

New VAT Penalty Rules from January 2023

What is changing?

The penalty regime for all VAT registered businesses is changing from 1 January 2023 to become a “points” based system for late Returns.

This will completely replace the former default surcharge system.

Points will be recorded by HMRC based on each failure to submit a VAT Return on time. When the points total exceeds the relevant threshold a fixed **£200 penalty** will be imposed. After reaching the threshold, no further points are added, but further £200 penalties are charged for each subsequent late Return.

The system is designed to reward good compliance, so when a period of full compliance is achieved the points are cancelled.

Late Returns

Points for Overdue Returns

Every late VAT Return incurs a **single penalty point**. HMRC will issue a notification of each point imposed. Penalty points are imposed for all late Returns, including those where a VAT repayment is due.

Penalty Threshold

The fixed penalty of **£200** is imposed when the thresholds below are reached.

Return Frequency	Initial Penalty Threshold
Monthly Returns	5 points
Quarterly Returns	4 points
Annual Returns	2 points

Points Reset

Each individual point is cancelled from HMRC's record after two years, unless the overall points total has reached the penalty threshold.

After reaching the penalty threshold the points are only cancelled and the total reset to zero when all Returns for the preceding 24 months have been submitted (including late submissions) and where Returns have been submitted on time for the periods below:

Return Frequency	Period of Compliance (Returns Submitted on Time)
Monthly Returns	6 months
Quarterly Returns	12 months
Annual Returns	24 months

Time limits for HMRC penalties

There are specific time limits for HMRC to allocate penalty points, meaning that if the Revenue delay notifying the imposition of the point they will be out of time. The time limits for this are as follows:

Return Frequency	HMRC Time Limit
Monthly Returns	2 weeks
Quarterly Returns	11 weeks
Annual Returns	48 weeks

Late Payment

Payment of VAT after the due date is subject to both interest and a separate penalty regime.

Late payment incurs penalties based upon the amount of VAT underpaid rather than the payment compliance history. No penalty points apply to late payment.

Late Payment Penalties

A new VAT penalty regime for late payments is also introduced from 1 January 2023. Although this penalty is calculated as a percentage of the VAT outstanding the amounts charged are penalties and are not interest.

The late payment of VAT will incur penalties as follows:

VAT Payment Made	Penalty
Up to 15 days late	No penalty
16 to 30 days late	2% of VAT outstanding at day 15
Unpaid after 31 days or more (replaces penalty for 16 to 30 days)	2% of VAT outstanding at day 15 plus 2% of VAT outstanding at day 30
Daily penalty from day 31 until fully paid	4% per annum, calculated daily on the amount of VAT outstanding

Interest on Unpaid Penalties

Where a late payment penalty remains unpaid after 30 days the penalty itself will be subject to late payment interest calculated on a daily basis.

HMRC will apply a “de minimis” threshold for interest on penalties, meaning that interest will not be charged where the amount is less than £2.

Late Payment Interest / Repayment Interest

Interest will be charged by HMRC, calculated on a daily basis, irrespective of any penalty imposed. Overpayments will benefit from repayment interest.

The late payment interest will be charged at a rate of 2.5% plus the Bank of England base rate and calculated on a daily basis.

Overpayments will be credited with repayment interest calculated at 1% below the base rate, with a minimum rate of 0.5%.

The repayment rules are much less generous than the repayment supplement system which provides for a credit equal to 5% of the repayment where it is delayed by more than 30 days. This change will remove the incentive for HMRC to promptly process VAT refunds, but will give credit interest for amendments to earlier periods.

Making a “time to pay” arrangement with the Revenue to settle the tax liability is treated as payment at that point and, provided that the terms of the agreement are followed, no further interest or penalties will arise.

Further Practical Points

HMRC Discretion

The Revenue has discretion whether to levy a point or to charge a penalty.

To benefit from this flexibility it will be necessary to request HMRC to apply their discretion before the penalty is imposed. The request will need to specify a reasonable excuse for the late filing.

Penalty Point Appeals

Once a penalty point is imposed the Revenue no longer have discretion to withdraw it and a formal appeal will be necessary, which could ultimately lead to a Tribunal hearing if HMRC do not agree.

It is possible to appeal each penalty point if there is a reasonable excuse for the late Return.

HMRC are planning a range of standard categories for appeals (bereavement, crime, fire/flood, health, loss of staff, technology or other), which may make this process easier. The system will also allow accountants to make appeals on behalf of the business where an issue delays a submission made by the agent.

Change of Return Frequency

Where the Return cycle changes an adjustment to the points total may arise. If the business is on zero points there will be no change, but where any penalty points have been accumulated the Revenue will adjust the running total as follows:

Change in Return Frequency	Adjustment
Monthly to Annual Returns	Deduct 3 points
Monthly to Quarterly Returns	Deduct 1 point
Quarterly to Annual Returns	Deduct 2 points
Quarterly to Monthly Returns	Add 1 point
Annual to Quarterly Returns	Add 2 points
Annual to Monthly Returns	Add 3 points

Any deduction will only reduce the current total to zero. No negative totals are permitted.

Any points deducted are applied to the oldest points first, while added points are treated as arising at the same time as the most recent points.

VAT Groups

Formal VAT groups will have a single points total.

Points will apply independently to the group, meaning that any points incurred by an entity prior to joining the VAT group will not be carried across and neither will the VAT group's points be allocated to an entity that leaves the group.

Transition to the New System

The default surcharge regime will be replaced by the points system. Where a business is already in a period of default under the former surcharge arrangements this has no impact on the points total and all businesses will start with zero points from 1 January 2023.

Light Touch

For the first year of the system the Revenue will not issue late payment penalties for tax paid up to 30 days late, but will apply the penalties above for tax paid more than 30 days late.

Further guidance on the penalty system will be published by HMRC in December 2022.

Future Expansion

The Revenue plan to extend the points based penalty system to other taxes, with taxpayers who report under the Making Tax Digital for Income Tax Self Assessment (MTD ITSA) regime scheduled to join the new penalty system from 6 April 2024.

The remaining Self Assessment taxpayers will join the new regime a year later, from 6 April 2025.

The points will be applied separately for each tax, so Self Assessment points will not be added to VAT points.

For further advice contact us on 023 8046 1200 or visit www.hwb-accountants.com

The above summary is based on legislation and guidance published as at 15 May 2022.
The summary is intended to provide a general guide and individual advice should be sought about your specific circumstances.