THE CHARTERED INSTITUTE OF TAXATION

HM Revenue and Customs Modernising powers, deterrents and safeguards

The first year

A report from
The Chartered Institute of Taxation

Contents

1 Introduction

Few people would argue with the proposition that in a democratic society the state needs to have powers to enable it to establish and enforce taxation liabilities. Only in the most utopian of societies could it ever be imagined that there could be 100% voluntary compliance with tax laws without any involvement from the state. But, equally, in a democracy the powers of the state must be balanced by the rights of the individual as recognised in the Human Rights Act. Even the most zealous tax official would accept that limits must be placed on the state's power - powers must be designed and operated in a way which is proportionate, fair and transparent and which does not place an undue burden on the citizen.

The powers of the state in relation to the administration of taxation have recently undergone a profound change in the UK. The CIOT has been very actively involved throughout this process. Over the last year we have seen some of the new powers regime in operation for the first time. As President of the Institute I have devoted a considerable amount of my time to understanding the basis of the new powers and, in particular, the way that their use has evolved. This has involved meetings with virtually all of our branches, engagement both publicly and privately with members of HMRC involved in the operation and implementation of the powers, speaking at events and writing on the subject. Many of my colleagues within the Institute have also spent many hours grappling with the implications of the new powers – during both consultation and implementation – and continue to do so.

As my Presidential year comes to an end, I thought that it would be useful for the Institute to produce a first end of year report on how we see the current state of the operation of the new powers. This document is the result of something of a taking stock exercise. As will be clear to those who read the report in full, experience on the ground of the new powers is still fairly limited, and it would be wrong to draw too many firm conclusions about the long-term effectiveness of the new powers regime purely on the basis of what has happened in this first year. But there are some emerging trends which are worth commenting on and recommendations to be made.

We intend to revisit this area annually over the next few years until the powers have bedded down and we have reached what I hope will be a position of stability.

I commend this report to all involved in the administration of the UK's taxation system.

Andrew Hubbard
President, The Chartered Institute of Taxation

2 Summary and recommendations

Key issues arising from this report

- Experience of the new regime to date for HMRC staff, tax advisers and their clients is limited.

- The changes on the ground have been introduced in a gradual, measured way with no 'horror stories' emerging.

- There is a mixed response to how penalties are being set – with some anecdotal evidence of reasonable spreads but with some bunching towards the middle and some concern over how suspended penalties are offered.

- Keep talking – it is important that HMRC and the professional bodies continue to iron out problems as they arise. The effort in the early years in getting the framework right will set the tone for the next 20 to 40 years. We all have an interest in a system that is fit for purpose.

Areas for further discussion

- What is the policy around the future use of bulk powers?

- Can powers be used informally with smaller business – where is the relationship in which to be informal?

- How do the profession and HMRC come up with an agreed framework of what constitutes reasonable care?

- Is there a loss of informal access to justice under the new tribunal regime?

Recommendations

1. We recommend that all stakeholders continue to invest in appropriate training of staff on the operation of the new powers.

2. We recommend that both HMRC and the agent community develop suitable feedback mechanisms to gather practical experience of the new powers.

3. We recommend that the CIOT undertakes some further work to investigate why 37% of CIOT members thought that the powers had been used unreasonably, to establish whether there are particular areas where change is required by HMRC, tax advisers or their clients.

4. We recommend that some further work is done jointly between HMRC and the professional bodies over timescales for information requests.

5. We recommend that HMRC give priority to the creation of specific training and development activity for staff who are to deal with cross-tax enquiries into small businesses.

6. We recommend as a matter of urgency that HMRC set up a system to facilitate agent authorisation for particular heads of duty merely for the purposes of cross-tax reviews. This could be by way of a paper 64-8 which is held by the HMRC officer leading the review, rather than processing it fully through HMRC's compliance system.

7. The CIOT needs to continue to poll members on the new penalty regime and confirm that clear explanations about the new penalty rules are being provided by HMRC officers.

8. We recommend that HMRC staff are given specific guidance on when to offer suspended penalties when dealing with unrepresented taxpayers.

9. We recommend that the current operational and technical guidance is reviewed in the light of experience to ensure that it is clear where suspended penalties can be offered.

10. We recommend that HMRC staff are given the confidence and support of their line managers to:

- charge high penalties in cases where there has been very clear evidence of deliberate understatement; and

- accept that mistakes happen and that people get into muddles and that such behaviour should not attract penalties.

This would have the support of most tax advisers. Reverting to the soggy middle ground achieves nothing and risks undermining the principles of the new regime.

11. We strongly recommend that the area of flat rate penalties is kept under review to ensure that it is delivering proportionate penalties.

12. In our view, it is absolutely essential that there is further serious engagement between HMRC and the profession to develop a robust framework within which tax advisers can be sure that they are working with reasonable care. This is a key priority.

13. We recommend that HMRC and the professional bodies do some more work to ensure that there is confidence in the internal review process and that it is something worth supporting. In particular, there needs to be greater clarity over the scope the reviewing teams have to look at the decision in the round.

14. We recommend that the whole area of 'discovery' is the subject of a proper review as part of the HMRC powers review exercise.

15. We recommend that HMRC

- ensure that adequate guidance is provided in respect of discovery and ensure that unfounded 'protective discovery assessments' are not issued; or

- explain the legal backing for protective assessments where there is only a suspicion of lost revenue.

16. It is essential that work is done jointly to create a broad framework in which it is clear which type of compliance check will be used in different circumstances.

17. We recommend that information notice letters are clear as to whether they are a routine request for information or an indication of serious concern on the part of HMRC. Allied to this, we recommend that HMRC do some work on standardisation of signatures and job titles.

18. We recommend that more work be done both by tax advisers and HMRC in educating taxpayers about the changes.

19. We recommend that more work is done on considering the interaction of informal and formal powers and obtaining certainty; a piece of work needs to pull all of these threads together to ensure proper safeguards for taxpayers in the use of informal v formal powers.

20. We recommend that VAT officers within HMRC are given proper training in understanding clients' businesses and behaviour, and also the proper people skills. It is unfair on them to expect them to administer a wholly new system without being given the proper support and skills. Training should include the sharing of experiences so that, gradually, some consistency will emerge in the application of the process.

21. We recommend that HMRC work with VAT practitioners to clear up confusion in this area and devise a better system for dealing with voluntary disclosure, in both senses of the word, for VAT, and issue clear guidance on how correction of errors and voluntary disclosure should work under the new regime.

22. Finally, we recommend that the CIOT revisits powers implementation annually over the new few years, and discusses its findings with HMRC, until the powers have bedded down and we have reached a position of stability.

3 About this report

This report relies on both objective and subjective evidence.

The objective evidence comes in the form of a brief online survey of CIOT members which was carried out in early March 2010. The survey asked a number of specific questions about the operation of the powers in practice and also gave respondents the opportunity to add their own comments.

The survey was completed by over 250 members. The results of the survey are tabulated in appendix one. Although this is a relatively small sample of our membership we believe that, taken in conjunction with the other evidence we discuss below, it does fairly represent the range of views and experience of the CIOT membership as a whole. Experience to date of the new powers is, inevitably, limited. Where percentages are quoted in this report they are percentages of members who responded to the survey.

The subjective evidence has been drawn from the experience of the whole of the CIOT community, from taxpayers and from members of HMRC. Some of it is based on examination of specific cases, other evidence is anecdotal. In particular, it reflects the views of members related to us at branch meetings, conferences, workshops and other events. Over the last 12 months there have been over 50 CIOT events, local and national, at which the subject of powers has in one form or another been on the programme.

We do not claim that this report is a fully scientific exercise, but we feel very confident that the material presented here does give a good overview of the ways that the new powers have started to be operated in practice.

4 The powers - a brief overview of the changes

Since the merger of the Inland Revenue and Customs and Excise in April 2005, to form HMRC, HMRC's review and modernisation of their powers, deterrents and safeguards project has been progressing. The areas covered and the changes made and in progress are significant, and have been the result of almost continuous consultation. The CIOT and other professional bodies have been fully engaged with this process: the HMRC Powers team has issued over 100 formal and informal consultative papers to date.

The CIOT has liaised with a range of other bodies, not just in the profession, about the review's proposals, particularly where there have been human rights concerns, as in the now deferred 2007 proposal to provide HMRC with access to taxpayers' bank accounts without adequate safeguards. The CIOT regards reasonable safeguards including fair legal process and access to justice as a high priority. The promotion of fairness, including justice between citizen and state, is one of our key aims.

Nevertheless, overall, we think this has been a good process and, whilst we still believe that a 'Keith Mk 2' independent review would have been preferable, the results to date of the process have been good and deserve our support.

The key areas of change include:

Criminal powers

HMRC powers of entry and search - now covered under the Police and Criminal Evidence Act 1984 (PACE), although the powers available to HMRC officers are limited.

Penalties

a. Penalties for inaccurate returns (Schedule 24 Finance Act 2007 & Schedule 40 Finance Act 2008).

b. Penalties for failing to notify a taxable activity and VAT and Excise wrongdoing (Schedule 41 Finance Act 2008).

c. Penalties for failure to make returns, etc (section 106 and Schedule 55 Finance Act 2009).

d. Penalties for failure to pay tax (section 107 and Schedule 56 Finance Act 2009).

e. Penalties for a senior accounting officer failing to take reasonable steps to establish and monitor accounting systems that are adequate for the purposes of tax reporting (section 93 and Schedule 46 Finance Act 2009).

Compliance checks:

a. Power to obtain information (Schedule 36 Finance Act 2008).

b. Powers to inspect premises, and to inspect and remove documents (Schedule 36 Finance Act 2008).

c. Record keeping (Schedule 37 Finance Act 2008).

d. Time limits for discovery assessments (Schedule 39 Finance Act 2008).

Internal reviews – facility to cold review cases once a decision has been reached as a low cost alternative to an appeal to the First-tier Tribunal.

Interest

Tribunals – changes from 1 April 2009

Reclaiming overpaid tax (section 100 and Schedule 52 Finance Act 2009) – 1 April 2010 (subject to transitional provisions). Applies to income tax, capital gains tax and corporation tax.

Debt management powers – 1 April 2010.

Voluntary code of practice for banks.

It is also worth noting that, as well as the legislation putting through the changes to the powers, there has been extensive guidance material rewriting sections of the HMRC manuals.

Further changes announced with Budget 2010

a. Interest harmonisation for corporation tax and petroleum revenue tax

b. Extensions to the Disclosure of Tax Avoidance Schemes (DOTAS) system

c. Penalties for late filing of returns and payment of tax

d. Tackling offshore tax evasion

e. Excise modernisation and compliance checks

f. Security for payment of PAYE

g. Powers to open packages in the post (to tackle tobacco smuggling)

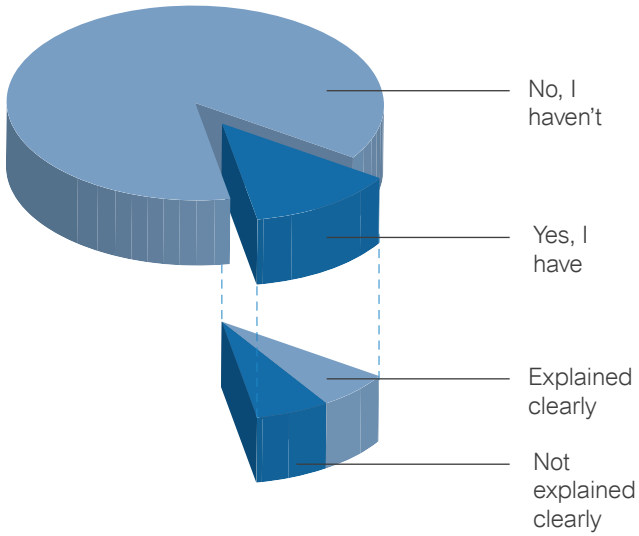
There are further changes to come – not least the taking forward of the Working with Tax Agents discussions, which is likely to result in further powers to tackle deliberate wrongdoing, among other things.

5 Powers - the first year

It is important to start by saying that experience of the new powers in practice is still limited. For example, only 12% of respondents have been involved in negotiating penalties under the new regime, only around 15% of tax advisers responding report that even one of their clients have had any pre-return checks and over 75% of tax advisers have not had experience of the internal review mechanism. These figures are consistent with the experience reported to us by members at conferences and seminars.

Chart 1

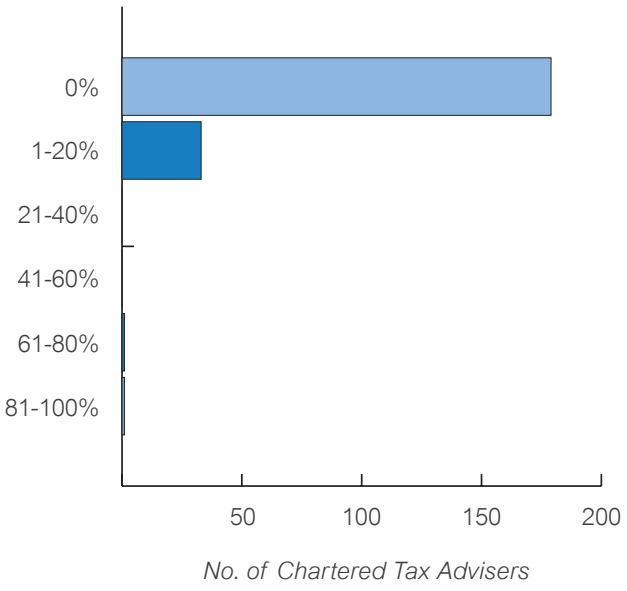
Proportion of Chartered Tax Advisers who have negotiated a new penalty for an incorrect return with HMRC



Proportion of Chartered Tax Advisers who had the new rules explained clearly and applied appropriately to them by HMRC

Chart 2

Approximate proportion of a Chartered Tax Adviser's clients who had a pre-return check



This is not a surprise. The new penalty regime has only applied to periods starting from 1 April 2009 and, for many self-assessment taxpayers, the normal working of the tax return cycle will mean that many returns for periods affected by the new penalties will not yet have been enquired into by HMRC. It will be some time before there is significant experience of all aspects of the new regime.

Some parts of the regime have had a more immediate impact. The new rules for information and inspection notices became operational on 1 April last year and, thus, there is almost a year's experience of how they have been used. So we are in a position to make some early observations.

Early observations

The first important finding is that that some of the early concerns about excessive and inappropriate use of the powers by HMRC have not proved to be correct. Some commentators (though not the CIOT) anticipated the worst, painting a picture of taxpayers and tax advisers being overwhelmed by requests for lorry loads of information and of vast armies of tax officials carrying out inspections of private homes on the flimsiest of pretexts. Manifestly that has not happened. Whilst it is still early days, it is clear that HMRC have kept to their promises and assurances about how the powers would be used. HMRC have been very cautious in the way that they have rolled out their use of the new powers, and it is right that this should be acknowledged.

That is not to say, of course, that everything has worked smoothly or that there are not some areas of concern. These are addressed later in this report. But it is important that these concerns are considered in the context of what we believe to have been a relatively soft landing for the powers as a whole.

The second overriding point is that taxpayers, their tax advisers and, in some cases, HMRC, have been slow in coming to terms with what the new powers mean in practice. A number of speakers who have lectured on the powers at conferences and other events have expressed concern that many tax advisers have had little engagement with the powers and have not really grasped the extent of the fundamental changes. Equally, anecdotal evidence suggests that at least some HMRC officials have felt that they have not had enough training and guidance on how to use the powers in practice. That said, we have seen some of the HMRC training material and events and feel they are of high quality, though in some cases they clearly have quite a task to change longstanding attitudes.

To some extent this is a matter of timing. In an ideal world, somebody gets training on a new development just before they come across it in practice for the first time and, in practice, that largely happened. However, life is never that simple. Our overall view is that – on all sides – timing of the training was not ideal. Some of the initial training on the new powers was probably too early – it was so far in advance of the new regime coming into effect that the messages were lost because people were concentrating on their immediate in trays. But detailed training was often left too late, and people were left struggling to deal with powers in practice without a proper understanding of what they needed to do.

It is clear to us that proper training for a change of this magnitude has to be a continuous process. The key concepts need revisiting and there must be a feedback mechanism under which experience on the ground informs the training.

Recommendation 1

We therefore recommend that all stakeholders continue to invest in appropriate training of staff on the operation of the new powers.

For professional firms, this means ensuring that powers remains a key part of training programmes over the next few years; for professional bodies, that powers are an important part of exam syllabuses and post qualification training; and, within HMRC, that all client-facing staff go through regular refresher training on their rights and responsibilities in dealing with the new powers in operation. None of us can afford the attitude of mind which says 'the new powers are up and running, now let's move on to something else!'

Recommendation 2

We recommend that both HMRC and the agent community develop suitable feedback mechanisms to gather practical experience of the new powers.

Training in the new powers will not only need to be on the technical details; almost more importantly, there will need to be meetings/discussions/workshops to allow practitioners – both advisers (and their clients) and HMRC – to share experiences on the new powers. If good 'feedback loops' can be created, these will contribute positively to the bedding down and eventual refinement/development of the new powers. Also, if those involved can see that their concerns are taken into account, they are more likely to accept the new powers and view them in a positive light.

6 Information and inspection powers

It is difficult at this stage to discern an overall picture on the use of information and inspection powers. But it is notable that the CIOT has not been overwhelmed with complaints from tax advisers about inappropriate use of powers. Certainly there have been some cases where it appears, on initial impressions, that HMRC are being unreasonable in the volume of information that is being sought. This may, however, be down to the style and approach of an individual officer at HMRC rather than a symptom of a larger trend (or it could, of course, be that on examination HMRC are justified in seeking the information).

The main concern which we do have about the use of information powers is how they fit into the wider picture – what we call below the new geography. Where there is a specific and clear reason for HMRC to use information powers, and this is articulated properly to taxpayers and their tax advisers, we do not see many issues. But where clients and tax advisers cannot discern the big picture and information requests relating to past, present and future liabilities appear to emerge mysteriously from random parts of HMRC, seemingly with no discernible logic, this causes concern, rightly in our opinion. We discuss this further below.

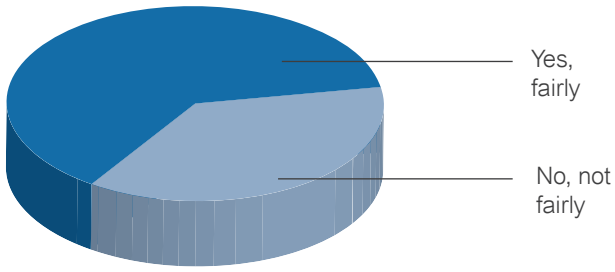
7 Reasonableness

The information and inspection powers rely on the concept of reasonableness – HMRC can only seek information which is reasonably required for the purpose of checking a person's tax position. It is essential that taxpayers and their advisers have confidence that, in the round, HMRC will use what could be very draconian powers reasonably and fairly. The safeguards in the powers need to be seen as clear, available and working.

Initial feedback from the survey is encouraging in this respect. 104 of the respondents said that they thought that, overall, the powers were being used fairly, with 61 saying that they did not. There is never going to be complete agreement about what is fair and reasonable, so a 100% YES response is never going to happen. But this early snapshot does offer some encouragement.

Chart 3

Proportion of Chartered Tax Advisers that think the information powers are being used fairly



However, it must be of concern that 37% thought that the powers had been used unreasonably to date. The reasons for this may be either that the powers are being used unreasonably in more than a third of cases, that some tax advisers expectations are at an unreasonably high level or a combination of these. These need to be explored further.

As the system settles down and more tax advisers have a wider range of engagements with HMRC, we would hope that the YES percentage moves up to much nearer 100%. A near-100% score may seem ambitious, but is surely appropriate in the context of an assessment of whether the powers are being used 'fairly'.

Recommendation 3

We recommend that the CIOT undertakes some further work to investigate why 37% thought that the powers had been used unreasonably to establish whether there are particular areas where change is required by HMRC, tax advisers or their clients.

Timing of checks

Underlying these figures are some illuminating comments from survey respondents. In particular, these show concerns about timescales:

> *"Timing of checks is still an issue: why are they always raised in December/ January? – i.e. our busiest time."*

> *"The timescales set by HMRC are completely one-sided. In one instance, a client has been chasing for a closure for 3 years only to be sent a 4-page letter and given 6 weeks to reply."*

> *"HMRC fail to appreciate that small firms have small numbers of staff and in busy times extended deadlines are needed."*

But it would be wrong not to point out that there are opposite views:

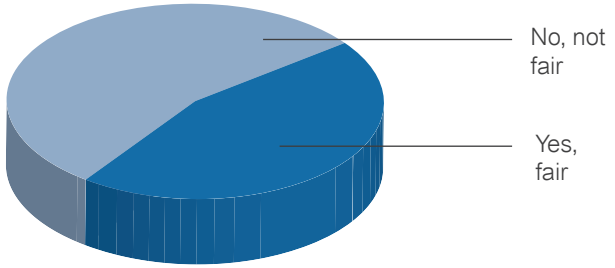
> *"I find that the time allowed is reasonable and have had no problems in asking for extensions."*

Volume of information requested

The overall conclusion from the survey was that 40% of respondents felt that HMRC were not being fair in the volume of information being requested and the time allowed for responses, and 33% thought that HMRC were being fair – the other 27% had not had any experience of the new information powers.

Chart 4

Proportion of Chartered Tax Advisers that think the volume of information being requested and the time provided for responses are fair



Recommendation 4

We recommend that some further work is done jointly between HMRC and the professional bodies over timescales for information requests.

It is clearly right that timescales have to be set – it is in nobody's interest for matters to drift along indefinitely. But we do believe that some officers within HMRC significantly underestimate both the time that it takes to get information together and the volume of information being requested. They also need to bear in mind the commercial pressures which tax advisers are under in balancing this with other aspects of their work, and also the pressures in meeting client expectations in bringing matters to a close. .

We do not have the answers, other than, perhaps, that it would be worth looking at some sort of informal sliding scale under which the greater the volume of information, the longer the period allowed for its production, together with agreeing an informal timescale for responses from HMRC.

8 Conduct of enquiries and compliance checks

The strict statutory language of the powers is one thing: the way that they are used in practice is quite another. We have, therefore, been very interested to understand taxpayers' and tax advisers' experience of the overall conduct of enquiries and compliance checks.

Perhaps not surprisingly, there has been a greater level of response (formally and informally) on this issue than any other. Tax advisers' day-to-day experience of working with HMRC on particular cases inevitably colours their overall attitude to the department – indeed, often to government as a whole.

General support for compliance approach

First of all, and this is not a point which is always appreciated, there is strong support from tax advisers for HMRC's compliance activities. Indeed, a recurrent view from tax advisers is that HMRC compliance activity is not visible or extensive enough and that, consequently, it is all too easy for clients to 'get away with it'.

> *"I think that cross tax compliance checks are more appropriate: too many clients feel that tax is an optional liability."*

> *"Small clients do not seem to be at any risk of an enquiry. We need more enquiries at this level to make them more aware of their duty to get it right and severe penalties if they it wrong. Otherwise we will get a culture of non-compliance among very small businesses of which there are hundreds and thousands and the government will lose a large amount of tax which is properly due."*

This issue is not confined to the very smallest businesses.

> *"HMRC seem to have adopted a policy of making as many companies as possible low risk so they don't have to do anything, which is probably good for those companies but not for the Exchequer."*

But, of course, there is more to it that this. In an ideal world, HMRC would only target those businesses where there was a real tax risk; would conduct those enquiries efficiently and

effectively and would come to a quick conclusion about the amount of tax which was due. But then again, in the ideal world, all clients would keep perfect records, would give tax a high priority and would give full cooperation to HMRC at all stages in the process.

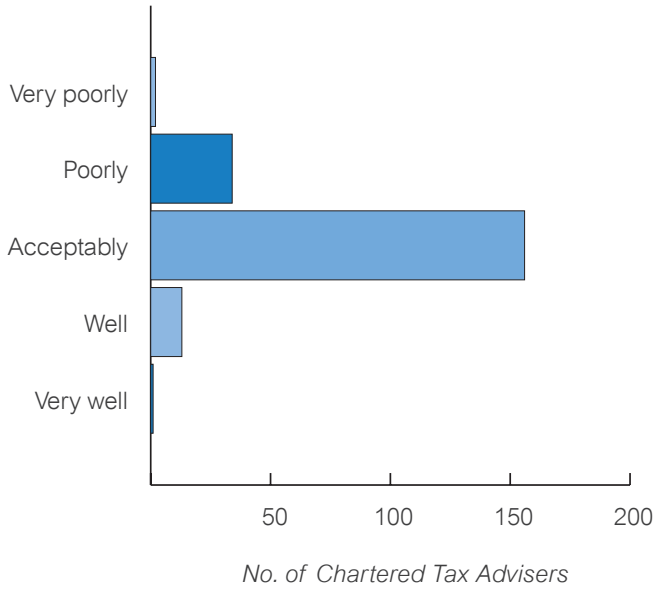
So what is it like in the real world?

One of the questions in our survey was 'how are HMRC running visits?' Overwhelmingly, the response has been 'acceptably', which was chosen by 75% of respondents. No doubt it would be preferable for the rating to have been 'well', but it might be unrealistic to expect this, given that nobody will exactly welcome a visit or inspection.

There are two particular aspects of the responses in this area which need further comment.

Chart 5

How Chartered Tax Advisers think HMRC are running visits and inspections



HMRC staff competence and attitude

There is a recurring theme in the responses about the competence of HMRC staff conducting enquiries. One respondent put it this way:

> ❝ *HMRC is really beginning to show the loss of a whole class of experienced, pragmatic Inspector of Taxes and the well-established practices that had served the country for the last generation. We are now dealing with staff who can barely follow the manuals they have been given, resulting in the constant referral of cases up the line, causing stress and unnecessary costs for all parties involved.*

Consequently a short term gain in HMRC's staff costs is leading to a long term loss to the Exchequer. ❞

This sense of 'more in sorrow than in anger' is typical of the views of many advisers. Tax advisers are proud of their professionalism and genuinely want their opposite numbers in HMRC to demonstrate the same level of professionalism.

There are also concerns about the attitude of some HMRC staff. For example:

❝ *There was an ex-Customs officer who was newly trained in income tax – he appears to have just done a course – who had the attitude that the tax payer was suppressing his income and was guilty before he started. Despite a grossing up exercise the client had no further tax or VAT to pay.* ❞

❝ *We have had experience of HMRC offers completing full reviews on a client, finding very little if anything to concern them but arguing one point, calling into doubt the client's honesty despite having not uncovered anything of substance across CT, personal tax, VAT etc.* ❞

❝ *HMRC set off very aggressively but once we ensured that they were aware that we knew what the law was things went smoothly.* ❞

But there were other views:

❝ *I have certainly seen a dramatic change in the approach taken in the last couple of years, This has changed from a distant and confrontational approach to a refreshing face to face open approach.* ❞

It is worth putting this into context. Most advisers will have little face-to-face contact with HMRC officers throughout the course of a typical year, so these comments may reflected the attitude and behaviour of a very small number of HMRC staff. But it does emphasise the point that a poor attitude by an individual HMRC staff member can colour a tax adviser's perception of the department as a whole. Equally, where a particular intervention is well handled, a tax adviser is likely to want to engage fully with HMRC the next time that questions are asked.

Cross-tax working

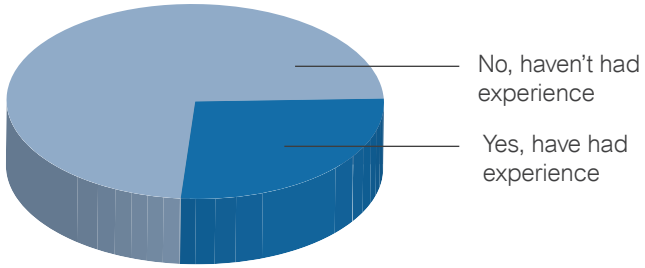
One of the key drivers of the new powers regime is the creation of a framework under which

HMRC can look across all of the taxes applying to a business at one time, rather than dealing with each separately.

At the moment, these cross-tax checks are still relatively uncommon – only 25% of respondents have experienced such a check, but it is very likely that this percentage will increase over the next few years. For those who have experienced them, the view is that they are more effective than having separate enquiries – but the sample is still too low (39 people say more effective, 25 say not) to draw any meaningful conclusions.

Chart 6

Proportion of Chartered Tax Advisers that have had experience of 'cross-tax checks'



Our sense is that there is a broad measure of support for the concept, but concern about the practicalities. A lot of this comes down to basic training.

> *Officers making the checks often have insufficient technical knowledge and lack some of the basic accountancy skills resulting in inappropriate and incorrect findings.*

> *On larger cases a direct tax case manager has been appointed who knows little about the client's VAT history. This has proved to be an inefficient use of client resources.*

> *One cross check only. CT VAT and PAYE had different officers – yet to see if any joined up correspondence on it.*

> *Although now one department HMRC are a long way from integrating the compliance actions of the various taxes they deal with, much less their knowledge base across the taxes.*

In our view, cross-tax working is something which should be supported. It must make sense for a client's tax affairs to be looked at in the round, rather than on a piecemeal basis. But this will only work if HMRC develop cross-tax skilled individuals, particular those who deal with

small businesses. For smaller cases, it is simply impractical for HMRC to put together teams of individual specialists. A typical adviser to a small business will have to deal with all of the taxes, and, of course, for the client him/herself tax will only be a very small part of running the business.

Recommendation 5

We recommend that HMRC give priority to the creation of specific training and development activity for staff who are to deal with cross-tax enquiries into small businesses.

Process Points

We did note some process problems in the early days of cross-tax working. For example, where an agent had an agent authority from the client (form 64-8) in place for direct tax only (which is likely to be common) and HMRC wanted to do a check to include other taxes for which the agent was not authorised, the process was to send letters to the client but not to the agent, on the basis that he was not authorised to deal with, say, PAYE. At a technical level this was logical, but it led in practice to some very odd results, with agents having no idea that a client was under enquiry. A workaround has been found for this which does not undermine client confidentiality but still allows agents to be aware of enquiries.

We mention this not to criticise HMRC, who were quick to respond when the implications of this process were realised, but to point out that in a new regime many teething problems of this nature are likely to emerge. It is essential that mechanisms remain in place to ensure that where such problems do arise, solutions can be found quickly.

Coupled with this, a number of members have contacted us direct regarding these practical problems on dealing with HMRC on cross-tax reviews. Tax advisers are often only involved in an advisory basis for aspects of a client's tax affairs, and may not be authorised by the client to communicate with HMRC (the form 64-8 process), because they do not need to become involved in the significant paper chain that that can engender. However, a client may wish the adviser to be fully involved in a cross-tax enquiry. HMRC's current systems for agent authorisation do not lend themselves to setting up this type of authorisation. This issue has been raised with HMRC.

9 Penalties

Penalties were always likely to be the most controversial part of the new powers framework, and it is not surprising that many members of the CIOT have commented to us about the new penalty regime.

The CIOT is happy to repeat its support for the broad framework of the new penalty regime. The old regimes were fairly blunt instruments: the direct tax regime squeezed very different types of behaviour into a very narrow range of penalty outcomes - the VAT regime often produced penalties which were simply the product of arithmetic with no relationship to the underlying behaviour. So it must be right that the penalty regime is designed to reflect behaviours.

We have no problems with high levels of penalties for those who are deliberately fiddling their taxes. Indeed, we believe that the way that HMRC has operated penalties in direct tax cases in the past has not created a significant deterrent. As one participant said:

> *❝ I think that a more rigorous penalty regime is long overdue. ❞*

The quotations in the section about the conduct of enquiries are particularly pertinent here.

But, and this point had been stressed to us again and again, there must be a balanced approach. The system must properly distinguish between those who are deliberately setting out to evade their taxes, those who are careless or generally in a muddle but who have no deliberate intent, and those who are simply making mistakes. The legislation recognises these different behaviours – there is no penalty for innocent error, a lower penalty for failure to take reasonable care and also the possibility of suspension of penalties where there has been a failure to take reasonable care but where matters can be put right for the future. The key question is how that framework is operating in practice.

One respondent put it this way:

> *❝ Some clients, probably the majority, will care about the penalties. Others will act no differently and a few will do their best but will still be charged a penalty because they are human and we all make mistakes. HMRC must ensure that the final group*

are not treated as if they are in the same league as those who deliberately fail to disclose income. It should not be the profession that keeps an eye on things but I suspect it will be. The Government is too desperate for funds to be overly fussy about how they are raised. ❞

At the moment the sample is too low to draw any firm conclusions. Only 31 respondents have negotiated a new penalty for an incorrect return: in those, about half thought that HMRC had explained the new rules clearly and applied them appropriately. This latter statistic is potentially worrying, as providing a clear explanation is an important part of ensuring that the new system has the support of tax professionals, but the numbers are so small that it would be wrong to raise this as a serious concern at this stage. It will be important to track responses on this point in future surveys.

Recommendation 7

The CIOT needs to continue to poll members on this area and confirm that clear explanations about the new penalty rules are being provided by HMRC officers.

Suspended penalties

There is strong support for the concept of suspended penalties. As yet, however, there is little practical experience. Only 30 respondents claimed experience of suspended penalties: of these, more that half reported that none of the penalties which had been imposed had been suspended. It may be, of course, that in these cases the penalties were not of a type which could be suspended. (Penalties for deliberate understatement cannot be suspended; HMRC are also unwilling to apply suspension to what are essentially one-off things such as CGT, due to what seems to be an extreme view of the legislation in Finance Act 2007 Schedule 24 paragraph 14. It may be that the Tribunals will have to decide in due course where the boundaries lie.)

In the majority of cases involving suspended penalties, HMRC had not offered a suspended penalty and the tax adviser had had to ask for it. This is a small sample and may not be typical, but we would be concerned if this pattern were replicated, especially as the CIOT has expressed concern from when the guidance was first drafted that it had been worded in such a way as to make it difficult to see who would be eligible for suspended penalties. Competent tax advisers will know to ask about suspended penalties, but unrepresented taxpayers may not know about this option and, if it is not offered to them by HMRC, they may be deprived of an important right.

Chart 7

What proportion of the new penalties which have been imposed on your clients have been suspended?

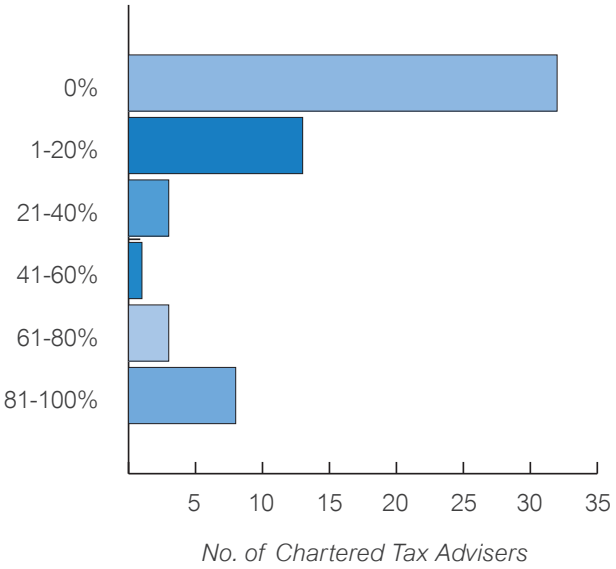


Chart 8

Where penalties have been suspended, in most cases:

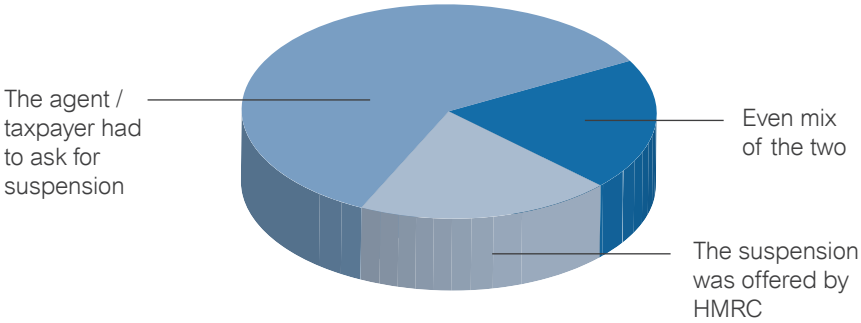
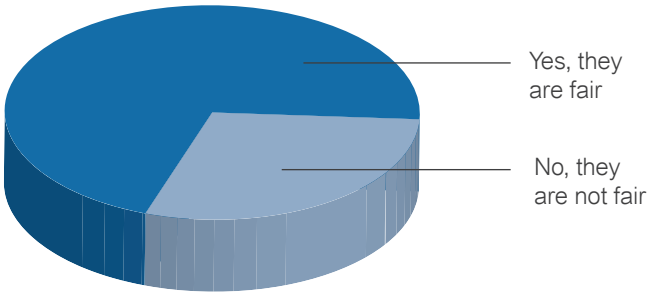


Chart 9

Proportion of Chartered Tax Advisers that thought the decisions on suspended penalties are by and large fair



Recommendation 8

We recommend that HMRC staff are given specific guidance on when to offer suspended penalties when dealing with unrepresented taxpayers.

Tax advisers also report that within HMRC there are very different attitudes to suspended

penalties:

> *❝ In my experience decisions on suspension of penalties depend on the individual 'Inspector' one is dealing with and the extent of one's relationship with them. I've noticed no change in this to date. ❞*

> *❝ Suspension in even the most deserving cases has had to be asked for and we only managed to get suspension after pressing for an internal review. ❞*

It is hardly surprising that there is as yet no consistency on this. HMRC and tax advisers are feeling their way in dealing with a fundamental new concept. We will return to this issue in our report next year, by which time we hope that there will be more evidence to go on. Suspended penalties are a very important development for the penalty regime and HMRC deserve real credit for introducing them; it is very important that they are used properly and consistently.

Recommendation 9

We recommend that the current operational and technical guidance is reviewed in the light of experience to ensure that it is clear where suspended penalties can be offered.

Drift to the soggy middle

The old penalty regime had, in effect, a single set of penalties which then got negotiated towards the 'soggy middle'. One of the main aims of the new regime is that different categories of behaviours will attract different levels of penalty. Deliberate understatement attracts a high penalty – innocent error, no penalty, and failure to take reasonable care a low penalty. We see, however, that this concept may be being compromised at both extremes.

Our informal conversations with staff within HMRC suggest that there is a real reluctance to impose the high penalties for deliberate understatement that the new regime imposes. The minimum penalty in cases of deliberate understatement is 35% (unless exceptionally there is a wholly voluntary disclosure), and even this depends on full cooperation from the taxpayer. Yet under the old regime penalties of this order were, in practice, only seen in cases which were tantamount to serious fraud.

Many tax advisers have the mindset that HMRC staff are sharpening their pencils with delight at the thought of being able to impose very high penalties: the reality is that HMRC staff seem very uncomfortable at imposing such high penalties because they represent such a break from the past. So we believe that there is a real danger that some of these cases are being dealt

with as if they were simply a failure to take reasonable care. This may be because deliberate intent is, and should be, much more difficult to prove (and accept) than carelessness; it may also be because the penalties for carelessness are much closer to the levels which HMRC staff are used to dealing with.

At the same time, we see significant concerns that HMRC staff will be reluctant to accept that there has been innocent error and will want to treat any mistake as constituting a failure to take reasonable care, and thus attracting a penalty.

> *❝ Lack of clarity on reasonable care is a problem. Anecdotally we hear that HMRC officers are arguing careless on every occasion – this is a worrying attitude. ❞*

We have heard similar comments from many members. It is still too early to know whether such fears have any foundation, but the risk must be there. The question of reasonable care is discussed in more detail below

We very much support the framework of the new penalty regime. It would be very unfortunate if the way that it was operated in practice undermined the design.

Recommendation 10

We recommend that HMRC staff are given the confidence and support of their line managers to:

- *charge high penalties in cases where there has been very clear evidence of deliberate understatement; and*
- *accept that mistakes happen and that people get into muddles and that such behaviour should not attract penalties.*

This would have the support of most tax advisers. Reverting to the soggy middle ground achieves nothing and risks undermining the principles of the new regime.

Construction Industry Scheme (CIS) and PAYE penalties

The framework of behavioural-based penalties is broadly supported by advisers (despite some reservations about how it is operated in practice). There is, however, very significant concern about the operation of some non-behaviourally based penalties, particularly the flat rate penalties for certain compliance failures relating to PAYE and the CIS scheme, although we

appreciate that the modernised scheme for CIS and PAYE has not yet been implemented.

The penalties for compliance failures with CIS are seen as very draconian – the potential loss of gross payment status can be commercially and financially damaging in a way that seems out of all proportion to the offence in many cases. These seem to many tax advisers to be completely over the top and can have the effect of putting the continuation of businesses at risk.

There is now a real disconnection between the behaviourally based penalties for understatement of tax liabilities and the fixed penalties for compliance failures, some of which can be levied even in cases where there is no loss of tax.

In the case *SKG (London) Limited v Commissioners for HM Revenue and Customs* TC00282 it was noted that the directors of the company had merely got in a muddle and that they had appointed an accountant to help them make a disclosure. However, under the CIS penalty regime, penalties totalling £2,800 had been issued for late returns where the involved was initially only £1,119.40. This represents a rate well in excess of 200%. This compares quite unfavourably with, for example, the 10% penalty rate charged in recent disclosure campaigns, whether for failure to take reasonable care or for a deliberate default.

If the new penalty regime is to have the confidence of taxpayers and their tax advisers it must be seen to operate fairly and proportionately. The risk with flat rate penalties is that they impose a penalty out of proportion to the offence; we need to keep this area under review and, particularly in the context of CIS, make sure that loss of gross payment status only results from serious breaches of the system that give a high risk of loss of tax.

Where an agent notices payments to sub-contractors that could be within CIS and registers the contractor going forward, tax advisers are telling us that HMRC are issuing penalties for past periods, even if the correct tax has been paid. This is not the best way to encourage compliance, and not good for the good advisers who want to get their clients to comply.

In addition to changes already faced, further real complications are being introduced for contractors – the new late payment regime kicks in from April 2010 (for in year payments) but the new rules for late monthly returns do not come online until April 2011. Members who specialise in this area think that the further staggered changes are likely to cause more confusion in a sector which has undergone several regime changes over a short period. Some transitional provisions may be needed.

Recommendation 11

We strongly recommend that this area of flat rate penalties is kept under review to ensure that it is delivering proportionate penalties.

10 What is reasonable care?

Reasonable care is an absolutely critical concept within the new regime. At one end of the spectrum, the distinction between simple error and failure to take reasonable care will mean the difference between being in a penalty position and not: at the other end, the distinction between failure to take reasonable care and deliberate error will not only mean different penalty levels and different time limits for assessment, but also determine whether or not a penalty can be suspended.

There is no doubt that the concept of having a distinct regime for failure to take reasonable care is welcomed by almost all of the people, whether within the profession or within HMRC, to whom we have spoken. The key question is, of course, whether there is any consensus on what failure to take reasonable care means, especially within direct tax scenarios, or, to put it another way, what HMRC will accept as showing that an tax adviser or taxpayer has taken reasonable care.

There is a strong body of opinion which fears that HMRC have or will set the bar too high and demand a standard of care from tax advisers which is either unattainable in absolute terms or is, at least, unattainable in the market place in which tax advisers currently operate. This is not in any way to suggest that tax advisers wish to operate at anything but the highest standards, but simply to recognise the reality that the bar must be placed at a sensible level which conscientious tax advisers regard as fair and reasonable and which is capable of being demonstrated fairly easily to HMRC. Tax advisers have frequently raised this issue with us, often in conjunction with the toolkits which HMRC have produced.

Recommendation 12

In our view, it is absolutely essential that there is further serious engagement between HMRC and the profession to develop a robust framework within which tax advisers can be sure that they are working with reasonable care. This is a key priority.

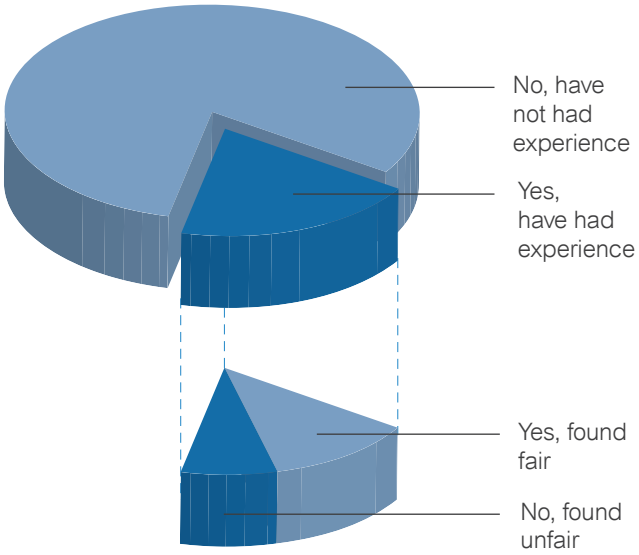
11 Internal reviews and tribunals

Internal reviews

The internal review system is a new feature of the direct tax environment. There is still only a minority of practitioners who have used it (18% in our survey), but there is enough experience of the review system in operation to draw some tentative conclusions.

Chart 10

Proportion of Chartered Tax Advisers that have had experience of the new internal review mechanism



Proportion of those Chartered Tax Advisers that found the process fair and reasonable (even if they didn't necessarily get the result they were hoping for)

Of the 47 tax advisers in our sample who have used it, 29 found the process fair and reasonable and 18 did not. (We deliberately did not ask whether or not respondents had got the outcome which they were hoping for.)

There is still a long way to go before the internal review process settles down. HMRC have published the results of reviews on their website. HMRC have not formally published the results to date of reviews, but some figures are in circulation. Discerning trends from these is difficult, but it appears that many of the reviews have been of fixed penalty cases where penalties have been imposed automatically in cases where they should not have been. There is comparatively little experience of reviews of substantive cases. This is not surprising, as it will take a while for such cases to reach the review process.

We do not at this stage therefore intend to comment in detail on the operation of the review process, and we will return to this subject in more detail in next year's survey. But we do encourage HMRC to be as open as possible about the way that the review process works. There is still a lot of confusion about this in the minds of practitioners. Some see it as little more than a rubber-stamping exercise (which may reflect previous experience of VAT reviews):

> *❝ It is all a waste of time as HMRC will do what they want to do anyway. ❞*

Recommendation 13

We recommend that HMRC and the professional bodies do more work to ensure that the process works fairly, that there is confidence in the internal review process and that it is something worth supporting. In particular, there needs to be greater clarity over what scope the reviewing teams have to look at the decision in the round.

And several are concerned that the purpose of the review appears to be limited:

> *❝ The [aim of the] officer undertaking the review was simply to ensure that proper steps had been followed and not to review the decision. ❞*

It is very important to be able to demonstrate that reviews are more than a 'rubber stamping' exercise in which the correspondence is reviewed and the HMRC decision automatically endorsed.

The CIOT has consistently supported the internal review concept, and there is little in the way that the reviews have operated to date which has caused us to change that view. We also welcome the commitment from HMRC to openness about the statistics on review decisions. Used properly, we are strongly of the view that a review process has an important part to play in dispute resolution.

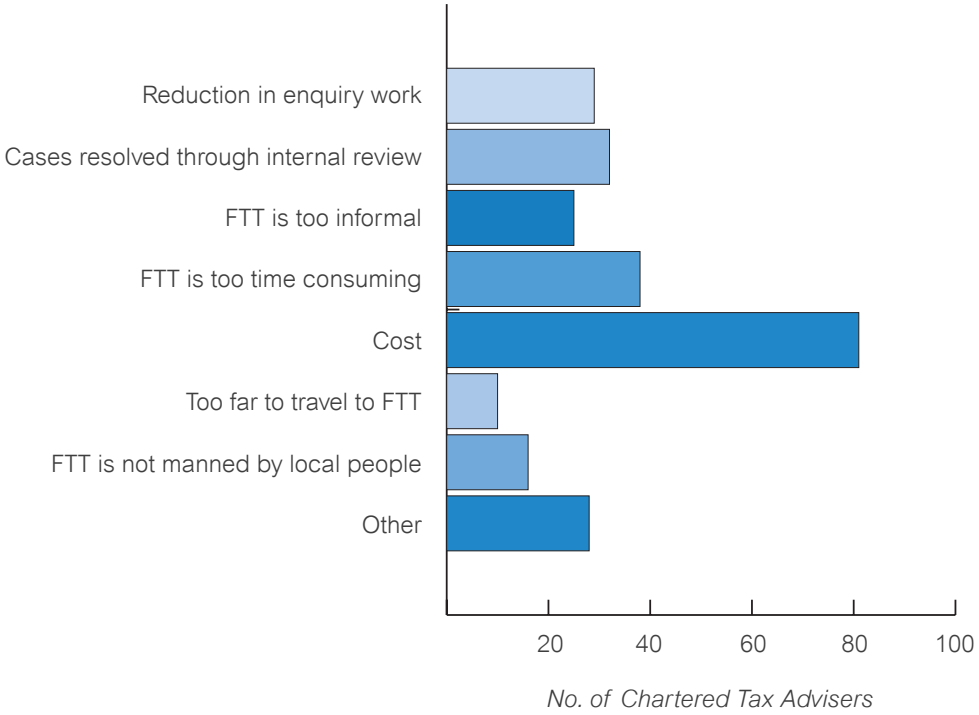
Tribunals

We are aware that there are far fewer cases being heard by the First-tier Tribunal than was anticipated. We therefore asked respondents for their views on why this might be.

Cost was seen as the major issue, with concerns also being expressed about formality and the time involved in taking cases to the Tribunal. Again, it is too early in the process to draw conclusions, but we do have a worry that much has been lost by the move from the informality of the old General Commissioners to the more legalistic processes of the First-tier Tribunal.

Chart 11

Main reasons why Chartered Tax Advisers think the number of appeals to the first tier tribunals is so low.



We have no doubt that the tribunals are well placed to deal with larger and more formal cases, but we have concerns that people who simply want to take up what might be a minor issue, but one which is very important to them, will find the apparent formality of the tribunal off-putting.

At the same time, the perceptible distancing of the tribunals from HMRC has real merits: there is now no risk that a taxpayer, who previously had to appeal via HMRC, then turns up to a hearing and finds the local inspector chatting in friendly terms to the General Commissioners, and gets the feeling that he has little chance of success. It must also be said that the HMRC review process may well be an adequate substitute for the cases where the taxpayer really just wanted to make sure their case had been properly considered and what seemed an unfair result really was in accordance with the law: early indications are promising.

The General Commissioners were not perfect and we understand the reasons for their replacement. But we remain very concerned that, despite the best of intentions, a whole group of taxpayers may perceive that their ability to have their case determined independently may have disappeared. We intend to return to this issue in later reports. Further research in this area is undoubtedly required as the new tribunal system itself beds down.

12 The new geography

Two of the most common reactions to the new powers have been:

- I think that I understand how each of the individual powers operates in isolation but I don't understand how they all fit together; and

- From when were specific powers introduced or when will they be introduced?

That has been said to us many times by tax advisers, but it has also been said to us by members of HMRC.

At the moment it is rather like having a guide book which has separate pages on each visitor attraction but without a note of opening hours, no map showing where they are relative to one another and no index.

Discovery

What lies behind these comments is a concern that the fundamentals of the self-assessment system have now largely broken down. Under the new powers regime, HMRC have the right to ask for information relating to a person's past, present and future tax position. This is clearly a very big change from the previous position, under which information could only be sought within the framework of an enquiry. Yet, at the same time, the boundaries of when information can be sought after the enquiry period has closed have also been extended by the way in which the courts have interpreted the rules relating to discovery. *Langham v Veltema* extended the discovery principle further than most commentators would instinctively have done, and subsequent decisions of the courts have further expanded the scope.

In particular, the relationship between information notices and discovery assessments has been further confused by the decision in the Scottish Judicial Review case of *Patullo*. This is not the place for a full analysis of the decision but, in shorthand terms, it does seem to suggest that HMRC are able to use information notices in order to obtain information for them to evaluate whether or not a discovery can be made. The rights and wrongs of that decision could be debated at length, yet, whilst accepting the unmeritorious facts of the case, unless this gets limited by further litigation then, in practice, there is very little limit now on HMRC's

ability to re-open cases. There is no doubt that the combination of the extended information powers plus the judicial extension of the discovery provisions has left many advisers in a very uncomfortable position. To be quite safe, in essence, all relevant documents plus a summary of the potential issues raised would have had to be handed over to HMRC with the return. A common question is 'when can I put the file away and tell my client that his affairs for a particular year are now final?' This really seems, therefore, to be an area where legislative clarification is required to get us back to something resembling self-assessment with closure.

We would stress that this whole area of discovery has nothing to do with cases where there are deliberate understatements of tax: it is accepted that, in such cases, different criteria apply and HMRC do have to have powers to go back into the past. We are concerned here with the generality of routine cases which form the bedrock of tax advisers' practices throughout the country.

This is not a plea for a wholesale return to the old system of self-assessment enquiries. We have been repeatedly told, by tax advisers and HMRC staff alike, that the old system of SA enquiries had become very ritualised, cumbersome and ineffective. There is a lot of support for lighter touch ways of working. Indeed, we have seen several examples where minor matters were sorted out very quickly via a phone call in situations where, previously, the only way of dealing with the issue would have been through the formal enquiry process. But there is very significant concern that everything seems now to be completely open-ended.

Recommendation 14

We recommend that the whole area of discovery is the subject of a proper review as part of the HMRC powers review exercise.

Protective discovery assessments

Connected with this area, concern has been raised recently by a number of members in connection with the issue by HMRC officers of 'protective discovery assessments' where time limits are about to expire. Our understanding is that:

- These are acceptable where the officer has good reason to believe that there is an understatement for an earlier year, and is in the process of obtaining the balance of information to quantify the amount – e.g. during an ongoing compliance check; but

- These are unacceptable where the officer merely has a suspicion of an understatement. We believe that such protective assessments have no formal standing.

Recommendation 15

We recommend that HMRC:

- *ensure that adequate guidance is provided in this specific area and ensure that unfounded 'protective discovery assessments' are not issued; or*

- *explain the legal backing for protective assessments where there is only a suspicion of lost revenue.*

Approach

The second related matter is that tax advisers do not have any sense of the process under which HMRC decide which particular form of intervention to use in any case. When is it appropriate for HMRC to use information notices or inspection powers? When is it appropriate for these powers to be used informally? When it is appropriate for matters to be dealt with under a formal enquiry? When should the various heads of tax be looked at separately and when should they be looked at together? And what significance should the tax adviser read into any particular choice of route by HMRC? Is one more serious than another? Will a different grade of HMRC officer deal with different types of intervention?

These are not easy questions and there will never be a one-size-fits-all solution.

Recommendation 16

It is essential that work is done jointly to create a broad framework in which the positioning of each of the various types of compliance check approach can be properly placed.

Finally, there is now a bewildering range of job titles within HMRC, and tax advisers often have very little idea of the significance of particular titles. Without knowledge of the HMRC officer's likely role, it can be very difficult to determine the appropriate level of response to a particular request. Neither is it is always easy to judge from the job title whether or not a particular letter is simply a routine request for information or an indication of serious concern on the part of HMRC. Without this basic knowledge it is often difficult to give clients the appropriate advice.

Recommendation 17

We recommend that information notice letters are clear as to whether they are a routine request for information or an indication of serious concern on the part of HMRC. Allied to that, we recommend that HMRC do some work on standardisation of signatures and job titles.

13 Informal vs formal use of powers

One of the criticisms of the old regime (certainly as it affected self-assessed taxes) was its inflexibility. In order to ask the simplest of questions, HMRC had to enquire into a return. In non-return cases, HMRC had first to issue a return before they could ask even ask the question. That rigidity imposed a formality (some would even describe it as a ritual) on tax enquiries which often meant that they became bogged down under their own weight and made progress painfully slow.

So there is strong support for a change of approach, and our survey shows that that change is already happening – almost 50% of respondents have seen an increase in informal checks and 62.5% of respondents have said that they are clear on the implications of informal checks – although tax advisers feel that only 13% of their clients are clear about this.

Chart 12

Proportion of Chartered Tax Advisers that have seen an increase in informal checks

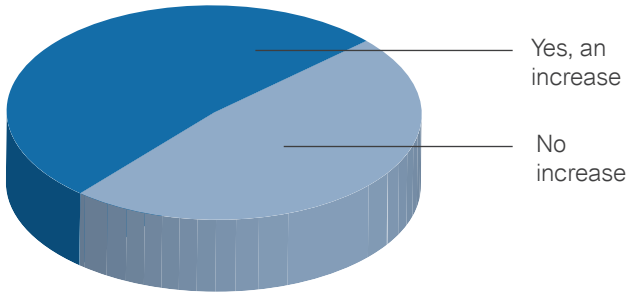


Chart 13

Proportion of Chartered Tax Advisers that are clear on the implications of informal checks

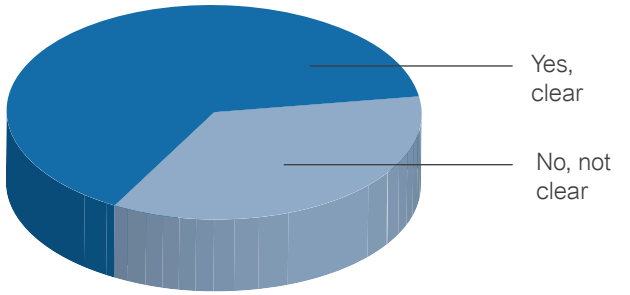
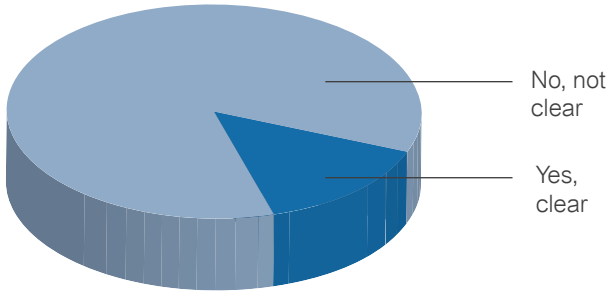


Chart 14

Proportion of Chartered Tax Advisers who say most of their clients are clear on the implications of informal checks



Recommendation 18

We recommend that more work be done both by tax advisers and HMRC in educating taxpayers about the changes.

If we go behind the surface of these numbers we do, however, see two distinct pictures.

With larger companies and their tax advisers, particular those dealt with by a customer relationship manager (CRM), there is a strong sense that there has been a huge change for the better in the relationship with HMRC. Not everything is perfect, of course, but the consistent feedback is that active engagement at an early stage in dialogue to identify matters of concern is working to everybody's advantage. Within that framework of trust and engagement, much can be done on an informal basis, with formal use of powers reserved for situations where cooperation is not working or where powers needs to be exercised to preserve assessing time limits, etc.

The picture for small businesses is very different. In most cases there is no CRM and, indeed, businesses often have no idea who is looking after them. These businesses often feel completely adrift within the system. There is no single HMRC point of contact and, apparently, no overall approach from HMRC in dealing with their affairs. At worst, such businesses' experience of HMRC is little more than seeming random interventions from various different parts of HMRC. Each of those interventions may be reasonable on its own terms, but when put together they do not create any coherence, either for HMRC or for the client.

In such circumstances, there is no realistic prospect of informal engagement with HMRC – there is no person to have that engagement with. Inevitably, therefore, the only way to operate is by formal use of powers. Thus, there is a danger of the old ritual being carried forward into the new regime: this is not to anybody's advantage.

Although many practitioners would like to engage informally with HMRC in dealing with their

clients' affairs, there are also some key problems over and above those already mentioned:

- Dealing with HMRC enquires is very time-consuming for many practitioners and, often, clients are unwilling to pay the proper cost of this. So tax investigation/enquiry insurance is an increasingly important part of the structure of many practices. Insurance companies have different approaches but, broadly speaking, the trend is that they will only cover costs where information powers are used formally: often, therefore, an adviser will want to put matters on a formal basis simply to ensure that his/her clients are properly covered.

- Similarly, in a litigious environment, many advisers will be nervous about providing information informally because they may face a challenge years later from a disgruntled client or new adviser. So, again, this tends towards the tax adviser needing a formal approach.

- Finally, there are issues of control. Many advisers would be reasonably happy to give HMRC minor bits of information on an informal basis and, where that enables matters to be settled quickly, it is an efficient way of working. But one of the things which is often raised is how the tax adviser keeps control – what happens if the information leads to other requests? At what stage does the intervention turn into something more significant which needs to be in a proper framework? Tax advisers often talk about having the protection of an enquiry – something that HMRC officers do not always understand (and, for that matter, many clients struggle with the concept as well).

In many ways, this is all part of the discussion about the new geography which we discuss above, and needs to be factored into the work which we recommend is done in that area.

Recommendation 19

We recommend that more work is done in considering the interaction of informal and formal powers and obtaining certainty; a piece of work needs to pull all of these threads together to ensure proper safeguards for taxpayers in the use of informal v formal powers.

We are very clear in supporting a broader range of interventions than the old one-size-fits-all enquiry regime. It is inevitable that it will take time to work through how it all fits together – it is only when people are dealing with these sorts of issues in practice that the real issues arise.

14 Indirect taxes

Our members generally have less experience and have provided less feedback on this area than for the direct taxes. This is to be expected, as VAT compliance tends to be dealt with more by in-house staff than by external advisers. However, what feedback we have received has some common threads and, therefore, we think it is valid.

Those dealing with indirect taxes - whether in HMRC or in the profession – have faced a different challenge from that of their direct tax counterparts in coming to grips with the new powers. In some respects, the changes for indirect tax were limited, in other respects they have been significant.

Judgements about reasonable care were embedded in the VAT law on penalties that VAT specialists had to deal with. Reasonable care was simply one factor taken into account in deciding whether a taxable person had a reasonable excuse for a compliance failure (where the legislation allowed such a defence) or in determining on a somewhat subjective basis whether a penalty could be mitigated under VATA 1994 section 72.

Equally, those dealing with indirect taxes are accustomed to compliance visits and the strong powers of HM Customs and Excise.

However, the wider concept of behaviourally based penalties was new and, because of the compliance cycle, it was VAT specialists who had to deal with the new powers first. Not surprisingly, this different approach created problems. While HMRC did provide their VAT officers with some training and, indeed, held a number of joint learning sessions with VAT practitioners, given the judgemental aspects of the new powers, it is inevitable that this is a process that cannot be learnt only in the lecture room. There is, unfortunately, a perception that some officers were encouraged not to use the judgement which the legislation permitted them to use. Equally, the impression is given to some of our members that many officers do want to do a professional job but are hampered by inadequate training.

In the same way that HMRC want the profession to help clamp down on rogue advisers, there needs to be a similar mechanism to clamp down on rogue HMRC officers. One member said that :

> *❝ Many Officers behave like traffic wardens and a small but significant number have a very poor understanding of the law with an appalling attitude towards taxpayers. When complaints are made nothing ever seems to happen and the Officers concerned are back out visiting raising unfounded unlawful assessments. Working with Agents goes two ways. ❞*

On the practice side, early training of VAT staff was probably not given sufficient priority. This may have been because practitioners, particularly experienced professionals who were familiar with the long bedding down process of the 1985 provisions, took the view that, to some extent, they would need to adopt a 'wait and see' approach. On both sides, steps have now been taken to address this issue, but there is still further work to do.

Our sense is that the VAT side of the new regime has not completely settled down. Again, we detect the drift to the 'soggy middle' that we identified in an earlier section. Anecdotally, we hear that VAT officers within HMRC are reluctant to impose penalties for deliberate understatement because of a lack of confidence in exercising the appropriate judgements. This is, perhaps, inevitable, as HMRC's policy is often to adopt a light touch to enforcement in the early years of new provisions. In some respects, it is only when measures are tested before the tribunals and courts that some issues, such as boundaries, can be properly determined.

Further, given some of the practices (such as not imposing penalties for failure to submit returns where no tax was due) adopted in relation to small and medium businesses under the old regime, it is likely that many officers will have difficulty reconciling the substantial increase in the severity of penalties imposed in similar circumstances under the new regime.

Equally, there are issues at the less serious end. Because the old regime broadly linked penalties to amount of tax rather than to behaviours, we sense that VAT officers are, even more than their direct tax colleagues, reluctant to accept that errors involving what can be large amounts of tax do not automatically trigger a penalty.

Some of the respondents felt that a significant amount of work was needed in this whole area in getting HMRC officers 'on message', with a certain amount of disgruntlement about the apparent acceptance and encouragement at certain levels within the Department of some 'rogue' officers.

Proper training can help to deal with this issue, but it is essential that the training is not simply on the detail of the rules, but on understanding the behavioural aspects and on the experiences of operating the new system.

Recommendation 20

We recommend that VAT officers within HMRC are given proper training in understanding clients' businesses and behaviour, and also the proper people skills. It is unfair on them to expect them to administer a wholly new system without being given the proper support and skills. Training should include the sharing of experiences so that, gradually, some consistency will emerge in the application of the process.

Some of these issues are mirrored on the practice side. Over time, there has always been some sharing of experiences between direct and indirect tax practitioners. Now that there is a single compliance regime, it is essential that processes are put in places to ensure that issues such as reasonable care are looked at in the round across all of the taxes, especially where a single action can lead to errors for both indirect and direct tax. Similarly, the new regime retains a concept of reasonable excuse, and here the extensive experience of VAT practitioners in dealing with this not so obvious issue may prove invaluable.

Voluntary disclosure

An area of frequent concern and confusion is voluntary disclosure. In the past, it was possible to correct small errors (originally £2,000, but recently raised to up to £50,000 for very large businesses) on the next VAT return without penalty – indeed, in some cases, it was not necessary to draw attention to the error. This process was part of what was termed voluntary disclosure. Under the new powers (which of course apply to VAT as well as direct taxes), the concept of voluntary disclosure is rather different, and there is a lot of confusion among practitioners about precisely how the new regime works. HMRC have indicated that voluntary disclosure by way of correction on a VAT return does not amount to voluntary disclosure for the purposes of penalties.

This has led to advisers being concerned that details of minor corrections, which inevitably occur in a transaction-based tax with tight reporting requirements, need to be separately disclosed to HMRC, giving rise to additional burdens. Indeed, it appears to defeat the objective of VAT Regulations 1995 regulation 34, which is to simplify VAT administration for both HMRC and the taxable person. In any event, one suspects that most of the penalties that can be corrected under the voluntary disclosure regime under regulation 34 would, in any event, escape a Schedule 24 penalty due to being mistakes.

To compound the problem, when an error is corrected on a VAT return within the allowable limits (now £10,000, plus a sliding scale up to £50,000), no interest is charged. However, a voluntary disclosure of any amount is subject to interest. The confusion with regard to the

penalty provision, resulting in protective voluntary disclosures, is leading to taxpayers being continually stung for small but irritating amounts of interest which they would not otherwise have to suffer.

Recommendation 21

We recommend that HMRC work with VAT practitioners to clear up this confusion and devise a better system for dealing with voluntary disclosure for VAT, in both senses of the word, and issue clear guidance on how correction of errors and voluntary disclosure should work under the new regime.

Recommendation 22

Finally, we recommend that the CIOT revisits this area annually over the new few years, and discusses its findings with HMRC, until the powers have bedded down and we have reached what, I hope, will be a position of stability.

15 Appendix

CIOT Members' Survey - HMRC Powers

1. Do you think that the risk of penalties for failure to take reasonable care helps you to persuade clients to take care with their tax?

	Percentage	Responses
Yes	49.4	126
No	47.5	121
N/A	3.1	8
	Total responses:	255

2. Have you negotiated a new penalty for an incorrect return with HMRC?

	Percentage	Responses
Yes	12.2	31
No	82.7	210
N/A	5.1	13
	Total responses:	254

3. If so, did HMRC explain the new rules clearly and apply them appropriately?

	Percentage	Responses
Yes	6.9	16
No	6.5	15
N/A	86.6	200
	Total responses:	231

4. The penalty regime for VAT has seen the most radical changes. Please provide any comments on how the new VAT penalty regime is working.

   Responses to this question were in free text format. They have been analysed and have contributed to the report's findings. Where appropriate representative comments have been used in relevant sections of this report.

5. Approximately what proportion of the new penalties which have been imposed on your clients have been suspended?

	Percentage	Responses
0%	12.5	32
1 - 20%	5.1	13
21 - 40%	1.2	3
41 - 60%	0.4	1
61 - 80%	1.2	3
81 - 100%	3.1	8
N/A	76.5	195
	Total responses:	255

6. Where penalties have been suspended, in most cases:

	Percentage	Responses
The suspension was offered by HMRC	2.5	6
The agent/taxpayer had to ask for suspension	7.5	18
It was fairly even mix of the two	2.5	6
N/A	87.6	211
	Total responses:	241

7. Do you think the decisions on suspended penalties are by and large fair?

	Percentage	Responses
Yes	14.8	36
No	6.1	15
N/A	79.1	193
	Total responses:	244

8. Please provide any other comments on this area.

Responses to this question were in free text format. They have been analysed and have contributed to the report's findings. Where appropriate representative comments have been used in relevant sections of this report.

9. Have you seen an increase in informal checks?

	Percentage	Responses
Yes	49.4	126
No	45.5	116
N/A	5.1	13
	Total responses:	255

10. Are you clear on the implications of informal checks?

	Percentage	Responses
Yes	62.5	160
No	34.4	88
N/A	3.1	8
	Total responses:	256

11. Are most of your clients clear on the implications of informal checks?

	Percentage	Responses
Yes	13.4	33
No	78.9	195
N/A	7.7	19
	Total responses:	247

12. Do you think the letters sent in respect of informal checks are clear?

	Percentage	Responses
Yes	25.7	65
No	49	124
N/A	25.3	64
	Total responses:	253

13. Are your clients experiencing an increase in HMRC visits since 1 April 2009?

	Percentage	Responses
Large increase	0.4	1
Small increase	23	55
About the same	66.9	160
Small decrease	7.1	17
Large decrease	2.5	6
	Total responses:	239

14. And how are HMRC running these visits?

	Percentage	Responses
Very poorly	1.0	2
Poorly	16.5	34
Acceptably	75.7	156
Well	6.3	13
Very well	0.5	1
	Total responses:	206

15. Since 1 April 2009, approximately what proportion of your clients have had a pre-return check (i.e. a check of their records relating to a return which is not yet due to be filed)?

	Percentage	Responses
0%	70.5	179
1 - 20%	13.0	33
21 - 40%	0.0	0
41 - 60%	0.0	0
61 - 80%	0.4	1
81 - 100%	0.4	1
N/A	15.7	40
	Total responses:	254

16. Are compliance checks by correspondence proceeding more quickly since 1 April 2009?

	Percentage	Responses
Much slower	3.9	9
Slower	20.1	46
About the same	59.4	136
Quicker	15.3	35
Much quicker	1.3	3
	Total responses:	229

17. Where you have been involved in a compliance check, did HMRC explain the new rules clearly, apply them appropriately and act reasonably?

	Percentage	Responses
Yes	35.5	88
No	20.2	50
N/A	44.4	110
	Total responses:	248

18. Overall, do you think that information powers are being used fairly?

	Percentage	Responses
Yes	41.3	104
No	24.2	61
N/A	34.5	87
	Total responses:	252

19. Is the volume of information being requested and the time provided for responses fair?

	Percentage	Responses
Yes	33.2	83
No	40.0	100
N/A	26.8	67
	Total responses:	250

20. Have you seen any change in the number of formal enquiries?

	Percentage	Responses
Fewer	23.1	58
About the same	52.6	132
More	15.5	39
N/A	8.8	22
	Total responses:	251

21. Have you had any experience of 'cross-tax checks', i.e. enquiries or compliance checks across more than one tax (e.g. a combination of CT, VAT and PAYE inspections)?

	Percentage	Responses
Yes	25.2	64
No	67.7	172
N/A	7.1	18
	Total responses:	254

22. If so did you find this more effective than having three separate enquiries under different rules?

	Percentage	Responses
Yes	16.3	39
No	10.4	25
N/A	73.3	176
	Total responses:	240

23. Please provide any other comments on this area.

Responses to this question were in free text format. They have been analysed and have contributed to the report's findings. Where appropriate representative comments have been used in relevant sections of this report.

24. Have you or your clients had any experience yet of the new internal review mechanism?

	Percentage	Responses
Yes	18.5	47
No	77.6	197
N/A	3.9	10
	Total responses:	254

25. If yes did you find the process fair and reasonable (even if you didn't necessarily get the result that you were hoping for)?

	Percentage	Responses
Yes	12.7	29
No	7.9	18
N/A	79.5	182
	Total responses:	229

26. The number of appeals to the first tier tribunals (FTT) is well below expectations. In your experience what are the main reasons for this? (Tick all that apply)

	Percentage	Responses
Reduction in enquiry work	11.2	29
Cases resolved through internal review	12.4	32
FTT is too formal	9.7	25
FTT is too time consuming	14.7	38
Cost	31.3	81
Too far to travel to FTT	3.9	10
FTT not manned by local people	6.2	16
Other		28
	Total responses:	251

27. Please provide any other comments on this area.

Responses to this question were in free text format. They have been analysed and have contributed to the report's findings. Where appropriate representative comments have been used in relevant sections of this report.

28. Which of the following would you prefer the CIOT to concentrate on?

	Percentage	Responses
Producing practical guidance on the new regimes as experience develops? Or	45.2	114
Feeding in members' comments to HMRC, seeking improvements to the system and reviewing new proposed HMRC Powers changes and HMRC guidance?	54.8	138
	Total responses:	252

29. To help us analyse the results please state which type of entity you work for.

	Percentage	Responses
Top 10 practice	10.3	26
Medium sized practice	24.1	61
Small practice including sole practitioners	51.8	131
Legal practice	1.6	4
Commerce and industry	9.5	24
HMRC	1.2	3
Other	1.6	4
	Total responses:	253

30. Any other comments would also be welcome.

Responses to this question were in free text format. They have been analysed and have contributed to the report's findings. Where appropriate representative comments have been used in relevant sections of this report.

16 Feedback and further information

If you wish to give the Chartered Institute of Taxation feedback on its *HM Revenue and Customs - Modernising powers, deterrents and safeguards* report you can do so by using the contact details below.

Post

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THE CHARTERED INSTITUTE OF TAXATION

The Chartered Institute of Taxation (CIOT) is a registered charity (number 1037771) and is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT deals with all aspects of direct and indirect taxation. Its primary purpose is to promote education in and the study of the administration and practice of taxation. One of its key aims is to achieve a better, more efficient, tax system for all affected by it - taxpayers, advisers and the authorities. The CIOT's comments and recommendations on tax issues are made solely in order to achieve its aims: it is entirely apolitical in its work. The 15,000 members of the CIOT have the practising title of 'Chartered Tax Adviser'.

The Institute was established in 1930 and received its Royal Charter in 1994. It enjoys a high international standing in taxation affairs and is a UK member body on the Confédération Fiscale Européenne (CFE), the umbrella body for 150,000 tax advisers in Europe.

As part of its charitable activities, the CIOT also sponsors the Low Incomes Tax Reform Group which works to improve and simplify the tax system so as to make it more responsive to the needs of those who cannot afford to pay for tax advice.

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