

Compliance Failure Example for APS VAT

Stokes Ltd (“Stokes”) is a fully taxable trading company, with a 31 March year end. Its turnover for y/e 31.3.20 was £6m and it is VAT registered. It is not part of a VAT group.

You have recently been appointed as Tax Manager for the company. Prior to your appointment, Lester Stokes, majority shareholder and Managing Director of the company, prepared Stokes’ tax filings himself, including the completion and submission of VAT returns. Lester is a Chartered Accountant and, whilst he has some VAT knowledge, he admits he is not a VAT specialist.

You have been reviewing the company’s VAT returns that have been submitted for the last 12 months, as part of an audit, and discover the following:

VAT return for q/e 31.3.20 – although payment was made on time, the return was submitted 10 days late.

VAT return for q/e 30.6.20 – payment and filing of the return were made on time but there was an omission of a large sales invoice. Lester explains that the invoice was for a total £100,000 (including VAT) but that due to a change in the company’s accounting systems, it was missed off and only picked up in December 2020 when a review was undertaken at the end of the calendar year. Turnover in this period was £1.6m.

It is now January 2021 and the q/e 31.12.20 VAT return is being compiled. Turnover for the quarter is £1.7m. Lester also explains to you that he did receive a ‘letter or something’ from HMRC concerning the March VAT return but has misfiled it since and is unsure if he should be concerned about it.

You inform Lester that this communication is likely to have been a ‘Surcharge Liability Notice’ (SLN) which is issued when either a VAT payment is made late or the return is submitted late. As the March 2020 return was submitted late this would identify a 12 month period within which Stokes needs to submit VAT returns on time (and pay them on time), otherwise they might face a monetary penalty for payments in the 12 month period which are made late. Therefore, the notice would mean that the four VAT returns to 31.3.21 all need to be submitted and paid on time to come out of the surcharge period. If a payment is made late within this period, then a monetary penalty is likely to apply. There will be no monetary penalty for the March 2020 return.

You also explain that the VAT return for q/e 30.6.20 contains an error and that this should be considered a careless mistake. Lester is keen to make a full disclosure to HMRC as soon as possible and wants to know how this should be done.

You have explained that as it is a careless error then it could be corrected on the December 2020 VAT return, provided it is within the maximum monetary threshold. The error is the output VAT underpaid on the return which is £16,667 (1/6 of £100,000).

Although this exceeds the £10,000 limit it is within 1% of the turnover on the current VAT return (1% x £1.7m) and can therefore be classed as ‘small’. The turnover for the VAT return that the invoice should have been declared on is not relevant. However, correcting the error on the current VAT return will not count as an unprompted disclosure for penalty purposes.

Therefore, you recommend that the error is corrected on the return and a letter is also drafted to be sent to HMRC’s error correction department.

The letter you draft:

- Includes a calculation of the VAT error of £16,667 and explains that it is an output tax error that relates to the VAT return for q/e 30.6.20 and that this is the only error;
- Apologises for this isolated error and that you have audited the last 12 months’ VAT returns and no other errors have arisen;

- Explains that the error has been corrected on the 31.12.20 VAT return;
- Explains to HMRC the grounds for a potential reduction of the error in that it was caused by the company changing over to a new accounting system and the sales invoice was missed off the June 2020 VAT return but picked up on a later audit; and
- Expresses Stokes' willingness to provide any further information that should be required by HMRC.

Now that the tax has been quantified and the error remedied, the next stage is to assess the potential penalty. HMRC will decide whether a penalty is appropriate and if so how much.

Stokes will reply promptly to any correspondence from HMRC and provide them with further information that they request, as this will assist in mitigation of a penalty.

As Stokes has made an unprompted disclosure of a careless error, under Sch 24 FA 2007 the penalty range is between 0% and 30% of the potential lost revenue (PLR) (here the PLR being £16,667).

In the light of the above, you analyse HMRC's criteria for mitigating penalties based on quality of disclosure:

<u>Criteria</u>	<u>Maximum mitigation</u>	<u>Reasoned support</u>	<u>Suggested mitigation</u>
"Telling"	30%	HMRC were unaware that the sales invoice had been missed off and Stokes admitted the inaccuracy as soon as it became aware of the issue and made a full disclosure and explained why the isolated error arose.	20%
"Helping"	40%	Stokes quantified the inaccuracy, calculated the underpaid VAT and provided evidence in support of computations. Requests from HMRC were answered quickly and politely.	40%
"Access"	30%	Stokes agreed to provide access to any appropriate records and duly did.	30%
Possible mitigation for quality of disclosure			<u>90%</u>

Contract settlements do not apply to VAT and HMRC's error correction department writes to you assessing Stokes to a penalty of 3% of the potential lost revenue.

As the error was corrected on a subsequent VAT return, it does not incur any interest charge.

Therefore, the penalty would be:

Error in VAT return:	£16,667 x 3% penalty	£ <u>500</u>
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This should be paid within 30 days of the notice of the penalty.

The penalty can be appealed within 30 days. HMRC should be asked to consider suspending the penalty for two years. If Stokes makes no further mistakes and files all VAT returns and makes payments on time for two years, the penalty will be cancelled.