

CHAPTER 16

PENALTIES FOR INCORRECT RETURNS

16.1 Introduction

A new penalty regime for incorrect returns was included in the Finance Act 2007. This applies to return periods commencing after 31 March 2008, where the return is filed after 31 March 2009.

16.2 When the penalties will apply

The new penalties will apply where a tax return or claim for a relief etc, contains either:

- a) a **careless inaccuracy**, or
- b) a **deliberate inaccuracy** (whether or not concealed),

which leads to:

- an understatement of tax; or
- a false or inflated statement of a loss; or
- a false or inflated claim to a tax repayment.

The new penalty regime has been designed so that:

- If taxpayers take "reasonable care" when completing their returns, they will not be penalised for an innocent error. Taxpayers will have to settle any underpaid tax and will be charged interest if the tax is paid late, but no penalty will be added on top;
- If taxpayers do not take reasonable care, errors will be penalised;
- The penalties charged will be higher if the error is deliberate;
- Disclosing errors to HMRC as early as possible will reduce any penalty due.

The new penalties apply for errors on returns and documents for Income Tax, Capital Gains Tax, Corporation Tax, VAT, PAYE, National Insurance and the Construction Industry Scheme.

The new regime has been extended to other taxes (Inheritance Tax, Stamp Duty Land Tax etc) from 2009/10.

Different levels of penalty will apply depending on the seriousness of the offence which gives rise to the error.

There are 3 categories of offences giving rise to errors as identified below:

Careless action = failure to take reasonable care

[FA 2007,
Sch 24 Para 3](#)

Deliberate but not concealed action = the inaccuracy is deliberate but the taxpayer does not make arrangements to conceal it.

[FA 2007,
Sch 24 Para 3](#)

Deliberate and concealed action = the inaccuracy is deliberate and the taxpayer made arrangements to conceal it (e.g. by submitting false evidence in support of an inaccurate figure).

[FA 2007,
Sch 24 Para 3](#)

"Reasonable care" varies according to the person, their circumstances and their abilities. HMRC expects every person to keep sufficient records to enable them to submit a complete and accurate tax return.

If a return contains more than one error, **a penalty is charged for each error.**

16.3 The amount of the penalty

The penalties are expressed as a **percentage of the potential lost revenue.**

The potential lost revenue is the amount of tax (and NIC if appropriate) due or payable as a result of correcting the inaccuracy or assessment.

[FA 2007,
Sch 24 Para 5](#)

Reason for penalty	Penalty	Possible reduced penalty for unprompted disclosure	Possible reduced penalty for prompted disclosure
Careless action	30%	0%	15%
Deliberate but not concealed action	70%	20%	35%
Deliberate and concealed action	100%	30%	50%
Error in HMRC assessment	30%	0%	15%

Notes to table:

1. The **"careless action" penalty can be suspended for a maximum of 2 years** where HMRC think that compliance with a condition of suspension would help the taxpayer avoid further penalties for careless inaccuracy. For example, if a careless inaccuracy is due to poor record-keeping, one of the conditions of suspension could be that specified improvements are made to the way records are kept. This will help the taxpayer avoid future errors.
2. There is **no suspension of a penalty where the error was due to deliberate action**.
3. A disclosure is "unprompted" if it is made at a time when the taxpayer has no reason to believe that HMRC has discovered (or are about to discover) the inaccuracy or under-assessment. A disclosure after an enquiry notice has been issued will not be an "unprompted" disclosure.
4. There can be a **special reduction of any of above penalties where HMRC considers there are "special circumstances"**. These special circumstances are not linked to ability to pay.
5. There are no penalties for inaccuracies where the person has taken **reasonable care**. But an inaccuracy that was **not careless or deliberate** at the time the return was submitted, will be **treated as careless** if the person discovers the inaccuracy at a later date but **does not take reasonable steps** to inform HMRC.

Illustration 1

Paige runs a VAT registered nursery. She files her VAT return for the quarter to 31 December 2010 on 30 January 2011. The return shows the VAT payable to HMRC to be £12,000. Due to carelessness on Paige's part this figure should have been stated to be £19,000.

We will calculate the maximum penalty that Paige could be charged by HMRC for this error.

The potential lost revenue as a result of Paige's error is:

£(19,000 - 12,000)	<u><u>£7,000</u></u>
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Paige's error is careless so the maximum penalty for error is:

£7,000 × 30%	<u><u>£2,100</u></u>
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This penalty will be charged in addition to the extra VAT of £7,000.

If the calculation of the potential lost revenue in respect of more than one inaccuracy depends on the order in which they are corrected, a **"careless inaccuracy"** is taken to be corrected before a **"deliberate inaccuracy"**.

[FA 2007, Sch 24 Para 6](#)

Similarly a “deliberate but not concealed” inaccuracy is taken to be corrected before a “deliberate and concealed” inaccuracy.

Where an inaccuracy has the result that a loss is wrongly recorded and the loss has been wholly used, then the potential lost revenue is as above.

[FA 2007,
Sch 24 Para 7](#)

In cases where the loss has not been wholly used, it is the sum of:

- a) The potential lost revenue in respect of the amount of the loss used to reduce the tax due or payable; plus
- b) 10% of any part that has not been so used.

Where the inaccuracy results in tax being declared later than it should have been, the potential lost revenue is 5% per annum of the delayed tax.

[FA 2007,
Sch 24 Para 8](#)

16.4 Collection of the penalty

Penalties will be collected by assessment. A penalty assessment will usually be made within 12 months of the date on which the inaccuracy is corrected.

[FA 2007,
Sch 24 Para 13](#)

16.5 Appeals

A taxpayer can appeal against:

- a penalty;
- its amount;
- a HMRC decision not to suspend it; or
- the terms of a suspension.

[FA 2007,
Sch 24 Para 15](#)

The appeal is to the First-tier Tax Tribunal. On appeal, the HMRC decision will be affirmed or substituted for another.

16.6 Other points

The taxpayer will not be liable for actions taken on his behalf by an agent where he can show that he took reasonable care to avoid an inaccuracy or failure.

[FA 2007,
Sch 24 Para 18](#)

Where a return is incorrect because a third party has deliberately provided false information or deliberately withheld information from the taxpayer, a penalty can be charged on the third party.

It is possible to collect a corporate penalty from an officer of the company for a deliberate understatement if it was attributable to that officer's actions.

[FA 2007,
Sch 24 Para 19](#)

There is a “double jeopardy” rule preventing a penalty being charged in respect of an inaccuracy or failure where there has already been a criminal conviction.

[FA 2007,
Sch 24 Para 21](#)

Example 1

Charlie Royal is a VAT registered children's entertainer. He files his VAT return for the quarter to 30 June 2011 on 29 July 2011. The return shows:

Output tax	£9,500
Input tax	<u>£3,200</u>
VAT payable to HMRC	<u>£6,300</u>

In fact, Charlie has deliberately increased the input tax claim by submitting expense invoices to the tune of £1,500.

After hearing about the penalties a friend recently paid when HMRC discovered he had made an error, Charlie decides to come clean with HMRC and to make a disclosure of the error.

State the maximum and minimum penalties that could be charged by HMRC on Charlie in respect of his error.

Answer 1

The potential lost revenue as a result of Charlie's error is: £1,500

Charlie's error is deliberate and concealed so the maximum penalty for error is:

£1,500 x 100% £1,500

However Charlie has made an unprompted disclosure so the minimum penalty for error is:

£1,500 x 30% £450