



THE
CHARTERED
INSTITUTE OF
TAXATION

CIOT/ATT East Midlands Branch

“The New Penalty Regime & Tax Investigations Update”

**Presented by Paul Lynam
Lynam Tax – Positive Tax Solutions**

Date: Tuesday 9 December 2008

Venue:

PricewaterhouseCoopers Offices
Donington Court
Pegasus Business Park
Castle Donington

Timetable:

6pm - Refreshments and registration*
6.30pm – Lecture begins
7.45pm - Questions
8pm – Close

CPD Hours: 1.5

*Refreshments sponsored by:



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THE NEW PENALTY REGIME CIOT DECEMBER 2008

Paul Lynam
Lynam Tax

LYNAM TAX **POSITIVE TAX SOLUTIONS**

- Specialists in managing tax enquiries; resolving tax disputes; advising on dealing with HMRC and on any thorny tax issues.
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NEW PENALTY REGIME: SIGNPOST

- Introduction
- Design Principles
- Overview of Key Features: Trigger Date, New Offences, Reduction
- The New “Offences”: Definition of Terms
- Penalty Levels
- Case Studies 1-4
- Specific Issues
- Wrap up/ Q&A

HMRC PRINCIPLES: PENALTIES SHOULD:

- **Influence behaviour**
 - Reinforce legal obligations thereby encouraging compliance
 - Help return people to compliance
 - Deter non-compliance
 - Escalate to achieve the objective
- **Be effective**
 - Visible and set in statute
 - Simple and cost effective to administer
 - Separate from interest
 - Applied consistently including enforcement once they have been awarded
- **Be Fair**
 - Proportionate
 - Customer focused, recognising differences
 - Subject to appeal (where they cannot be overturned by taxpayer action), and
 - Conform with Human Rights legislation

OVERVIEW

- Statute: Schedule 24 FA 2007 Paragraphs 1-31: “*Penalties for Errors*”.
- Applies to the main taxes: (IT; CT, ;VAT; PAYE; NIC).
- Extended to cover other taxes.
- Applies to:
 - Return periods starting on or after 1 April 2008; and
 - Returns filed on or after 1 April 2009.
- “*A penalty is payable*” where
 - 1. A person gives HMRC a “*document*”
 - that contains an “*inaccuracy*” [not defined]
 - which leads to an understatement of tax; or a false or inflated loss; or a false or inflated repayment claim; and
 - 2. The “*inaccuracy*” is “*careless or deliberate*”.

OVERVIEW (CONTINUED)

- New regime is behaviour based.
- Higher penalty levels for more serious faults.
- No penalty for mistakes, misinterpretations, innocent errors [non statutory terms]. (I.e. an inaccuracy not caused by carelessness).
- 3 “*Degrees of Culpability*”:
 - “*Careless*”: i.e. “*Due to failure to take reasonable care*”.
 - “*Deliberate but not concealed*”.
 - “*Deliberate and concealed*” (e.g. by “*false evidence*”).
- Document includes:
 - “*Any document which is likely to be relied upon by HMRC...*”
 - “*...communicating information to HMRC in any form or by any method...*”
 - New concept: Penalty is % of the “*Potential Lost Revenue*”.
 - Normal rule: PLR is the additional amount of tax due as a result of correcting the inaccuracy (para. 5). [But see special cases below]
 - “*Reduction*” in penalties is given only for “*Disclosure*”.

PENALTY LEVELS: MATRIX

Behaviour causing error	Penalty ranges: % of Potential Lost Revenue	
	Voluntary disclosure	Prompted disclosure
Mistake or misinterpretation	0	0
Failure to take reasonable care ("careless inaccuracy")	0 - 30	15 - 30
Deliberate understatement or overclaim	20 - 70	35 - 70
Deliberate understatement with concealment	30 - 100	50 - 100

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DEFINITIONS: MISTAKE OR MISINTERPRETATION

Statute

- Non statutory term because non culpable (i.e. no penalties).

HMRC GUIDANCE

- Not carelessness.
- An innocent error after taking reasonable care.
- A reasonable view of the law that proves to be wrong or is not pursued.
- An action or omission that does not form part of a pattern of behaviour, i.e. It is untypical of the taxpayer concerned.
- The adoption of a treatment for tax purposes that is clearly disclosed to HMRC in a return or accounts, even if subsequently changed by determination of a Tribunal.

DEFINITIONS: CARELESS

Statute

- Failure by the taxpayer to take reasonable care.
- Culpable.

HMRC GUIDANCE

- A breach of duty existing at the time when the duty should have been performed.
- Not doing something that the person knew or should have known ought to be done and which the person concerned had the power to do.
- The absence of such care, skill and diligence as it was the duty and capacity of the person to bring to the work.
- Omitting to do something a reasonable person would do and the person concerned could do, or doing something a reasonable person would not to.
- Negligence,
 - e.g. some neglect of duty in relation to facts or to interpretation of the law; provided the capacity to perform the duty is present.

DEFINITIONS: DELIBERATE BUT NOT CONCEALED

Statute

- The inaccuracy is deliberate but the taxpayer does make arrangements to conceal it.
- Culpable.

HMRC GUIDANCE

- Deliberately getting something wrong, or
- Deliberately not doing something that ought to be done.

Examples:

- Adopting inappropriate accounting treatment in circumstances that appear to rule out genuine misunderstanding.
- Describing transactions inaccurately or in a way likely to mislead.
- Deliberately misinterpreting the law with a view to understatement .

DEFINITIONS: DELIBERATE AND CONCEALED

Statute

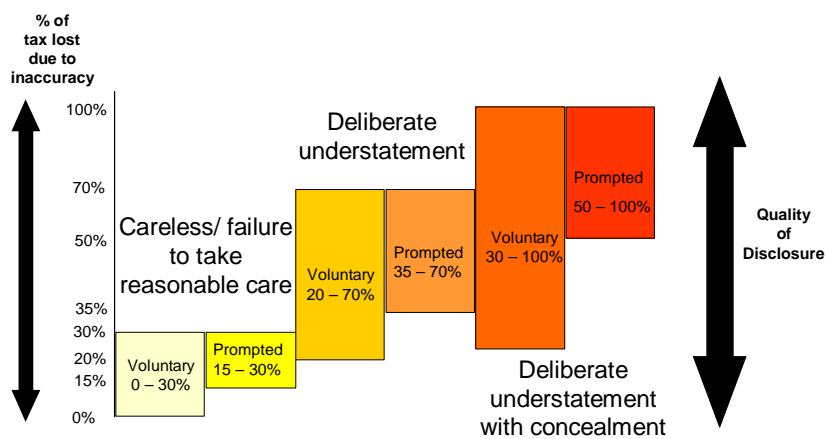
- The inaccuracy is deliberate and the taxpayer makes arrangements to conceal it (e.g. by submitting false evidence in support of an inaccurate figure).

➤ culpable.

HMRC GUIDANCE

- Deliberately getting something wrong and systematically covering it up.
- n.b.: could be in relation to facts or to interpretation of the law and concealment could be before or after the understatement.
- **Examples:**
 - Creating fictitious minutes of meetings or minutes of fictitious meetings.
 - Destroying books, records and documents in order that they may not be available.
 - Deliberately misleading accountants or HMRC.

PENALTY LEVELS: GRAPHIC



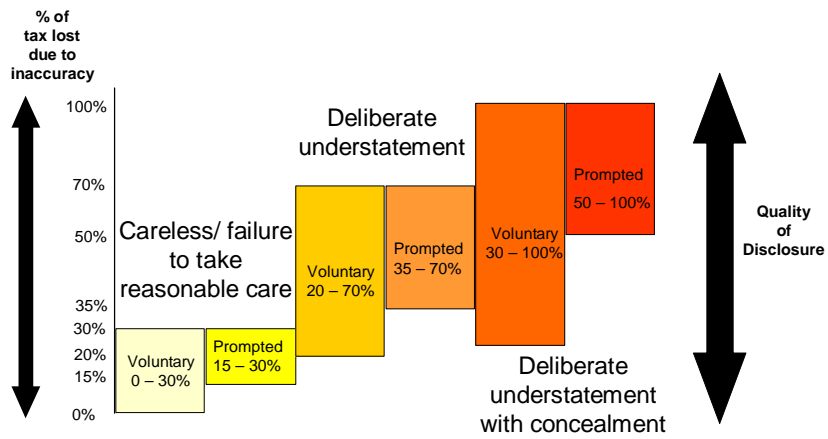
REDUCTION OF PENALTIES

- Reductions in penalty levels (i.e. mitigation/ abatement) are based solely on the “*quality of the disclosure*” of the inaccuracy.
- Quality includes “*timing, nature and extent*”.
- Disclosure is made by:
 - Telling HMRC about it;
 - Giving HMRC reasonable help in quantifying it;
 - Allowing HMRC access to records for the purpose of ensuring the inaccuracy is fully corrected.
- Initial disclosures are in 2 categories:
 - “*Unprompted if made at a time when the person making it has no reason to believe that HMRC have ...or are about to discover the inaccuracy...*”.
 - “*Prompted*”: all other cases
 - Unprompted disclosures (i.e. wholly voluntary disclosures made without fear of challenge) potentially qualify for larger reductions.
 - “In “*special circumstances*” HMRC may reduce penalties further.

CASE STUDIES

- Bespoke Coach Co Ltd
- Thompson Twin Tubing Ltd
- Ahmed the cabbie
- Georgiou’s Kebab shop

PENALTY LEVELS: GRAPHIC



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PENALTIES - SPECIFIC ISSUES

- Failure to notify underassessment
- *Potential Lost Revenue*: special cases:
 - Losses
 - Groups
 - Timing differences
- Agents
- Company officers
- Suspended penalties
- Appeals
- Extension to other taxes
- Failure To Notify

FAILURE TO NOTIFY UNDERASSESSMENT

- Old VAT provision now extended to direct taxes
- Applies where:
 - HMRC have issued an assessment which understates the tax liability, and
 - The person assessed fails to take reasonable steps to notify HMRC within 30 days.
- Penalty is 30% of “*Potential Lost Revenue*”, subject to reduction for disclosure.

S419 ICTA 1988 TAX

S419 ICTA 1988 tax (loans to participators)	PLR is calculated before S419(4) relief (para. 5 i.e. “normal rule”)
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- *Potential Lost Revenue* is calculated without taking account of S419(4) relief.

PENALTIES FOR OVERSTATED LOSSES

Overstatement of used losses	<i>Potential Lost Revenue</i> = Tax on used losses
Overstatement of unused losses	PLR= 10% of unused losses
Overstatement of unused loss: But no reasonable prospect of loss being used	PLR = Nil

- *Potential Lost Revenue* is
 - Additional tax due as a result of correcting the error, plus
 - 10% of any part of the loss which has not been used to reduce tax payable.
- *Potential Lost Revenue* is nil where there is “no reasonable prospect of the loss being used... to reduce a tax liability (of any person)”.

GROUP RELIEF

Group in overall profit: understated profits or overstated loss of a group company	<i>PLR</i> is calculated before Group Relief (para. 5 i.e. “normal rule”)
Group in overall loss: understated profits	<i>PLR</i> is calculated before Group Relief (para. 5 “normal rule”)
Group in overall loss: overstated loss	<i>PLR</i> is after Group Relief (para. 7 (4))

Group in profit overall

- Where a group is in profit overall and a group company has an adjustment to either a profit or loss: *PLR* is calculated on that co. before taking account of any Group Relief (i.e. It could pay a tax geared penalty even though after GR, there is no tax to pay).

Group in loss overall

- Where a group is in loss overall and a group company has an adjustment to a loss : *PLR* is calculated on that co. after taking account of Group Relief.

TIMING ISSUES

Timing Differences	PLR= 5% of delayed tax p.a.
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Current rules

- Each year is treated separately: i.e. a Year 1 understatement could suffer the maximum penalty even if reversed in year 2.

New rules

- Penalty for timing differences.
 - At a reduced level.
 - Applies where tax is “*declared later than it should have been*”.
 - *Potential Lost Revenue* is 5% of “*the delayed tax*”, for each year of delay.
 - Does not apply to overstated losses (separate rules, as above).

AGENTS

Agent gives HMRC a “ <i>document</i> ” containing a “ <i>careless inaccuracy</i> ”	Penalty as for careless inaccuracy unless the taxpayer took “ <i>reasonable care</i> ”
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Current rules

- A taxpayer is not liable to a penalty in respect of negligence by a third party (e.g. an agent)

New rules

- Apply where an agent
 - Gives HMRC “*a document*” containing a “*careless inaccuracy*”.
- Taxpayer is liable to a penalty: as if the careless inaccuracy was his own.
- No penalty if: taxpayer satisfies HMRC that he took “*reasonable care*”.

COMPANY OFFICERS

"Deliberate inaccuracy" attributable to an officer of the company	Up to 100% of penalty chargeable on the officer
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Current rules

- Company officers are not subject to penalties in respect of misstatements of direct tax liability by the company (but may be subject to VAT "Civil Evasion Penalty").

New rules

- Apply to all covered taxes.
- Only applies to a "deliberate inaccuracy" which was attributable to that officer of the company
- HMRC may pursue that officer for up to 100% of the penalty.
 - But HMRC cannot recover more than 100% of penalty overall.
- For a body corporate, "officer" means director, shadow director or secretary.

SUSPENDED PENALTIES

Suspended penalties	Where cause of understatement rectified
Suspension of Careless Inaccuracy penalty for up to 2 years (HMRC choice)	Penalty cancelled if conditions complied with
Penalty offence during suspension period	Suspended penalty becomes payable

- HMRC can suspend all or part of a penalty, for "careless inaccuracy" only, if compliance with a condition of suspension would help avoid taxpayer becoming liable to further penalties.
- Suspension period can be up to 2 years.
- HMRC must specify conditions to be complied with by taxpayer.
- Suspended part of penalty:
 - Is cancelled if conditions have been complied with at end of period;
 - Becomes payable if taxpayer incurs another penalty during period of suspension.
- Taxpayer can appeal against decision not to suspend or against conditions of suspension, but only if HMRC decision was "flawed" on "Judicial Review" principles.

APPEALS

- Penalties are imposed by assessment. [Although a “compromise” (e.g. Contract settlement) can be agreed].
- Taxpayer can appeal against
 - the imposition of a penalty
 - the amount of the penalty.
- Appeals to the Tribunals.
- The Tribunals can substitute their own judgment for that of HMRC.
- Appeals on Suspension issues are on “*Judicial Review*” lines only.

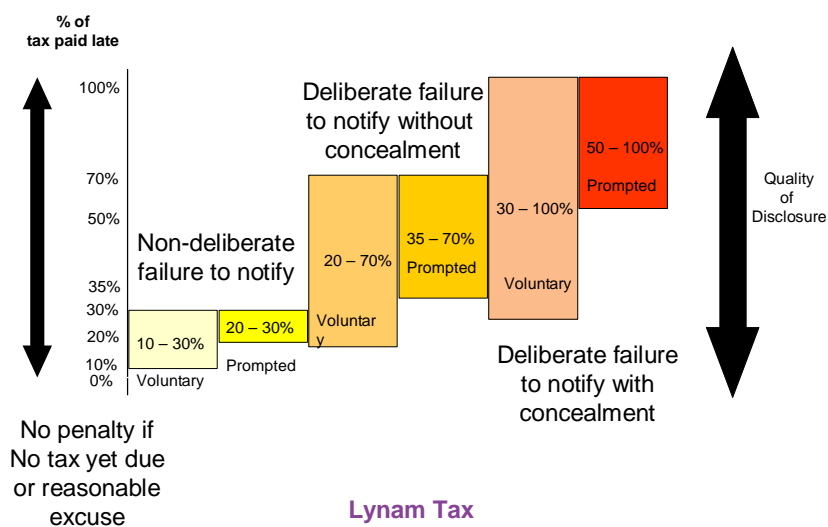
EXTENSION TO OTHER TAXES:

- Expected for return periods from 1st April 2009 and returns filed after 1st April 2010
 - Environmental taxes (aggregates levy, climate change levy, landfill tax);
 - Excise duties (alcohols, tobacco, oils, gambling and air passenger duty);
 - Inheritance tax;
 - Insurance premium tax;
 - Pension schemes (the “accounting for tax” form);
 - Petroleum Revenue Tax;
 - Stamp duties (stamp duty land tax, stamp duty reserve tax);
 - Accounting to HMRC for repayments of student loans;
 - Recovery of statutory payments from HMRC (sick, maternity, paternity and adoption).

FAILURE TO NOTIFY

- HMRC plan to extend this new regime to cover the offence of Failure To Notify liability.
- Expected from 6th April 2009.
- Tax geared penalties only where tax due.
- Offences
 - No tax yet due or reasonable excuse: No penalty
 - Non-deliberate failure to notify
 - Deliberate failure to notify
 - Deliberate failure to notify with concealment
- Reduction for quality of disclosure (same as for incorrect returns).
- But no 100% reduction even for full voluntary disclosure.
- No penalties where there is a “*Reasonable Excuse*”.
- Right of appeal against penalty and quantum.

FAILURE TO NOTIFY: GRAPHIC



Q&A

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Case study 3: Ahmed the cabbie: Careless inaccuracy or Deliberate understatement or Deliberate understatement with Concealment?

Facts

Ahmed has been a self employed hackney cab driver for 5 years since being made redundant from the “cut make and trim” factory where he had worked since he was 16. Ahmed submits his tax returns to HMRC on time and has not previously been the subject of an enquiry.

It is a cash business. Ahmed takes money for the fares and puts it in a moneybelt he wears when driving. He pays for his fuel by taking money out of his “fares bag”. When he returns home Ahmed counts up the money in his “fares bag” and writes the figure in a diary. He doesn’t rely on his meter as he had problems with foreign coins, counterfeit notes and people “doing runners”. When it comes to completing his tax return Ahmed counts up all the takings figures from the diary to arrive at his turnover figure. This is actually the figure net of his fuel costs. Ahmed then totals up all the receipts he has for fuel and claims this as an expense in the profit and loss account.

Ahmed decided to engage an accountant to complete his tax return because he intended to make a long term go of the business. His accountant explained to Ahmed that he had been recording his takings incorrectly and persuaded Ahmed to approach HMRC and make a full disclosure.

As a result of the disclosure made to HMRC Ahmed’s profits were increased by £4,000 per year giving rise to additional duties of £4,500. Ahmed attended one interview as requested and apart from 3 months after the initial disclosure while he waited for the case to be allocated to an inspector and another 3 months while the inspector prepared a “means test” - which supported Ahmed’s disclosure - the case was settled in under 6 months.

Questions

1. Is the return inaccurate? No Yes
2. Has an inaccuracy led to a loss of tax? No Yes
3. What is the degree of culpability, if any?
Mistake Careless Deliberate Concealed
4. Is a penalty appropriate in this case? No Yes
5. Was this a voluntary or prompted disclosure case? Voluntary Prompted
6. What is the quality of the disclosure? Excellent Moderate Poor
7. What % penalty should be applied?



CIOT/ATT East Midlands Branch would like to thank and acknowledge the support of the sponsors who made this event possible:



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EAST MIDLANDS CIOT & ATT – Events for 2008/2009

Date	Details	Timetable	Venue
Tuesday 10 February 2009 4.00pm – 8.00pm Cost: £40.00 CPD Hours: 3	Charity Update – accounts, law & tax Rebecca Benneyworth BSc FCA Tax writer & lecturer Lexis Nexis Tax Lecturer of the year 2007	4.00pm - Registration & refreshments 4.30pm - Lecture starts 6.00pm - Break for refreshments 6.15pm - Lecture resumes 8.00pm – Close	The Novotel Nottingham/Derby Junction 25 M1 Bostock Lane Long Eaton Nottingham
Tuesday 10 March 2009 4.00pm – 8.00pm Cost: £40.00 CPD Hours: 3	Property Tax Update By Brian Ogilvie FCCA CTA Freelance Tax Lecturer & Consultant	4.00pm - Registration & refreshments 4.30pm - Lecture starts 6.00pm - Break for refreshments 6.15pm - Lecture resumes 8.00pm – Close	Comfort Inn A46 Fosse Way Upper Broughton Leicestershire
Wednesday 22 April 2009 4.00pm – 8.00pm Cost: £40.00 CPD Hours: 3	The Interaction between Accounting Standards & Tax By Andrew Guntert MSc FCA Lecturer for Mercia	4.00pm - Registration & refreshments 4.30pm - Lecture starts 6.00pm - Break for refreshments 6.15pm - Lecture resumes 8.00pm – Close	Premier Inn, Braunstone Lane East Leicester
Wednesday 20 May 2009 4.00pm – 8.00pm Cost: £40.00 CPD Hours: 3	Finance Bill 2009 Mark Morton BA ATII ATT Senior Tax Lecturer for Mercia	4.00pm - Registration & refreshments 4.30pm - Lecture starts 6.00pm - Break for refreshments 6.15pm - Lecture resumes 8.00pm – Close	Comfort Inn A46 Fosse Way Upper Broughton Leicestershire
Date to be advised 6.00pm – 8.00pm Cost: £15.00 , CPD Hours: 1.5	Topical Tax Issues Andrew Hubbard BMus PhD ATT CTA (Fellow) Tax Director, Tenon Group PLC	6.00pm - Registration & refreshments 6.30pm - Lecture starts 8.00pm – Close	PricewaterhouseCoopers Offices Donington Court, Pegasus Business Park, Castle Donington, Derbyshire

The Branch Committee reserves the right to alter the above programme without prior notice.
For more details of any of the above events or to book a place please contact the Branch Secretary, Martin Tomes at
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2A Peveril Drive, Nottingham. NG7 1DE

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