

# Reducing the new tax penalties for clients

– this factcard summarises the rules for the new penalties for **errors** regime

## Commencement and taxes covered

The new rules apply for return periods beginning on or after 1 April 2008 where the return is due to be filed on or after 1 April 2009. From these dates, the new rules will cover all the main taxes.

Finance Bill 2008 will extend these penalties to all UK taxes and duties for return periods commencing on or after 1 April 2009 where the return is due to be filed on or after 1 April 2010. A similar range of penalties will apply for failure to notify HMRC of chargeability to tax, e.g. where a company fails to register with HMRC, from 1 April 2010.

## When will a penalty be charged?

When an inaccurate return or document is submitted leading to:

- an understatement of tax, or
- a false or inflated loss, or
- a false or inflated repayment claim.

A separate penalty will be calculated and levied for each inaccuracy in a tax return (rather than charging a penalty for the incorrect document as a whole as is now the case) with the most serious inaccuracy considered last.

## Reasons for errors

The different ways inaccuracies arise trigger different levels of penalty (see table overleaf).

## *Error despite taking reasonable care*

Where a taxpayer has taken 'reasonable care' to ensure a return is correct, no penalty is charged if:

- a reasonable view of law later proves to be wrong
- the taxpayer followed advice from HMRC or a competent professional which proves wrong
- good accounting systems and controls exist but errors arise in processing items
- inconspicuous arithmetical/ transposition errors were made.

**WARNING** - in some circumstances, penalties may still be levied for an inaccuracy arising as a result of careless action by an agent for the taxpayer, e.g. his accountant.

## *Carelessness*

Whether or not an error is deemed to have arisen as a result of carelessness depends in part on the taxpayer's ability and experience and the size and complexity of the transaction. HMRC will consider how a reasonable person would act in similar circumstances.

## *Deliberate, but not concealed, inaccuracy*

This applies where a taxpayer intentionally gets something wrong or intentionally fails to do something that should have been done, for example:

- not keeping books or records

- not recording all sales
- describing transactions inaccurately or misleadingly
- poor record keeping that goes beyond lack of care.

## *Deliberate inaccuracy that is concealed*

This applies where a taxpayer intentionally gets something wrong or intentionally fails to do something that should have been done and active steps are taken to cover up the resulting inaccuracy. For example:

- diverting takings into undisclosed bank accounts
- creating false invoices or minutes of meetings
- invoice routing
- altering purchase invoices to inflate their value
- destroying books and records.

## **Directors' personal liability**

An officer of a company (including shadow directors, managers and company secretaries) may be liable for a deliberate action penalty if HMRC thinks the penalty is attributable to his or her actions. At present (apart from PAYE and dishonest VAT evasion) directors do not have personal liability for penalties for tax errors.

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## Rates of penalty and reductions

– periods beginning on or after 1 April 2008 where return is due on or after 1 April 2009

Cause of error or inaccuracy	Penalty as % of 'potential lost revenue' <sup>2</sup>	Reducing penalties <sup>1</sup>	
		% for unprompted disclosure <sup>3</sup>	% prompted disclosure
Mistake made despite taking reasonable care	no penalty	N/A	N/A
Taxpayer became aware of a mistake but reasonable steps not taken to inform HMRC	30% penalty	30%, min. penalty 0%	15%, min. penalty 15%
Carelessness <sup>4</sup>	30% penalty	30%, min. penalty 0%	15%, min. penalty 15%
Deliberate inaccuracy but not concealed	70% penalty	50%, min. penalty 20%	35%, min. penalty 35%
Deliberate inaccuracy that was concealed	100% penalty	70%, min. penalty 30%	50%, min. penalty 50%
Tax under-assessed by HMRC and no reasonable steps taken to correct	30% penalty	30%, min. penalty 0%	15%, min. penalty 15%

## Notes

<sup>1</sup> **Reducing penalties** - determining how much of the maximum reduction is given for a disclosure

<b>Telling HMRC about it</b> - admitting the document is inaccurate, disclosing in full and explaining how it arose	30% of maximum reduction
<b>Giving HMRC reasonable help</b> - assisting by volunteering relevant information and actively working to quantify	40% of maximum reduction
<b>Giving HMRC access to records</b> - positive replies to information and document requests and allowing access to business and other relevant documents	30% of maximum reduction

<sup>2</sup> **Potential tax lost** is not always the actual tax lost. For example: a 10% penalty can arise on overstated losses that are not used to reduce tax due (e.g. losses carried forward), group relief of losses will be ignored, penalties will be charged on the under-declaration of tax due on an overdrawn participator's loan account even if the tax subsequently becomes repayable. Where the inaccuracy results in a timing difference that delays the tax due, the potential tax lost will be deemed to be 5% of the delayed tax for each year of delay.

<sup>3</sup> **Disclosure** is deemed to be unprompted where the taxpayer has no reason to believe HMRC has discovered or will discover the inaccuracy / underassessment.

<sup>4</sup> **Suspended penalties** – HMRC can suspend for up to two years. Suspension will be on condition that all tax returns and payments are made on time and other conditions may be set. Penalty cancelled at end of period if all conditions are met. No suspension for isolated incidents, where avoidance schemes used or taxpayer has history of non-compliance.

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