

Penalties for incorrect VAT returns

A new penalty regime for incorrect VAT returns was introduced from 1 April 2009.

HMRC can charge a penalty if you make a mistake in a VAT return and the mistake results in an amount owing to HMRC. Typically an amount will be owed to HMRC because the mistake resulted in you underpaying output VAT and/or over-claiming input VAT. The penalty is a percentage of the net amount owed to HMRC and depends on the reason for the mistake and how HMRC became aware of the mistake:

Reason for mistake:	Disclosure is un-prompted	Disclosure is prompted
Error despite reasonable care	No penalty	
Careless error	0% - 30%	15% - 30%
Deliberate but not concealed error	20% - 70%	35% - 70%
Deliberate and concealed error	30% - 100%	50% - 100%

Prompted and un-prompted

A disclosure is unprompted if it is made when you have no reason to believe HMRC have discovered or are about to discover the error. Amending a later VAT return to correct for a previous mistake does not count as un-prompted disclosure.

Penalty ranges

For careless and deliberate errors, the default penalty is the higher percentage. This is then reduced depending on the quality of the disclosure and the degree of co-operation with HMRC:

- **Providing full information:** HMRC will give up to 20% of the total reduction available for the quality of the disclosure to HMRC, for example explaining fully what has happened, why it was not discovered previously and the full extent of the problem
- **Helping:** HMRC will give up to 40% of the total reduction available for helping quantify the error. So if you provide HMRC with an full and accurate calculation, appropriately documented and supported by evidence, you should obtain 40% of the possible reduction
- **Giving access to HMRC:** HMRC will give up to 30% of the total reduction available for providing HMRC with full and timely access to records that are reasonably required for the purpose of ensuring that the document is corrected

Suspended penalties: HMRC can suspend a careless error penalty for up to 2 years, subject to improvements being made that will avoid such errors in the future. If at the end of the suspension period, the improvements have been made, the penalty is waived. HMRC not suspend penalties for one-off type errors nor if they consider the taxpayer is unlikely to comply with the suspension conditions.

Special circumstances: HMRC can reduce a penalty below the minimum percentages if they think it right because of special circumstances. In the tax tribunal case *Russell Francis Interiors* (2011, FTT107) a business mistook the tax point on an unusually large one off property transaction, resulting in input VAT being reclaimed one quarter early. The tribunal directed that these were special circumstances and that the prompted careless error penalty should be reduced to 7.5%. The tribunal found that the one-off nature of the transaction, its unusually large value together with no real likelihood of tax loss constituted special circumstances for reducing the penalty.

Meaning of reasonable care, careless, deliberate and concealed

Error despite reasonable care: HMRC do not expect the same level of knowledge or expertise from a self-employed un-represented individual as it does from a large multinational company. HMRC would expect a higher degree of care to be taken over large and complex matters than simple straightforward ones. HMRC's view it is reasonable to expect a person who encounters a transaction with which they are not familiar to take care to find out about the correct tax treatment or to seek appropriate advice. HMRC examples of errors despite reasonable care are:

- Transposition errors that are not so large as to be obvious or be picked up by a quality check
- A reasonably arguable view of situations that is subsequently not upheld
- Following advice from HMRC or a competent advisor that later proves to be wrong
- Accepting and using information from another person where it is not possible to check that the information is accurate and complete
- Good systems are in place but despite these inaccuracies arise in processing or coding items and the effect is not significant in relation to the overall tax liability for the period

Careless errors: these are errors that are not deliberate but which are the result of a failure to take reasonable care. In HMRC's view this is similar to the general law concept of negligence: the omission to do something which a reasonable person would do, doing something which a reasonable person would not do, unintentionally omitting to do that which a reasonable person would have done, or doing that which a person taking reasonable care would not have done. HMRC examples are:

- Not keeping proper business records
- Not being sure of the correct treatment, but not looking into the matter or seeking advice
- Ignoring (without good reason) advice provided directly to the taxpayer by HMRC (eg: at a previous visit or in writing)

Deliberate but not concealed error: a deliberate but not concealed error occurs when a person knowingly and intentionally gives HMRC an inaccurate document but does not try to conceal the error. Examples are:

- Deliberately entering incorrect amount on a VAT return
- Giving a VAT return to HMRC that includes a figure of net VAT due that is too low because the person does not have the cash at that time to pay the full amount, and later telling HMRC the true figure when they have the funds to pay

Deliberate and concealed error: a deliberate and concealed error occurs where, as well as deliberately recording an inaccuracy, the taxpayer has to take active steps to cover their tracks by making arrangements to conceal the inaccuracy. HMRC provide the following examples of concealment:

- Creating false invoices to support inaccurate figures in the return
- Backdating or postdating contracts or invoices
- Creating false minutes of meetings or minutes of fictitious meetings
- Destroying books and records so that they are not available
- Systematically diverting takings into undisclosed bank accounts and covering the traces
- Describing expenditure in the business records in a deliberately misleading way