme is responsible for disclosure of information related to VAT avoidance scheme to HMRC.[39] Notifiable schemes fall into two categories, as follows:

— *Listed schemes* are specific schemes defined in the disclosure legislation. There are currently 10 such schemes, and they require disclosure by taxpayers with annual turnover above £600,000.

[37] FA 2004, s308(4).
[38] FA 2014 s26 part 5.
[39] FA 2004, Sch2.

— *Hallmarked schemes* are schemes that include or are associated with a 'hallmark' of avoidance defined in the legislation. Disclosure is not required where: a third party, such as the scheme promoter, has voluntarily disclosed the scheme to HMRC and provided the taxable person with the Voluntary Registration Scheme (VRS) reference number; or the taxable person has an annual turnover below £10 million.

'*A party to a scheme*' mean a person who knowingly takes part in it; hence, the person is not a party to scheme when is unwittingly involved in any of the steps of the scheme or acts purely in an advisory capacity.[40]

2. Definition and Categorisation of different Types of Surcharges

Under the UK tax law system two categories of offences are recognised, namely: minor offences, such as unintentional late tax payment, which may be subject to civil penalties; and major or severe offences, such as negligently or fraudulently making an under payment, in which criminal procedure and charges may be involved.[41] The definition and categorisation of these different types of surcharges will be addressed in this section, beginning with criminal penalties, and then administrative tax penalties, and interests.

2.1 Criminal Penalties

Criminal penalties regarding tax disputes apply when taxpayers deliberately fail to comply with tax law. Therefore, it is up to HMRC to determine whether to pursue criminal investigation, and to attempt to pursue criminal charges against taxpayers. The following are circumstances where HMRC is entitled to pursue criminal proceedings.

<u>Income Taxes</u>

Criminal penalties will arise where fraudulent evasion of income tax is found.[42] Under TMA 1970 s95, penalties arise where taxable persons are fraudulently or negligently made in an incorrect return or accounts for personal income tax. Similar penalties are also applied to corporations.[43] Nonetheless, in case of error in a taxpayer's document and failure to make a tax return, HMRC has the right to press charges in the criminal court only in the most severe cases. Criminal penalties may also arise in case of tax

[40] HMRC, *VAT Notice 700/8: disclosure of VAT avoidance schemes*, 30 October 2013.
[41] A.K. Jain, "Income tax penalty and persecution provisions: a comparison of the United Kingdom and Indian experience" (1997) *British Tax Review* 10, 355.
[42] FA 2000, s144.
[43] TMA 1970, s96.

avoidance, under the offence of cheating the public revenue set out in the Theft Act (TA) 1968.[44]

VAT

Criminal penalties can be applied in case of VAT evasion and conduct involving dishonesty, such as: fraud;[45] false accounting;[46] fraudulent evasion of VAT;[47] false statement for VAT purposes;[48] and conduct amounting to an offence.[49] The criminal penalties that can be imposed include 100% of the VAT evaded to up to 10 years of imprisonment. Examples of circumstances where HMRC will generally consider commencing criminal charges are, as follows:

- in cases of organised criminal gangs attacking the tax system or systematic frauds where losses represents a serious threat to the tax base, including conspiracy;
- where materially false statements are made or materially false documents are provided in the course of a civil investigation;
- where, pursuing an avoidance scheme, reliance is placed on a false or altered document or such reliance or material facts are misrepresented to enhance the credibility of a scheme;
- where deliberate concealment, deception, conspiracy or corruption is suspected;
- in cases involving the use of false or forged documents;
- in cases involving importation or exportation breaching prohibitions and restrictions;
- in cases involving money laundering with particular focus on advisors, accountants, solicitors and others acting in a 'professional' capacity who provide the means to put tainted money out of reach of law enforcement;
- where the perpetrator has committed previous offences / there is a repeated course of unlawful conduct or previous civil action;
- in cases involving theft, or the misuse or un lawful destruction of HMRC documents; and,

[44] TA 1968, s32(1)(a).
[45] Fraud Act 2006, s.1.
[46] Theft Act 1968, s17.
[47] VAT Act 1994, s72(1).
[48] VAT Act 1994, s72(3).
[49] VAT Act 1994, s72(8).

— where there is a link to suspected wider criminality, whether domestic or international, involving offences not under the administration of HMRC.[50]

Box 1: Key Aspects of Criminal Penalties and Surcharges

Purpose: to prevent criminal behaviour, particularly tax evasion

Prerequisites: taxpayers deliberately not paying tax due; one important factor that determines whether it is a civil dispute or criminal offence is whether the taxpayers have made a complete and unprompted disclosure of the offences committed.

Timing of the surcharge: immediately after tax due date

Amount of the surcharge: based upon tax evasion amount

Maximum surcharge: 100% of extra tax due and 7 years imprisonment. In the case of most serious cases HMRC has right to prosecute under the common law offence of cheating the revenue, under which the fine imposed and imprisonment time are unlimited.

Whether the surcharge is dependent on fault or not: the surcharge is dependent on fault by taxpayers, having deliberately attempted not to pay tax due.

Exception: where taxpayers get a letter explaining that HMRC suspects tax fraud, they have a chance to admit to fraud; admitting to tax fraud is the only exception to ensure that a criminal penalty is not applied.

Who imposes the penalty: HMRC is responsible for investigating crimes involving all of taxes; these criminal investigations are carried out with a view to prosecution by either the Crown Prosecution Service (CPS) in England and Wales, the Crown Office and Procurator Fiscal Service (COPFS) in Scotland, or the Public Prosecution Service Northern Ireland (PPSNI) in Northern Ireland.

2.2 Administrative Tax Penalties

Administrative tax penalties are those applied where taxpayers fail to comply with tax law. In principle, the focus of this kind of penalty, however, is supposed to be upon prevention / deterrence, ensuring that taxpayers seriously comply with the law, rather than on punitive function, of punishing non-compliant taxpayers.

There are various categories of non-compliant behaviour which can give rise to administrative penalties – which in turn are divided into sub-categories – as follows.

2.2.1 Penalties for errors

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[50] *HMRC Criminal Investigation Policy*, available at: http://www.hmrc.gov.uk/prosecutions/crim-inv-policy.htm.

Income Taxes and VAT

Error in taxpayer's document penalty applies where taxpayers give HMRC listed documents that contains an inaccuracy, which amounts to, or leads to: [51]

— an understatement of taxpayers' liability to tax;
— a false or inflated statement of loss by taxpayers; or
— a false or inflated claim to repayment of tax, and that the inaccuracy was careless or deliberate.[52]

Taxpayers are liable to a penalty when they make a careless error or mistake in a tax return or related documents and that has resulted in a potential loss of tax. [53]

Table 1: Penalties' Rates for Error in a Return

Behaviour that led to error[54]	Maximum	Minimum (Unprompted)	Minimum (Prompted)
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%

[51] For further analysis on this category see H. Adams and D. Boodnah, "A simple mistake" (2014) *Taxation* 174, 14-16; P. Tew, "HMRC filing penalties" (2008) *Company Secretary's Review* 32(4), 30-31; S. Whitehead, "Penalties for errors in returns" (2010) *Tax Journal* 1016, 11-15; P. Berwick and R. Shiers, "HMRC powers and approach: Part 1: the new penalty regime" (2010) *Private Client Business* 3, 205-214; M. Kitt, "Bad Company" (2011) *Taxation* 168, 16-19; and A. Broadey, "VAT Penalties – Mitigating the effect" (2003) *Taxline*, 323-336.
[52] FA 2007, sch24 and s97.
[53] Introduced in 2007 to substitute the previous used concept of "negligence", the concept of "careless" has been given rise to much litigation, although in practice there seems to be little difference in the determination of whether a taxpayer is careless or negligent, see H. Poon, "*Litman & Newall v HMRC*: DOTAS and taxpayers' obligations" (2014) *British Tax Review* 2, 138-145. In 2011, the first-tier tax tribunal stated that the standard by which carelessness falls to be judged "is that of a prudent and reasonable taxpayer in the position of the taxpayer in question", in *Collins v HMRC*, [2011] UKFTT 588.
[54] On the difference between these categories of behaviour see amongst various others *Litman & Newall v HMRC*, [2014] UKFTT 89; and *Servbet Ltd v The Commissioners of HMRC*, [2015] UKFTT 130, 19 March 2015.

These penalties can be reduced according to the level of disclosure taxpayers made to HMRC, as follows: reduction of penalty of up to 30% for telling HMRC about it; 30% for allowing HMRC access to records for the purpose of ensuring that the inaccuracy or under-assessment is fully corrected; 40% for giving HMRC reasonable help in quantifying the inaccuracy or under-assessment. In addition, taxpayers can assert their innocence, by proving that they have taken reasonable care, in which case an exception to the surcharge will apply.[55]

2.2.2 Penalties for failure to notify

<u>Income Taxes</u>

Failure to notify (FA 2007, Sch 24 amended by FA 2008, Sch 40 and FA 2009, s109 Sch 57) arises when HMRC raises an assessment or determination for tax, and taxpayers fail to notify HMRC that the assessment or determination of tax is under assessed. Notification must be submitted to HMRC within 30 days. The amount of the surcharge is based upon the period of lateness, the taxpayers' underlying behaviour, and whether the failure was prompted or not.

Table 2: Penalties' Rates for Failure to Notify

Type of behaviour	Unprompted or prompted disclosure	Penalty range
Non-deliberate	Unprompted - within 12 months of tax being due	0% to 30%
	Unprompted - 12 months or more after tax was due	10% to 30%
	Prompted- within 12 months of tax being due	10% to 30%
	Prompted - 12 months or more after tax was due	20% to 30%
Deliberate	Unprompted	20% to 70%
	Prompted	35% to 70%
Deliberate and concealed	Unprompted	30% to 100%
	Prompted	50% to 100%

<u>VAT</u>

[55] See recently amongst many others *Bilal Jamia Mosque v Revenue and Customs Commissioners*, [2015] UKFTT 126, 18 March 2015.

Failure to register for VAT arises where taxpayers fail to register; as the businesses' turnover exceeds the registration threshold; following the transfer of a going concern, where there are acquisitions or supplies from other EU countries or the nature of the supplier's transactions change, and where that person had previously been exempted from registration; and where an overseas person has disposed of assets for which a VAT repayment had been claimed.[56]

Table 3: Penalties' Rates for Failure to Register for VAT

Fail to register VAT	Penalty rate
Up to 9 months	5% (of a percentage of the VAT due)
more than 9 months up to 18 months	10%
more than 18 months	15%
Note the minimum of penalty is 50 Pounds	

Unauthorised issue of invoices arises in the context of a failure to notify HMRC of a liability and chargeable event. Taxpayers are liable for this penalty when:

- making an unauthorised issue of an invoice showing VAT or an amount inclusive of VAT;
- misusing a product so that a higher rate of excise duty is due; and
- handling goods that are subject to unpaid duty e.g. alcohol or tobacco products.[57]

Table 4: Penalties' Rates for Unauthorised Issue of Invoices

Type of behaviour	Unprompted disclosure	Prompted disclosure
Non-deliberate	10% to 30%	20% to 30%
Deliberate	20% to 70%	35% to 70%
Deliberate and concealed	30% to 100%	50% to 100%

These penalties could be reduced according to the level of disclosure taxpayers made to HMRC, as follows: 30% for telling HMRC about it; 40% for giving HMRC reasonable help in quantifying the inaccuracy or under-assessment; and 30% for allowing HMRC access to records for the purpose of ensuring that the inaccuracy or under-assessment is fully corrected. In addition, taxpayers can prove a reasonable excuse, in which case an exception to the surcharge may apply.

[56] VAT Act 1994, s67.
[57] FA 2008, s123 and sch 41.

2.2.3 Penalties for failure to submit returns and make payments on time

Income Taxes

Failure to make return for income tax applies to taxpayers who have been required by a notice to deliver a return and failed to do so.[58]

Late payments will arise where taxpayers fail to make a tax return by the deadline. Penalties are charged if the payment is due monthly, quarterly or annually, and taxpayers fail to pay by the due date.[59] Since 2014, late payments penalties can also arise in the context of accelerated payment notices, which are used to inform taxpayers' of the need to pay a tax in dispute, as a result of the use of an avoidance scheme, before the dispute is resolved.[60] These arrangements are intended to remove the cash-flow advantage of adopting tax avoidance schemes, as well as help resolve the backlog of cases.[61]

In both cases of failure to make returns and late payments the amount of the surcharge is based upon the potential amount of revenue loss, the period of lateness, or taxpayers' underlying behaviour. Taxpayers can prove existence of a reasonable excuse, in which case an exception to the surcharge may apply.[62]

Table 5: Penalties for Failure to make Returns and Late Payment in Income Tax

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: — Deliberate and concealed withholding 100% of tax due, or £300 if greater. — Deliberate but not concealed 70% of tax due or £300 if greater. — Reductions apply for prompted and unprompted

[58] FA 2009, sch55, s106.
[59] FA 2009, sch 56.
[60] FA 2014, s219-229 and sch 32.
[61] H. Gething, "Finance Act 2014 notes: sections 199-218 and schedules 30-31; follower notices; sections 219-229 and schedule 32: accelerated payment notices" (2014) *British Tax Review* 4, 445-454.
[62] On reasonable excuse for late payments, see amongst others recent cases: *Guest (t/a All Hours Drain and Rumbling Services Ltd) v Revenue and Customs Commissioners*, [2015] UKFTT 0135, 24 March 2015.

	disclosures and telling, giving and helping.

Underpayments' surcharges will apply where tax is not paid or is underpaid.[63] However, HMRC has a right to waive or reduce the surcharges where they see appropriate; moreover, surcharges are not applied in case taxpayers could proof a *bona fide* mistake, disclose information, and deliver the tax to HMRC.

<u>VAT</u>

Late submission of a VAT return and/or VAT payment surcharge is imposed where taxpayers fail to make a payment by the due date,[64] and penalties will be applied for late submission even where no VAT was due.[65] Additionally, it is the taxpayer's responsibility to ensure that the payment is also received by HMRC by the due date. However, the penalty will not be imposed where the taxpayer can show that the return was sent to HMRC in such a manner that it would be expected that the return and payment would be received by HMRC by the due date, or there is a reasonable excuse e.g. system failures.

The surcharge is calculated as a percentage of the VAT outstanding on the due date for the accounting period that is in default. The surcharge rate increases every time taxpayers default again in a surcharge period. Table 6 shows the amount taxpayers will be charged if they default within a surcharge period. In particular, it is noteworthy that HMRC has the right to charge taxpayers up to100% surcharge of tax under-stated or over-claimed, if taxpayers send a return that contains a careless or deliberate inaccuracy.

Table 6: Penalties for Failure to make Returns and Late Payment in VAT

Defaults within 12 months	Surcharge if annual turnover is less than £150,000	Surcharge if annual turnover is £150,000 or more
2nd	No surcharge	2% (no surcharge if this is less than £400)
3rd	2% (no surcharge if this is less than £400)	5% (no surcharge if this is less than £400)
4th	5% (no surcharge if this is less than £400)	10% or £30 (whichever is the greater)
5th	10% or £30 (whichever is the	15% or £30 (whichever is the

[63] FA 2009, sch56.
[64] VAT Act 1994, s59.
[65] *Douglas Tate v The Commissioners for Her Majesty's Revenue and Customs*, [2015] UKFTT 122, 17 March 2015.

	greater)	greater)
6 or more	15% or £30 (whichever is the greater)	15% or £30 (whichever is the greater)

Underpayments. A penalty of 15% is imposed in cases where the assessment paid is understated and the amount of the understatement exceeds the lesser of £1 million, or 30% of the true amount of VAT, for the period.[66] However if the misdeclaration has occurred under three circumstances the penalty would not be applied: firstly, where the taxpayer is convicted of a criminal offence for VAT evasion; secondly, where the taxpayer had a reasonable excuse for the conduct; and thirdly where the taxpayer had no reason to believe that there were any enquiries into his conduct and a full disclosure had been made to HMRC. In practice, HMRC will not impose this penalty where: the amount is less than £300 in the period between the period end and the date the return should be rendered to HMRC, the error has been compensated for by another balancing error in respect of the same transaction in the following VAT period, or the disclosure is made after HMRC have started their assurance visit.[67]

Failure to submit an EU sales list to HMRC by the due date will result in a penalty being imposed.[68] Similarly a penalty will also apply where the list is submitted but there are inaccuracies within it.[69]

2.2.5 Record keeping penalties

<u>Income Taxes and VAT</u>

Under FA 2008, Sch 37 and s 155, taxpayers are obliged to keep records related to tax that has been paid, so as to allow HMRC to investigate; failure to do so may give rise to penalties.

2.2.6 Avoidance and aggressive tax planning penalties

<u>Income taxes</u>

Failure to disclose tax avoidance schemes, under DOTAS may give rise to penalties for scheme promoters. An initial penalty of up to £5,000 will apply, followed by penalties of up to £600 per day for continued failure to disclose.[70] However, FA 2007 allows HM

[66] VAT Act 1994, s63.
[67] J. Davison, n. 3 above, at 5.
[68] VAT Act 1994, s66.
[69] VAT Act 1994, s65.
[70] TMA 1970, s98.

Treasury to set a higher penalty in certain circumstances.[71] In particular if it is felt that the maximum penalty under the daily penalty would constitute an insufficient deterrent, it may determine a higher penalty, not exceeding £1 million. This possibility was introduced by FA 2010 after it was felt that a small minority of promoters deliberately did not comply with the DOTAS regime; and the maximum penalty level should increase, thereby offsetting the economic advantages of not disclosing a scheme.[72]

Failure to disclose other information under DOTAS, apart from disclosure of scheme itself, may also give rise to penalties. An initial penalty of up to £5,000 will apply, followed by penalties of up to £600 per day for continued failure to disclose.[73] Also here, FA 2007 allows HM Treasury to set a higher penalty in certain circumstances.

Failure by a scheme user to report a scheme under DOTAS on a return, or separately may be subject to an initial penalty of £100 per scheme in the first occasion, rising to £500 per scheme in second occasion, and £1000 per scheme in the third occasion.

Failure to follow a judicial ruling on aggressive tax planning may also result in a penalty.[74] Following a judicial decision on aggressive tax planning HMRC will issue follower notices to taxpayers, identifying the decision, and explaining the potential penalties that can ensure if the judicial decision is not followed, and the relevant return not amended.[75] The penalty can go up to 50% of the value of the denied advantage, and cannot be lower than 10% of that value. Cooperation is specifically denied; a taxpayer will not be taken to cooperate unless assistance has been provided to enable HMRC to quantify the denied advantage, counteract the denied advantage, or provided information to enable corrective action to be taken, and provided access to enable full counteraction. Where under two or more penalties maybe imposed in respect of the same amount of tax, a maximum aggregate penalty will apply, the amount of which can range from 200% to 105%; the applied amount will depend on whether the errors are deliberate and concealed, or deliberate but not concealed, and whether the issues are domestic, or relating to offshores, in what has been characterised as a clear attempt to ensure penalties are not deemed disproportional.[76]

<u>VAT</u>

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[71] FA2007, s306A and 314A.
[72] L. Oats and D. Salter, n. 45 above.
[73] TMA 1970, s98.
[74] FA 2014, S199 to s218, and sch30-31.
[75] H. Gething, n. 76 above.
[76] Ibid.

Failure to disclose tax avoidance schemes may give rise to a penalty, namely: 15% of the VAT you've sought to save for 'listed schemes'; or up to £5,000 for 'hallmarked schemes'.

2.3 Interests

Interest on late payments and repayment interest are applied across all taxes, as per s101 and s102 and Sch 53 and 54 FA 2009.

<u>Personal Income Tax</u>

Late payment interest can be applied when payment has not been made by the due date.[77] The interest is also applied to tax due on an assessment, payment on account, the balancing charge to tax, an amendment to a self-assessment, and unpaid PAYE.

<u>Corporation (Income) Tax</u>

Instalment payments interest. Under the Corporation Tax (Instalment Payments) Regulations 1998, corporations are liability to pay interest where they make underpayments;[78] moreover in cases where the underpayments are due to deliberate or reckless a penalty of twice the interest would be charged. Nonetheless, in such cases where corporations have overestimated its liability to tax, they may pay less in the later quarter, and HMRC may pay interest on the overpayment.

Late payment interest. Corporations are liable for interest charge where they fail to make a payment by the due date.[79]

<u>VAT</u>

Default interest may be charged where VAT is not paid by the due date stated on the VAT bill, VAT is not paid due to registration for VAT purposes, or VAT is underpaid. However, interest will not be charged in cases where VAT is unpaid (bad debts).[80]

2.4 Comparison of procedures applied to administrative tax penalties and criminal penalties

For every tax dispute HMRC will first investigate whether civil disputes or criminal charges should be involved. Most civil cases are settled via negotiation with HMRC, however some are appealed through the civil courts e.g. the Tax Tribunal. In civil cases taxpayers can be ordered to pay the unpaid tax including penalties or interest of tax due. Hence, in severe case of tax evasion HMRC will investigate and provide relevant

[77] TMA 1970, s86.
[78] IP Regs, reg7.
[79] TMA 1970, s 87.
[80] VAT Act 1994, s74.

evidence to the prosecutor, who will then make a decision on whether to bring in criminal charges.

3. Surcharges regarding third parties

Generally, taxpayers are liable to penalties for errors or inaccuracies in any documents given to HMRC, even where error was made by their agents or other hired persons. Taxpayers will not be liable to a penalty, however, where HMRC is satisfied that they took reasonable care to avoid the error, and/or inaccuracy.[81] Instances of third party liability, however, have significantly increased over the last decade.

Supply of false information or withholding information

Third parties may, nevertheless, be liable to penalties, in particular where they have deliberately supplied false information (whether directly or indirectly), or withheld relevant information in connection with the document that has resulted in a loss of tax. Under the dishonest tax agents regime, introduced in 2012, tax agents who act dishonest with a view to bringing about a loss of tax revenue, even if this loss is not actually brought about, will be subject to subject to civil Civil penalties of usually no less than £5,000, and no more than £50,000.[82]In addition to tax legislation, third parties can also be subject to criminal charges and penalties for failure to report under Anti-Money Laundering legislation. Financial reporting duties under the so-called POCA regime (Proceeds of Crime Act 2002) have increasingly been used by HMRC to impose disclosure duties on financial institutions not only as regards tax evasion, but also on tax avoidance cases.[83] Failure to report is punishable by a maximum sentence of 5 years imprisonment and an unlimited penalty.

Promotion of tax avoidance and facilitation of tax evasion

The most recently introduced penalties for third parties are those concerning promotion of tax avoidance and facilitation of tax evasion. In 2014, the UK introduced the Promoters of Tax Avoidance Schemes (POTAS) regime, which is meant to work

[81] FA 2007, Sch 24.
[82] FA 2012, S223 and Sch38. For a review of this regime see D. Salter, "Finance Act notes: section 223 and schedule 38: tax agents – dishonest conduct" (2012) *British Tax Review* 4, 494-498.
[83] J. Fisher, "The anti-money laundering disclosure regime and the collection of revenue in the United Kingdom" (2010) *British Tax Review* 3, 235-266.

alongside the DOTAS regime, set out above.[84] In particular, POTAS is meant to address the so-called "supply side of tax avoidance" by tackling the behaviour of avoidance scheme promoters. Non-compliance with the regime will give rise to graduated series of penalties.[85]

Table 5: Penalties for Promoters of Tax Avoidance Schemes

Duty not complied with	Maximum penalty
Duty to notify clients of monitoring notice	£5,000
Duty to publicise monitoring notice	£1,000,000
Duty to include information on correspondence, etc	£1,000,000
Duty of promoter to notify clients and intermediaries of reference number	£5,000
Duty of those notified to notify others of promoter's number	£5,000
Duty to notify HMRC of reference number	£5,000-10,000
Duty to provide information or produce document	£1,000,000
Ongoing duty to provide information or produce document	£1,000,000
Duty of person dealing with non-resident promoter	£1,000,000
Monitored promoter: duty to provide information about clients	£5,000
Intermediaries: duty to provide information about clients	£5,000
Duty to provide information about clients following an enquiry	£10,000
Duty to provide information required to monitor compliance with conduct notice	£5,000
Duty to provide information about address	£5,000
Duty to provide information to promoter	£5,000

This year (2015), HM Treasury and HMRC proposed the introduction of criminal offences for corporate failure to prevent tax evasion or the facilitation of tax evasion, and collateral civil penalties for those who enable tax evasion.[86] This latest announcement, primarily directed at income tax evasion, supplements existing rules on penalties for facilitation of VAT evasion, in particular for supplying products knowing they will be used for evasion.

[84] FA 2014, Sch34.
[85] FA 2014, Sch35. For a detailed analysis of the regime see D. Salter and L. Oats, "Finance Act 2014 notes: Sections 234-283 and schedules 34-36: promoters of tax avoidance schemes (high risk promoters)" (2014) *British Tax Review* 4, 454-463.
[86] HM Treasury and HMRC, *Tackling Tax Evasion and Avoidance*, Policy Paper, March 2015, available here: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/413931/Tax_evasion_FINAL__with_covers_and_right_sig_.pdf. For a commentary see J. Bullock, "New proposed criminal and civil powers to combat evasion" (2015) *Tax Journal* 1256, 7.

Table 6: Penalties' Rates for Supplying a Product Knowing it will be Misused

Type of behaviour	Unprompted disclosure	Prompted disclosure
Deliberate	30% to 100%	50% to 100%

4. Legal protection of the taxpayer/Third parties

The UK tax system grants various legal protection measures to taxpayers and third parties, as follows.

4.1 Recourse of legal action

Generally UK taxpayers have the right of appeal in tax cases where they disagree with decision made by HMRC, as per Article 6 of the European Convention on Human Rights (ECHR),[87] and penalties are not exception to this rule.[88] This right, however, is not universal, and there are instances in the UK where the right of appeal is not (fully) ensured for tax penalties. Unsurprisingly this gives rise to significant concerns, manifested not solely in significant case law on the matter,[89] but also in strong criticism, in particular directed at the lack of right of appeal against penalties applied in the context of the new aggressive tax planning regime.[90]

For taxpayers on low incomes, the Citizens Advice will provide free, independent, confidential and impartial advice to taxpayers' rights and responsibilities;[91] Tax Aid, an independent charity, also provides free, professional tax advice to low-income taxpayers, including in cases of appeal;[92] finally for taxpayers above 60 years old, there is another organisation, which provides tax advice: Tax Help for Older People.[93]

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[87] There is a growing literature in the UK on the application of, and respect for, Article 6 in tax matters. See generally: J. Tiley and G. ‚Loutzenhiser, n. 27 above, at 94; P. Baker, "Taxation and the European Convention on Human Rights" (2000) *British Tax Review* 4, 211-377; J. Schwarz, "Rights and Powers: Protecting the Legitimate Interests of Taxpayers" (2009) British Tax Review 3, 306-318; and J. Hilliard, "Article 6 and the scope of the right not to incriminate oneself in the tax field" (2002) *British Tax Review* 6, 470-488.

[88] For a detailed examination of the right of appeal in Article 6, as applied to UK civil and criminal tax penalties, see R.M. White, "'Civil penalties': oxymoron chimera and stealth sanction" (2010) *Law Quarterly Review* 126, 593-616, at 602-609; for an brief outline of UK taxpayers' rights of appeal, see also M. McLaughlin, "Penalties saved!" (2012) *Taxation* 170, 16-18.

[89] See amongst others, the recent decisions in *Bluu Solutions v HMRC* [2015] UKFTT 25 (TC); and *Dyson v Revenue and Customs Commissioners* [2015] UKFTT 131.

[90] See H. Gething, n. 76 above; and C. Davidson, "The appeal right against a follower notice penalty" (2015) *Tax Journal* 1246, 7.

[91] See: https://www.citizensadvice.org.uk/tax/

[92] See: http://taxaid.org.uk/

[93] See: http://www.taxvol.org.uk/

For a few tax penalties, where the dispute is appealed to a tribunal, taxpayers also have the right to apply for state-funded legal assistance.[94]

4.2 An authority or institution has to be addressed by the taxpayer/third party if he/she wants to file an objection

Where taxpayers disagree with a tax decision, they can appeal to HMRC; if they disagree with the outcome of the appeal, they can request a review, asking that their case is reviewed by a different officer from the one who made the decision on the appeal;[95] if they disagree with the outcome of the review, they can ask that their cases are heard by an independent tax tribunal.[96] The appeal must be made to the First-Tier Tribunal (Tax), which is composed of expert tax judges and/or panel members who will hear the case. The tribunal will usually arrange a hearing to decide the appeal or, in less complicated cases, they may decide the appeal on the basis of information sent by taxpayers. Taxpayers have the right to represent themselves, or be represented by lawyers, tax advisers, or accountants.[97]

Whilst the UK appellate system for tax decisions follows broadly a similar pattern to many jurisdictions, the HMRC appeal level is perhaps more unusual. In practice, it means that most cases will be settled by agreement between HMRC and the taxpayer, in what HMRC refers to as a process of "collaborative working".[98]

4.3 Interim measures regarding legal protection

In cases regarding direct taxes, taxpayers have the right to request for postponement of part or all of the tax in dispute, as well as any penalty imposed, until the appeal is settled.[99] An appeal may be resolved by being settled by agreement between taxpayers and HMRC or decided by the tribunal. After the decisions have been made, taxpayers would then pay tax due. For indirect tax cases, HMRC will not collect the disputed tax during the review process. However, if taxpayers appeal the case to the tribunal, the disputed tax must be paid.[100] In addition, interim payments are also available in all tax

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[94] See: http://www.lawsociety.org.uk/for-the-public/paying-for-legal-services/legal-aid/

[95] For a comprehensive analysis of these various stages, as well as a criticism of HMRC review stage, introduced in 2010, see M. Gammie, "Tax appeals and reviews: the new landscape" (2010) *British Tax Review* 6, 650-670. It is noteworthy that this HMRC power to review has been recently challenged in the UK for constituting a violation of Article 6 ECHR, but dismissed by the court, see *Pendle v Revenue & Customs Commissioners* [2015] UKFTT 27 (TC).

[96] HMRC, *Disagree with a tax decision – Guide*, April 2015, available at: https://www.gov.uk/tax-appeals/overview.

[97] Ibid.

[98] R. Williamson and I. Young, n. 13 above.

[99] Ibid.

[100] Ibid.

cases for repayment of overpaid tax.[101]

4.4 Advance ruling in the UK

Advance rulings are not available in the UK.

4.5 Alternative Dispute Resolutions

Alternative dispute resolutions are available in the UK for tax disputes since 2011. ADR can be particularly useful in the following circumstances where:

1. The parties are unclear or unable to articulate the points in dispute;

2. The parties have taken entrenched views or relationships have become strained;

3. There is a dispute over facts (particularly in complicated cases);

4. There is no dispute over any technical analysis but the parties need to agree the methodology to quantify liability;

5. There are "non-tax" issues with no precedent value or wider impact.[102]

The circumstances in which ADR would not be suitable are, as follows, where:

1. The resolution of the disputes could only be achieved by departure from an established "HMRC" view on a technical issue;

2. There is doubt over the strength of evidence and HMRC wants to test it by cross-examination at a tribunal;

3. An issue needs to be clarified judicially so that the precedent gained can be applied to other cases; and also

4. The customer does not appear to be working collaboratively with HMRC.[103]

4.6 Tax Law Safeguard

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[101] Rule 25.7(c) Court Procedural Rules; on these claims see K. Stricklin-Coutinho, "New restrictions on interim payments in tax cases" (2013) *Tax Journal*, 12 July, 7.

[102] *Tax disputes: Alternative Dispute Resolution (ADR) guidance*, available at: https://www.gov.uk/tax-disputes-alternative-dispute-resolution-adr

[103] Ibid.

BOX 2: *Your Charter* - Rights of UK Taxpayers

1. Right to be presumed honest and compliant
2. Right to be treated fairly, to Human Rights and European Community freedoms
3. Right to professional service and assistance
4. Right to your information
5. Right to appeal or review
6. Right to be represented and advised
7. Right to preserve privileged communications from disclosure
8. Right to privacy, confidentiality and trade secret
9. Right to complain
10. Right to an effective remedy and compensation
11. Right to minimise compliance costs. Right to entitlements, deductions, allowances and refunds
12. Right to minimise tax liability
13. Right not to be subject to retrospective taxation
14. Right to request a payment plan

In the UK, the main legal safeguards for taxpayers set out in non-tax specific legislation, such as The Data Protection Act 1998, The Freedom of Information Act 2000, The Human Rights Act 1998, The Police Reform Act 2002, and include taxpayers' right of appeal, right to confidentiality of information, right to be represented by tax advisers, and other related rights.

In 2008, the Chartered Institute of Taxation published *A Taxpayers' Charter for the United Kingdom*, which set out a balanced set of rights and obligations of taxpayers. The draft was partly based upon the *UK Civil Service Code*, *OECD Taxpayers Rights and Obligations Guidance*, as well as other charters' models, in particular the *Australian Taxpayers' Charter*.[104] The Charter, known as *Your Charter,* it is not intended at substituting taxpayer's legal protections of taxpayers, as set out in the law,[105] but it is meant rather to act as an additional safeguard. In this context, the Charter is overseen by an independent committee that reviews how HMRC upholds the principles set out therein; HMRC is required to produce a written report each year, and the committee writes a foreword to that annual report reflecting his /her views as to how the charter principles have been upheld.[106] Box 2 sets out the rights of UK taxpayers under the Charter.

5. Deductibility of surcharges

[104] *A Taxpayers' Charter for the United Kingdom*, at 6, available at: http://www.tax.org.uk/Resources/CIOT/Migrated%20Resources/a-c/annexe-1-the-taxpayers-charter_1.pdf
[105] Ibid, at 8.
[106] R. Williamson and I. Young, n. 13 above.

Under the UK Income Tax Act 2005 S54 and Corporation Tax Act S1303 most penalties and interest paid are not allowed as deduction to the tax base, when computing taxable profits. The rationale for the non-deductibility of penalties and interest is clear: the deterrence effect would decrease if penalties and interests charged could be used as deduction to tax bases. HMRC provides a non-exhaustive list of penalties, which cannot be deducted, as follow:

— Interest on overdue tax paid under any provision of Part 9 Taxes Management Act 1970;
— Penalty paid under S60-S70 VAT Act 1994 e.g. penalty on VAT evasion and administrative penalty;
— Interest on VAT recovered or recoverable by assessment paid under S74, S85A VAT Act 1994;
— Default surcharges paid under S59 VAT Act 1994;
— Error in taxpayer's documents penalty paid under Sch24 Finance Act 2007; and
— Failure to notify and VAT wrong doing penalty paid under Sch41 Finance Act 2008.

There are only a few exceptions to the above rule. In particular, HMRC charges interest on late and insufficient instalment payments for corporation tax purposes is tax deductible; this interest is known by HMRC as debit interest, precisely to distinguish it from interest on normal late payments.[107]

6. Numbers and development of proceeding regarding surcharges

Reportedly motivated by institutional changes, as well as the need to intensify the deterrence element, and to encourage further compliance, the UK has witnessed over the last decade a clear toughening of the surcharges and penalties regime. In 2004, the merger of what were previously Her Majesty's (HM) Customs and Excise and the Inland Revenue, prompted the UK Government to announce a review of the Revenue's powers in relation to tax enforcement.[108] The review of HMRC's Powers, Deterrents and Safeguards, as it became known, ran from 2005 to 2012, and it included a consistent programme of consultation and legislative change to reportedly provide a modern framework of law and practice for tax administration.[109] The review covered HMRC's

[107] FA 1998, s33.
[108] For an overview of the initial steps in this process see R. Fraser, "The White Open Spaces – Revenue practice and penalties for negligent conduct" (2006) *British Tax Review* 4, 385-394.
[109] See *Review of HMRC's Powers, Deterrents and Safeguards*, available at:

powers to obtain documents and information (compliance checks), penalties and interest, and powers on criminal investigations, and led to legislative changes made in FAs 2007, 2008, 2009, 2010, 2011 and 2012.[110]

The first step towards implementation of the results of this review came in 2007 when new penalties were introduced in a clear attempt to change taxpayer behaviour:[111] not solely are new penalties for taxpayers who make errors in documents sent to HMRC or unreasonably fail to report errors in assessment by HMRC;[112] but also the concept of "behaviour-based" penalties is introduced,[113] with amounts due calculated according to the potential loss of revenue.[114] Penalties were thus granted a bigger role than before, and the levels of penalties became substantially higher.[115] The following year, HMRC began a consultation process with a view to reforming the provision for, and application of, penalties for late filing or returns and late payments of tax, reportedly informed by research which suggested that taxpayers found it difficult to understand the consequences of not meeting their obligations.[116] As a result of that consultation process, the FA 2009 introduced several new legislative measures, aimed at increasing the proportion of taxpayers filling their returns on time, and reducing very late payments.[117] In 2010, 2011 and 2012 more legislation was approved, to include in particular new penalties for third parties for dishonest tax agents.[118]

Unsurprisingly, since the new penalties' regime and procedure has been in place, the number of penalties issued has significantly increased, as has the amounts involved. In terms of criminal proceedings and penalties, in the 2012/13 tax year more than 5,000 penalties were issued; HMRC criminal investigations brought in more than £1 billion

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http://webarchive.nationalarchives.gov.uk/+/http://www.hmrc.gov.uk/about/powers-appeal.htm

110 Amendments to UK tax law, including tax administration elements therein, are included every year in the FA.

111 J. Collins and M. Piggin, "Finance Act Notes: Penalties – Section 97 and Schedule 24" (2007) *British Tax Review* 5, 572-573.

112 FA 2007, S97 and Sch24.

113 H.L. McCarthy, 'Navigating the Finance Act 2007 penalty regime: three case studies' (2011) *Private Client Business*, 211.

114 FA 2007 Sch.24, para.4, 5, 8.

115 P. Berwick and R. Shiers, n. 66 above.

116 HMRC, *Meeting the obligations to file returns and pay tax on time*, Consultation Document, June 2008.

117 See D. Salter, "Finance Act Notes: Sections 106-109 and Schedules 55-57 – penalties" (2009) *British Tax Review* 5, 642-646; and H. Adams and D. Boodnah, n. 66 above.

118 For details on these legislative measures see R. Shiers, "Finance Act notes: section 25-29 and schedules 9-13: administration" (2011) *British Tax Review* 1, 67-70; D. Salter, n. 98 above; P. Baker, "Finance Act notes: section 219: penalties: offshore income, etc" (2012) *British Tax Review* 4, 492; and S. Ball, "Finance Act notes: section 224: information powers" (2012) *British Tax Review* 4, 498-499.

and 540 people were convicted of tax evasion. During 2014/2015, HMRC attempted to bring about 1,165 tax fraud prosecutions, and over 3,500 cases are at present under scrutiny. Overall, the records from the last three years show that 2,343 people were prosecuted, including some very high-profile barristers, accountants and lawyers.[119]

For civil proceedings statistics for 2013-2014 show there were 37,668 new requests from taxpayers for a review to be carried out of penalties imposed, with HMRC completing 38,621 reviews (to include cases from previous years) in the same year. Most reviews related to late filing and late payment penalties, many of which are issued automatically when a return or payment is not received on time. A review by HMRC gives taxpayers an early opportunity to challenge these decisions and put forward an explanation. Nonetheless there were 7,081 cases appeals to courts in 2013-14, of which 6,626 cases were settled either by a formal tribunal hearing, or by agreement before the hearing. Where court decisions were issued, 1,943 cases were in favour of HMRC, whilst 164 were partially in HMRC's favour, and 443 were in favour of taxpayers.[120]

7. Effectiveness

The global economic crisis had a significant impact in the UK surcharges and penalties system, intensifying the process initiated before, towards a much tougher regime. Struggling to reduce their budget deficits in the context of a shrinking economy, characterised by substantially lower income tax receipts,[121] the UK Government, like many other European governments, faced a dilemma: how to stimulate investment and growth, whilst reducing the deficit and protecting public spending. Amongst various other tax and non-tax measures taken, there was also increased attention given to the penalty system, not only for the traditional deterrence and punishment reasons, but, arguably, also for new ones. Certainly there was a sense that the system needed to increase its deterrence effect, and thus compliance; and, in addition, public spending cuts, particularly as regards social security benefits, added to the public sentiment that

[119] See HMRC, *How we resolve Tax Disputes,* The Tax Assurance Commissioner's Annual Report 2013-14, July 2014, available at: https://www.gov.uk/government/publications/how-we-resolve-tax-disputes-2013-to-2014.
[120] *HMRC's Reviews and Appeals - 2013-14*, available at: www.gov.uk/government/uploads/system/uploads/attachment_data/file/267713/131202_Reviews_and_Appeals_Statistics_2012-13.pdf
[121] G. Maffini et al, n. 1 above, at 8.

those who do not pay tax should be punished, as a fundamental reflection of the principle of equality amongst taxpayers.[122]

These traditional elements of the UK penalty regime –namely increasing the deterrence element – are reflected, for instance, in the strengthening of the DOTAS regime. Equally, and more recently, in the introduction in the UK Budget 2015 of an obligation, placed upon financial intermediaries, to inform their customers of penalties for evasion, and outlines plans to introduce new specific penalties that apply to cases tackled by the General Anti-Avoidance Rule (GAAR).[123] HMRC numbers, as well as anecdotal evidence,[124] seems to indicate that this has been to some extent a successful strategy, which has resulted in an increase in that deterrence element, as well in punishment levels. Yet, the UK penalties system as it stands gives rise to some significant concerns, some of which are of a procedural nature, whilst others are of a substantive one.

In terms of procedure and implementation, one major point of contention has been – like in many other countries –the fine line between deliberate and inadvertent non-compliance, for the purposes of the distinction between civil and criminal penalties. Whilst not much in-depth research has been carried out to investigate the potential difficulties in establishing this distinction, the significant amount of case law in this area, is indicative of the size of the problem.

Another area of concern is taxpayer equality as regards tax disputes. The increase in HMRC's powers of investigation in criminal matters raises concerns that more power, results in more taxpayers are targeted, and some innocent taxpayers who fail to comply are investigated under criminal procedures, which is costly and timely. Research also confirms the intuitive perception that those with more financial power are in an advantages position when it comes to tax disputes,[125] e.g. cases of self-represented taxpayers with a high status tend to obtain more advantageous settlements than the ones with lower status.[126] The lack of prosecution in high profile cases, such as the so-

[122] As demonstrated by the reaction to the HSBC scandal, and the establishment of a parliamentary enquiry in the UK to investigate the approach adopted by HMRC following the receipt of the leaked tax data. See UK Public Accounts Committee, *Tax Avoidance and Evasion: HSBC*, available at: http://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/inquiries/parliament-2010/tax-avoidance-evasion-hsbc/

[123] HMRC, *Budget 2015: HM Revenue and Customs Overview*, 18 March 2015.

[124] As R. Collier-Keywood mentions "There has undoubtedly been a change in behaviour in the market place…" in "Widening the Disclosure Regime" (2006) *Tax Journal* 837, 11.

[125] As reported by R Williamson and I. Young, n. 13 above.

[126] J. Tiley and G. Loutzenhiser, n. 27 above, at 91.

called HSBC scandal, tax amnesties and disclosure facilities which have been offered since 2006 to high-income taxpayers, further fuels this perception.[127]

Finally, concerns have been raised about taxpayers' inequalities as regards penalties' levels. Critics have commented that many taxpayers who unintentionally fail to comply can be victims of this tougher penalties regime; and that, whilst various legal safeguards are in place to ensure taxpayers' rights, in practice lower income taxpayers' are unable to take advantage of them due to financial constraints.[128] Others have pointed out that whilst the aim is to have a harmonised penalties regime, the fact that changes are piecemeal has resulted in complexity and variations between taxes not having been avoided,[129] with inconsistencies across the tax system.[130]In terms of measuring the effectiveness of the substance and ratio of the current UK penalties regime, there is also cause for concern. Like in many other areas of law, compliance and penalties regimes are subject to a law of diminishing returns. A good example of this has been the DOTAS regime: after a flurry of activity when the regime was introduced, the number of disclosures has dropped steadily since then. Whilst several explanations are possible, including decrease in avoidance schemes, consecutive alterations to the scheme raise the suspicion that "people [are] applying their ingenuity to getting round the disclosure requirement".[131] Maintaining the deterrence effect will, in many situations, mean toughening the penalties regime; nevertheless, there is the suspicion that this tough approach may be also based on other considerations, beyond the traditional rationales of deterrence and punishment.

Indeed, the penalty regime, and anti-fraud policy more generally, now appear to be perceived as an additional source of revenue, or as compensatory measures for the revenue lost through fraud. Beyond the mere increase in the size of penalties, other factors can be found as evidence for this new approach, in particular an excessively formalistic approach to tax obligations; and instances of third party liability. Other relevant elements are the lack of prosecution of high value cases, and the argument implicitly made that this constitutes a positive outcome for the UK taxpayer, since revenue has been recovered without incurring prosecution costs; and the evaluation of

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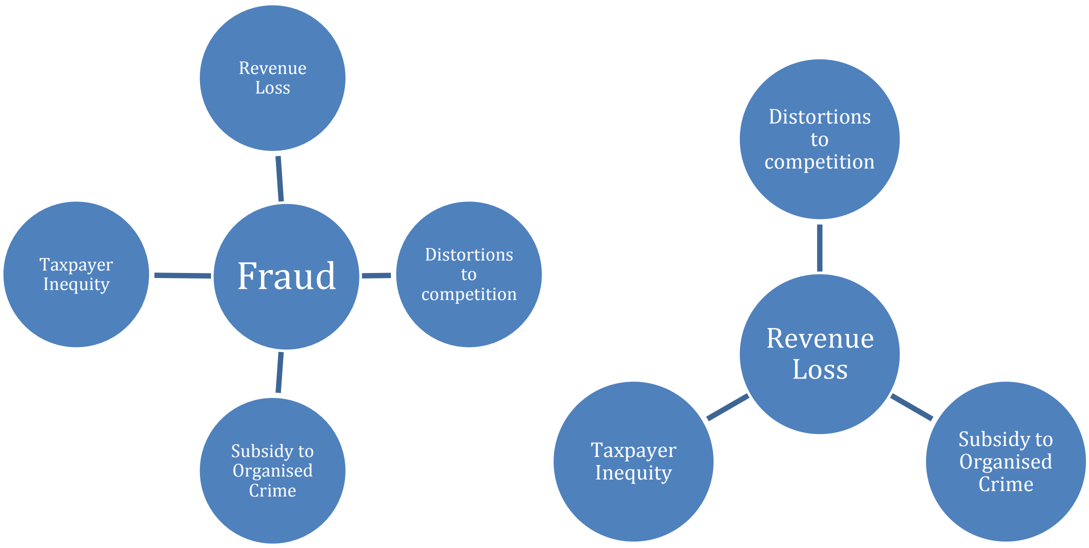
[127] HMRC, *Offshore disclosure facilities*, December 2014, available at: https://www.gov.uk/offshore-disclosure-facilities
[128] R Williamson and I. Young, n. 13 above.
[129] R. Shiers, n. 135 above.
[130] F. Fernie, "Penalties in Practice" (2015) *Taxation* 175, 14-16; N. Warren, "Juggling the tax balls" (2015) *Taxation* 175, 8-9.
[131] S. Walton, Head of the Anti-Avoidance Group at HMRC, UK House of Lords, *Select Committee on Economic Affairs, 4th Report of Session 2010–12, Finance Bill 2011*, HL Paper 158, 17 June 2011, at 33.

HMRC performance primarily on the basis of how much revenue is collected,[132] incentivised by performance-related pay.[133] All these factors seem to evidence a crucial shift, whereby revenue collection seems to not be at the centre of anti-fraud policy, as represented in Diagram 1 below.[134]

Diagram 1: Shift in UK Anti-Fraud Policy



This new approach – which does not appear to be limited to the UK – has, unsurprisingly, given rise to a staggering increase in litigation, raising concerns over the legality of many of those new measures. Specifically insofar as penalties are concerned there have been significant concerns over their proportionality: for example, UK courts have been recently asked whether penalties amounting to 100% of tax owed are excessive;[135] and have tackled excessive formalism on the imposition of penalties.[136]

Against this background, it is important to remember that the EU Charter of Fundamental Rights requires that "the severity of penalties must not be

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[132] HMRC, *How we're doing: our performance so far this year*. 20 November 2014, available at: https://www.gov.uk/government/publications/issue-briefing-how-were-doing-our-performance-so-far-this-year/how-were-doing-our-performance-so-far-this-year

[133] S. Burgess et al, "Smarter Task Assignment or Greater Effort: The impact of incentives on team performance" (2010) *Economic Journal* 120, 968-989.

[134] On this shift, see R de la Feria, "Anti-Tax Fraud Policy: Tackling Fraud Proportionally and Effectively" (2015) *Durham Law School Research Briefing* 23; and R de la Feria, "VAT Anti-Fraud Policy, Third Party Liability, and the Rule of Law" (Unpublished Working Paper).

[135] *Tager v Revenue and Customs Commissioners*, Unreported, 6 March 2015; for commentary on his case see C. Djanegly, "Tax-geared penalties" (2015) *Tax Journal* 1255, 5.

[136] *CJS Eastern Limited v The Commissioners of Her Majesty's Revenue & Customs*, [2015] UKFTT 213 (TC).

disproportionate to the criminal offence".[137] In addition, whilst this provision has not yet been applied by the Courts,[138] the CJEU has nevertheless ruled recently on the proportionality of tax penalties, stating that "*penalties must not go beyond what is necessary to prevent fraud*".[139] Similarly, in a case concerning Article 6(2) ECHR, the European Human Rights Court stated that penalties were not compensation, but their imposition was punitive and deterrent.[140] These statements are a clear endorsement of the traditional functions of penalties regimes, namely that of deterrence and punishment; *a contrario*, they also exclude the possibility of using tax penalties for any other purpose. Tax penalties whose ratio is no longer (solely) deterrence are therefore disproportionate, and as such, contrary to EU law, and the ECHR.

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[137] Article 49(3) of the Charter.

[138] V. Mitsilegas, "Article 49. Principles of legality and proportionality of criminal offences and penalties" in S. Peers et al (eds), *EU Charter of Fundamental Rights: A Commentary* (Oxford: Hart Publishing, 2014).

[139] C-259/12, *RODOPI-M91*, ECLI:EU:C:2013:414.

[140] 2547/86, A/284, *Bendenoun v France*, (1994) 18 EHRR 54, paras. 44-48.

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