EXPLANATORY MEMORANDUM TO

THE FINANCE ACT 2021 (INCREASE IN SCHEDULE 26 PENALTY PERCENTAGES) REGULATIONS 2025

2025 No. [XXXX]

1. Introduction

1.1 This Explanatory Memorandum has been prepared by His Majesty's Revenue and Customs (HMRC) on behalf of HM Treasury and is laid before the House of Commons by Command of His Majesty.

1.2 This Memorandum contains information for the Select Committee on Statutory Instruments.

2. Declaration

2.1 James Murray MP, Exchequer Secretary to the Treasury, confirms that this Explanatory Memorandum meets the required standard.

2.2 Paul Riley, Director for Tax Administration Policy Directorate, at HMRC confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Katherine Smith at HMRC Telephone: 03000 540166 or email: katherine.smith@hmrc.gov.uk can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 These regulations increase penalties charged for late payment of certain taxes. They do this by amending the percentage points by which the late paid tax is multiplied to calculate the penalties. The taxes impacted by this SI are Value Added Tax (VAT) and Income Tax or Capital Gains Tax (CGT) for Income Tax Self Assessment (ITSA) Making Tax Digital (MTD) volunteers.[1]

4.2 The effect of the amendments will be an increase to late payment penalties for those that do not pay on time. The current penalties are 2 percentage points (ppts) of the amount outstanding at the end of 15 days after the due date for payment if the tax is paid in full before the end of 30 days, that amount plus 2ppts of the amount outstanding at the end of 30 days if the tax is paid after the end of 30 days, and 4ppts per annum from day 31 onwards. These Regulations increase those figures to 3ppts at 15 days, 3ppts at 30 days and 10ppts per annum from day 31 onwards.

Where does the legislation extend to, and apply?

4.3 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is the United Kingdom.

[1] Relevant appointed day regulations are: S.I. 2022/1278 (VAT) and S.I. 2024/440 (eligible volunteers).

4.4 The territorial application of this instrument (that is, where the instrument produces a practical effect) is the United Kingdom.

5. Policy Context

What is being done and why?

5.1 Late payment penalties are charged when a taxpayer does not pay their tax liability by the due date.

5.2 These regulations increase penalties charged for late payment of certain taxes. They do this by amending the percentage points by which the late paid tax is multiplied to calculate the penalties. The taxes impacted by this SI are VAT and ITSA MTD volunteers. The effect of the amendments will be an increase to late payment penalties for those taxpayers that do not pay on time.

5.3 Schedules 24-27 to the Finance Act 2021 introduced a new penalty regime for late submission of returns and for late payment of tax. Schedule 26 imposes late payment penalties which are assessed on the amount of tax outstanding by reference to the length of time the taxpayer takes to pay that amount. Taxpayers who agree 'Time to Pay' (TTP) arrangements with HMRC are not penalised, or are penalised in a lower amount, depending on when they make those proposals. Taxpayers have a right of appeal and are not liable to a penalty if they have a reasonable excuse for not paying on time.

5.4 Schedule 26 has been commenced for VAT taxpayers from 1 January 2023 and ITSA/CGT taxpayers who volunteered to test services from 6 April 2024. The Government's intention is to extend the application of these provisions to all ITSA taxpayers over time and, in the meantime, those taxpayers will continue to be subject to late payment penalties charged by Schedule 56 to the Finance Act 2009.

5.5 Increasing late payment penalties in Schedule 26 to Finance Act 2021 encourages taxpayers to pay on time and help raise vital revenue for public services.

5.6 Those taxpayers in financial difficulty can arrange a TTP payment plan with HMRC which enables them to pay their outstanding tax liability in instalments over a longer period and where penalties are not charged.

5.7 These penalty increases are part of a package of measures to reduce debt owed to HMRC and were announced at Spring Statement 2025.

What was the previous policy, how is this different?

5.8 The new policy is an increase in late payment penalties as set out in paragraph 4.2.

6. Legislative and Legal Context

How has the law changed?

6.1 Schedule 26 to the Finance Act 2021 imposes penalties for the late payment of VAT, ITSA and CGT as explained above. A person who pays tax later than the date specified in the table in paragraph 1 of Schedule 26 may be liable to a penalty.

6.2 Under paragraph 5, no penalty is charged if the person pays in full within 15 days of the specified date or if a TTP payment plan is made by a taxpayer before the end of those 15 days which HMRC accept. If the tax is paid in full after the end of 15 days but before the end of 30 days, a penalty of 2ppts of the amount unpaid at the end of those 15 days is payable.

6.3 If tax remains unpaid at the end of 30 days, a penalty of 2ppts of the amount unpaid at the end of 15 days and 2ppts of the amount unpaid at the end of 30 days is payable. However, if the taxpayer makes a TTP payment proposal after the 15 day period has ended but before the end of 30 days which HMRC accept, the penalty is 2ppts of the amount outstanding at the end of the 15 day period.

6.4 A second late payment penalty is payable under paragraph 8 if any amount of tax remains unpaid at the end of 30 days. The amount of the penalty is calculated by applying the penalty rate of 4ppts per annum to the amount of tax unpaid during the 'further penalty period'. That period begins on the 31st day after the specified date and ends on the day the amount is paid in full. However, it does not include any period during which a TTP agreement is in effect (starting from the date on which the taxpayer makes a proposal for paying tax).

6.5 This instrument amends the percentages so that 2ppts becomes 3ppts in paragraphs 5 and 4.

6.6 In paragraph 8 the 4ppts per annum becomes 10ppts per annum.

6.7 This is the first use of the power in paragraphs 11 and 22(4) of Schedule 26 to the Finance Act 2021. Those powers will be commenced for all purposes before these regulations are made.

Why was this approach taken to change the law?

6.8 This was considered an appropriate approach to change the law considering the power granted to make the change by statutory instrument.

7. Consultation

Summary of consultation outcome and methodology

7.1 No consultation was necessary as the instrument amends the percentages for each late payment penalty in line with the measure announced at Spring Statement 2025

8. Applicable Guidance

8.1 Existing external guidance on penalties and late payments on the gov.uk website will be updated to reflect the changes provided for by this instrument. This will be updated as soon as possible after the instrument is laid.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A Tax Information and Impact Note will be published on the gov.uk website.[2]

Impact on businesses, charities and voluntary bodies

9.2 There is no significant impact on business, charities, or voluntary bodies because those that pay their liabilities on time will be unaffected by this instrument.

9.3 The legislation does not impact small or micro businesses because those that pay their liabilities on time will be unaffected by this instrument.

[2] Tax Information and Impact Note: https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins

9.4 There is no significant, impact on the public sector.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The measure will be monitored and assessed alongside other measures in the governments package for [closing the tax gap] tax changes.

10.2 This instrument is not required to include a statutory review clause in accordance with section 28 of the Small Business, Enterprise and Employment Act 2015, as it is not made by a Minister of the Crown.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 This is the first use of the powers in paragraphs 11 and 22(4) of Schedule 26 to the Finance Act 2021. Those powers will be commenced for all purposes before these regulations are made.

12. European Convention on Human Rights

12.1 The Exchequer Secretary to the Treasury has made the following statement regarding Human Rights:

"In my view the provisions of the Finance Act 2021 (Increase in Schedule 26 Penalty Percentages) Regulations 2025 are compatible with the Convention rights."

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").