

Guide to Penalties that Apply Under the Income Tax Law

Guide No. 5 in the Tax Guide Series

About This Guide

This Guide has been prepared to help you understand the system of penalties that will apply from 1st April 2010. If you still have some questions after reading it, please call into the Income Tax Office.

1. What is the difference between penalties and offences?

The new Income Tax Ordinance, 2009 introduces a number of sanctions against people who do not honestly meet their tax obligations on time. In a number of cases, the Commissioner can impose a monetary penalty and the law spells out how the penalty is calculated. In more serious matters, the Commissioner is required to lay charges in Court and the Court will determine the penalty. Matters brought before the Court are referred to as Offences and other monetary penalties charged by the Commissioner are simply referred to as penalties.

THIS GUIDE FOCUSES ONLY ON PENALTIES

2. What do penalties apply to?

The Commissioner will charge a penalty in the following circumstances.

1. Failing to file an annual income tax return
2. Failing to file a monthly or annual employer statement.
3. Failing to file a monthly or annual statement by a withholding tax payer.
4. Failing to pay income tax by the due date.
5. Making a false and misleading statement.
6. Failing to deduct income tax from employment income and withholding income.

7. What is the rate of penalty for failure to file an income tax return, an employer statement or a withholding tax statement?

The penalty for failure to file an income tax return, employer statement or withholding statement by the due date is a flat amount of £100 plus a further amount of £10 for each month the return is late.

For example, an income tax return is 3 months late if it should have been filed by 31st March but was not filed until 30th June. In this case, the late

filing penalty will be £120. This is calculated as £100 flat penalty plus £10 for each complete month (April and May). There is no penalty for June as the return was filed during the month.

Monthly employer and withholding statements are due every month and are late if not filed by the 15th day of the month. For example, a statement for the month of March 2010 is due by the 15th day of April 2010. If the statement is filed on 14th June, a penalty of £110 will be applied. This is calculated as £100 flat penalty plus £10 for each complete month (to 15th May). There is no penalty for the period up to 15th June as the statement was filed before the 15th day.

8. *Can the late filing penalty be reduced or waived?*

No. The penalty is mandatory and cannot be reduced or waived.

However, it is important to realize that you can avoid a late filing penalty in relation to an income tax return (but not an employer statement or withholding statement) by requesting an extension of time to file. No penalty will be applied where a person files a return within the extended due date.

9. *What is the rate of penalty failure to pay income tax by the due date?*

The standard rate of penalty for failing to pay any tax by the due date is a flat penalty of 10% (of the tax outstanding) plus 1.67% for each month that the tax remains outstanding. The rate of 1.67% is equivalent to 20% per annum but it is applied every month.

The late payment penalty will be applied to all the following payments:

1. Annual income tax (normally due on 30th June of every year;
2. PAYE deducted from payments to employees (due by the 15th day of the month after the month in which it was deducted);
3. Withholding tax deducted from withholding payments (due by the 15th day of the month after the month in which it was deducted).

For example, PAYE taxes deducted from employee payments during the month of March 2010 are due by 15th April 2010. If the tax deducted in March was £150 and it was paid on 20th April 2010, the late payment

penalty is £15. If the payment was not made until 20th May 2010, the late payment penalty increases to £17.50 because of the addition of the monthly penalty of £2.50 (£150 x 1.67%).

10. Can the late payment penalty be reduced or waived?

Yes, the Commissioner does have the authority to reduce or waive a late payment penalty but this is discretionary.

In the majority of cases, forgetfulness or carelessness will not be sufficient reason to avoid a penalty. However, if you are experiencing difficulty in making payment and you approach the Commissioner before the due date for payment, you may be granted an extension of time for payment.

11. What is the rate of penalty for making a false and misleading statement?

A penalty for giving false information to the Commissioner will apply if you:

- (i) Make a statement in writing or verbally that is false or misleading;
or
- (ii) Omit any relevant information from a statement that causes it to be false or misleading.

Providing false information or omitting relevant information is a serious offence and carries the harshest penalty but the amount of the penalty will depend on your circumstances. The penalty is calculated by reference to the amount of tax you could have evaded by making the statement or omission. This is referred to as the tax shortfall.

Deliberate Omission

If the false statement or omission was made deliberately or recklessly, a penalty of 75% of the tax shortfall will be applied. For example, if you deliberately omit £1,000 of income in your annual income tax return and the tax applicable to that income is £270, you are liable for a penalty of £202.50 (75%). This penalty is in addition to the payment of tax so the full cost of attempting to evade payment of income tax is £472.50.

Carelessness

If you are careless in preparing your income tax return but do not deliberately try to evade paying tax, a penalty of 20% of the tax shortfall will be applied. For example, a 20% penalty will apply if you make some mistakes when keeping your book and records or in transposing the information from your records to your income tax return but did not do this deliberately to evade taxes. However, if you deliberately refuse to keep accurate records and the Commissioner has advised you to do so, any errors in your return may be regarded as deliberate and a penalty of 75% will be applied.

The 75% rate of penalty is not intended to apply to people who make an honest mistake in preparing their tax returns. However, everyone has an obligation to prepare their returns accurately and if you do make a mistake, the rate of 20% will be applied even if the mistake was unintentional.

If the false information

12. Will the penalty apply if I claim deductions to which I am not entitled?

Yes. A false or misleading statement applies to anything that may have reduced your tax liability. For example, if you claim a deduction for the business purchases in your income tax return but have no evidence to show that you actually spent the money, you have made a false and misleading statement and are liable for penalty. The rate of penalty will be decided by the Commissioner dependant on the circumstances.

13. Can the penalty for false and misleading statements be reduced or waived?

Yes.

Voluntary Disclosure

If you discover that you have made a false statement and voluntarily tell the Commissioner, the base rate of penalty will be reduced by 10%. For example, a penalty that might have been applied at the rate of 75% will be reduced to 65% and penalty that may have applied at the rate of 20% will be reduced to 10%.

Unaware

In addition, if you made a false statement and were not aware that it was false and could not have been expected to know that it was false, no penalty will apply. For example, if you prepare your return based on information supplied by a third party (such as a bank or a business associate) and that information proves to be incorrect, it is likely that you will not be charged any penalty. However, you will have to pay any tax that relates to the error.

However, if you make a false statement in your income tax return because you have not kept accurate records of your income and expenditure, this will not be regarded as something that you were unaware of. The reason for this is because everyone has an obligation to keep accurate records and provide accurate information to the Commission. If you do not do this, you have been at least careless and at worst made a deliberate error.

Reasonably Arguable Position

The final category under which a penalty may be reduced or waived relates to a person who files an income tax return under the new self-assessment and does not include an item that is liable for tax or claims a deduction for an item that is not deductible and reasonable steps have been taken to ensure that the income tax return is correct. For example, a person may receive an amount that they believe is not liable to income tax. To make sure that it is not, they ask for advice from the Commissioner or someone else who is qualified to give tax advice. If that advice confirms that the item is not taxable but it subsequently proves to be wrong, no penalty will be applied.

In some circumstances, the Commissioner may take a different view of the tax consequences of a transaction than the person who provided advice. If the advisor had good legal reasons for having a different opinion than the Commissioner, no penalty will be applied.

14. Can the Commissioner increase the rate of penalty?

Yes. The penalty can be increased by 10% if the false statement or omission has occurred previously. Thus, a penalty for carelessness may be increased from 20% to 30% if there were previous instances of false or misleading statements.

In addition, the history of a person's honesty and accurateness in providing information to the Commissioner may be a factor in determining whether the statement was deliberately made or carelessly made. Where there several instances of a false statement to the Commissioner, it may be concluded that a person is deliberately providing false information. If so, the rate of penalty will be increased to 75%.