

# How to reduce HMRC's VAT penalties

VAT penalties can be confusing, but depending on the type of compliance breach they either follow the same penalty regime which applies to direct taxes or a VAT specific penalty regime.

Penalties can be issued for:

1. failure to notify of VAT liability
2. late filing
3. HMRC underassessment
4. inaccuracy: error in making a return
5. late deregistration
6. VAT wrongdoing
7. late EC sales list
8. SAO (Senior Accounting Officer) penalties
9. VAT fraud
10. MTD penalties.

HMRC has stated that for MTD that it will have a soft landing period for submission during the first year of MTD. This soft landing relates to submission and digital changes but there are many areas where penalties may apply.

VAT penalties are usually based on a percentage of HMRC's potential lost VAT revenue. To identify the potential lost revenue, HMRC looks at UK VAT payable only. Any reclaim of non-UK VAT a taxpayer is entitled to is disregarded in establishing the figure of potential lost revenue. Any payments made on account already are also disregarded when establishing the potential lost revenue.

Not all defaults are equally penalised. It is good to remember that demonstrating mitigating circumstances behind a VAT breach and cooperating with HMRC is likely to reduce penalties significantly. As are areas that tie into reasonable excuse for issues concerning MTD submissions.

Below we are looking at some of the most frequent penalty scenarios and ways to mitigate the levied charges.

### *Failure to notify and late filing*

Penalty for failure to notify and late VAT filing depends on whether the default is deliberate or not, and whether the subsequent disclosure made to HMRC is prompted or unprompted. If the disclosure is made in circumstances when HMRC is about to make a discovery, it is considered a prompted disclosure. Penalties may range from 0% to 100% of potential lost VAT revenue. Please see our [Feb 2016 in Practice Edition](#) for further details on how this is applied.

In addition to standard penalties, surcharges may be levied for any subsequent failure or delay in submitting VAT returns or paying VAT. Surcharges against very small entities are less severe and you need to fall foul of the compliance regime twice before those are going to affect you.

The following applies:

<b>Default</b>	<b>Turnover more than £150k</b>	<b>Turnover £150k or less</b>
1 <sup>st</sup>	No surcharge for 12 months	No surcharge for 12 months
2 <sup>nd</sup>	No surcharge for 12 months	2%*
3 <sup>rd</sup>	2%*	5%*
4 <sup>th</sup>	5%*	10%**
5 <sup>th</sup>	10%*	15%**
6 <sup>th</sup>	15%*	

\* except if VAT is less than £400 (surcharge will be different); 12 months is counted from the most recent default

\*\* except if VAT due is less than £30; 12 months is counted from the most recent default

Surcharges do not apply to late returns if they are NIL returns or there is a VAT repayment owed, VAT payment was made on time or the tax payer had a reasonable excuse.

### **HMRC under-assessments**

If no VAT return has been submitted, HMRC may issue a VAT assessment for an estimated VAT amount. If the amount assessed is lower than the correct amount, you must notify HMRC within 30 days. Settling a correct VAT does not amount to such a notification. The penalty for failure to notify of an underassessment may range from 15% to 30% of potential lost revenue.

### **Errors: inaccurate VAT returns**

Unless it can be demonstrated that 'reasonable care' was taken when completing VAT return, HMRC may impose the following penalties for inaccurate returns.

Default	Min penalty – unprompted disclosure	Min penalty – prompted disclosure	Maximum penalty
Careless (not deliberate and not concealed)	0%	15%	30%
Deliberate but not concealed	20%	35%	70%
Deliberate and concealed	30%	50%	100%

### VAT wrongdoings

VAT wrongdoings are failure to register for VAT when registration is mandatory and issuing a VAT invoice when not authorised. The amount of penalty depends on whether the wrongdoing is deliberate and concealed or not. The following applies:

Wrongdoing	Unprompted disclosure	Prompted disclosure
Non-deliberate	10% to 30%	20% to 30%
Deliberate	20% to 70%	35% to 70%
Deliberate and concealed	30% to 100%	50% to 100%

### Personal Liability Notice (PLN)

In majority of cases, penalties issued against the entity owing VAT. However, this may sometimes not be possible, particularly with respect to VAT wrongdoings.

Where the wrongdoing is attributable to a deliberate action of a company officer (this includes a shadow director), including for personal gain, or the company becomes insolvent, HMRC may issue a personal liability notice against the company officer personally.

In a recently concluded *Stanley John Chmiel v HMRC [2018] TC7112* case, a PLN was issued against a director of a construction company, which exceeded the VAT threshold for just over a year in 2011/12 but failed to register for VAT, and subsequently ceased trading in 2016.

### How to reduce penalties

In case of most VAT breaches, including wrongdoing, you may not be penalised if you show that the following three conditions apply:

- you have a reasonable excuse – an unexpected, unusual, unforeseeable event that was out of your control (flood, fire etc.)
- non-compliance was not deliberate
- you notified HMRC without unreasonable delay.

If a penalty is issued, you may seek to reduce it, if you:

- ‘tell’ HMRC of VAT breach (30% reduction)
- ‘help’ establish correct VAT amount (40% reduction)
- ‘give access to records’ (30% reduction).

Demonstrating that a genuine innocent error has occurred may result in significant reduction or cancellation of penalties. However, appealing large or repeated VAT defaults is unlikely to succeed.

### **VAT penalty appeals**

An appeal to HMRC is usually the first step to reduce or cancel VAT penalties. If you do not agree with the first HMRC decision, you have 30 days to accept the offer of independent HMRC review, which HMRC must allow, or appeal to a tribunal. If you agree to HMRC’s independent review, you will be unable to take the matter to the tribunal until the review is concluded. HMRC have 45 days to conclude an independent review, although this can be extended if both parties agree. More information about the tribunal process can be found [here](#).

One of the grounds for a tribunal appeal could be undue hardship. In *M Hodges v HMRC [2015] TC04419* a taxpayer appealed assessed VAT penalties of £394,694. The tribunal allowed a claim of undue hardship: payment would have bankrupted the taxpayer. The tribunal ruled that penalties should be agreed at £7,807.