Making the best of it

Mark McLaughlin explains how you can mitigate penalties by making good quality disclosure

The penalty regime in FA 2007 et seq offers taxpayers and their advisers the opportunity to obtain penalty mitigation in a very different way from the old regime. Whereas previously mitigation was arrived at by taking into account the three long-established and fairly well-known factors – disclosure, co-operation and size and gravity – the new system places the emphasis for the mitigation and negotiation process solely on the concept of 'disclosure'. Whilst it is true that the old factors do form part of this disclosure process to some extent, the emphasis is now very different indeed. Disclosure represents the sole factor that will determine the level of penalty to be imposed and will be the major factor considered by HMRC in such negotiations.

The concept of disclosure does not initially sound too difficult. Clearly it represents the degree of openness that a taxpayer exhibits in providing HMRC with the necessary information to enable it to assess and collect any unpaid taxes arising as the result of taxpayer errors or inaccuracies in returns and other documents. What is important however is the type of disclosure that a taxpayer makes and thereafter the speed and accuracy with which the taxpayer facilitates the disclosure process. HMRC places great emphasis on whether or not the taxpayer made his disclosure voluntarily or had to be encouraged to make it by the department. Thus, a disclosure will be categorised as either 'prompted' or 'unprompted'.

There is nothing new in HMRC offering greater mitigation for a taxpayer who voluntarily discloses past defaults. There has always been some mitigation of penalties for this. However, the whole process now deals with mitigation in terms of the quality of the disclosure made by the taxpayer.

HMRC has stated that an unprompted disclosure occurs when the person making it 'has no reason to believe HMRC has discovered or is about to discover the inaccuracy or under-assessment'. On the other hand, an unprompted disclosure (ie all other types of disclosure), will occur when HMRC has already taken some action towards identifying inaccuracies in returns or other documents which prompts the taxpayer into providing details of those matters. Prompted disclosures will carry significantly lower levels of mitigation although it is still possible to obtain a high level of reduction of the penalty weighting in any case by adopting a constructive and co-operative approach to the disclosure process after the 'prompt'.

What is very different from the old regime is that it is now virtually impossible to obtain a very low level of penalty when the case falls into the 'prompted' category. Indeed, in the years since the new regime was introduced it has become apparent that there is in practice a 'floor' of 15% below which prompted penalties cannot fall.

HRMC has adopted three criteria which will be examined when deciding the level of

mitigation to be allowed for the various types of penalty. These are 'telling', 'helping' and 'giving access'.

The statute in FA 2007, Sch 24, para 9(1) defines disclosure in the following terms:

- informing HMRC about the return inaccuracy or under-assessment of tax;
- providing reasonable help to HMRC in quantifying the potential tax loss; and
- allowing HMRC access to books, records and information for the purpose of ensuring that the inaccuracy or understatement has been completely corrected.

The criteria HMRC has said it will use in mitigating penalties draw on and expand the statute so that 'telling' includes admitting a document (or documents) was inaccurate or that there was an under-assessment, disclosing the inaccuracy in full, and explaining how and why it arose. 'Helping' includes giving HMRC officials reasonable help in quantifying the inaccuracy or under-assessment. 'Giving access' is defined by HMRC as where a person 'responds positively to requests for information and documents, and allows access to their business and other records, or other relevant documents'.

The levels of penalty which HMRC will impose for the different types taking into account differing categories of disclosure are as follows: *HMRC guidance indicates that the penalty charged for each inaccuracy can be the maximum, the minimum or any amount in between, but it is clear that the only 0% penalty on offer is for an unprompted disclosure of a 'carelessness' penalty. The most common type of penalty encountered in practice, the carelessness penalty imposed during a compliance check where inaccuracies are identified as the result of HMRC review or other action, can never be mitigated below 15%, or so it would appear.*

CH82410 outlines the HMRC's views on the penalty reductions for disclosure, and CH82430 and CH82432 its views on the weighting that may be given to the elements of disclosure. CH82440–CH82460 explain the penalty reductions for 'telling', 'helping' and 'giving access'.

While to some extent the table above is the only explicit indication of percentages for mitigation that are available, the HMRC Compliance Handbook at CH82430 does provide some further detail by indicating that the 'telling', 'helping' and 'giving access' elements may be weighted as follows:

- telling – 30%
- helping – 40%
- giving access – 30%

HMRC has given little further indication of its approach to penalty mitigation than those comments in the Compliance Handbook referred to above. Practitioners and taxpayers will need to take considerable care therefore during any compliance check or investigation process to pay attention from the outset to the factors that will secure greatest mitigation of penalties likely to be imposed at the end of any enquiry process.

Whilst this has always been the case the emphasis on the 'disclosure' aspects of a case will mean that taxpayers need to understand from the start of any compliance check that it is in their interest to make as complete and detailed a disclosure as is possible and to thereafter facilitate the rest of the disclosure process in as timely and co-operative a fashion as is practical. Even then the most commonly imposed penalty, the 'carelessness' penalty for a system failure (eg errors in business records), will not fall below 15% of the PLR.

Thus, if the taxpayer himself, or his adviser, identifies any error or inaccuracy in his tax returns, the possibility exists that the taxpayer can get the tax paid, plus interest of course, with no penalty at all where it can be demonstrated that the error was one of simple carelessness and so long as HMRC has been provided with the necessary information in as speedy and helpful a manner as possible. Thus, a disclosure is only 'unprompted' if it is made at a time when the taxpayer has no reason to expect that HMRC has discovered the problem or is about to discover it. In any other circumstances the disclosure will therefore be regarded by HMRC as 'prompted'. Mitigation for 'prompted' penalties will never offer any reduction greater than 50% of the total possible penalty.

What exactly constitutes 'prompting' can clearly be a matter of some debate and conjecture. If an error becomes apparent during the compliance check process there can be little debate that this is a 'prompted' disclosure, once it has been agreed with HMRC. However, whether or not a general discussion of something over the telephone or during a meeting which leads to the client and his adviser identifying some other separate issue which should be disclosed to HMRC constitutes prompting might perhaps be open to question.

If, for example, some general discussion about the taxpayer's tax affairs takes place that triggers a train of thought on the part of the taxpayer leading to a disclosure, could this be regarded as 'prompting' when the new issue was totally unconnected with the matters discussed?

See also M Baines-Stiller (TC 5233) in which a taxpayer who had filed his return late appealed on grounds of reasonable excuse claiming that injuries suffered in a car accident had rendered him unable to attend to his tax affairs which excuse the Tribunal readily accepted.

In G MacDonald (TC5246) a taxpayer's appeal against a penalty for the late submission of a tax return was refused. The appellant argued that she had relied on her accountant to deal with her tax affairs and that he should have notified her appointment as a director to HMRC timeously and that this was a reasonable excuse. However, the tribunal took the view that this excuse was only available in more exceptional cases where the appellant could show that there was clear miscommunication between agent and client and that the taxpayer could not abrogate their ultimate responsibility for their own tax affairs in such a case and ought to have enquired about the tax return progress more carefully and kept track of her affairs more satisfactorily.

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