

Revenue



New Civil Penalty Regime

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Introduction

The Finance (No. 2) Act 2008 introduced a new penalty regime. The new provisions will apply to both new cases and existing unresolved cases as from the 24 December 2008, where there has been an underpayment of tax or breach of tax filing requirements.

The Code of Practice for Revenue Auditors 2002, ("the 2002 Code") which formally governed the agreement of monetary settlement with the Revenue Commissioners, was effectively withdrawn from the passing of the Act on 24 December 2008. Therefore transitional arrangements will be required pending a new Code of Practice being put in place. It will only be possible to make informed comment regarding the practical and legal difficulties inherent in

the new regime when both the legislation and the new Code of Practice (once introduced) have been tried and tested over a sufficient period of time.

The Minister for Finance cited the requirement for this change to Revenue's civil penalties regime as being to ensure its compatibility with the provisions of Article 6 of the European Convention of Human Rights and with the Constitution.

Since the introduction of the European Convention on Human Rights into law in Ireland in 2003, concern has been raised by many practitioners, regarding the legal basis for penalties being recovered by the Revenue Commissioners from the estates of deceased persons. In March 2008, the Revenue

Commissioners announced a change of practice, confirming that they would no longer seek penalties from the estates of deceased persons where there had been an underpayment of tax by the deceased. This change of practice is also provided for in the Finance (No. 2) Act 2008.

In addition, the Revenue Commissioners have indicated that further changes were required to ensure that the civil penalty regime afforded a taxpayer the right to have the penalty element of any settlement adjudicated on by the courts to ensure that the taxpayer was afforded a right of full hearing as required by the European Convention on Human Rights.

It is understood that the rationale for its introduction also arose due to concerns regarding the legal difficulties which existed

in relation to recovery of mitigated penalties applied pursuant to the 2002 Code.

While it is appreciated that there was a legal requirement for the new penalty regime, the absence of consultation with practitioner bodies in relation to the most significant and complex change to the penalty regime in many years could potentially give rise to far-reaching issues for both taxpayers and the Revenue Commissioners.

As a result of the early Budget in October 2008, there was little scope for amendments due to the tight timeline between the publication and the passing of the Finance Bill through all stages in the Dáil and the Seanad. This was compounded by the fact that, despite representations from Representative Bodies to delay the introduction of the Finance Bill pending finalisation of a Code of Practice, there was no deferral of the introduction of the legislation to enable administrative practices to be resolved prior to its implementation and to allow for revision of the existing 2002 Code.

Fundamental, from the taxpayer's perspective, is the lack of safeguards and, in particular, that the new provisions, while introducing a new statutory voluntary disclosure mechanism, are not accompanied by a Code of Practice in statutory form. In the authors' view, the most intrusive powers should have the highest levels of pre-use control and post-use scrutiny as

confirmed in a recent UK decision. Safeguards, of necessity, are required to be embedded in legislation of a penal nature, in order to ensure that they are effective in providing the appropriate balance between protecting taxpayers and the need to secure the revenue of the State.

Safeguards ensure that taxpayers are treated fairly and in accordance with the law. Most importantly, safeguards are required to ensure equity and consistency of treatment as between one taxpayer and another in like circumstances and there should be a proportionate safeguard against abuse built into every specific power of the Revenue Commissioners.

This article is intended to outline the key elements of the new regime for taxpayers and their advisers, highlighting the main areas of concern and comparing the new UK equivalent penalty regime. It is intended in a subsequent article, by a number of authors, to provide detailed consideration of the new regime under each tax head with a particular focus on the new fixed penalty regime.

Old Penalty Regime

In advance of considering the new penalty regime it is probably useful to consider the key elements of the old regime for comparison purposes.

Statutory and non-statutory voluntary disclosure prior to the introduction of the new penalties regime

Section 1086(4) TCA 1997 formerly provided the taxpayer with a statutory entitlement to make a voluntary disclosure in advance of the commencement of an audit. However, a voluntary disclosure under s1086 was required to cover **all tax heads for all years** and, in order

to be effective, was required to be a **complete disclosure**. Therefore, such a disclosure did not have any restrictions or limitations in terms of materiality or time.

In addition, the Revenue Commissioners, under the Care and Management provisions, introduced the 2002 Code which provided for the concept of a "qualifying disclosure", which was a further option available to the taxpayer and indeed the option that was generally availed of. The 2002 Code provided the basis for Revenue's approach to audits and monetary settlements and deals with categorisation of tax defaults, mitigation of penalties, publication of a taxpayer's name as a defaulter, and prosecution criteria.

The primary benefits of making a disclosure under the 2002 Code were as follows:

- › mitigation of penalties,
- › assurance in respect of non-prosecution, and
- › non-publication of the taxpayer's name where a qualifying disclosure was made.

Mitigation of penalties

The mitigation of penalties under the 2002 Code was dependent on:

- › the category of tax default,
- › whether the disclosure was prompted or unprompted, and
- › co-operation provided by the taxpayer.

The category of tax default was divided into four categories:

- › deliberate default,
- › gross carelessness,
- › insufficient care, and
- › innocent error.

The category of innocent error applied where Revenue was satisfied that the tax default was not a deliberate tax default and was not attributable in any way to the failure by the taxpayer to take reasonable care to comply

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with his/her tax obligations – i.e., the error was neither deliberate nor due to insufficient care on behalf of the taxpayer. Where the category of innocent error applied no penalty was payable.

The 2002 Code also provided the opportunity for a taxpayer for self-correction in certain circumstances.

Non-prosecution

One of the benefits of a qualifying disclosure under the 2002 Code was that, where a qualifying disclosure was made by a taxpayer, Revenue would not initiate an investigation with a view to prosecution of the taxpayer. Although Revenue provided an assurance not to initiate an investigation in such cases, no assurances could be provided by other stakeholders and ultimately the decision to prosecute may only be exercised by the DPP.

Non-publication

Details of the settlement with Revenue would not be published where a disclosure satisfied the criteria for a “qualifying disclosure” under the 2002 Code. Also, under s1086(4) no publication occurs where the penalty does not exceed 15% of the tax due or the total tax interest and penalties included in the settlement was less than €30,000.

Thus, provided a qualifying disclosure was made, the confidentiality of taxpayers’ affairs was maintained.

Fixed penalties

In addition to the penalties applied in respect of qualifying disclosures/monetary settlements with Revenue, a wide range of fixed penalties apply for specific breaches of the Taxes Acts. Significant amendments have been by Finance (No.2) Act 2008 to these fixed penalties. However, a detailed discussion of these provisions is outside the scope of this article.

New Penalties Regime

For all new and unsettled cases as at 24 December 2008 the new regime will apply. The new provisions are contained in Schedule 5

of Finance (No.2) Act 2008, which places the qualifying disclosure regime on a statutory basis and introduces new categories of default for mitigation of penalties purposes.

The core new definitions are as follows:

- › “qualifying disclosure”
- › “prompted qualifying disclosure”
- › “unprompted qualifying disclosure”
- › “carelessly”.

In summary, the new regime provides as follows:

- › All qualifying disclosures must be in writing. There is no facility for oral disclosures.
- › A declaration is required to be signed **by or on behalf of the taxpayer** that – to the best of that person’s knowledge, information and belief – all matters contained in the disclosure are correct and complete.
- › Payment must accompany the disclosure in respect of tax and interest.
- › A qualifying disclosure must be a “... disclosure of complete information in relation to, and full particulars of, all matters occasioning a liability to tax that gives rise to a penalty...”. In the case of qualifying disclosures relating to a deliberate default, a disclosure must be made **for all tax heads for all years**, whereas a qualifying disclosure in respect of a default made carelessly but not deliberately may be limited to the period under review.
- › The definition of behaviour giving rise to a tax-g geared civil penalty has been changed from “fraudulently” and “negligently” to “deliberately” or “carelessly”, thereby significantly reducing the level of proof. In particular, s1077E(9) of Finance (No.2) Act 2008 should be noted, which provides as follows:

“where any return, statement, declaration or accounts mentioned in subsection (2) or (5)

was or were made or submitted by a person, neither deliberately nor carelessly, and it comes to that person’s notice that it was or they were incorrect, then, unless the error is remedied without unreasonable delay, the incorrect return, statement, declaration or accounts shall be treated for the purposes of this section as having been deliberately made or submitted by that person.”

Thus, failure to remedy a breach made innocently could result in an increased penalty if it is not remedied and could impact on the extent of the disclosure required.

- › Categories of Tax Default: A new category of “careless behaviour with significant consequences” replaces the category of “gross carelessness”. “Significant consequences” means that the difference between the tax/duty underpaid is greater than 15% of the correct tax/duty payable for the relevant period.
- › The legislation does not include a category for innocent error, nor is there scope for self-correction as contained in the 2002 Code. This is in marked contrast to the equivalent UK provisions which were introduced by the UK Finance Act 2007 and provide that no penalty will be imposed where the taxpayer took reasonable care and there was a genuine mistake made. It is critical that provision for innocent error is included in the revised Code, together with provisions regarding no loss of revenue the ability to self-correct as contained in the 2002 Code.
- › Fundamentally, there is no reference in the proposed legislation to the mechanism governing the manner in which the settlement is reached, nor is there any reference to the 2002 Code. There is an urgent requirement to introduce transitional measures pending finalisation of a revised Code.
- › Where a second qualifying disclosure is made within five years and where the nature of the default is categorised as either “deliberate

behaviour” or “careless behaviour with significant consequences”, reduced mitigation of penalties will apply.

- › Fixed-rate penalties, which apply in respect of defaults of specific sections of the Taxes Acts, have been substantially increased for all taxes save Customs Duty. However, while these penalties have not been increased for some years, the incremental effect for each tax filing breach is likely to give rise to a significant liability in addition to tax-gear penalties, e.g., the key lesser fixed penalty of €125 has been increased 24 times to €3,000 and the higher key fixed penalty of €315 has been increased to 15 times to €3,000. A detailed discussion of the fixed penalty provisions is outside the scope of this article.
- › Revenue’s practice regarding the recovery of penalties from the estate of a deceased person is put on a statutory footing, i.e., such penalties will only be recovered from an estate where the person either agreed in writing to pay the penalties or a court has determined, prior to death, that the person was liable to the penalties.
- › Section 1077E (10) provides “*that subject to section 1077D(2), proceedings or applications for the recovery of any penalty under this section shall not be out of time because they are commenced after time allowed by section 1063*” (which provides for a six-year time limit). Therefore, this section would appear to provide that there is no time limit for the recovery of penalties for carelessly or deliberately making incorrect returns.
- › It should be noted that these new provisions apply retrospectively to all open or unsettled cases.

The following table summarises the revised categories of default and the applicable level of penalty under the new legislation.

Category of default giving rise to a penalty	Base penalty	Co-operation only	Co-operation with:	
			Prompted Qualifying Disclosure	Unprompted Qualifying Disclosure
Deliberate behaviour	100% of underpaid tax	75%	50%	10%
Careless behaviour with significant consequences	40% of underpaid tax	30%	20%	5%
Other careless behaviour	20% of underpaid tax	15%	10%	3%

The new legislation provides that in the absence of agreement on a penalty, Revenue may issue an opinion setting out the amount of penalty which it believes the person is liable to pay. Such an opinion must identify:

- › the provision of legislation under which the penalty arises;
- › the circumstances in which that person is liable to the penalty;
- › the amount of the penalty to which that person is liable; and
- › other details which Revenue considers necessary.

Notably, there is no requirement in the legislation that such an opinion be approved by a senior Revenue official. This is another critical safeguard which needs to be included in the revised Code.

The taxpayer has 30 days to agree the opinion and make the payment. Failure to do so means Revenue may apply, in accordance with Section 94 of the Courts of Justice Act 1924, to the District, Circuit or High Court to enforce payment. There is no scope for the taxpayer to appeal the opinion to the Appeal Commissioners. In the absence of a dedicated tax court this is likely to

lead to inconsistencies between the outcomes in various cases.

The choice of court is dependant on the amount of penalty involved and must be within the jurisdictional limits of the particular court. These limits are as follows:

- › District Court – Up to €6,349
- › Circuit Court – Up to €38,092
- › High Court – Amounts in excess of €38,092.

Clearly, the costs associated with court proceedings – and in particular High Court proceedings – will be a deterrent if not a prohibitive factor for most taxpayers and therefore in the absence of any other avenue of appeal they will be left with no option but to pay the penalty imposed. In addition, unlike Appeal Commissioner hearings, such court proceedings will be heard in public.

Key Issues for Practitioners:

The new regime poses a number of both practical and legal issues for taxpayers and their advisers, which include the following:

- › The only mechanism under the current system for an independent appeal where a taxpayer disagrees with any aspect of the Revenue audit/investigation (which gives rise to the level of penalty) is by way of judicial review in

the High Court which carries with it inherent risks and potentially significant costs. This means of resolution is impractical in all but exceptional cases.

Practitioners would welcome a mechanism for speedy, independent, and non-costly resolution of disputes with Revenue which give rise to the penalty in the first place. This, of necessity, is also likely to give rise to cash-flow benefits for the Irish Exchequer.

- › The rights of a taxpayer to confidentiality in his/her dealings with Revenue were protected where there was a voluntary disclosure made under the old regime. Currently, tax appeals heard before the Appeal Commissioners and the Circuit Court, are heard *in camera*, thereby allowing the taxpayer confidentiality. However, under the new regime, where the level of penalties is disputed, the only option open to taxpayers is to apply to the District, Circuit and High courts, depending on the level of penalty involved. Such hearings, unlike tax appeals, are not heard *in camera*, rather, involving public hearings in open court, which is likely to prove a significant deterrent to many taxpayers and will impact upon the right to confidentiality of the taxpayer. This is irrespective of the amounts involved or the seriousness of the default.

Thus, while publication of the taxpayer's name may not be required under the legislation this will inevitably be an unavoidable consequence if a dispute is heard in open court. It may also have other unintended consequences, in particular, that

the matter may become the focus of another regulatory investigation, e.g., the ODCE.

- › The Revenue Commissioners have indicated that the Finance (No. 2) Act 2008 was introduced following recommendation of the Law Reform Commission Report in 2004. However, while this report and that of the Revenue Powers Group recommended the introduction of a formal penalty regime with consequent capacity to appeal, both envisaged that this would be dealt with by the Appeal Commissioners, which of course would afford taxpayers the right to have a hearing *in camera*.

Furthermore, the Revenue Powers Group, in 2004, recommended that a voluntary disclosure should be defined and its consequences regulated by primary legislation and supported, where necessary, by subordinate legislation and administrative directions.

This proposal envisaged that in default of agreement, the Appeal Commissioners would have power to adjudicate in respect of the conduct of audits. While constitutional issues may arise should the Oireachtas vest the Appeal Commissioners with the jurisdiction to determine the amount of a particular penalty,

there does not appear to be anything to prevent the Appeal Commissioners from being given jurisdiction to determine the tax issue as to whether or not the penalty is due as a matter of tax law.

Clearly, if the Appeal Commissioners have jurisdiction to determine whether an assessment is correct, in the author's view it is difficult to understand why the Appeal Commissioners should not be vested with a similar jurisdiction to determine whether, as a matter of principle,

a penalty is due by reason of non-compliance by the taxpayer with the obligations imposed by the Taxes Acts.

The appeal of the imposition of a penalty by the Revenue Commissioners to the Appeal Commissioners (who are an independent tribunal) would be significantly quicker and less costly for both the taxpayer and indeed for the Revenue Commissioners.

- › One of the benefits of a qualifying disclosure as outlined in paragraph 10.3 of the 2002 Code was that, where a qualifying disclosure was made by a taxpayer, the Revenue Commissioners would not initiate an investigation with a view to prosecution of the taxpayer. On the enactment of the new regime, the assurance contained in the Audit Code of Practice in relation to non-prosecution was withdrawn. It is critical that any transitional measures and the revised Code of Practice include such an assurance.
- › The new regime requires that "A declaration ... be signed **by or on behalf of the taxpayer** that to the best of that person's knowledge, information and belief, all matters contained in the disclosure are correct and complete."

In the event of a criminal prosecution it is likely that the person who signed the qualifying disclosure would need to be a witness to prove the admission. This raises the spectre of the tax practitioner appearing as a witness for the prosecution against his or her client, where the practitioner assisted in formulating the disclosure.

The practical implication of this paragraph is that it requires the taxpayer to "self assess" penalties which may arise following any tax default. In the first instance there is very little by way of judicial or other guidance on how to determine the extent of a tax default. Clearly, these are issues which will require careful consideration and emphasise the seriousness of these provisions and the overriding requirement to ensure that

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an assurance, in respect of non-prosecution, is reinstated.

While the authors have endeavoured to outline key concerns, it is clear that until such time as the new regime and the revised Code of Practice are in place, one could not possibly predict with any certainty all of the potential issues which may arise.

UK Single Penalty Regime

The UK introduced a new penalties regime in Finance Act 2007, Schedule 24, which became effective pursuant to a Commencement Order dated 3 March 2008 SI568(C20). This new single penalty regime was introduced from 1 April 2008, in relation to incorrect tax returns for income tax, corporation tax, PAYE, national insurance contributions and VAT which are due to be filed on or after 1 April 2009.

The stated objectives of the new UK regime were:

- › to consolidate penalty powers covering both direct and indirect taxes following the merger of the then UK Inland Revenue and UK Customs and Excise;
- › to make the tax system simpler and more consistent by aligning penalties for all taxes; and
- › to encourage positive behaviour, and in particular to encourage disclosure mirroring the qualified disclosure regime which has been in place in Ireland for a number of years.

The main thrust of the new regime is to apply a greater level of penalty to those who deliberately conceal taxable income or gains rather than those who merely make an innocent error. The old UK penalty concepts of fraud and neglect have been replaced by deliberate conduct and failure to take reasonable care.

There are four different categories of penalties, depending on the behaviour that gave rise to the error – the less serious the behaviour, the lower the penalty imposed.

1. There will be no penalty imposed where the taxpayer took reasonable care and there was a genuine mistake made.
2. A penalty from 0% up to a maximum of 30% will be imposed where the inaccurate tax return was due to carelessness on the taxpayer's behalf.
3. Where there has been a deliberate inaccuracy on the part of the taxpayer, a penalty ranging from 20% to 70% will be imposed.
4. Finally, where there is a deliberate inaccuracy, with concealment, a minimum penalty of 30% will be imposed and this rises to a maximum of 100%.

Summary of penalties applicable under the new UK regime:

Behaviour leading to the error	Percentage of tax charged
Reasonable care taken but error made	No penalty
Error due to carelessness	0 to 30% of the tax due
Deliberate error	20 to 70% of the tax due
Deliberate and concealed error	30 to 100% of the tax due

A detailed analysis of the UK regime is outside the scope of this article. However, the key differences are as follows:

- › It appears that there is a single new penalty regime (as opposed to a tax-geared and civil penalty regime in Ireland).

- › It provides for zero penalties in cases of genuine error (no equivalent safeguard is included in the Irish regime).
- › It introduces new concepts to penalty regime such as suspension of part or all of a careless inaccuracy penalty – where a penalty is charged for failure to take reasonable care, this may be suspended for up to two years, after which it can be either cancelled or enforced.
- › The UK differentiates between cases where there has been a deliberate inaccuracy and such a breach with concealment, thus affording greater protection to the taxpayer.
- › Most importantly, there is a statutory right to appeal that a penalty is payable, the amount of a penalty, the suspension of a penalty and the conditions of such suspension to the General Commissioners or the VAT Tribunal, thus providing a speedy non-costly means to resolve penalty disputes.

It should be noted that the UK has also implemented the ECHR. Thus, it is interesting to note that the General Commissioners or the VAT Tribunal (who, similar to Irish Appeal Commissioners, have no judicial status) are considered to have the power to adjudicate on civil penalty matters.

Conclusion

While it is anticipated that it will be possible to resolve certain issues addressed in this article and elsewhere by means of discussion and clarification between Practitioner Bodies and the Revenue Commissioners, only certain matters may be resolved by means of a non-statutory Code. In the authors' opinion, the new regime will effect a fundamental shift in the existing balance between the taxpayer and the Revenue Commissioners, whether intentional or otherwise.