

New ways to tackle non-compliance

Mala Kapacee runs the rule over the Tax Administration Framework Review, and questions whether it will make tax collection more efficient and fairer

As often happens with a new government, tax collection is an obvious way to demonstrate to the public that the new government is 'in charge'. Unfortunately, that often means handing HMRC new powers without a clear understanding of what the department can do with existing powers and why the current system is not working. Hint: even with the best tools, the unskilled will only do mediocre work.

On 30 October 2024, HMRC issued a new consultation to explore "whether HMRC's approach to correcting mistakes... could be improved". The consultation looks at two areas for change:

- Reform of HMRC's existing powers; and
- A new power to address non-compliance.

The government has said that the 'need for change' reforms are required because "the self-assessment population has grown over the last 10 years by 25%, from 9.2 million to 11.5 million...[this and other factors has led to] high volumes of relatively low value inaccurate repayment claims. HMRC has also seen an increase in situations where taxpayers have felt misled when using companies that claim to specialise in claiming tax refunds from HMRC."

Nowhere in 'the need for change' does it state that there are not enough powers or that the existing power do not work or why they are insufficient. What also remains unsaid is that HMRC's resources have not kept up with the number of SA taxpayers and the system is not built to deliver so many services, and that the number of SA taxpayers has risen in part due to the freezing of allowances and thresholds.

As an aside, consider whether increasing all the allowances, bands and tax rates, while increasing the tax liability on higher earners, would be a viable way of taking lower income (and lower tax yield) people out of self-assessment. We could increase the personal allowances to say £20,000, the higher rate threshold to £80,000 and the additional rate threshold to £250,000, with basic rate tax increased to 25-30%, higher rate tax to 45% and additional rate tax to 50% or 55%. It would be interesting to see the tax impact of adjusting the rates and bands.

If the higher rates are a disincentive for people to work full time, then employers can employ more people working part time and the general population can have a better work-life balance. And a social life.

But I digress...

We could also consider having more technically trained HMRC staff on helplines (and 'webchat') to provide better advice to taxpayers (thereby reducing smaller errors that are 'costly' for HMRC to enquire into) – although this is not an option in the consultation.

Reform of HMRC's existing powers

Those reading this magazine will likely already know the breadth of powers currently at HMRC's disposal. These include opening enquiries and raising assessments where HMRC is out of time to open an enquiry and suspects a loss of tax.

The consultation suggests reforming HMRC's existing powers by:

- 1) Requiring all claims to be supported by Additional Information (AI);
- 2) Reforming the rejection process for Revenue Correction Notices; and
- 3) Introducing the concept of a partial enquiry.

Additional Information (AI) for claims

In August 2023, a requirement was implemented for AI to be provided in relation to claims for Research and Development tax credits. The theory was that with the AI provided, HMRC would be better placed to assess the validity of the claim and make appropriate payments, minimising delays and reducing fraudulent repayments.

The consultation states: “Additional checks and more upfront information helps HMRC make better judgements when claims are received and therefore payments are able to be processed and paid more promptly with certainty.”

Tax advisers are instead seeing HMRC opening enquiries into the R&D claims without any indication of fraud or suspicion of an incorrect claim. The case workers then proceed to ask questions which for bona fide claims have usually already been addressed in the AI form. The enquiries take a long time, with the case officer having to continually refer to their technical colleagues. Often, the claims are denied out of hand because of caseworkers’ lack of understanding in the new technology and lack of appropriately qualified staff to explain it to them.

The enquiries are costly and often unfounded, with the result that smaller companies relying on the R&D credit to stay afloat either go insolvent while waiting for the refund or decide not to claim the allowance in the future, both of which defeat the object of the R&D tax credit.

It is clear therefore that the AI is only helpful if HMRC reads and understands it. Currently, HMRC does not have the expertise to understand the information it is asking for. This could be an issue specific to R&D due to the inherent technical nature of the relief. However, it is not clear exactly what AI HMRC would request in relation to other reliefs. Overpayment relief claims, for example, already require a detailed explanation of what is being claimed and why and other claims also have a ‘prescribed format’.

Having trialled AI with R&D credits, it seems the more information HMRC is provided with the longer any repayments will take, and the more likely the claims are to be rejected. If HMRC wants to stop paying out on claims and relief, perhaps the government should just legislate to remove them.

Reform of Revenue Correction Notice (RCN) conditions

Currently, HMRC has the power to amend obvious errors in a taxpayer’s return without opening an enquiry. It does this by issuing an RCN (within nine months of submission), which the taxpayer can then accept or reject. Currently, the taxpayer does not need to justify a rejection.

The consultation seeks to require taxpayers to provide evidence to explain the rejection (and for HMRC to explain why it was making a correction) in order to “avoid the need for a full enquiry”. The consultation reiterates many times the time and financial cost of an enquiry on taxpayers and stresses that circumventing formal enquiry processes is to reduce the cost.

Taxpayers tend to fall into one of two categories: the ones that receive informal queries from HMRC who do not seek advice because of the informality, and the ones who seek professional advice on receipt of any brown envelopes.

For the former, responses to HMRC may result in incorrect or irrelevant information being provided. This could then lead to an enquiry or an (incorrect) assessment. In respect of the latter, the taxpayer will seek professional advice for the informal queries and will nonetheless be left to bear the cost of HMRC’s questions. Questions from HMRC whether formal or informal rarely come without a cost.

An enquiry in this context can be a good thing because it confers safeguards on the taxpayer, particularly in relation to the information HMRC can request.

By requiring a taxpayer to explain a rejection, HMRC is effectively requesting additional information without opening an enquiry. This goes directly against the requirement to open an enquiry (or suspect a tax loss) when requesting information. It effectively circumvents another very important taxpayer safeguard.

At worst, HMRC could issue an RCN with (wild) estimates. If the taxpayer has to explain why they are rejecting the RCN, this in effect becomes the same as an appeal against closure notice without the associated safeguards. HMRC can still then be in time to open an enquiry into the return whilst holding all the additional information relating to the rejection.

Introduction of a partial enquiry

The consultation also suggests the introduction of a ‘partial enquiry’ where checks are limited to a particular area of the return (e.g. a claim or a relief). The consultation suggests that HMRC would be obligated to work within certain time limits, but that the opening of a partial enquiry would not affect time limits of a normal enquiry window.

This strikes me as again potentially giving HMRC multiple opportunities to enquire into the same return. However, if the time limits for an enquiry are not affected it would only seem to serve a purpose if, during the partial enquiry, the return was amended and HMRC sought to use the date of the amended return as

restarting the clock for enquiry purposes. I have seen this happen previously with rejected RCNs, even though the return was not amended.

I also ask whether, if HMRC would be required to stick to deadlines following the opening of a 'partial enquiry', the same could be made possible for a normal enquiry...

A new power to address non-compliance

The idea behind this new power is that it becomes a legal obligation for taxpayers to "respond and, if required, act on a notice informing them when HMRC has reason to believe their return is incorrect".

This sounds like HMRC may not be getting enough amendments to returns as a result of nudge letters and may not have the resources to go after the taxpayers who do not respond. The consultation states: "This power could allow taxpayers to review their position and correct any inaccuracies, without needing HMRC to pursue the risk further using more expansive enquiry powers."

The consultation does not suggest that the notices should be time-restricted which, in theory, means HMRC could send out a nudge letter referencing the past and a taxpayer would be obligated to review previous tax returns. If these returns are amended or a disclosure made, then HMRC is given the option of raising enquiries/assessments, even though under current legislation if no amendments were made, the enquiry window would have closed.

The consultation suggests that the power requiring taxpayers to respond could "be matched by an obligation by HMRC to respond within a specified timeframe". I am not convinced that burden of requiring taxpayers to go back and review and possibly amend (past) tax return(s) can be matched by a requirement to provide a timely response, where the timely response can be tailored depending on the severity of the issue.

In HMRC's case, a timely response may also simply be a holding letter. In any case, a timely response addressing the issues raised should be a basic courtesy and in any 'customer-facing' business is the bare minimum.

Submission of a correct return is a legal requirement and a requirement to self-correct is effectively saying that the existing legislation is not well policed. If HMRC added a line to their nudge letters explaining the legal obligation, and that once a taxpayer becomes aware that their return is incorrect it is a criminal offence (tax evasion) to leave it uncorrected, this implies the legal obligation to correct the affected return(s). A new piece of legislation is simply not required.

If this power is brought in, the legislation may be drafted along the lines of the 'Requirement to Correct', which required the resolution of outstanding UK taxes arising from offshore assets by September 2018. Penalties in relation to those that Failed to Correct were increased to up to 200% of the tax due. Should this new power be brought in, it may well be a repeat of the RTC, but instead of relating to 'offshore' matters it would relate to 'all' matters identified in HMRC's notice.

There is no consideration of what would happen if HMRC identified an issue and sent a notice to a taxpayer and then a few years later identified a second issue which also affected the same taxpayer. Would the taxpayer be required to check their tax return again? Would the review of the return relate solely to the notice issued or to the whole return, in which case, would HMRC be entitled to issue a second notice if the return had already been reviewed.

This is another proposed power that may give HMRC multiple opportunities to raise queries into a return requiring the taxpayer to do the hard work, even though HMRC may be out of time to enquire into the return/raise an assessment.

For example, if it is found that a tax avoidance scheme entered into six-plus years ago does not work and HMRC is out of time to open an enquiry, would the department still be able to send out this notice and expect the taxpayer to review and amend the return, despite the department being out of time to raise a discovery assessment?

This would be contrary to the statement in the consultation that "certainty is important for trusted relationships". However, the devil is in the detail, and we will learn more about the future of HMRC's time limits if/when draft legislation is published.

Summary

Overall, this consultation is looking at shifting responsibilities from HMRC to the taxpayer, perhaps because of the lack of appropriate technical resource at HMRC (vis a vis the AI for claims and requiring taxpayers to respond to notices).

As with previous consultations on HMRC powers, it also appears to be attempting to erode taxpayer safeguards by introducing the option to open informal enquiries under the guise of saving the taxpayer time and money, when in fact informal queries by HMRC can often lead to a much larger tax bill.

The legislation on requiring taxpayers to correct also has the potential to erode safeguards by potentially allowing HMRC to require taxpayers to correct their tax returns despite enquiry windows being closed. It is well understood that the time limits regarding the opening of enquiries and raising assessments are there to protect taxpayers and to give us all certainty as to our tax affairs. It will be interesting to see what this government considers more important: taxpayer safeguards and public trust or tax collection.

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