ICAEW
REPRESENTATION 45/25

REFORM OF BEHAVIOURAL PENALTIES

Issued 17 June 2025

ICAEW welcomes the opportunity to comment on the consultation entitled 'Reform of behavioural penalties' published by HM Revenue & Customs on 26 March 2025, a copy of which is available from this link.

1. We believe that the principal purpose of penalties regimes should be to encourage compliant taxpayer behaviour and to encourage taxpayers to come forward to disclose prior incidences of non-compliance.
2. This purpose is most easily achieved if the regimes concerned are easy to understand and interact with for taxpayers, agents and HMRC. This should be the aim of any future reform.
3. Reform should include legislative changes, more consistent and understandable guidance from HMRC and more consistent application of the guidance and legislation by caseworkers.
4. The penalty regimes also need to reflect the widening range of HMRC activity taken to tackle non-compliance, such as nudges and prompts.
5. Any change also needs to be apply immediately after implementation to prevent multiple regimes applying concurrently to different tax years.

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This response of 17 June 2025 has been prepared by the ICAEW Tax Faculty. Internationally recognised as a source of expertise, the ICAEW Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business. ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark the tax system and changes to it, are summarised in Appendix 1.

KEY POINTS

GENERAL

1. We agree with HMRC that the current penalty regime is complex and in urgent need of simplification. We also agree with the general theme from the 2024 call for evidence that more work could be done to provide stronger incentives for taxpayers to make disclosures and cooperate with HMRC's enquiries.
2. As a general principle, we believe that the purpose of the penalty regime should be to influence behaviour, rather than to raise revenue. This principle extends beyond the current consultation, e.g. to daily penalties, where we consider HMRC reform is needed. The behavioural focus should both deter non-compliance in the future and encourage taxpayers to come forward to correct non-compliance in the past.
3. The complexity of the regime has mostly arisen over time as HMRC has repeatedly identified behaviours it wishes to discourage and introduced bolt-ons to the penalty regime that are designed to discourage those behaviours. HMRC should review whether the resulting complexities in the system are having the desired effect on taxpayer behaviour and, if not, consider removing them.
4. Reform is also important as it is becoming increasingly difficult to answer the question "what constitutes a prompt" for the purposes of determining the size of penalties chargeable. More clarity is required here, especially as the means by which HMRC interacts with taxpayers has expanded since this distinction was introduced (eg through the introduction of one-to-many letters).
5. Multiple penalties can often arise in situations such as, for example, failure to notify, late filing and late payment penalties arising in respect of a single disclosure. Situations such as this should be reviewed by HMRC during the course of its penalty reform as this appears more like a revenue raising exercise than influencing behavioural change.
6. Consistent application of penalties could also be improved by enhanced training for case workers at HMRC and the inclusion of more guidance in HMRC's manuals on the reason why penalties were introduced and when they should be applied.
7. If changes are to be made to penalty systems, we can see benefit to them being operative immediately and apply to all open years, ie all existing penalties carry on as normal, but all new penalties issued after the start date should be under the new system regardless of which tax year they relate to. When the last big changes occurred with regard to penalties through FA 2007, old penalties still applied to earlier years. If we follow this model, we will have three different penalty regimes for 20-year disclosures, plus all the bolted-on complexities will still apply for several years to come.
8. To be truly effective, taxpayers need to be aware of and understand the different penalties that could apply if they were to undertake certain behaviours. Simplification will help with this, but continuing publicity at the point before an error has potentially occurred (eg HMRC educational videos) will also be important.

ANSWERS TO SPECIFIC QUESTIONS

Improving existing penalties

Question 1: What are your views on removing the minimum 10% penalties for:

1. ***inaccuracies disclosed after 3 years***
2. ***failures to notify disclosed after 12 months for non-deliberate behaviour?***

9. We believe it is important that taxpayers are not discouraged to come forward to correct historic tax errors. For that reason, we support removal of the minimum 10% penalties. This would also help to simplify the relevant penalty regimes.

10. The practice of adding 10% to penalties currently means that taxpayers who make careless/non-deliberate mistakes and whose disclosure is prompted have almost no incentive to co-operate with HMRC's compliance check as the potential reduction for the quality of their disclosure is only 5% (15% + 10% = 25% compared to a maximum penalty of 30%). The extra 10% can seem unfair to taxpayers who come forward immediately on realising they made a mistake more than three years ago, having been previously unaware of their error.

11. These minimum penalties were introduced at a time when HMRC was offering time-limited disclosure facilities, to prompt previous non-disclosure. As there are now permanent disclosure regimes in place, time-sensitive penalties feel less relevant. Removing them would provide a greater incentive for taxpayers to make disclosures and co-operate with compliance checks.

Question 2: What are your views on the ways in which HMRC could:

1. ***simplify penalty reductions for unprompted disclosure***
2. ***simplify penalty reductions for the quality of disclosure?***

12. We agree that the penalty system needs to be simplified, however we do not believe that the penalty reductions are the main area of complexity. Essentially, the rules ask three simple questions:

    a. Why did the taxpayer mis-state their tax position?

    b. Was their subsequent disclosure prompted?

    c. Did the taxpayer co-operate once an investigation was opened?

13. These questions and their order remain appropriate, and we believe that HMRC's proposals will unfortunately add further complexity to the system whilst removing important distinctions. Below we offer some alternative suggestions for improving the current rules.

Prompted v Unprompted

14. We believe that it is still relevant to make a distinction between prompted and unprompted disclosures and important to retain an incentive for taxpayers to disclose errors. However, as HMRC's compliance activity has diversified, what constitutes a prompt has become harder to define. This reflects discussions that professional bodies have had with HMRC around when a one-to-many campaign constitutes a prompt (on which we have never come to a definitive position). Rather than remove this distinction altogether, it would be helpful if the difference could be set out in legislation.

15. Ideally this should confirm that something can only constitute a prompt if it is issued after the deadline to notify has passed (for failure to notify penalties) or after a tax return is filed (for error penalties). This would mean that on-screen prompts and educational nudge letters would not constitute prompts.

16. We believe that there should be no penalty charged in cases where:
    a. the taxpayer has made a full disclosure, without being prompted by HMRC through a formal enquiry or compliance check;
    b. the behaviour of the taxpayer was not deliberate; and
    c. the taxpayer has no history of ongoing or persistent non-compliance.
17. Where taxpayers receive a nudge letter which prompts a tax disclosure and they register to make that disclosure within 60 days of the nudge letter being issued, we would like to see a fixed 50% discount for prompt disclosure. This should provide greater incentive for taxpayers to come forward to correct their tax affairs, reducing the number of formal compliance checks that HMRC needs to conduct.

Penalty reductions for quality of disclosure

18. The consultation also suggests simplifying the reductions for the quality of a disclosure. This is possible, but HMRC will still need to provide a mitigation percentage for this factor and a clear scale to ensure consistency, meaning that this proposal is unlikely to create any change in practice. A more effective change would be for HMRC to remove its current practice of reducing the penalty mitigation where it issues a formal information notice during a compliance check. A high proportion of information notices are issued where the customer is co-operating but struggling to comply with HMRC's deadlines (e.g. because a third party is being slow at providing them with some information which they need to answer HMRC's questions) and this adjustment damages perceptions of fairness and trust in HMRC.
19. If updating any penalty mitigations, HMRC should amend other penalty legislation which uses similar mitigations e.g. MTD penalties, enabler penalties, 12-month late filing penalties in Sch 55 FA 2009.

Question 3: With reference to the existing inaccuracy and failure to notify penalty ranges, what would you consider to be proportionate and appropriate penalty rates for both deliberate behaviour and repeated instances of deliberate behaviour? Which factors should be considered when applying these?

20. We agree that penalties should be considerably higher for taxpayers with deliberate behaviour compared to those whose conduct was innocent or careless. However, we are hesitant to suggest particular penalty ranges. In setting these, it is important to ensure that penalties are not so high as to be seen as unfair or to cause taxpayers to incur liabilities which they simply cannot pay.
21. It's important to retain a distinction where items have been concealed as it's much harder for HMRC to detect fraud if false documents etc are used.
22. Where HMRC identifies examples of taxpayers deliberately underpaying tax after there has been a settlement or litigation to correct a prior deliberate error, we believe that HMRC should consider effective intervention in a broad sense (e.g. consider whether a criminal litigation is required) rather than introducing further tiers into deliberate penalties. As set out below in our answer to Q7, further complexity would place further administrative burdens on HMRC. In cases where HMRC considers that a second or further deliberate error has occurred, the current penalty range already permits HMRC to remove co-operation mitigations and to potential publish taxpayers' details.

Question 4: How could penalties for offshore non-compliance be simplified whilst still acting as an effective deterrent?

23. The offshore penalty regime was introduced to encourage taxpayers to make disclosures such as through the offshore disclosure facility or specific regimes such as the Lichtenstein facility. These facilities are now in the past, and as the penalties charged remain high many taxpayers consider them inherently unfair. There is a risk that they in fact disincentivise further disclosures from being made.
24. In addition, the tax world is very different to the one when those facilities were introduced. The common reporting standard and other reporting regimes have allowed HMRC to gain much more information about the income that UK taxpayers are earning offshore and assets held offshore. Hiding income offshore is now considerably more difficult than it was in the past and we are not sure that penalties are needed to change these taxpayer behaviours.
25. Imposing separate offshore penalties therefore seems to be unnecessary and could be removed from the penalty system. There are also offshore-based aspects to the strict liability offences in s106B et seq and the para 6/6A/6AA/6AB Sch 55 FA 2009 penalties (12-month late filing), for example, so these regimes will need amending too.
26. If HMRC and ministers disagree with this recommendation, would it be possible for HMRC to provide information on the number of offshore penalties that have been raised year-on-year so we can better assess whether their inclusion in the regime remains relevant?
27. Other offshore penalties: asset-based penalties (Sch 22 FA 2016) and offshore asset moves penalties (Sch 21 FA 2015) are rarely if ever charged. They should be repealed, thus simplifying the legislation and reducing the training needs for HMRC staff and tax advisers. Similarly other unused penalties could be repealed e.g. serial tax avoidance regime (Sch 18 FA 2016). These regimes are not used awareness of them is very low, so repealing them is unlikely to change the deterrent effect of penalties in general.

Question 5: How could HMRC simplify penalty suspension while retaining an effective prompt to taxpayers to address the source of the inaccuracy?

28. We believe that HMRC should look to apply penalty suspensions wherever possible and appropriate, especially for a first offence. We agree with HMRC's proposal that penalties for all such first offences could be suspended where the associated behaviour was not deliberate as this could potentially reduce administrative costs for HMRC, taxpayers and agents.
29. We believe that suspension provides a greater incentive to correct behaviour than a caution. Taxpayers know that if they make a subsequent mistake, the suspended penalty becomes chargeable. Hence, this should encourage them to take care with their tax affairs in the future. However, this will only work if HMRC is diligent in applying the suspended penalty and has procedures in place to ensure this happens. We understand that this does not work in many cases at present so this needs to be reviewed.
30. If this is not possible, then issuing a caution – by issuing a letter saying "we could have charged you a penalty (in the range of x) but we didn't as we're giving you a chance to learn from the mistake, improve your record keeping etc but we will charge the penalty next time" could work well and incentivise future compliance. This would need to be within reasonable bounds e.g. a second similar mistake on the same tax in the next three or five years.
31. HMRC should ensure that whichever approach is chosen it applies to all taxes and situations, including non-deliberate failures to notify. Currently HMRC refuses to suspend careless error penalties in some situations e.g. where the taxpayer also made a deliberate error on a different tax or was involved in tax avoidance (even if they were unaware that what they were doing was avoidance or could be deemed careless under the rules in para 3A Sch 24 FA 2007). A significant amount of the remaining avoidance we become alerted to involves parties insisting that workers enter into tax advantaged contracts where the worker is given no other choice and is unaware of the purpose of the arrangements. Failure to apply

suspensions or cautions in these cases increases perceptions of unfairness in the tax system.

Alternative approaches

Question 6: What do you see as the opportunities and challenges of this approach? How does it compare with potential simplification to existing penalties, as outlined in Chapter 3?

32. We are pleased to see that HMRC is considering more fundamental reform of the penalties regime which would potentially be simpler to understand and administer than the existing system. However, we have concerns over the design of the proposed system set out in the consultation document, which we do not consider to constitute a simplification.
33. First of all, while we agree with greater alignment between the penalty regimes, we do not agree with the proposal to merge penalties for failure to notify and inaccuracies in returns. We believe that the former is a failure to do something while the latter involves doing something but doing it incorrectly and need to be reflected as separate "failures".
34. The current regimes are complex simply because the calculation process for the penalties under the error and failure to notify regimes are somewhat different and only error penalties can be suspended. If HMRC made the penalty calculation processes the same then this would reduce mistakes in penalty computations, reduce time in compliance checks and reduce training for HMRC staff and advisers.
35. While it adds complexity, making a distinction between innocent, (i.e. reasonable care or reasonable excuse), careless and deliberate behaviour remains a useful way to categorise taxpayer behaviour when it comes to designing deterrents and sanctions. There is now a considerable body of case law to help taxpayers, agents and HMRC understand the meaning of these terms. They also apply to other aspects of the legislation e.g. discovery assessment criteria, so changing them would not remove HMRC's need to consider these behaviours before assessments can be issued.
36. We also note that case workers are often reluctant to accept that taxpayers had made errors despite reasonable care and, in some cases, seem to start at 'deliberate' despite lacking evidence for this position, perhaps due to a perception that taxpayers know more about tax then they actually do as the officer is more familiar with the tax issues. To weaken the distinction between careless and deliberate behaviour risks having all penalties charged on a similar basis. It is important that penalties are perceived as fair to prevent them undermining trust in the tax system and discouraging voluntary disclosures.

Question 7: What is your view on HMRC's use of tougher non-financial sanctions to deter and respond to deliberate and repeated non-compliance and to promote future compliance?

37. While we support the sharing of more information with supervisory bodies and regulators, we believe that this should only be considered for the most egregious of cases (i.e. those involving repeated deliberate non-compliance) and shouldn't therefore be an HMRC priority.
38. In particular, the proposals to remove driving licences or passports do not seem naturally connected to offences related to taxation and may also be contested under human rights laws.
39. Even if HMRC were to pursue limited non-financial sanctions – which we do not recommend – applying these would involve significant administrative time and costs for HMRC.
40. To consider such action to be appropriate, deliberate mistakes would need to have been made, then tackled (via a disclosure or compliance check for all affected years). The taxpayer would need to receive a formal written warning that if they make more deliberate mistakes in the next five years then HMRC could ask the First Tier Tribunal (FTT) to

authorise specified non-financial sanctions or prosecute them (list the maximum sanction for a conviction for cheating the public revenue).

41. Appropriate legislative safeguards should be introduced before the non-financial sanctions proposed in the consultation can be imposed. They should only be issued by the FTT, after HMRC has demonstrated that all the legislative criteria are met. The person who is to be sanctioned must be party to the hearing and should be able to appeal the FTT's decision.

42. In addition to this administrative process for applying non-financial sanctions, we anticipate that a policy change in this direction would deter voluntary disclosure of deliberate errors (COP9/CDF). We also anticipate that HMRC would encounter greater resistance in tax-geared penalty negotiations, including appeals to the Tribunal. By contrast, at present, some taxpayers simply agree to pay a deliberate penalty to get a case closed, reduce the pressure of the investigation etc where the amounts are not large given their wealth/income, even if they fundamentally believe that their behaviour was not deliberate.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see https://goo.gl/x6UjJ5).