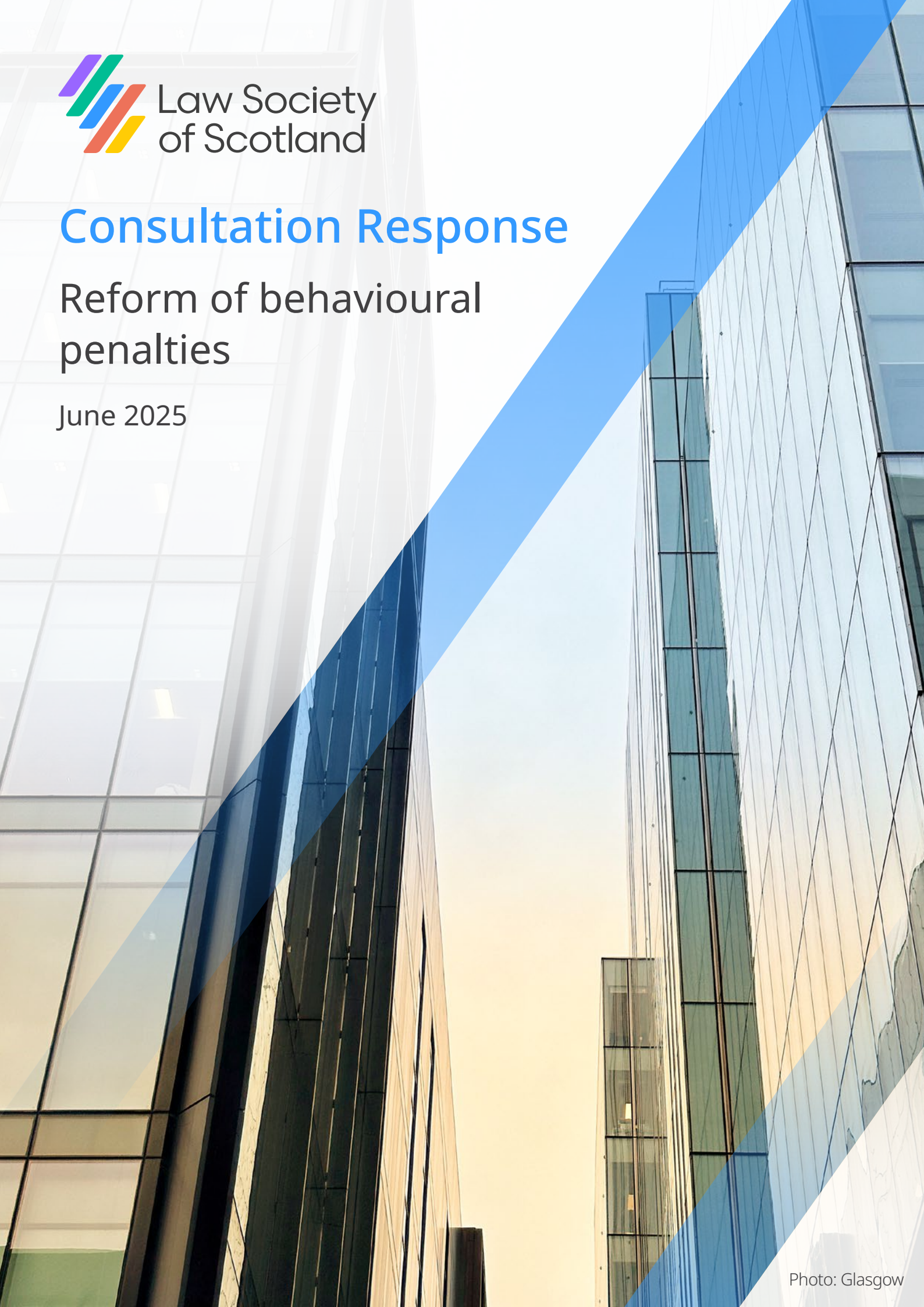
Law Society of Scotland

Consultation Response

Reform of behavioural penalties

June 2025



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Introduction

The Law Society of Scotland is the professional body for over 13,000 Scottish solicitors.

We are a regulator that sets and enforces standards for the solicitor profession which helps people in need and supports business in Scotland, the UK and overseas. We support solicitors and drive change to ensure Scotland has a strong, successful and diverse legal profession. We represent our members and wider society when speaking out on human rights and the rule of law. We also seek to influence changes to legislation and the operation of our justice system as part of our work towards a fairer and more just society.

Our Tax law sub-committee welcomes the opportunity to consider and respond to the HMRC consultation *Reform of behavioural penalties*.[1] The sub-committee has the following comments to put forward for consideration.

3. Improving existing penalties

Timing of disclosure

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

- inaccuracies disclosed after 3 years

We would welcome the removal of the minimum penalty level for the reasons set out in the consultation and agree that it may be acting as an unnecessary deterrent to those taxpayers who are generally honest and diligent about their tax affairs but later discover that they have made an error in an earlier year's reporting.

[1] Reform of behavioural penalties - GOV.UK

- failures to notify disclosed after 12 months for non-deliberate behaviour?

We agree with the removal of the minimum penalty level for the reasons set out in the consultation document. Furthermore, we would highlight the question of whether maintaining "failure to notify" as a standalone penalty separate to those for late filing or for filing inaccurate returns serves a purpose in a modernised tax system. With most tax references and filing now done digitally it is difficult to understand what mischief an earlier notification deadline and associated penalty is targeted to reduce. If late notification results in a taxpayer missing a payment or filing deadline then it is more intuitive for them to be penalised for those failures rather than the failure to notify itself, which does not directly lead to a loss of Revenue or a significant additional administration burden for HMRC. If "failure to notify" was removed from the penalty regime it would seem fair and sensible that HMRC would no longer be expected to provide any grace period in respect of payment and filing deadlines missed as a result of a taxpayer's failure to notify. At present, HMRC sets a somewhat artificial notification deadline, penalises failure to meet that deadline and offers an extension to the filing deadline to accommodate the effects of the already penalised failure to notify. Removing both the penalty and the extension would simplify the regime and move towards a position that places responsibility on the taxpayer to notify HMRC in good time to enable them to meet their obligations.

Reductions for type and quality of disclosure

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

- simplify penalty reductions for unprompted disclosure

We welcome the proposal that a fixed penalty reduction be applied for unprompted disclosures and agree with the consultation's suggestion that a known percentage reduction for unprompted disclosure would encourage taxpayers to disclose voluntarily.

- simplify penalty reductions for the quality of disclosure?

The proposals in respect of penalty reductions for the quality of disclosure are still relatively complex, even if the current 3 categories are reduced to 2. We would highlight that "telling, helping and giving access" could all be consolidated into "co-operation", which is far more easily understood by taxpayers. HMRC could still incorporate factors such as the extent of the disclosure; the explanation; the help and information given; and the quality of the access given in assessing the level of reduction given and could publicise that these are all factors which they consider without putting specific percentage reductions on each factor. The suggested 10% increments would simplify matters for taxpayers and could reduce the temptation to argue for minimal further reductions. More broadly, we would highlight that when discussing and publicising the penalty disclosure regime it would be beneficial for the narrative to focus on the reduction to the 100% penalty which can be achieved through co-operation rather than the penalty range which can be imposed despite such good behaviour.

Deliberate and repeated inaccuracies/failures to notify

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?

We do not consider the current penalty rate range for deliberate behaviour as proportionate, particularly (i) for first-time taxpayer offences, (ii) where the tax at stake is modest, and (iii) where disclosure is eventually made, and in all cases, where there is ultimately taxpayer cooperation with HMRC. We would question the minimum 20% rate for deliberate but not concealed, and consider that, and the upper 70% rate, ought to be reduced by 10% in each case. Motivation towards, and encouragement for, compliance is likely eroded where there is a risk to the taxpayer of lack of clarity of outcome coupled with the risk, perceived or otherwise, of a disproportionately higher rate penalty. This could deter disclosure from otherwise willing taxpayers who have misjudged their appropriate compliance with the tax regime and are prepared to engage and cooperate. As noted above, there should be a focus instead on the available mitigation framework that enables substantial reductions to headline penalty rates through early, unprompted disclosure and full cooperation. Transparent communication of how cooperation reduces penalties is essential. Headline penalty rates should not overshadow the potential for the availability of reductions for compliant behaviour. This would help narrow the perceived risk of penalties and encourage early cooperation. This seems fairer and clearer.

We agree that a higher upper penalty rate (and *de minimus* rate) within a strict regime generally ought to apply for repeated instances of deliberate behaviour. This is on the premise that harsher penalties deter misconduct. We encourage this

part of the regime being appropriate and fair, based on the circumstances (considering the undernoted factors). This includes accounting for periods of taxpayer compliance following a penalty. There ought not to be an enduring arbitrary application of higher penalty in future because of a single past act (or a closely related series) of non-compliance. A clear and published reset mechanism could instead apply after a certain period (for example, after a continuous 3-year period of compliance). This should help to balance fairness with the need for deterrence, especially when any future non-compliance is modest, inadvertent, or unintentional. We would not wish to see the regime discourage future voluntary disclosure by taxpayers who once in the past made an error of judgement in their filing or failure to notify. A reset based on taxpayer compliance history, could enable that, even if discretionary in nature. This would be proportionate and fair and would provide certainty for taxpayers.

Factors relevant for consideration of mitigation of penalty might include:

- Size and scale of instance and of tax at stake (value of tax lost)
- Frequency of errors
- Disclosure timing
- Return complexity
- Taxpayer compliance history
- Intent and concealment
- Extent of professional advice

For example, minor albeit deliberate oversights could attract warnings or lower-value penalties below the current range instead of the perceived dual risks of full-scale sanction and exposure to higher penalties. We would suggest that HMRC should consider the particulars concerning to tax return or structure arrangement complexity, alongside the past behaviour of the individual taxpayer and the circumstances in question to help inform and recognise the severity of the instance of deliberate behaviour. For example, was the taxpayer fully aware and informed of, and even advised against, the deliberate course of action or did the deliberate instance arise through complexities which often lead to higher error risk. HMRC should where possible seek to help taxpayers understand and trust the system. As noted above, a period of clean compliance before and after an instance of deliberate behaviour should be capable of being accounted for, without undermining the regime for repeat instances where penalties logically should be set higher for persistent or habitual non-compliance.

As set out in 5 below, we would support clearer guidance and broader eligibility for the suspension of penalties, in appropriate cases (first-time deliberate but not concealed errors, voluntary corrective disclosure, and borderline cases).

Offshore penalty rates

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

We would highlight that the current regime for penalties for offshore non-compliance is overly complex and we welcome that HMRC is seeking to simplify this regime. It is notably more varied and complex than the onshore regime. As with the penalty regime generally, we would wish to see a balance struck to ensure proportionality and fairness. A less complex regime should improve taxpayer understanding and help motivate compliant behaviour, whilst still acting as an effective deterrent.

For example, the layering of offshore penalties could be removed to streamline penalties and prevent cumulative charges which can be regarded as disproportionate and, in some cases, unfair, where a single misjudgement or mistake (or a closely related series of acts/omissions) results in the application of multiple penalties under different heads. The application of a single action penalty cap would be simpler and fairer.

It is important for HMRC to understand and rationalise the true intent of taxpayer behaviour which includes the reason and justification for a taxpayer's activity in a certain jurisdiction. The instance of non-compliance should be based on taxpayer behaviour ("what they did") in association with the jurisdiction ("where the asset was held"), and not overly focussing penalties because of the latter. The current jurisdictional categories are generally regarded as opaque. A clear banding system might be more effective.

We also consider that this clearer banding system should be applied more broadly by HMRC for offshore reporting. Many taxpayers hold legitimate offshore assets and investments, for example because they are dual nationals or ex-pats, or have inherited foreign wealth or because their UK asset structuring is administered offshore (for example, through family companies, nominee arrangements, OEICs, or bonds). HMRC communication and messaging around the feature of offshore tax risk needs to evolve to align with this legitimacy, and away from an historic culture of non-compliance or tax evasion. The current penalty regime is explicit in framing offshore taxpayer activity in this way, which suggests wrongdoing and may not be conducive with voluntary compliance.

The effectiveness of this penalty regime could be reviewed and assessed more widely. In addition to simplifying penalties for offshore non-compliance, there should be scope for other, non-punitive, initiatives to improve voluntary compliance. For example, better digital data collection and exchange, increased data prompts and notifications, pre-emptive digital/nudge letters, and other active engagement and awareness raising to promote (and incentivise) correct and voluntary corrective disclosure. Then the penalty regime could act as a measure

of last, not first, resort in combatting non-compliant behaviour. Guidance for taxpayers and advisers will help, especially if including a framework of scenario-based examples, decision flows, and clarity around definitions (for example, what constitutes concealment in respect of a nominee arrangement). As noted in 3 above, HMRC should where possible seek to help taxpayers understand and trust the system.

There will be a point at which financial penalties are set so high that they do not enhance behavioural compliance but have a counterproductive effect, acting as a disincentive for taxpayers from disclosure and open co-operation. Penalties of up to 200% for deliberate and concealed offshore non-compliance would seem to fall into that category, because they seem disproportionate and excessive, even if the headline rate is not frequently imposed as a sanction. More moderate rates and a lower cap could be a more effective deterrent to non-compliance whilst encouraging compliance. An extremely high penalty rate, in the context of an unduly strict regime, risks discouraging disclosure and reporting, as non-compliant taxpayers willing to correct past mistakes and historic matters would fear potentially harsh treatment.

Penalty suspension

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

We consider it essential that HMRC set out clear and simple criteria for suspension. We suggest that consideration should be given towards introducing automatic suspension of penalties for non-deliberate behaviour. This could be balanced by introducing more severe penalties for reoffenders, should suspension conditions not be met.

We would highlight that there is a risk of an inconsistent approach There appears to be no consistency in HMRC's approach due to each suspension being considered on its own merits, and taxpayers often being unaware of the ability to have penalties suspended. We would further highlight the existing penalty suspension flowchart, which demonstrates the complexity of the current approach. The conditions hinge upon the taxpayer's likelihood to reoffend. As this is behaviour based, it is highly subjective. In the case of first-time offenders, it is incredibly difficult to ascertain the likelihood of reoffending where there is no track record to base this on.

4. Alternative approaches

Civil evasion penalty

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?

We would highlight the risk of further delays in designing a new regime, rather than modifying existing legislation, which risks causing uncertainty for taxpayers. Any new regime should be highly publicised, in order to educate taxpayers, the costs of which would need to be carefully balanced. We would highlight the need also to ensure that the new regime is properly resourced.

We consider that the proposed new regime does provide opportunities to further tackle the tax gap and make the penalty system fairer. As we said in question 5, the current regime is already complex and is particularly harsh for those who have no tax liability, and are still issued with late filing penalties, causing financial hardship for those on low incomes. We would also highlight that new legislation could also provide the opportunity to harmonise penalties for all taxes, as inheritance tax and corporation tax still operate under separate penalty regimes.

Non-financial penalties and sanctions

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?

We would highlight the risk of unintentional consequences in the introductions of these measures. While non-financial sanctions such as the cancellation of passport or driving licence may be appropriate for extreme cases of non-compliance, it is important that these powers are used proportionately and that these measures should only be used as a last resort, and only where removal has a direct impact on the ability to trade (for example, removing a driving licence of a delivery driver who has repeatedly failed to comply with their tax reporting obligations may be appropriate). The move towards focusing on repeated non-compliance, rather than one off mistakes, would be welcomed, but introducing non-financial sanctions would result in significantly increased powers for HMRC, and would have to be carefully evaluated prior to introduction.

For further information, please contact:

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