



VAT - How to Survive the Enforcement Powers

Although some of the penalties for VAT infringements have been less severe in recent years, there is still an alarming array of enforcement powers to trap the unwary. By being aware of the problem areas and planning carefully, it should be possible to avoid becoming an unwitting victim of the system.

Late registration

You must notify HM Revenue & Customs (HMRC) if at the end of any month, your taxable turnover has exceeded £85,000 in the previous twelve months, or if you believe it will exceed £85,000 in the next thirty days alone.

Notification is required to be made to HMRC within 30 days, using form VAT1 which is available online. A penalty may be charged for failing to notify HMRC of the liability to register for VAT or for being late in notifying HMRC (see our separate title 'Take care to avoid a penalty'). There is no penalty if the taxpayer can demonstrate a reasonable excuse for not registering at the correct time.

After registration

Every VAT registered business needs to ensure that it is organised to deal with VAT correctly and on time:

- Is there someone in your business who controls VAT accounting and ensures that new products etc. are properly dealt with for VAT purposes?
- Do your business systems ensure that all output tax and input tax are properly recorded?
- Are systems in force to ensure that proper evidence is obtained to support VAT input tax claims?
- Where VAT is not charged on supplies made, is this correct in law and is proper evidence retained?

- Are there systems in force to ensure that non-deductible input tax is not reclaimed, e.g. most VAT on motor cars, or business entertaining?
- Is VAT always considered before contracts are made?

Late filing of VAT returns

For VAT accounting periods commencing on or after 1 January 2023 a new penalty regime has been introduced to deal with late submission of VAT returns. This replaces the previous Default Surcharge regime.

The new penalty regime is points-based. Each VAT return submitted late will incur a penalty point. When a taxpayer reaches the relevant penalty point threshold a penalty of £200 will be issued. Further penalties of £200 will be issued for each subsequent late VAT return submission.

The penalty point threshold varies according to the frequency of VAT returns:

- Monthly returns - five points
- Quarterly returns - four points
- Annual returns - two points.

It is possible to 'wipe the slate clean' and remove penalty points by submitting subsequent VAT returns on time for a 'period of compliance.' In the case of a taxpayer submitting quarterly returns this means putting four returns in on time over the next 12 months, as well as ensuring that any outstanding VAT returns in the previous 24 months have been submitted.

The stated purpose of the new regime is to drive better taxpayer compliance. In a significant departure from the previous Default Surcharge regime under the new system points will be incurred when the VAT return is a repayment return or a nil return. Previously, such returns did not trigger a penalty since under the old regime penalties were calculated as a percentage of the tax due.

Late payment of VAT

Also with effect from 1 January 2023 there is a completely new regime to penalise the late payment of VAT amounts due to HMRC.

The previous Default Surcharge regime was often criticised for being inflexible. The new regime contains a relatively complex set of thresholds, but broadly speaking there is no penalty for late payment provided the VAT due has been paid to HMRC in full by the end of day 15 following the due date.

Any tax still unpaid at this point will attract a 2% penalty. There will be a further 2% penalty on tax amounts remaining unpaid 30 days after the due date. Thereafter, an annualised penalty of 4% will apply on all unpaid balances.

It is worth noting that if the taxpayer successfully agrees a Time to Pay arrangement with HMRC

the late payment penalty clock is stopped, although interest will still be charged (as interest is viewed as commercial restitution rather than as a penalty).

Where a taxpayer disagrees with HMRC imposing a late payment penalty (or similarly disagrees with a late submission penalty) they have the right of appeal, particularly in cases where the taxpayer can demonstrate 'reasonable excuse' for the actions leading to the penalty.

Interest charged on late payments of VAT

Under the new penalty regime that applies from 1 January 2023 if a business pays its VAT late, it will be charged interest by HMRC at a rate of 2.5% over Bank of England base rate. Strictly, this is regarded by HMRC as commercial restitution rather than as a penalty.

Late payment interest applies to all late payments where VAT is due. This includes not only late payments associated with submitting a VAT return, but also to matters such as VAT assessments, error corrections and missed payments on account.

The flip-side of this interest measure is a change to the way in which HMRC compensates taxpayers when HMRC is late in making refunds of VAT. With effect from 1 January 2023 if HMRC take longer than 30 days in making a repayment of VAT, they are liable to pay the taxpayer repayment interest calculated at the Bank of England base rate *minus* 1% (subject to a minimum rate of 0.5%). This is noticeably less generous than the previous regime whereby HMRC were liable to pay the taxpayer a Repayment Supplement calculated at 5% of the delayed VAT repayment amount.

Errors on returns and claims

Errors made on VAT returns potentially incur a penalty. The usual starting point for errors deemed 'careless' is 30% of the tax due, although penalties can be higher - and as much as 100% of the VAT amount - depending on whether the error is considered by HMRC to be the result of deliberate behaviour, and whether or not there has been concealment.

HMRC has the discretion to mitigate penalties (potentially to nil) or suspend them depending on the circumstances leading to the error and the level of cooperation provided by the taxpayer. Therefore, where an error has been made in a VAT return there is a strong incentive to disclose it promptly to HMRC in order to maximise any opportunity for mitigating any potential penalties.

Retention of business records

The period for retaining business records is six years. There is a fixed penalty of £500 for breaching this requirement.

Appeals

In the majority of cases where a taxpayer disagrees with a decision of HMRC (including a VAT assessment or a penalty decision) they have the right to request a review by an independent

officer at HMRC who is not connected with the case.

If the taxpayer still disagrees with HMRC following the review they have the right to make an appeal to the independent tax tribunal. Appeals can also be made to the tribunal in the first instance, however in most cases it makes sense to try to resolve the dispute initially via HMRC review. In all cases when seeking a review or making an appeal, the process is subject to strict time limits and these are normally indicated by HMRC in their assessment notice or their decision letter.

The tribunal has powers of mitigation in appropriate circumstances. Where the appeal is against the imposition of tax, interest, penalties, or surcharge, the disputed amount must normally be paid before an appeal can be heard. In the alternative the taxpayer can make an application for 'hardship' and seek HMRC consent to the appeal proceeding without the disputed amount being paid first.

The tribunal is also given the authority to increase assessments that are established as being for amounts less than they should have been.

A formal procedure is established for appeals to be settled by agreement. This agreement must be in writing, and there is a 30-day cooling off period during which the taxpayer may cancel the agreement.

Access to information

HMRC has extensive powers to obtain information. It can enter premises and gain access to computer systems and remove documents.

A walking possession agreement can arise where distress is levied against a person's goods. Broadly, this means that HMRC can seize the business assets of a defaulter against the debt due to HMRC, and either remove the assets or retain ownership but leave them at the defaulter's premises.

The sting in the tail

None of the above penalties or interest is allowable as a deduction when computing profits for corporation or income tax purposes.

Action points

- If you receive a VAT assessment (because you have not submitted a return), you must check it and notify HMRC within thirty days if it understates your liability.
- Make sure your systems and records are adequate to enable you to establish the gross amount of tax relating to a VAT period. The preparation of annual accounts cannot be regarded as a safeguard against penalties.
- Make sure you get your VAT return and payment in on time.

- If you cannot make your VAT payment by the due date HMRC encourages you to contact them straight away and seek agreement to put in place a Time To Pay arrangement. Doing this should ensure a late payment penalty is not imposed.
- Some of the above-mentioned penalties may not apply if the taxpayer can demonstrate evidence of a reasonable excuse, but the scope for this is limited and should not be relied upon. A simple lack of funds is not in itself regarded as a 'reasonable excuse' - the circumstances leading up to the default need to be both exceptional and unforeseen.

If in doubt, contact us. It is important that you seek professional advice as early as possible. We can help you!