



HM Revenue
& Customs

Follower Notices and Penalties

Summary of responses

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1. Introduction

- 1.1 On 16 December 2020 the government published a consultation document *Follower Notices and Penalties*. A Follower Notice (FN) is a legal request by HMRC to a taxpayer who has used a tax avoidance scheme to remove the tax advantage they have claimed. FNs can only be issued when the scheme has been defeated in another person's litigation.
- 1.2 For example: taxpayers A, B, C, D and E all used the same tax avoidance scheme called XYZ, arguing that it secured them a tax saving of £10,000 each. HMRC believed that the scheme did not work and did not deliver the tax saving. HMRC and taxpayer A took the matter to litigation and a tribunal ruled that scheme XYZ did not deliver the tax saving. Taxpayer A did not appeal so the decision was final.
- 1.3 Before FNs were introduced it was not unusual for taxpayers B, C, D and E to all litigate their cases too. This meant the same issue had to be heard several times over with the tribunal reaching the same decision each time. This was slow and expensive.
- 1.4 Following the introduction of FNs, when the tribunal reaches its decision in relation to taxpayer A's litigation and explains why the avoidance scheme does not work, HMRC can issue FNs to taxpayers B, C, D and E requiring them to take steps (referred to in the legislation as "corrective action") to remove the £10,000 tax saving they claimed and bring this amount back into charge.
- 1.5 A person who receives a FN can incur a penalty if they do not take action in response to the notice, and there is a right of appeal against a FN penalty. A taxpayer who has received an FN can decide to take their own case to litigation but they still need to pay the penalty, unless, the tribunal or court in their case reaches a different decision.
- 1.6 The consultation document asked for views on how FNs could place a stronger focus on those whose continuation of their dispute with HMRC, following receipt of a FN, is without merit or substance and deemed by the tax tribunal to be unreasonable.
- 1.7 The document invited comments on proposals to reduce the rate of FN penalty from 50% of the disputed tax to 30%, and to introduce a further penalty of 20% for those cases in which the tax tribunal concluded the litigation was time-wasting, vexatious or otherwise without merit.
- 1.8 Five responses were received, three from representative bodies and two from professional advisers.
- 1.9 In general respondents expressed their dissatisfaction with the Follower Notice regime, but all supported some level of reduction to the FN penalty. The government is grateful to those stakeholders who participated and for their constructive engagement with the consultation.

2. Responses: Follower Notices and Penalties

The role of Follower Notices

- 2.1 The FN regime is an important element of the legal framework HMRC deploys to tackle the use of tax avoidance schemes. It reduces the incentive for taxpayers to continue their dispute where the Courts have already made a decision in HMRC's favour on the same, or very similar cases. FNs ensure an efficient use of public money in both the judicial system and HMRC.
- 2.2 Some commentators have expressed concerns that FNs act to deny taxpayers access to justice because, although recipients still have a choice of actions, the high penalty makes it difficult for most to do anything other than settle their cases with HMRC, even if they believe strongly in the correctness of their position.
- 2.3 In December 2018 the House of Lords Economic Affairs Committee published its report ['The Powers of HMRC: Treating Taxpayers Fairly'](#). In that report, the Committee recommended that FN penalties be abolished. Commenting on the report, Lord Judge suggested that the safeguards in the FN and Accelerated Payment Notice (APN) regimes should be overseen by the courts. Lord Judge said that it should be left to the courts to decide if litigation were frivolous or time-wasting and whether to penalise litigants in such cases.
- 2.4 The Financial Secretary to the Treasury gave evidence to the Committee in June 2019. In that evidence, the government rejected the Committee's recommendation to abolish FN penalties as this would render the regime ineffective. However, the government acknowledged the concerns raised by the Committee and undertook that HMRC would examine the possibility of providing greater judicial oversight of the FN and APN safeguards. This work was done with help from the Ministry of Justice.
- 2.5 The government has been unable to identify any effective means of providing greater judicial oversight of the FN regime that would not re-introduce or even worsen the delays in settlement and payment of disputed tax, which the regime was designed to address, and which would not significantly increase the administrative costs of both HMRC and HM Courts and Tribunal Service and their equivalent bodies in the devolved administrations.
- 2.6 However, the government accepts that a better balance can be struck between encouraging taxpayers who have used tax avoidance schemes which are shown not to work to reach agreement with HMRC, and allowing those who genuinely believe their case is different from a previous case that was litigated, to continue to pursue their dispute.

- 2.7 Therefore, the government proposed in the consultation document that the standard FN penalty should be reduced to 30% of the disputed tax, which is the same as the maximum penalty for a careless inaccuracy on a tax return.
- 2.8 In order to focus the effects of the FN regime more strongly on those who persist in prolonging their dispute with HMRC, even when their case is without merit, the consultation document proposed that in such cases the highest total rate of penalty should remain at 50%. This would be achieved by charging a further penalty of 20% in the cases where the tax tribunal concluded the litigation was time-wasting, vexatious or otherwise without merit.
- 2.9 In addition, the recently published report titled ['Evaluation of HMRC's implementation of powers, obligations and safeguards introduced since 2012'](#) contains commitments to update HMRC's guidance to clarify taxpayer rights and obligations in respect of FNs, and to explore ways to improve awareness of HMRC's internal governance process for the regime.

The consultation document posed the following questions:

Q1. Do you agree that reducing the penalty rate would better balance the objective of FNs to discourage further litigation of points already settled with the rights of taxpayers to continue genuine disputes?

Q2. Do you have any further suggestions to better achieve this balance?

- 2.10 All respondents supported a reduction in the FN penalty, though there was little agreement on what the rate should be. Of those who expressed a view, one agreed that 30% was an appropriate penalty rate and others suggested penalty rates of 20% and 25%. One respondent suggested this change would not by itself be sufficient to strike the balance sought.

"We support the proposed reduction in the standard rate of penalty for failing to act in response to a follower notice (FN). However, we do not believe that this would be sufficient by itself in balancing the objective of FNs to discourage further litigation of points already settled with the rights of taxpayers to continue genuine disputes."

- 2.11 Respondents generally held the view that there should be a right of appeal against a FN. One respondent suggested such a right could be on very narrow and limited grounds, and proposed that those grounds could include arguing that the judicial ruling on which the FN relied was not relevant to the person's arrangements.
- 2.12 One respondent suggested that the FN penalty should only be charged after the recipient's case had been considered by the tribunal. This respondent suggested that FN penalties should be limited to cases where the tribunal issues a costs order on the basis that the continued litigation was unreasonable. The respondent argued

that such an order would put the taxpayer on notice and negate the need for two penalties.

- 2.13 One respondent also said that FNs are complicated and taxpayers can be confused by them. They suggested that HMRC should issue clearer guidance on what actions a person needs to undertake in order to take 'corrective action' and on taxpayers' rights in relation to FNs.
- 2.14 Another respondent suggested the penalty should be reduced to 0% if the tribunal found that there was merit in the litigant's case, even if ultimately unsuccessful, and that it was reasonable for the person to pursue the litigation.

Government response

- 2.15 The government is grateful for the views expressed. It notes the support for the proposal to reduce the level of the FN penalty while acknowledging the views expressed about the FN regime more generally. The government believes that FNs are a necessary part of HMRC legal framework for tackling avoidance but that reducing the level of the FN penalty would provide a better balance than now between the objectives of FNs and the rights of taxpayers who believe their dispute is genuine. The government also believes that a penalty rate of 30% for FN penalties is appropriate for achieving this aim.
- 2.16 The government is not persuaded that a single FN penalty, to be applied only when continued litigation was determined by the tribunal to be unreasonable, would achieve the objectives of the FN regime, which is to encourage prompt settlement of disputes when the points at issue have already been resolved in a relevant judicial ruling.
- 2.17 The objective of the FN regime is to deter taxpayers from taking cases to litigation where the point has already been considered, it therefore needs to apply in advance of such litigation. Many FNs are issued in cases where there is an open enquiry (either into a tax return or a claim to relief), the case has not yet been litigated but HMRC wish to close the enquiry in line with a relevant judicial ruling. FNs issued in such cases encourage the taxpayer to amend their return or claim, to give up the advantage sought by the avoidance scheme. The change suggested would remove the effectiveness of FNs issued in enquiry cases.
- 2.18 The government does not accept that introducing a right of appeal against a FN would be helpful. As has been noted before, by introducing a further opportunity to carry on a dispute with HMRC such an appeal right would frustrate the purpose of the FN regime.
- 2.19 HMRC is currently looking at the guidance on FNs and plans to expand and update it, clarifying potential points of difficulty. The responses to the consultation will help to inform that work and the updated guidance which will be published later in 2021. HMRC will engage with bodies representing taxpayers and take their views on what is needed, before the revised guidance is published.
- 2.20 A taxpayer can already appeal against a FN penalty on the basis that it was reasonable in all the circumstances for the person not to take corrective action. If

HMRC or the tribunal accept that not taking corrective action was justified on that basis, any FN penalty is cancelled. This is a strong safeguard. Allowing a 0% penalty in the circumstances suggested in paragraph 2.14 is not materially different from this.

Q3. How effective do you believe a further penalty would be as a deterrent to time-wasting litigation of avoidance schemes?

2.21 The consultation document proposed that in cases that were time-wasting, vexatious or otherwise without merit the highest total rate of FN penalty could apply:

- if the tax tribunal or court strikes out a taxpayer's appeal on the grounds either that it has no reasonable prospect of success or that there is an abuse of process; or
- if the tax tribunal or court makes a statement that the taxpayer has acted unreasonably in bringing or conducting the proceedings.

2.22 The consultation proposed that this would be achieved by having an initial FN penalty at the reduced rate of 30% and a second, further FN penalty, that could be imposed by the tribunal where these conditions were met.

2.23 Respondents generally agreed that a further penalty would act as a deterrent to time-wasting litigation, though one pointed out it would depend on how strongly litigants felt that their position was justified.

"We believe that the further penalty may prove to be an effective deterrent, but that depends on the extent to which the taxpayer believes that the appeal is valid and would not be struck out by the FTT."

2.24 Some respondents, while agreeing with the principle, expressed concerns that the legislation as drafted might result in a small number of 'legitimate' cases falling into its scope. Another was concerned that once such a sanction is introduced there is a danger of the principle being applied to litigation not involving FNs.

"We should be wary of mission creep. HMRC might consider introducing tax-related penalties in other cases of timewasting, over and above costs. That would tilt the balance further in HMRC's favour and encourage petty procedural arguments which would be counterproductive."

2.25 Another respondent agreed that in principle the proposal would act as a deterrent to unreasonable litigation. However, the respondent felt that the conditions required for a further penalty meant that the likelihood of HMRC obtaining a statement from the tribunal, or the tribunal striking out an appeal on the required grounds, was so slight as to mean the further penalty would have little practical effect.

Government response

2.26 The government is grateful for the responses and is satisfied such a further penalty would deter time-wasting litigation of avoidance schemes.

- 2.27 The draft legislation sets out strict criteria which must apply before a further penalty can be issued (see paragraph 2.30), including that a tribunal decides that the person was acting unreasonably in pursuing the appeal. This is a powerful safeguard.
- 2.28 The government notes the concerns raised that the principle behind the further penalty might be applied in wider circumstances. However, these proposals are targeted to the specific aims and structure of the FN regime. The legislation sets out precise and narrow conditions which have to be met before the further penalty can be charged and they could have no application outside these circumstances. The government has no plans to extend this approach to other regimes.
- 2.29 The government acknowledges that the criteria for issuing a further penalty are stretching. However, the government believes the criteria to apply achieve the right balance between being an effective deterrent to unreasonably prolonged litigation and the rights of genuine litigants.

Q4. Are the suggested criteria the correct ones to adopt? Do you have any further suggested criteria to apply?

Q5. Are these the correct conditions to apply before such a further penalty can be issued? If not, what other criteria do you suggest?

- 2.30 The document proposed that a further penalty of 20% should be chargeable only when:
- a FN has been issued
 - corrective action has not been taken
 - a FN penalty has been issued under s208 Finance Act 2014 and not withdrawn; and
 - one of the conditions in paragraph 2.21 applies.
- 2.31 There was general agreement from respondents that these conditions provide a reasonable basis for charging the further penalty.

One respondent commented:

'We agree with the principle of making the further 20% penalty judged by reference to decisions by the tribunal or court, rather than HMRC's discretion.'

- 2.32 One respondent felt that a further penalty should not be chargeable when a tax appeal is struck out by a tribunal or court because having an appeal struck out would achieve the aim of the FN. Further, as HMRC can apply for a strike-out before a FN is issued, there would be a disparity in treatment between those facing a strike-out application before receiving a FN and those in the same position after receiving a FN.

- 2.33 Other respondents suggested that the first condition should be amended so that it should be a requirement that the FN was validly issued. Another suggested the condition that an appeal is struck out as having no reasonable prospect of success could be better focussed. They suggested this could be achieved by requiring the prospect of success to be judged in 'light of the relevant judicial ruling'.
- 2.34 One respondent felt more clarity is needed over the circumstances in which HMRC would make an application to the Tribunal that litigation was unreasonable and therefore the further penalty was due.

Government response

- 2.35 The government is grateful for the views expressed and believes the criteria suggested in the consultation are the right ones to apply before a further penalty can be issued. The government believes the draft legislation is already clear that if a FN is withdrawn or cancelled for any reason, including a finding that it was not validly issued, any penalty issued in respect of that FN will similarly be cancelled and the required conditions for the further penalty could not be met. A further penalty could not be issued in such circumstances.
- 2.36 Engaging in the litigation involved in handling cases that are struck out incurs costs for HMRC and the courts, and delays the settlement of cases. Excluding cases struck out by the tribunal from the proposals would therefore not discourage such time-wasting cases.
- 2.37 Under the existing legislation the FN itself has to have a direct link to the relevant judicial ruling, and the draft legislation only allows for the further penalty for the continuation of disputes relating to the disputed avoidance arrangements. The government is satisfied that the proposal in paragraph 2.33 is already dealt with by the draft legislation.
- 2.38 It would be up to the tribunal to decide if the conduct or continuation of litigation was unreasonable, and tribunals already make such decisions under the Tribunal Rules in respect of certain applications for costs.

Q6. Do you believe the further penalty should be reducible to reflect further co-operation by the recipient of a FN? If so, what factors should be taken into account?

- 2.39 Respondents generally felt that the further penalty should be reducible to reflect co-operation but there were differing views on what should qualify as co-operation, and some respondents made no suggestions. One stated that the criteria to determine co-operation which are applied to the current penalty should also apply to the further penalty and another suggested that agreement from the taxpayer to settle quickly after the penalty is issued should count as co-operation.

2.40 One respondent agreed that it would be difficult to determine a level of co-operation for penalties issued in respect of unreasonable conduct.

Government response

- 2.41 The government is grateful for these responses. A further penalty could only be issued at the end of an extended process where the taxpayer has had several opportunities to settle the dispute with HMRC but persisted until such a time as a tribunal decided that their continued litigation was unreasonable. In such circumstances, the government does not accept that a person could be said to have co-operated with HMRC in resolving the dispute and does not believe that it would be appropriate to reduce the penalty. The purpose of the reductions for co-operation in relation to the current FN penalty is to encourage those receiving a FN to settle their cases promptly and, if they are unwilling to do so on HMRC's terms, to co-operate with them to help move any dispute on to the next stage. Once a taxpayer has lost their appeal to the tribunal and the tribunal has ruled that their continued litigation was unreasonable, or they have had their case struck out and there is no further prospect of appeal, there is no further co-operation that can be offered as the matter would now be closed.
- 2.42 Therefore, the government does not believe it would be appropriate to offer any reduction to the further penalty for co-operation. This does not affect the FN penalty itself, which will still be reducible to reflect co-operation.

Appeals

- 2.43 Under the existing legislation anyone who receives a FN penalty can appeal against it on a number of grounds, including that it was 'reasonable in all the circumstances' for the person not to have taken corrective action.
- 2.44 As a further penalty would only be issued when a Tribunal or court had ruled that the litigant had not acted reasonably in pursuing their challenge, it would not be appropriate to include 'reasonable in all the circumstances' or the similar 'reasonable excuse' as grounds of appeal against this penalty. Therefore, the consultation document proposes that it should only be open to appeal against this further penalty on the grounds that the statutory grounds for issuing it have not been met.

Q7. Would these grounds of appeal provide sufficient safeguards for taxpayers incurring this penalty? Are there any other appeal grounds you think should be applicable?

2.45 There was general agreement that the suggested grounds of appeal are sufficient to provide proper safeguards for taxpayers.

One respondent said:

“Assuming that the additional penalty can only be issued in cases where a tribunal or court has held that the taxpayer has acted unreasonably in bringing or conducting the proceedings, it seems reasonable that this penalty may only be appealed on the grounds that it has been issued in error.”

2.46 One respondent felt that there should be an explicit right of appeal against the ruling by a tribunal that the person’s conduct in the litigation was unreasonable. However, this would constitute an appeal against the tribunal’s decision to grant HMRC’s application and as such is already provided for in the tribunal rules.

Government response

2.47 The government is grateful for the general support for the proposed grounds of appeal.

Annexe: List of stakeholders consulted

Association of Accounting Technicians

Chartered Institute of Taxation

Institute of Chartered Accountants of England & Wales

PricewaterhouseCoopers

Taylor Wessing LLP