

Association of Accounting Technicians response to HMRC consultation document “Tackling the hidden economy: Sanctions”

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1. Introduction

- 1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to HMRC consultation document “Tackling the hidden economy: Sanctions” (condoc), published on 26 August 2016
- 1.2. AAT is submitting this response on behalf of our membership and for the wider public benefit of achieving sound and effective administration of taxes.
- 1.3. AAT has added comment in order to add value or highlight aspects that need to be considered further.
- 1.4. AAT has focussed on the operational elements of the proposals and has provided opinion on the practicalities of implementing the measures outlined.
- 1.5. Furthermore, the comments reflect the potential impact that the proposed changes would have on SMEs and micro-entities, many of which employ AAT members or would be represented by AAT’s 4,200 licensed accountants.

2. Executive summary

- 2.1. The subject of this consultation is the potential for new sanctions to tackle hidden economy activity including repeated non-compliance. It explores the potential for new penalties and sanctions to tackle those operating in the hidden economy, including those who have already been penalised for non-compliance, but have not changed their behaviour.
- 2.2. This is one of three consultations, issued concurrently, relating to measures intended to tackle the hidden economy. The others, to which AAT is also responding, are:
 - Access to data held by Money Service Businesses (MSBs) – new powers to gather customer data held by MSBs for tax compliance purposes, ahead of potential legislation in Finance Bill 2017
 - Conditionality – defined as the principle of making access to licences or services for businesses conditional on them being registered for tax.
- 2.3. This consultation is wider in relation to penalties and covers some issues which AAT has previously responded¹ (AAT’s earlier response) and to which reference is made in part 3 below where appropriate.
- 2.4. AAT supports the proposal to amend the existing failure to notify penalty regime as an appropriate way to deter repeat offenders (3.1, below), but at the same time urges caution in respect of the use of accumulated penalties. Such penalties catch some employers unaware. (3.2, below) and may lack proportionality and fairness.
- 2.5. AAT suggests action to improve proportionality and fairness of penalties (3.8, below)
- 2.6. AAT also gives views on monitoring taxpayers potentially involved in the hidden economy (3.21 below) and employers of illegal workers (3.28, below)

¹ [AAT response to HMRC penalties: a discussion document](#) - April 2015

3. AAT response to the consultation paper on Tackling the hidden economy: Sanctions

Question 1: What are your views on the principle of an escalating financial penalties regime associated with repeat failure to notify failures?

- 3.1. AAT agrees with the option “to amend the existing failure to notify penalty regime so that a second failure to notify attracts a higher penalty rate than a first failure” (3.3, condoc) on the basis that penalties are proportionate and take account of past behaviour.
- 3.2. This condoc covers a wide range of situations. AAT warns at paragraph 3.16 of AAT’s earlier response that “automated penalties can also catch some taxpayers unaware if they are caught by an accumulation of these penalties in a complex situation” and at 3.4 of that response AAT highlights rigidity in Schedule 55 to the 2009 Finance Act.

Question 2: Do you think increasing financial penalties for repeat failures will deter repeat failures? If not, why not? What more do you think could be done?

- 3.3. AAT considers that increasing financial penalties for repeat failures may deter some further failures by taxpayers who have previously been penalised for failure to notify chargeability and who would otherwise deliberately offend again in a later year. However, AAT recognises at 3.4 (below) there will be a cohort of taxpayers who are unaware of some of the complexities of complying with reporting legislation, such as CIS compliance and who may be caught by an accumulation of repeat penalties. Tribunals regularly decide on these and an example of this is the Laithwaite case².
- 3.4. At 3.38 of AAT’s earlier response reference was made to VAT default surcharge legislation at S59 VATA 1994 as an example of penalty application in response to individual behaviour where an initial failure to comply within a 12 month period attracts a warning rather than a penalty but successive failures attract stiffer penalties. AAT believes that this is consistent with the HMRC statement in condoc 1.10 that penalties are not designed to raise revenue.

Question 3: What are your views on the design proposals for escalating financial penalties regime associated with repeat failure to notify failures set out here and in Annex B?

- 3.5. To avoid situations of the type described at 3.3 (above), the words ‘and which a previous penalty was charged’ should be added to the words “increased penalty percentages for second and third failures by the same individual or business” in the proposed legislation in Annex B Option A table A1.

Question 4: Do you have initial views on the detailed design points in paragraph 3.7?

- 3.6. Paragraph 3.7 condoc raises a number of considerations for the design of changes to ‘failure to notify’ penalties (Schedule 41). AAT agrees with these considerations such as how the penalty could apply in cases of phoenixism.
- 3.7. However, it is likely to prove difficult to translate the considerations to legislation as they would need to apply to a range of situations.
- 3.8. It is a concern that one of considerations is “whether the penalty was proportionate and could be paid by those penalised” (3.7, condoc), as stated in the earlier response current legislation is inflexible towards ‘proportionality’.

² Gary Laithwaite V HMRC [2014] UKFTT 0759 TC

Question 5: What other design points should be taken into consideration?

- 3.9. With respect to the consideration ‘whether the penalty was proportionate and could be paid by those penalised’, legislation needs to be rewritten to allow for real proportionality on penalties.

Question 6: What are your views on excluding changes to Schedule 24 from the wider package of proposed sanctions to deter Hidden Economy activity including repeated non-compliance?

- 3.10. It is considered that excluding changes to Schedule 24 from the wider package of proposed sanctions to deter Hidden Economy activity including repeated non-compliance is appropriate.
- 3.11. Furthermore, repeated non-compliance should be factored into the gravity of behaviour as illustrated in example 2.4 (condoc).

Question 7: Would such an exclusion create any imbalances in the way in which hidden economy activity is penalised by HMRC?

- 3.12. AAT considers that Schedule 24 is extensive and sufficiently flexible to cover the various offences for which hidden economy activity is penalised by HMRC.
- 3.13. The illustrative example set out at 2.4 (condoc) should be regarded as deliberate and subject to a maximum of 70% of tax lost. Where it is considered deliberate and hidden it should be 100% (subject to any discount for disclosure).

Question 8: Do you think that there is an inconsistency between the strength of penalties for hidden economy employers that fail to operate PAYE, and penalties for other hidden economy failures like failure to notify?

- 3.14. The example in 3.13 (condoc) illustrates the point in question 8 that failure to notify a PAYE liability may lead to much lower penalties than would be experienced under Schedule 41.
- 3.15. The possible inflexibility of PAYE penalties was illustrated in the earlier response (3.17, earlier response) by case of Hok Ltd V CIR [2011] UKFTT 433 (TC) (Hok) where the Tribunal criticised HMRC’s system of waiting “until 4 months have gone by” causing a ‘build up’ of automated penalties. This caught the company, which considered it was acting correctly, by surprise. The Tribunal considered this was unfair although it is understood that HMRC now issues penalties earlier.
- 3.16. Hok is an example of inflexibility where the Upper Tribunal held that the First-tier Tribunal had exceeded its powers. To mitigate this, the powers of the First-tier tribunal should be made more flexible in cases of appeals against penalties.
- 3.17. It is agreed that the ‘reasonable excuse’ rules may need updating to better support those genuinely wanting to comply, especially the difference between HMRC considerations (which bind HMRC staff) and those allowed by the tribunal from time to time.

Question 9: What options should HMRC consider for strengthening penalties for hidden economy employers that fail to operate PAYE?

- 3.18. AAT agrees that, in planning to tackle PAYE failures in the hidden economy, careful consideration should be given before rushing to legislate on any new penalties or changes to existing penalty models with a view to minimising the impact on compliant employers and those who make mistakes.

- 3.19. AAT suggests that HMRC may consider strengthening penalties for hidden economy employers that fail to operate PAYE where the tax lost is high (the level of which would obviously need to be brought into legislation) and for repeated failures to operate PAYE.

Question 10: Do you think there should be any additional safeguards put in place to ensure the fair application of changes associated with repeat failure to notify failures?

- 3.20. It is considered that the basic safeguards listed at 3.15 (conduc) are sufficient to ensure the fair application of changes associated with repeat failure to notify failures.

Question 11: What are your views on increased monitoring of individuals and businesses engaging in hidden economy activity?

- 3.21. Increased monitoring of individuals and businesses engaging in hidden economy activity would be an appropriate step. As would the monitoring of any individual(s) or business(es) considered to be a serious defaulter.

Question 12: How could increased monitoring be designed to effectively target hidden economy individuals and businesses and motivate future compliance?

- 3.22. AAT accept that monitoring phoenixism or directors with a history of tax motivated insolvencies is difficult because their next employer may be a newly formed company with a name different from their former and now insolvent company.
- 3.23. It is accepted that the monitoring regime would need to have the capability to track the risks posed by individuals involved in tax-motivated insolvencies in order to make effective use of securities powers in cases of serious non-compliance, by asking for a deposit or bond in advance of payment.
- 3.24. It is agreed that serious action should be taken against those who conspire to make arrangements to evade PAYE in planned phoenixism by tracing and targeting them under the Managing Serious Defaulters (MSD) programme and Serial Avoiders Regime.
- 3.25. At 3.37 of AAT's earlier response it was recommended that suspension of penalties provided for in Schedule 24, paragraph 14, which gives HMRC the discretion to suspend for up to two years all or part of a penalty for careless action, provides a model for focussing on individual behaviour which could be applied to other penalty situations. The suspension scheme legislation sets out the mechanics of how this would happen and how the penalty can be cancelled or become payable depending on the taxpayer's subsequent behaviour in following years.

Question 13: What safeguards do you think would be necessary and proportionate to ensure the fair application of increased monitoring?

- 3.26. The statutory conditions required for monitoring serious defaulters are necessary and proportionate to ensure the fair application of increased monitoring.
- 3.27. Furthermore, it is reasonable for HMRC to monitor serious defaulters until satisfied that the taxpayer is complying with tax obligations and has rectified previous non-compliant behaviour. This would include putting right any inaccuracies identified. The fact that there is a time limit to the serious defaulters monitoring regime is also a safeguard.

Question 14: Where illegal working is found alongside tax non-compliance, could the penalty regime for tax failures be strengthened or changed?

- 3.28. AAT notes government proposed restrictions to the Employment Allowance for employers found to be employing illegal workers as one of "a range of activity to strengthen government response to illegal working" (5.3, conduc). In addition there is the Home Office penalty of up to £20,000 for each worker. AAT therefore considers the penalties to be sufficient.

3.29. In addition current legislation in this area and the way that information is exchanged between the Home Office and HMRC should be reviewed in order ensure that it remains fit for purpose.

Question 15: Do you have any other suggestions for financial or non-financial sanctions that could be effective in responding to hidden economy noncompliance and promoting good compliance?

3.30. As previously observed at 3.50 of AAT's earlier response "that HMRC might look at the practice of some gas, electricity and telephone companies which give a modest discount if payment is made by a certain date although this might only encourage the already compliant rather than the careless".

Question 16: Do you have any suggestions or comments on the most effective way to understand and measure the likely impacts arising from potential policy changes set out in this consultation?

3.31. AAT has nothing to add to HMRC's assessment and summary of aspects in condoc Part 6.

4. About AAT

4.1. AAT is a professional accountancy body with approximately 50,000 full and fellow members and 80,000 student and affiliate members worldwide. Of the full and fellow members, there are over 4,200 licensed accountants who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types.

4.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

5. Further information

If you have any questions or would like to discuss any of the points in more detail then please contact Aleem Islan, AAT Technical Consultation Manager, at:

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