



House of Commons
Treasury Committee

The Administrative Costs of Tax Compliance

Seventh Report of Session 2003–04

*Report, together with formal minutes, oral and
written evidence*

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Introduction

1. The Treasury Committee established a Sub-committee in July 2001 to scrutinise the work of the various bodies for which Treasury Ministers are accountable. The Sub-committee announced, in November 2003, an inquiry into the administrative costs of tax compliance. The terms of reference of the inquiry were to examine:

- the extent of the administrative cost of tax compliance placed on business;
- how this has changed over time; and
- what steps have been taken to reduce the administrative cost and whether they are working.

2. During the course of this inquiry the Government announced that the Revenue Departments would be merged to form a new tax department.¹ We have looked separately at the proposed merger, which is not the subject of this report.

3. We heard oral evidence from HM Customs and Excise and the Inland Revenue on 21 January 2004, from the Federation of Small Businesses, the Institute of Directors, and the Institute of Payroll and Pensions Management on 4 February 2004, from the Chartered Institute of Taxation, the Institute of Chartered Accountants in England and Wales, and PricewaterhouseCoopers on 25 February 2004, from the CBI on 9 March 2004, and from the Rt Hon Dawn Primarolo MP, the Paymaster General, and John Healey MP, the Economic Secretary on 21 April 2004.

4. We visited the Netherlands in February 2004 to be briefed by the Ministry of Finance, the Tax and Customs Administration, tax practitioners and business organisations on the administrative costs of tax compliance in the Netherlands. We also received a number of written submissions, most of which we have published with this volume. We are grateful for all the evidence we received, written and oral, and for the help given by those who briefed us.

5. The terms of reference of this inquiry were widely drawn, encompassing all taxes administered by Customs and Excise and the Inland Revenue. We have concentrated on the general issues and main areas of concern identified during the course of our work. A number of witnesses supplied detailed information on particular areas of concern suggesting specific measures for reducing the administrative cost of tax compliance in respect of individual taxes. We have not sought to investigate the merits of these, but we expect the Revenue Departments to give due consideration to all the detailed suggestions for reducing compliance costs that have been made to us.

Government policy on the costs of tax compliance for business

6. The Government aims “to deliver a modern and fair tax system [which] ... provides incentives to work and save, adapts to changes in business practice and the global economy, and raises sufficient revenue to allow the Government to pursue its objectives of

1 HC Debates, 17 March 2004, col 331

providing world class public services.”² The Revenue Departments told us that the tax system can also “play a vital role in correcting market failures, promoting fairness and delivering social or environmental objectives”³ and that the Government is “committed to reducing tax compliance costs where this can be done consistently with its other objectives.”⁴

7. The Revenue Departments provided the Committee with a list setting out what they were doing to reduce compliance costs.⁵ Asked how long a list would be of measures that had added to compliance costs, Mr Robin Martin, Director, Better Regulation, at the Inland Revenue admitted that :

“I think the truthful answer is, it would be a longish list. I think really the reason for that is that the Government has other objectives for the tax system, and in my experience these are often conflicting objectives. For example, the Government has social aims which sometimes it delivers through the tax system, I suppose the main example here being tax credits. Some of the things the Government does will add to compliance costs, and there is no doubt about that at all. To be fair, that includes, I think, some of the tax reliefs which the Government gives in order to try to help people. For example, on things like the newly introduced tax credits for research and development and all the reliefs that are given for employee share schemes. Undoubtedly, these measures fall into the list to which you have referred, but they have purposes which are not necessarily to do with reducing regulation. To be honest, I think it is a matter of the Government having a number of different objectives.”⁶

8. We asked Treasury Ministers how they prioritised the various objectives for the tax system when they conflicted and whether the priority given to reducing tax compliance costs had changed. The Economic Secretary told us that:

“... Sometimes [reducing compliance costs] is the principal objective of tax reform and tax design on the basis that if we reduce the costs to business, we are likely to have a more vibrant enterprise and that is particularly true for new and small businesses. ... We have got other objectives and clearly the tax system can be used to pursue other objectives, whether that is protecting or raising revenue, whether it is correcting certain market failures, whether it is pursuing fairer policies or protecting the environment, and it will always be a major consideration or concern in the decisions or the design of the tax policy and indeed it is delivering now. ... [Reducing compliance costs], therefore, features strongly in the internal assessment that we do, it features strongly in any external consultation that we do and it features strongly in the regulatory impact assessments that we produce, but in the end when there is a

2 Ev 84, para 1.3

3 *Ibid.*

4 Ev 84, para 1.5

5 Ev 90, Annex B

6 Q 9

tension between those potential aims, then clearly it is a question of judgment and balance, one that we take and others will judge.”⁷

The Paymaster General told us that it was probably fair to say that reducing compliance costs had a higher priority now than five years ago and that “whilst it was always there, we are pushing ahead and trying actually to bear down on it in a more systematic way.”⁸

9. The Revenue Departments noted that businesses could also play a role in reducing tax compliance costs as “many of the checks and safeguards which add complexity to the tax system have had to be introduced to deal with tax evasion and avoidance. Where some businesses continually seek out and exploit opportunities to reduce their tax bill unfairly, the Revenue Departments must protect the Exchequer.”⁹ The need to protect the Exchequer was accepted by other witnesses although some felt that anti-avoidance provisions were unduly complex. The Institute of Chartered Accountants in England and Wales noted that “we live in a world where there is a lot of tax avoidance and the Government has to be conscious that there will be tax avoidance. They have to try to block it in advance but there is more than one way to skin a cat. It depends how you introduce the provision because in most cases it is possible to bring in an anti-avoidance provision without creating uncertainty and undue complexity.”¹⁰ Mr John Whiting, Tax Partner, PricewaterhouseCoopers told us that “one accepts that anti-avoidance has to go on. Of course it does. It does create more complexity and there is an argument that if we wrote better, simpler law to start with, we might not have to go there to that extent.”¹¹

10. We recognise the conflict between producing a tax system that is simple to understand and operate, and the need for checks and safeguards to bear down on tax avoidance. We also note that the Government has a number of other objectives for the tax system, such as promoting fairness and delivering social or environmental objectives, which can add to the administrative costs of tax compliance. As a result, the Government’s objective of reducing compliance costs is only one of a number of objectives for the tax system. We recommend that the Government sets out more clearly the relative priority it attaches to each of these objectives.

Public Service Agreement targets

11. The Government’s objective of reducing the administrative costs of tax compliance on businesses is specifically recognised in the Revenue Departments’ Public Service Agreement (PSA) targets. The Inland Revenue’s PSA target is “to deliver reductions in compliance costs of small business.”¹² Customs and Excise’s PSA target is “to improve customer service by ... delivering reductions in the costs of compliance for businesses.”¹³ The Revenue Departments accepted that these targets were vague in that they could be

7 Q 321

8 Q 322

9 Ev 84, para 1.8

10 Q 193

11 Q 195

12 Ev 85, para 3.2

13 *Ibid.*

achieved by any reduction in compliance costs but considered that “people will accept that the aspiration of reducing costs, if we can achieve it, is a valuable one.”¹⁴ The Economic Secretary accepted that the PSA targets were not quantified but noted that “I would argue very strongly that it is important to have a PSA. ... It signals both the serious intent and concentration of the Department on this area and focuses the mind and the work of the Department in doing so ...”¹⁵

12. In March 2004 the Treasury published a review of the Revenue Departments by Gus O’Donnell, Permanent Secretary to the Treasury, which made a number of recommendations including the merger of the two departments to create a new tax department. The review noted that “concrete evidence on compliance costs is limited, but the evidence is that they are substantial and fall disproportionately on small and medium sized businesses, although they are still significant for large businesses.”¹⁶ The review recommended that the management of the new merged revenue department should “develop a better focussed PSA target on customer service and compliance costs for the 2004 Spending Review, supported by work to develop understanding of compliance costs.”¹⁷

13. The Revenue Departments’ current PSA targets for reducing tax compliance costs can be met by any reduction in compliance costs, however small, and are not rigorous enough. We note and endorse the recommendation in the O’Donnell review of the Revenue Departments that the new merged revenue department should develop a better focussed PSA target on compliance costs supported by work to develop a better understanding of compliance costs.

Measuring the administrative cost of tax compliance

14. Recent surveys indicate that, in international terms, the overall UK regulatory requirement is lower than in many competitor countries. For example, in 2003 the OECD found the UK to have the lowest administration cost and fewer regulations for entrepreneurs than any other EU country, and in 2001 the UK was ranked jointly with the Republic of Ireland by the European Commission as the cheapest and fastest place in the EU in which to set up a business. But these comparisons were of regulatory requirements, which cover a wider area than the administrative costs of tax compliance. The latter, as far as officials were aware, had not been the subject of any international surveys.¹⁸

15. The administrative costs of tax compliance include the costs of collecting data, keeping records, filing returns, making payments on the due date, liaising with the relevant tax authority and dealing with their enquiries. Businesses may also incur costs at their own discretion through the use of tax planning and other devices designed to reduce their liabilities.¹⁹ The Revenue Departments told us that “reliably estimating tax compliance

14 Qq 41, 42

15 Q 345

16 *Financing Britain’s Future*, Cm 6163 HM Treasury March 2004, para 3.83

17 *Financing Britain’s Future*, Cm 6163 HM Treasury March 2004, page 38

18 Qq 3, 4, 8 and Ev 88, Table 1

19 Ev 84, para 2.2

costs is problematical. A business may incur costs directly or pay an intermediary such as an accountant to deal with its tax obligations, often as part of a more general accounting service. So, if asked to give a figure for compliance costs, the method businesses use to calculate the figure can vary considerably, from including the full costs of an accountant or book-keeper, to zero because they complete the necessary paperwork in their own time and so do not believe this to be a cost.”²⁰ The Economic Secretary told us that:

“... In an ideal world, we would be able to say, ‘this is the cumulative total cost of complying with the tax regime for this or this business’. Our principal problem is disentangling the obligations which flow from tax legislation and, therefore, the requirement to comply with taxation from the costs of normal business administration. ... Now, in circumstances like that, it is very difficult to give a consistent analysis which gives you the sort of baseline which would allow ...the ideal situation which is where we knew where the compliance costs lay and we were able then to track changes over time from having established that baseline ...”²¹

16. The Revenue Departments considered that many costs perceived as taxation compliance costs were in fact those which would be incurred anyway for financial management purposes and noted that “because businesses do not generally manage their taxation activities in isolation from their other accounts work, it can be difficult for them to determine where activities solely related to taxation—as opposed to other obligations to backers or bankers and necessary accounting activity in running the business—begin and end. This means that estimates of compliance costs can vary significantly and are subject to wide margins of error.”²²

17. We asked business organisations and professionals whether they agreed with the Revenue Departments’ view that many costs perceived as taxation compliance costs would be incurred anyway for financial management purposes. The Institute of Directors noted that “to some extent, any business is going to have to record some information for financial reporting, for other purposes, but a large part of the reporting requirements for tax goes way above and beyond what most businesses would require.”²³ The Institute of Payroll and Pensions Management noted that while the reporting requirements for corporation tax might include sensible reporting rules that you would want to follow as a business “... PAYE is a completely different beast. What you need to do to run your business from your payroll point of view bears no relation to your statutory obligations, you would have simply a database of people to whom you paid money. All the other obligations which are built into the running of a payroll are statutory obligations and not just Revenue ones.”²⁴ The CBI told us that it agreed that “a significant proportion of the costs are indeed the costs which would be incurred by any reasonable business manager, but ... there are an awful lot of other costs which are imposed by the tax system ...”²⁵

20 Ev 85, para 2.6

21 Q 323

22 Ev 85, para 2.7

23 Q 87

24 Q 94

25 Q 228

18. As a result of the difficulties in measuring tax compliance costs and disentangling them from costs which would be incurred anyway for financial management purposes, the Revenue Departments have not sought to measure the administrative cost of tax compliance in total and have adopted an approach based on Regulatory Impact Assessments to evaluate changes in compliance costs (see paragraphs X to Y below).²⁶ The Revenue Departments accepted that “it would be very helpful if we had a clear baseline at the start and a clear baseline at the end and you were looking at total costs, but unfortunately our experience is that this is actually very difficult to arrive at ...”²⁷

19. This contrasts with the approach we noted during our visit to the Netherlands. There, the Government has sought to identify the administrative burden placed on business, which it defined as the cost to the business sector of supplying information required by Government regulations. This was measured by:

- identifying each information obligation arising from legislation;
- calculating for each information obligation the number of companies required to comply with it, the time needed to comply, the frequency with which they have to comply, and multiplying this by the wage costs of the employer/accountant, using a tariff.

20. Each Ministry in the Netherlands was required to calculate the administrative burden it imposed on business at the end of 2002 to produce a baseline against which progress in cutting the burden could be measured. As a result of this exercise, the cost to business in the Netherlands of supplying information required by Government regulations was estimated to be some €17 billion a year. Tax compliance costs were estimated to be some €4–5 billion of this total.

21. Although measuring the administrative costs of tax compliance is difficult, comparative analyses confirm that the UK has lower administrative costs and fewer regulations than most EU countries. Nevertheless, we would like to see a determined effort to achieve a more accurate calculation of compliance costs. We believe a baseline figure would provide a greater impetus to the Government’s objective of reducing compliance costs and inform decisions when the objectives of the tax system conflict. We recommend the Treasury consider the work done on this in the Netherlands.

How the administrative costs of tax compliance have changed

22. We asked the Revenue Departments whether compliance costs were increasing or decreasing. Customs and Excise told us that, excluding measures introduced to combat fraud, “... the effect, at worst case, actually is neutral.”²⁸ The Inland Revenue told us that it had been monitoring the cumulative effect of all Regulatory Impact Assessments undertaken since the introduction of a PSA target in April 2001 to reduce the compliance costs of small business and that it was “in a position where we have kept level, and have

26 Ev 85, para 2.8

27 Q 37

28 Q 12

done slightly better than that, if you net off the increased costs against savings.”²⁹ Subsequently the Inland Revenue provided further information which estimated that the annual savings in compliance costs for all businesses since 2001 totalled some £28 million a year.³⁰ Mr Robin Martin of the Inland Revenue told us that he was “... not making any comment about the period before that, because at that stage we were not measuring this in quite the organised fashion that we are now, and, of course, the earlier period included things like the introduction of tax credits.”³¹ The scale of that particular change was illustrated by the fact that the decision, announced in Budget 2004, that the Inland Revenue will pay working tax credits directly to employees, will reduce compliance costs for business by an estimated £90 million a year.³²

23. Mr Robin Martin also noted that:

“... I am very well aware that the perception of people outside Government is that costs have grown, and I quite understand the reasons for that. I think there may be some ways in which costs have been helped. For example, I think the greater use of IT undoubtedly has helped to restrain costs in relation to accounting and payroll. I am sure this is something that people recognise but it does not often get said overtly, but the more people can use IT, I think the more they will benefit from lower costs. The other thing I would want to say is that we have made quite a lot of changes which are almost, if you like, below the surface and which are not necessarily very easily perceived by the outside world. For example, in the late 1990s the Inland Revenue merged with the then Contributions Agency of the DSS, and as a result of that we have made significantly fewer visits to employers to check up on payroll. The old Contributions Agency used to make, I think, 90,000 or 100,000 visits a year to employers. We used to make 40,000 or 50,000 visits. Now that we have merged with them and the process has gone through its full course, we make only one visit to the employer and we are making about 35,000 of those per year. That is an example of where we have reduced costs but where it may not be immediately apparent, necessarily, to the outside world.”³³

24. Most business witnesses to the inquiry believed that tax compliance costs have increased over recent years and that employer taxes are the area where the burden is greatest. The Institute of Directors told us that it had surveyed its members in 2003 asking them whether the amount of time and money their business had spent on tax-related paperwork had increased, decreased, or stayed the same over the past few years. Some 78% said it had increased, only 1.2% felt it had decreased.³⁴ The Institute of Directors considered that for many employers the greatest amount of time and effort taken in tax compliance was incurred in dealing with employer taxes and noted that “a significant proportion of time and expense in running any business payroll is tax administration, although larger businesses in particular can mitigate the time and expense by outsourcing

29 Q 14

30 Ev 116

31 Q 16

32 Qq 377–379

33 Q 16

34 Ev 68, para 1.3

or automating the process. Nonetheless, for ‘non-routine’ items, such as reimbursing employee expense claims, or establishing taxable ‘benefits in kind’, some form of manual intervention will always be required.”³⁵

25. The Institute of Chartered Accountants in England and Wales considered that tax legislation had become a lot more complex over recent years, which had resulted in additional administrative costs and they noted that “... however helpful the Revenue and Customs are, people feel a need because it is a complex system to turn to outside advisers and that is where the costs really start to mount up when people are forced to buy in advice.”³⁶ Mr John Whiting told us that employer taxes were the biggest burden for business and that his perception “... backed up by many discussions with clients, is that the costs of the employer compliance is steadily going up.”³⁷ The Institute of Payroll and Pensions Management told us that:

“In the last ten years, the role of the employer in correctly administering the tax affairs of their employees has changed dramatically. Formerly a business only had to concern itself with the correct deduction of tax and NI according to a tax code and NIC category letter. Today an employer is potentially responsible for: three types of NI (Class 1, 1a and 1b); payment of tax credits; collection of Student Loans; four statutory payments (SSP, SPP, SAP, SMP); the Construction Industry Scheme tax; [and] monitoring National Minimum Wage compliance. These are of course only the obligations administered by the Inland Revenue.”³⁸

26. The Inland Revenue confirmed that this evidence from the Institute of Payroll and Pensions Management was factually correct and noted that “...it is undoubtedly the case that the requirements to which they are alluding, like the National Minimum Wage and collection of Student Loan repayments, in a sense, are new requirements placed on employers. I think I would go back to the original point, that the Government has objectives for the tax system which are not necessarily ones which reduce regulation. In the case of National Minimum Wage, that is not part of the tax system as such, but the Government had a clear social objective in introducing it and I think their judgment was that, yes, this would increase compliance costs but, in relation to the benefits which the Government saw for them, they felt that was justified.”³⁹

27. The Paymaster General considered that there had been “overwhelming policy, social and economic reasons [for introducing each of the measures referred to by the Institute of Payroll and Pensions Management]”⁴⁰ and that “there are other things and a great many changes which have been made in Finance Bills year on year since 1997 which have benefited all these businesses as well. It is not a one-way street.”⁴¹

35 Ev 69, para 4.2

36 Q 178

37 Q 196

38 Ev 65, para 2.1

39 Q 56

40 Q 373

41 Q 375

28. In the absence of firm data it is not possible to determine conclusively how the administrative costs of tax compliance have changed over time. Most business witnesses believed that tax compliance costs, particularly payroll-related costs, have increased. The Revenue Departments considered that compliance costs have been broadly neutral since April 2001. But the Inland Revenue accepted that a number of new payroll requirements had been placed on employers before this, such as the introduction of tax credits, that added significantly to compliance costs. We also note that in reaching its view on compliance costs Customs and Excise specifically excluded measures introduced to combat fraud. We note some evidence which suggested that the administrative costs of tax compliance have risen. But the absence of any reliable method of measurement makes it difficult to adjudicate between these claims. In the absence of any agreed method of measurement these ambiguities will remain.

The Bath study of Pay As You Earn and National Insurance Contributions

29. Asked which areas of the tax system generated the highest compliance costs for businesses, Mr Robin Martin of the Inland Revenue told us that:

“... it is very clear, from the evidence which has been looked at, that costs are regressive, they fall most heavily on small firms, so, as far as the Revenue is concerned, we try to focus our efforts particularly on helping small firms cope with the tax system. ...The DTI Small Business Service do regular surveys of business opinion and it is clear from their latest surveys that businesses do have quite clear perceptions themselves of where their costs fall. Looking at the evidence which is available from that source, they seem to put payroll problems at the top of the list. In other words, doing Pay As You Earn, National Insurance, other payroll tasks, is reckoned to be, to them, the most burdensome area of tax. It seems that, in relation to corporation tax and income tax, they are more concerned about the actual level of the tax and less concerned about the administrative costs. We feel it is very important to base our efforts on evidence, so far as we can. Bearing all that in mind, what we have tried to do is focus our efforts on helping small firms, and particularly helping them with payroll. ...”⁴²

30. The Revenue Departments provided details of research that has been carried out in the UK into tax compliance costs. This included a study by Bath University published by the Inland Revenue in 1998 measuring the overall compliance cost of PAYE and NICs which found that costs were not evenly distributed among firms, with the smallest 30% of firms paying around 75% of the total costs, suggesting strong economies of scale. According to the Bath study, the compliance costs of PAYE and NICs per employee for a business with 1–4 employees increased in real terms from £147 in 1981–82 to £284 in 1995–96. Over the same period, costs per employee for businesses with more than 500 employees fell from £28 to £23.⁴³ Some witnesses referred to the lack of detailed research into the costs of tax compliance and called for the 1998 Bath study to be repeated. The Institute of Chartered Accountants in England and Wales noted that the results of the Bath study were considerably out of date, they pre-dated, for example, the introduction of self assessment,

42 Q 26

43 Ev 87, Annex A

and suggested that “at the very least the previous research is repeated and the results compared ... to determine more accurately how the administrative costs of tax compliance in this area have changed over time...”⁴⁴ The Institute also called for further research to produce quantitative and qualitative data in other areas of the tax system.⁴⁵ The Chartered Institute of Taxation noted that the figures in the Bath study “were based on the burdens of 10 years ago; since then the employer’s burden has increased considerably. Even large employers – who at the time made a ‘profit’ from their payroll administration costs through the cash flow benefits of ‘holding’ PAYE/NIC – will surely now be out of pocket. It would be timely to commission a similar study of the position now.”⁴⁶

31. The Inland Revenue told the Committee that there were no immediate plans to update the Bath study as “... a lot of things are happening in the field of payroll and compliance costs and I think that, doing it just at the moment, we would be aiming very much at a moving target.”⁴⁷ The Inland Revenue also noted that the Bath study had contained more than 30 recommendations and provided a list of the actions that had been taken in response.⁴⁸ The Paymaster General considered that at present “... there is a sufficient amount of pressure in the system to drive us to sustain an objective where we should always ensure that the compliance costs are reasonable and proportionate. We could never say there would not be another study and we need to reflect on that, but at the present time the policy levers are sufficient, in our view, to deliver that and are working.”⁴⁹

32. Witnesses agreed that employer (or payroll) taxes generate the highest compliance costs for business and that these can fall disproportionately on small businesses. The Bath study published in 1998 by the Inland Revenue examined the compliance costs of PAYE and NICs and identified how these costs had changed between 1981–82 and 1995–96. It made a number of recommendations for reducing these costs on which action is being taken by the Inland Revenue. We note that there are no plans to update this work despite the significant changes that have been made subsequently to the tax system, such as the introduction of self assessment and the introduction of tax credits. We welcome the announcement in Budget 2004 of the Government’s intention to remove the responsibility for the payment of working tax credits from employers. We recommend the Bath study be updated to determine what changes there have been in compliance costs.

Regulatory Impact Assessments

33. The Revenue Departments use Regulatory Impact Assessments (RIAs) in accordance with published Cabinet Office guidelines to assess and quantify the impact of policy decisions. RIAs provide a statement of the policy objectives and the issues and set out the problem to be addressed. They identify the options, pros, cons, risks, benefits and costs of each option and specifically address the impact of the options on businesses. Ministers are

44 Ev 72, para 9

45 Ev 72, para 10

46 Ev 81, para 11

47 Q 22

48 *Ibid.* and Ev 117, Annex B

49 Q 330

required to sign the RIA stating that they are satisfied that the benefits of the final proposal justify the costs, if any.⁵⁰

34. Witnesses were concerned that RIAs were not capturing the administrative costs of tax compliance accurately. The Institute of Chartered Accountants in England and Wales noted that “we believe that it is extremely important to consider the cost of the obligations imposed on business when seeking to implement new tax policy. We do not believe that the existing system of RIAs properly reflects these costs. Frequently, RIAs are partial and appear to be merely a best guess of the costs involved. Furthermore, once a proposal is implemented, there is little evidence of any attempt to return to the original estimate and assess with the benefit of hindsight whether the change was cost effective when compared to the benefits achieved.”⁵¹ The CBI noted that “other measures introduced by Government to address compliance burdens include RIAs for new legislation. Unfortunately it is not always evident on what information they are prepared or that they are properly addressing businesses' real compliance issues.”⁵²

35. In response to these points, Mr Robin Martin of the Inland Revenue noted:

“The way that we operate the Regulatory Impact Assessment process is that we do encourage very much the outside world to contribute to it. What happens normally is that we will produce a draft or a provisional Impact Assessment, that will be published, it will be looked at by people in the outside world, including the CBI, the accountants themselves, and they will be able to come back to us if they think that it is deficient or unrealistic in any way. ... The process is open and does take account of views of business. Also it is scrutinised extremely carefully by the Cabinet Office, the Treasury, the DTI Small Business Service and we are subject to audit by the National Audit Office, who can come in and have a look at the thing to see whether it does stack up or not ...”⁵³

36. The Economic Secretary told us that :

“It is important to stress that RIAs are the best estimate based on the best information available. Now, that is why we are striving to improve the process, but they are at that stage a best estimate. I think it is fair to say that we generally do not get the direction of the costs wrong. If we think a particular instrument or policy change can reduce costs, we may under or overestimate the scale of that, but we do not generally get it going in the wrong direction. There is one important point to add, ... which is that the costs of compliance for companies also will alter from operational changes, not just legislative changes which may be covered by a Regulatory Impact Assessment. ... For that reason, within Customs we are now starting to apply the same sort of RIA process internally to major operational changes which do not have a legislative dimension, but nevertheless potentially may

50 Ev 86, paras 3.6, 3.7

51 Ev 71, para 5

52 Ev 99, para 19

53 Q 52

have an impact on the costs of compliance and we are essentially using the same methodology and the same approach.”⁵⁴

37. The Revenue Departments told us that they were carrying out post-implementation assessments of changes that have been introduced to provide assurance that the figures used in RIAs are reasonable and to build up a database of the impact of different types of change on businesses, to inform future estimates of the impact of similar or related changes. The Inland Revenue have completed two post-implementation reviews and Customs and Excise have completed one. In each case the review found that the original assessment had been pessimistic, either by overstating the expected costs, or by understating the expected savings that would be generated by the proposal. The Economic Secretary told us that in the case of Customs and Excise a decision had not been taken on whether individual post-implementation reviews would be published, but he expected to report on the post-implementation research and assessment in the annual report to be published later in the year. The Paymaster General noted in the case of the Inland Revenue that decisions on these issues had not been taken.⁵⁵

38. The Revenue Departments use Regulatory Impact Assessments to assess and quantify the impact of policy decisions on the administrative costs of tax compliance. We note the concerns expressed by the CBI and others about the accuracy of the figures used for tax compliance costs and savings in these assessments. We endorse the introduction of post-implementation reviews of these assessments to provide assurance that the figures used were reasonable and we consider that the results of such reviews should be made available to business and tax practitioners for comment. We therefore recommend each individual review be published.

39. The Regulatory Impact Assessment process does not apply to operational changes. Such changes can have a significant impact on tax compliance costs. We note the initiative by Customs and Excise to apply the process internally to major operational changes that have no legislative dimension. Given that such an assessment seeks to measure the impact of a major operational change on business, it is not clear why this process should be confined to the department. We therefore recommend that the full Regulatory Impact Assessment process be applied by the Revenue Departments to all major operational changes that are proposed.

Measures taken to reduce the administrative cost of tax compliance

40. The Revenue Departments provided a list of measures designed to reduce compliance costs grouped under four main headings which are shown below, with some examples of actions taken:

- *regulatory reform including simplifying the regulatory framework.* Recent examples include: raising the threshold for quarterly payments of PAYE⁵⁶; simplifying employee share schemes; rewriting direct tax legislation, such as the Capital Allowance Act 2001

54 Q 353

55 Qq 53–55, 337–339, and Ev 86, para 3.8

56 The threshold for quarterly payments of PAYE was raised to £1,500 allowing more small employers to benefit from the reduced costs of quarterly rather than monthly payroll accounting—Ev 90, Annex B

and the Income Tax (Earnings and Pensions) Act 2003, with a better structure and simpler language to make it easier and clearer to use; having the highest VAT registration threshold in the EU; and a range of self-help schemes, targeted primarily at small businesses, to make the administration of VAT easier and less costly.

- *improved administrative processes (including new e-services)*. Examples include: the merger of the Inland Revenue with the Contributions Agency so that customers have to deal with only one organisation for tax and NICs matters; on-line filing and payment facilities for Self Assessment, PAYE for employers and Corporation Tax, and cash incentives for smaller employers to encourage e-filing; the introduction of a new Customs and Excise e-business strategy designed to simplify contact between business and taxpayers; and the development of shorter and simpler income and corporation tax returns.
- *education and support*. Providing timely, accurate and up-to-date information and support to reduce compliance costs. Examples of that include: the introduction of Inland Revenue business support teams and Customs and Excise business advisers; a Customs and Excise National Advice Service; and new help for employers including Employer Talk events and an improved annual Employer's Pack in CD-ROM format, providing forms, guidance and calculation tools.
- *joint and cross-Government activities*. Work with other Government Departments and Agencies to deliver integrated information services, minimising the need for need for contact with separate Departments. Examples of these initiatives include Business Advice Open Days which are free events designed for small and medium sized businesses to obtain information and advice from a wide range of Government Departments and Agencies; and the introduction of businesslink.gov, a cross-government web based service to provide a single point of contact that will make it simpler and easier for people to find out what they need to develop and run their business.⁵⁷

41. In this inquiry we have not sought to examine the impact of individual measures designed to reduce compliance costs that have been implemented by the Revenue Departments or those that have been proposed by witnesses. But the evidence we have received from Mr Robin Martin of the Inland Revenue suggested that employer taxes are perceived as a burdensome area, especially for most small businesses.⁵⁸ The Inland Revenue has sought to reduce compliance costs in this area by actioning the recommendations of the Bath study, by commissioning a review to examine the issues around PAYE and National Insurance to identify where improvements could be made, and by introducing the National Insurance Contributions and Statutory Payments Bill⁵⁹ to streamline the administration of tax and NICs.⁶⁰

42. While witnesses recognised that improvements had been made to simplify and harmonise PAYE and NICs, they considered there was scope for them to be more closely

57 Ev 86, paras 4.1–4.4, and Ev 90, Annex B

58 Q 26

59 This Bill received Royal Assent on 13 May 2004

60 Qq 356, 357, Ev 90, Annex B, Ev 117, Annex B

aligned. Difficulties that were raised included the different definitions of earnings that are used and how company cars, petrol allowances and benefits in kind are treated.⁶¹

43. Concern was also expressed about the administration of Statutory Sick Pay. The Institute of Payroll and Pensions Management noted that "... for 20 years [Statutory Sick Pay has been] ... largely unaltered and it delivers nothing for employers. They get no money back from administering it and we run the scheme for the odd few people who transfer out onto incapacity benefit. ... it is one of the most complex areas for small businesses ..."⁶²

44. We note the complications that have arisen from definitions used in PAYE calculations differing from those used in calculating National Insurance Contributions and from Statutory Sick Pay being the responsibility of another Government Department. We recommend that a deliberate effort should be made to rectify and eliminate such unnecessary complexity by harmonising definitions, accounting principles, administration arrangements etc.

45. In January 2004 the Department of Trade and Industry (DTI) announced that from 2004 changes in employment regulations will only be implemented on two days each year, 6 April, the start of the tax year, and 1 October, when the national minimum wage is reviewed. The DTI noted that "this harmonisation of commencement dates should make it easier for employers and employee representatives to implement and respond to changes in employment law and practice, helping to increase clarity and awareness"⁶³ and that "other government departments are considering how they might follow the DTI's lead where appropriate."⁶⁴

46. We note the DTI's announcement that changes in employment regulations will only be implemented on two set days each year which should reduce costs and make it easier for businesses to implement and respond to changes made. We hope that other departments will follow this lead. In particular, we would welcome a statement from the Revenue Departments setting out how they intend to respond to this initiative.

47. With the reorganisation proposed for the Treasury and the amalgamation of the Inland Revenue and the Customs and Excise, it is an appropriate time to establish a deliberate strategy for reducing or, at least, containing tax gathering and benefit paying compliance costs.

61 Qq 199, 205, 272–277, Ev 73, paras 22–27, Ev 81, para 10, Ev 103, paras 58, 59

62 Q 160

63 DTI publishes first annual statement on employment law changes, DTI news release P/2004/019, 14 January 2004

64 Employment regulations—Statement of forthcoming employment regulations in 2004, www.dti.gov.uk.

Conclusions and recommendations

1. The terms of reference of this inquiry were widely drawn, encompassing all taxes administered by Customs and Excise and the Inland Revenue. We have concentrated on the general issues and main areas of concern identified during the course of our work. A number of witnesses supplied detailed information on particular areas of concern suggesting specific measures for reducing the administrative cost of tax compliance in respect of individual taxes. We have not sought to investigate the merits of these, but we expect the Revenue Departments to give due consideration to all the detailed suggestions for reducing compliance costs that have been made to us. (Paragraph 5)
2. We recognise the conflict between producing a tax system that is simple to understand and operate, and the need for checks and safeguards to bear down on tax avoidance. We also note that the Government has a number of other objectives for the tax system, such as promoting fairness and delivering social or environmental objectives, which can add to the administrative costs of tax compliance. As a result, the Government's objective of reducing compliance costs is only one of a number of objectives for the tax system. We recommend that the Government sets out more clearly the relative priority it attaches to each of these objectives. (Paragraph 10)
3. The Revenue Departments' current PSA targets for reducing tax compliance costs can be met by any reduction in compliance costs, however small, and are not rigorous enough. We note and endorse the recommendation in the O'Donnell review of the Revenue Departments that the new merged revenue department should develop a better focussed PSA target on compliance costs supported by work to develop a better understanding of compliance costs. (Paragraph 13)
4. Although measuring the administrative costs of tax compliance is difficult, comparative analyses confirm that the UK has lower administrative costs and fewer regulations than most EU countries. Nevertheless, we would like to see a determined effort to achieve a more accurate calculation of compliance costs. We believe a baseline figure would provide a greater impetus to the Government's objective of reducing compliance costs and inform decisions when the objectives of the tax system conflict. We recommend the Treasury consider the work done on this in the Netherlands. (Paragraph 21)
5. In the absence of firm data it is not possible to determine conclusively how the administrative costs of tax compliance have changed over time. Most business witnesses believed that tax compliance costs, particularly payroll-related costs, have increased. The Revenue Departments considered that compliance costs have been broadly neutral since April 2001. But the Inland Revenue accepted that a number of new payroll requirements had been placed on employers before this, such as the introduction of tax credits, that added significantly to compliance costs. We also note that in reaching its view on compliance costs Customs and Excise specifically excluded measures introduced to combat fraud. We note some evidence which suggested that the administrative costs of tax compliance have risen. But the absence of any reliable method of measurement makes it difficult to adjudicate between these

claims. In the absence of any agreed method of measurement these ambiguities will remain. (Paragraph 28)

6. Witnesses agreed that employer (or payroll) taxes generate the highest compliance costs for business and that these can fall disproportionately on small businesses. The Bath study published in 1998 by the Inland Revenue examined the compliance costs of PAYE and NICs and identified how these costs had changed between 1981–82 and 1995–96. It made a number of recommendations for reducing these costs on which action is being taken by the Inland Revenue. We note that there are no plans to update this work despite the significant changes that have been made subsequently to the tax system, such as the introduction of self assessment and the introduction of tax credits. We welcome the announcement in Budget 2004 of the Government's intention to remove the responsibility for the payment of working tax credits from employers. We recommend the Bath study be updated to determine what changes there have been in compliance costs. (Paragraph 32)
7. The Revenue Departments use Regulatory Impact Assessments to assess and quantify the impact of policy decisions on the administrative costs of tax compliance. We note the concerns expressed by the CBI and others about the accuracy of the figures used for tax compliance costs and savings in these assessments. We endorse the introduction of post-implementation reviews of these assessments to provide assurance that the figures used were reasonable and we consider that the results of such reviews should be made available to business and tax practitioners for comment. We therefore recommend each individual review be published. (Paragraph 38)
8. The Regulatory Impact Assessment process does not apply to operational changes. Such changes can have a significant impact on tax compliance costs. We note the initiative by Customs and Excise to apply the process internally to major operational changes that have no legislative dimension. Given that such an assessment seeks to measure the impact of a major operational change on business, it is not clear why this process should be confined to the department. We therefore recommend that the full Regulatory Impact Assessment process be applied by the Revenue Departments to all major operational changes that are proposed. (Paragraph 39)
9. We note the complications that have arisen from definitions used in PAYE calculations differing from those used in calculating National Insurance Contributions and from Statutory Sick Pay being the responsibility of another Government Department. We recommend that a deliberate effort should be made to rectify and eliminate such unnecessary complexity by harmonising definitions, accounting principles, administration arrangements etc. (Paragraph 44)
10. We note the DTT's announcement that changes in employment regulations will only be implemented on two set days each year which should reduce costs and make it easier for businesses to implement and respond to changes made. We hope that other departments will follow this lead. In particular, we would welcome a statement from the Revenue Departments setting out how they intend to respond to this initiative. (Paragraph 46)

11. With the reorganisation proposed for the Treasury and the amalgamation of the Inland Revenue and the Customs and Excise, it is an appropriate time to establish a deliberate strategy for reducing or, at least, containing tax gathering and benefit paying compliance costs. (Paragraph 47)

Formal minutes of the Committee and the Sub-committee relating to the Report

Sub-committee

Wednesday 26 May 2004

Members present:

Mr Michael Fallon, in the Chair

| | |
|--------------------------|-------------------|
| Mr Nigel Beard | John Mann |
| Angela Eagle | Mr George Mudie |
| Mr David Heathcoat-Amory | Mr James Plaskitt |
| Norman Lamb | Mr Robert Walter |
| Mr John McFall | |

The Sub-committee deliberated.

Draft Report (The Administrative Costs of Tax Compliance), proposed by the Chairman, brought up and read.

Ordered, That the Chairman's draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 47 read and agreed to.

Resolved, That the Report be the Second Report of the Sub-committee to the Committee.

Ordered, That the Chairman do make the Report to the Committee.

Several papers were ordered to be appended to the Minutes of Evidence

Ordered, That the Appendices to the Minutes of Evidence taken before the Sub-committee be reported to the Committee.—(*The Chairman.*)

[Adjourned till Wednesday 9 June at 2.15 pm

Main Committee

Wednesday 26 May 2004

Members present:

Mr John McFall, in the Chair

Mr Nigel Beard

Angela Eagle

Mr Michael Fallon

Mr David Heathcoat-Amory

Norman Lamb

John Mann

Mr George Mudie

Mr James Plaskitt

Mr Robert Walter

Draft Report from the Sub-committee (The Administrative Costs of Tax Compliance), brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 47 read and agreed to.

Resolved, That the Report be the Seventh Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the Appendices to the Minutes of Evidence taken before the Sub-committee be reported to the House.—(*The Chairman.*)

[Adjourned till Tuesday 8 June at 9.15 am

Witnesses

Wednesday 21 January 2004

Page

Mr Chris Tailby, Director of Tax Practice, and, **Mr Roger Halson**, Small Business Champion, HM Customs and Excise, **Mr Robin Martin**, Director, Better Regulation, and **Miss Sarah Woollard**, Head of Regulatory Impact Unit, Inland Revenue

Ev 1

Wednesday 4 February 2004

Mr Neil Hamper, Chairman, Taxation and Financial Affairs Committee, Federation of Small Businesses, **Mr Derek Brownlee**, Taxation Executive, Institute of Directors, **Ms Kate Upcraft**, Policy and Research Manager, and **Mr Norman Green**, Fellow, Institute of Payroll and Pensions Management

Ev 14

Wednesday 25 February 2004

Mr Nigel Eastaway, Chairman, Technical Committee, Chartered Institute of Taxation, **Mr John Whiting**, Tax Partner, PricewaterhouseCoopers, Chairman, Tax Policy Sub-Committee and Past President of the Chartered Institute of Taxation, **Mr Robert Maas**, Member of the Tax Technical Committee, and **Ms Anita Monteith**, Consultant to the Tax Faculty, Institute of Chartered Accountants in England and Wales

Ev 25

Tuesday 9 March 2004

Mr Philip Gillett, Group Taxation Controller ICI, Chairman, CBI Taxation Committee, **Mr John Hampton**, Senior Personal Tax Manager, BT, Chairman CBI Personal Taxes Sub-Committee, and **Mr Mervyn Woods**, Head of Tax Policy, CBI, Confederation of British Industry

Ev 35

Wednesday 21 April 2004

Rt Hon Dawn Primarolo, a Member of the House, Paymaster General, **Mr John Healey**, a Member of the House, Economic Secretary, HM Treasury, **Mr Robin Martin**, Director, Better Regulation, Inland Revenue, and **Ms Jen Little**, Policy Manager, Business VAT, Customs & Excise

Ev 48

Written evidence

| | |
|--|------------|
| Institute of Chartered Accountants of Scotland | Ev 61 |
| Institute of Payroll and Pensions Management | Ev 64, 110 |
| Institute of Directors | Ev 68 |
| Tax Faculty of the Institute of Chartered Accountants in England and Wales | Ev 71, 109 |
| Association of British Insurers | Ev 75 |
| PricewaterhouseCoopers | Ev 77 |
| Chartered Institute of Taxation | Ev 80 |
| HM Customs and Excise and the Inland Revenue | Ev 84 |
| Federation of Small Businesses | Ev 94 |
| Confederation of British Industry | Ev 96 |
| Webster Horsfall Limited | Ev 106 |
| HM Customs and Excise | Ev 107 |
| Inland Revenue | Ev 112 |
| HM Treasury | Ev 121 |

List of Reports from the Treasury Committee since 2001

Session 2003–04

| | | Report | Govt Response* |
|----------------|---|--------|----------------|
| First Report | The Transparency of Credit Card Charges | HC 125 | <i>HC 431</i> |
| Second Report | Child Trust Funds | HC 86 | <i>HC 387</i> |
| Third Report | The 2003 Pre-Budget Report | HC 136 | <i>HC 478</i> |
| Fourth Report | Annual Report for 2003 | HC 386 | — |
| Fifth Report | Restoring confidence in long-term savings: Endowment mortgages | HC 394 | <i>awaited</i> |
| Sixth Report | The 2004 Budget | HC 479 | <i>awaited</i> |
| Seventh Report | The Administrative Costs of Tax Compliance | HC 269 | |

Session 2002–03

| | | | |
|----------------|--|---------|----------------|
| First Report | National Statistics: The Classification of Network Rail | HC 154 | <i>HC 550</i> |
| Second Report | The 2002 Pre-Budget Report | HC 159 | <i>HC 528</i> |
| Third Report | Split Capital Investment Trusts | HC 418 | <i>HC 651</i> |
| Fourth Report | The Handling of the Joint Inland Revenue/ Customs and Excise PFI Project | HC 184 | <i>HC 706</i> |
| Fifth Report | Annual Report for 2002 | HC 491 | — |
| Sixth Report | The UK and the Euro | HC 187 | <i>HC 1004</i> |
| Seventh Report | The 2003 Budget | HC 652 | <i>HC 1028</i> |
| Eighth Report | Appointment to the Monetary Policy Committee of the Bank of England of Mr Richard Lambert | HC 811 | — |
| Ninth Report | Appointment of Ms Rachel Lomax as a Deputy Governor of the Bank of England and member of the Monetary Policy Committee | HC 1011 | — |
| Tenth Report | Inland Revenue Matters | HC 834 | <i>HC 1181</i> |

Session 2001–02

| | | | |
|----------------|---|---------|-------------------------|
| First Report | The 2001 Census in England and Wales | HC 310 | <i>HC 852</i> |
| Second Report | Budget 2002 | HC 780 | <i>HC 1075</i> |
| Third Report | The Office of Government Commerce | HC 851 | <i>HC 1217</i> |
| Fourth Report | Appointment to the Monetary Policy Committee of the Bank of England of Mr Paul Tucker and Ms Marian Bell | HC 880 | — |
| Fifth Report | Banking, the Consumer and Small Businesses | HC 818 | <i>HC 1218</i> |
| Sixth Report | The Financial Regulation of Public Limited Companies | HC 758 | <i>HC 1219</i> |
| Seventh Report | Parliamentary Accountability of Departments | HC 340 | <i>HC (2002–03) 149</i> |
| Eighth Report | Inland Revenue: Self Assessment Systems | HC 681 | <i>HC 1220</i> |
| Ninth Report | Appointment of Sir Andrew Large as a Deputy Governor of the Bank of England and member of the Monetary Policy Committee | HC 1189 | — |

* Government Responses are usually received in the same session as the Report was published. Accordingly, the HC number refers to that session unless otherwise indicated.

Oral evidence

Taken before the Treasury Committee (Treasury Sub-Committee)

on Wednesday 21 January 2004

Members present

Mr Michael Fallon, in the Chair

Mr Nigel Beard
Norman Lamb
Mr John McFall

John Mann
Mr James Plaskitt
Mr David Ruffley

Witnesses: **Mr Chris Tailby**, Director of Tax Practice, and **Mr Roger Halson**, Small Business Champion, HM Customs and Excise, **Mr Robin Martin**, Director, Better Regulation, and **Miss Sara Woollard**, Head of Regulatory Impact Unit, Inland Revenue, examined.

Q1 Chairman: Mr Martin, can I welcome you and your colleagues to the Sub-Committee this afternoon. Could you introduce yourself and your colleagues formally for the shorthand-writer, please?

Mr Martin: Yes. Thank you. My name is Robin Martin. I am the Director in the Inland Revenue responsible for Better Regulation. On my immediate right is Chris Tailby from Customs. Chris was a tax partner in PricewaterhouseCoopers and is now Director of Tax Practice at Customs. On my far right is Roger Halson, who is the Small Business Champion in Customs. On my left is Sara Woollard, who is the Head of our Regulatory Impact Unit in the Revenue.

Q2 Chairman: Thank you very much. Perhaps you could clarify what a Small Business Champion is?

Mr Halson: My role is to represent the views and interests of small businesses within Customs and Excise with colleagues who make strategy policy and conduct operations. In that sense, my goal is to make contact with small businesses and their representatives and then feed in their views to colleagues in Customs and Excise.

Q3 Chairman: I see. You note in your memorandum that surveys show that the overall regulatory environment in the UK is lower than in many competitive countries, and the OECD has borne that out, I think. How would you define regulatory requirements in that sense? That goes wider than tax compliance and the cost of that compliance, presumably?

Mr Martin: Yes. I think most of the surveys to which we have drawn attention are looking at the whole regulatory environment, and not particularly at tax costs. I am almost certain that is correct.

Q4 Chairman: Are there any international surveys of tax compliance costs?

Mr Tailby: If I can deal with that, Sir, not specifically on costs. There have been comparative studies as to the requirements, and I am speaking on the indirect tax side, which is my specialism. We ourselves are doing a benchmarking study to compare the UK

with other countries, both in the EU and beyond. The last job I had in PricewaterhouseCoopers was running a global outsourcing unit, which involved preparing VAT returns for businesses which are required to be registered throughout the Community, and certainly my personal experience was that the UK's regime was much better than other countries'.

Q5 Chairman: That is your personal experience. Your memorandum refers to your assessment that our requirement is lower. Part of that requirement is tax compliance cost but you are not able to justify that in specific evidence from international surveys on that aspect, are you?

Mr Tailby: It is a personal view based on my professional experience of the regime which we have in the UK compared with other countries. For example, in the UK, we have quarterly VAT returns, most other countries require monthly VAT returns and others require monthly returns plus an overarching return per annum. On that basis, the UK comes out of it rather better than other countries.

Q6 Chairman: I just want to be clear, that you say this is your personal view, or your hunch, or your own experience?

Mr Tailby: It is a professional view.

Q7 Chairman: Is it the Government's conclusion?

Mr Tailby: It is certainly the Government's conclusion, and in fact there is an OECD study which has rated the UK as having the lowest barriers to entrepreneurship of any major economy, so there is that corroboration.

Q8 Chairman: Barriers to entrepreneurship are not quite the same as tax compliance costs, are they, it is a much broader definition?

Mr Tailby: I think that is right, but my own experience is in the field of tax.

Q9 Chairman: I see. In Annex B of your memorandum you have put out quite a long list of what you are doing to reduce compliance costs, but,

I suppose understandably, you have not listed the additional taxes or costs that have been imposed, have you? How long would that list be?

Mr Martin: I think the truthful answer is, it would be a longish list. I think really the reason for that is that the Government has other objectives for the tax system, and in my experience these are often conflicting objectives. For example, the Government has social aims which sometimes it delivers through the tax system, I suppose the main example here being tax credits. Some of the things the Government does will add to compliance costs, and there is no doubt about that at all. To be fair, that includes, I think, some of the tax reliefs which the Government gives in order to try to help people. For example, on things like the newly introduced tax credits for research and development and all the reliefs that are given for employee share schemes. Undoubtedly, these measures fall into the list to which you have referred, but they have purposes which are not necessarily to do with reducing regulation. To be honest, I think it is a matter of the Government having a number of different objectives.

Q10 Chairman: I understand that, but, in terms of regulatory budgeting, it is fairly difficult for us to measure whether this list actually is impressive or not, if we do not see the additional costs of compliance which have been imposed on the other side?

Mr Martin: Yes, I accept that.

Q11 Chairman: Is there any way of allowing us to make that kind of assessment?

Mr Martin: What the two Revenue Departments do in order to try to get a handle on this, and Chris will be able to speak for himself, I think, if he wishes to, we produce, in relation to any significant tax change, a Regulatory Impact Assessment. As a matter of course, the Regulatory Impact Assessment will consider whether the measure proposed increases business costs or reduces them. I think the answer to your question is that there is a published record in relation to each significant tax initiative which aims to show what the effects are on business costs. That is a way of looking at, if you like, the pluses and minuses which are involved in this.

Q12 Chairman: We would have to total all that up. Looking at it in a different way, one of the things we are looking at is whether this administrative cost of tax compliance actually has changed over time, whether it has got better or whether it has got worse. There is nothing in your memorandum on that. What is the answer, are things getting better or are they getting worse?

Mr Tailby: I think one has got to be careful how one takes compliance costs, because clearly there are measures which are introduced which do raise compliance costs but they are introduced to prevent fraud, or for social reasons, or matters of that sort. Certainly we look at the RIA assessments, but again we do look at the proportionality of the measures to ensure that we do not have too great a burden. I

think, if one stands back and looks at the measures and you take out measures which were introduced to combat fraud, missing trader fraud, for example, I would say that the effect, at worst case, actually is neutral. When you consider compliance costs, I think you do have to consider the individual measure that is introduced and ask why has that been introduced, has it been introduced for avoidance, to combat fraud, or matters of that sort?

Q13 Chairman: Right; so your view is, apart from fraud, the overall position has not got worse?

Mr Tailby: I would say that, yes.

Q14 Chairman: The evidence we have received so far seems to be to the contrary. The Institute of Payroll and Pensions Management said "there is no doubt that the administrative cost of tax compliance has risen in the short term." The Institute of Chartered Accountants of Scotland said "administrative tax compliance responsibilities carried by UK businesses have been increasing over recent years, and are still increasing, with no sign of abatement." Are they wrong?

Mr Tailby: I will leave Mr Martin to deal with the pensions one. If I can comment from the VAT point of view, we talk to small business advisers and small business and the message that we get is that, from a VAT point of view, the basic compliance with the VAT regime is not particularly difficult. I am a bit surprised at some of the comments that you read out, Sir, if, in fact, they relate to VAT, because what we hear is rather different.

Mr Martin: To be frank, I think a lot of the comments that people are making relate probably to direct tax, and obviously this falls to me to answer. Since April 2001, we have had a specific target, under our Public Service Agreement, to reduce, broadly speaking, the compliance costs of small businesses, and we have looked at the cumulative effect of all the Regulatory Impact Assessments we have done since that date, since April 2001. Looking from that point forwards, we are in a position where we have kept level, and have done slightly better than that, if you net off the increased costs against savings.

Q15 Norman Lamb: Could you provide us with that analysis?

Mr Martin: Yes, certainly we could, I am sure.

Q16 Chairman: Can I just be clear what it means. You are saying that, administrative tax compliance, so far as direct tax is concerned, for UK business, the effect has been neutral since 2001?

Mr Martin: Yes, indeed. I am not making any comment about the period before that, because at that stage we were not measuring this in quite the organised fashion that we are now, and, of course, the earlier period included things like the introduction of tax credits. If I could add just a couple of very general comments to that. I am very well aware that the perception of people outside Government is that costs have grown, and I quite understand the reasons for that. I think there may be some ways in which costs have been helped. For

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example, I think the greater use of IT undoubtedly has helped to restrain costs in relation to accounting and payroll. I am sure this is something that people recognise but it does not often get said overtly, but the more people can use IT, I think the more they will benefit from lower costs. The other thing I would want to say is that we have made quite a lot of changes which are almost, if you like, below the surface and which are not necessarily very easily perceived by the outside world. For example, in the late 1990s the Inland Revenue merged with the then Contributions Agency of the DSS, and as a result of that we have made significantly fewer visits to employers to check up on payroll. The old Contributions Agency used to make, I think, 90,000 or 100,000 visits a year to employers. We used to make 40,000 or 50,000 visits. Now that we have merged with them and the process has gone through its full course, we make only one visit to the employer and we are making about 35,000 of those per year. That is an example of where we have reduced costs but where it may not be immediately apparent, necessarily, to the outside world.

Q17 Mr Ruffley: Could I start with you, Mr Tailby. In the joint memorandum which both Departments have put to us there is reference to the difficulties in measuring tax compliance costs, and that, as a result, really you have fallen back, in effect, on an approach based on Regulatory Impact Assessments. Is it fair to deduce from this that, in fact, you do not have any up-to-date information on the total administrative costs of tax compliance for businesses?

Mr Tailby: I do not have an up-to-date figure, no. As I said earlier, it is very difficult to define compliance costs. It depends very much on the size of the business that you are dealing with, also it depends very much on the sort of accounting systems that businesses employ. Some businesses will have extremely good accounting packages which capture all the information and the VAT figure drops out at the end, others will have accounting packages which are not particularly good and are quite difficult to administer, and obviously that drives up costs. The approach we are taking is to look at specific measures and look to see what the impact is of that measure on the business, so if a proposal is being put forward that would raise X amount of revenue then you would look to see, "Well, what is the compliance burden?" You have to have a sense of proportionality with regard to that. I think it is difficult to measure costs themselves, because it is highly subjective as to what you include in that and it does depend very much on the type of business, the nature of the business. If you have got a big company which is making standard-rated widgets then the VAT is pretty straightforward; if you have got a company which makes taxable supplies and exempt supplies it does get more difficult. As I say, it is difficult to reach a figure.

Q18 Mr Ruffley: It sounds a bit of a counsel of despair. You do not think the total of administrative costs can be measured. Are you saying it is all too difficult?

Mr Tailby: No, I am not. I do not think it is a counsel of despair at all. I happen to think that the approach we are taking is the right approach, I think it is a sensible approach and I think it is one which has got a great deal of benefit for business, that we are looking at the detail.

Q19 Mr Ruffley: I follow your logic, but is not the problem with Regulatory Impact Assessment that it measures only the cost of changes, it does not actually tell you anything about existing costs, you are measuring just the cost of changes which come in from time to time? Is it not inadequate for that reason?

Mr Tailby: If all we were doing was using RIAs then I would agree with that, but actually we are doing more than that, and, of course, we are in constant dialogue with business and with their advisers, and we are listening to what are the areas of the tax which are causing difficulties.

Q20 Mr Ruffley: Could I switch over to Mr Martin. I think this bears reading into the record in full. The Institute of Chartered Accountants in England and Wales have said to us: "As far as we are aware, there has been little detailed research into the costs of tax compliance. In 1996, the Centre for Fiscal Studies at the University of Bath was commissioned jointly by the Inland Revenue and Contributions Agency to research the costs to business of PAYE and National Insurance compliance. The project . . . took in excess of a year to complete and cost hundreds of thousands of pounds. To date, there has been little evidence that its findings were acted upon." Then they went on to say, referring to this 1996 study, eight years ago, and I continue the quote: "These results will now be considerably out of date, and for example, pre-date the introduction of self assessment." That is what the Institute of Chartered Accountants in England and Wales says. Can you give me your response, because those are fairly powerful criticisms about the data being out of date?

Mr Martin: If I may, I would like to comment first of all on their assertion that, so to speak, no results have come out of this. I think the first thing to say is that the research was very useful to us and it showed us certain very key facts, and one of those is that compliance costs in the area which was examined are regressive, in the sense that they fall more heavily on small firms than on large. That is a very key element in our thinking about compliance costs. The first thing I would say is that the research was extremely valuable.

Q21 Mr Ruffley: That was in 1996, Mr Martin. The burden of their argument is that, "We" the Institute of Chartered Accountants "would like this work to be redone," in effect, that is what they are calling for, and I wonder if you would like to respond to the Committee on that specific point?

Mr Martin: Yes. I can understand entirely the point which they are making. At the moment, we do not have any immediate plans to update that research.

Q22 Mr Ruffley: Why not?

Mr Martin: A lot of things are happening in the field of payroll and compliance costs and I think that, doing it just at the moment, we would be aiming very much at a moving target. We have had the Bath study itself, which had a lot of recommendations in it, upwards of 30, I think, most of which we accepted and have implemented.

Q23 Mr Ruffley: Could you give us a list of those things, because one would not assume that or understand that to be the case from what we have been told by the ICA. If you could send the Committee a note on that I think I would find that helpful?

Mr Martin: Yes. I am very sorry, I do not have the list immediately to hand.¹

Q24 Chairman: It would be important for the Sub-Committee, because we have evidence, "little evidence that its findings are being acted upon," and you have told us all the recommendations are being acted upon?

Mr Martin: There were a lot of recommendations, I think around 30, more than 20 of which certainly we have acted on in some way, so I think there may be a bit of a misconception there.

Q25 Mr Ruffley: I am still labouring under a misconception. It will be helpful to have a full list and the degree to which each of the things you think you are implementing have been implemented or partially implemented. As I am sure you understand, the Committee does need to see that. The Institute of Directors have made the obvious point that the Revenue details the cost of collection of individual taxes. Would it not be a good idea commensurately to know the compliance cost, or a good estimate of it, for each individual tax?

Mr Martin: I think the job of finding out what tax yield is in relation to the Inland Revenue's costs is an easy one, relatively speaking, in the sense that we run one business, we have quite good records of where our costs fall and it does not cause us any great difficulty to produce a figure which I think gives a good general impression of the costs of administering a tax by the Revenue authority. As perhaps Chris has implied, and as we tried to set out in our memorandum, it does become more difficult when you are looking at the costs which businesses face. I think our experience is that in many situations actually it is very difficult to disentangle the compliance costs of tax from other costs which businesses may incur, in particular, I think, on accounting, and I know that some of the research which has been done has found that actually it is quite difficult to get hold of, if you like, a reliable figure in relation to business costs. I can see the suggestion which the Institute of Directors are

making, but I think that even the Institute itself would accept that there are considerable difficulties in trying to work out, in some areas, in some cases, and obviously VAT is a good example of that, a reliable figure for compliance costs.

Q26 Mr Ruffley: If you knew or had a good idea of which specific elements of the tax system generated the most administrative costs for business, presumably then you could target your Department's efforts on cutting away those costs. Can you tell us the specific parts of the tax system, the taxes indeed, which appear to you to be generating most compliance costs for British business, some more than others, and I wonder if you could differentiate them for us?

Mr Martin: Yes. I think this is a very important question and it goes to the root of what we are trying to do. First of all, I think it is very clear, from the evidence which has been looked at, that costs are regressive, they fall most heavily on small firms, so, as far as the Revenue is concerned, we try to focus our efforts particularly on helping small firms cope with the tax system. That is not saying we neglect large firms, we do not, certainly we try not to, and we have had a lot of reviews of how we interact with large firms, but our specific efforts over the last few years have been directed towards helping small firms. The DTI Small Business Service do regular surveys of business opinion and it is clear from their latest surveys that businesses do have quite clear perceptions themselves of where their costs fall. Looking at the evidence which is available from that source, they seem to put payroll problems at the top of the list. In other words, doing Pay As You Earn, National Insurance, other payroll tasks, is reckoned to be, to them, the most burdensome area of tax. It seems that, in relation to corporation tax and income tax, they are more concerned about the actual level of the tax and less concerned about the administrative costs. We feel it is very important to base our efforts on evidence, so far as we can. Bearing all that in mind, what we have tried to do is focus our efforts on helping small firms, and particularly helping them with payroll. I hope that is an answer to your question.

Q27 Mr Ruffley: Could you provide us with a note of the specific elements of the payroll problems that you are trying to tackle with small businesses?

Mr Martin: I am sure we could.²

Mr Ruffley: That will be helpful. Thank you.

Q28 John Mann: In the last decade the Revenue has made fairly strenuous efforts in terms of trying to tighten definitions of self-employment. Has any research been carried out into the impact that has had on the costs of small businesses and on any distortions to international markets? I am thinking in particular of especially the construction industry, but there are a number of other highly defined sectors which have been targeted by the Revenue?

¹ See Ev 112

² See Ev 112

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Mr Martin: To the best of my knowledge, I do not think any research of that sort has been carried out, but if I turn out to be wrong on that certainly I will correct myself by putting in a note to the Committee. I think the answer to your question is, as far as I am aware, no, specific research has not been carried out in those areas.

Q29 Mr McFall: Should it not have been, seeing that the logical consequence of that would be, especially in high value-added industries, that would lead to a quite significant increase in administrative costs for small businesses?

Mr Martin: Certainly it is true that some of the things which the Government has done, of the type that you are referring to, have led to additional costs, and I think you may have in mind, for example, the measures which normally are referred to as the IR35 measures, which apply to service companies. I think, however, that the Government did have very good reasons for wanting to introduce those measures and it was trying to address the problem, or what it saw as a problem, of a situation in which a service company is interposed between a person and whoever he is working for, when, in practice, the relationship really is one of employer/employee. If I may say so, I think the Government did have good reasons for wanting to take action of that sort, and I am sure it did not do this without thinking about the consequences.

Q30 Mr Plaskitt: We are hearing concerns about the extent to which the burden falls disproportionately on small firms. Mr Halson, do the small firms come to you, as their Champion, with suggestions and proposals, things the Government could do in specific areas to ease their compliance costs?

Mr Halson: I have not had specific proposals from small firms. I have invested a lot of effort over the last 12 months in making contact with small firms, representative bodies and with the accountancy bodies. What we are finding is that, through looking at our small firm simplification measures which we have introduced, in many cases small firms are saying that VAT has bedded in quite well and they are not finding excessive difficulties. As Mr Tailby has explained, for many businesses and for many small businesses, VAT is quite straightforward. I think the UK has an advantage in that it has the highest VAT registration threshold in Europe, which means that two million small businesses are freed from registering for VAT. That excludes a large number of the very smallest businesses from VAT altogether. I think also it is important to note that, nonetheless, a large number of small businesses choose to register voluntarily, because I think they see advantages to them in being part of the VAT system. That can give them support in terms of advance cash flow, reducing costs in certain areas, but also helps them in dealing with other registered businesses. At the moment, I think what we are seeing is small businesses saying, "VAT in itself is not an onerous burden." They are looking at and using increasingly the small firms simplification schemes that we have introduced.

Q31 Mr Plaskitt: Do you listen to what small businesses have to say to you about tax compliance right across the spectrum, or do you say to them, "I can only hear what you've got to say about Customs and Excise-based taxes." If they want to make comments and suggestions about, for example, payroll taxes, do you direct them to somebody else, or also do you take on board what they say?

Mr Halson: We make it quite clear to people. I think the people I talk to very much understand the differing responsibilities of the two Revenue Departments, and in that sense I find that queries about indirect taxes, or comments about indirect taxes, are pushed in my direction. The people I talk to are very clear on the responsibilities of colleagues in the Inland Revenue and see that difference and do not make comments to me. I do not find that is happening.

Q32 Mr Plaskitt: I can just imagine the reaction of small companies, when they want to make a point about tax compliance costs, being told by the authorities, "Well, there are two people you can talk to." If we turn to Inland Revenue, Mr Martin, have you got an equivalent of Mr Halson who is out there championing small businesses in respect of payroll taxes and coming back to you with ideas from the businesses themselves, saying, "This is what we do; this is what you should do;" is that happening?

Mr Martin: This works at two levels. First of all, we have business support teams, we have about 600 business support advisers up and down the country, whose job it is to contact new small businesses and new employers, to help them, to educate them, look at their payroll arrangements to see if they seem to be working properly. They do seminars and things of that sort. From that route we do get ideas directly from the people concerned. Also, we have groups based on our Head Office, groups of people from representative bodies, who come in and discuss with us different aspects of the tax system, including payroll. Sara Woollard sits on groups which hear suggestions directly from business representatives at Head Office.

Q33 Mr Plaskitt: Can you give us an example of a change which has been made which has come directly from a suggestion which has come from business?

Miss Woollard: I can, yes. One of the prime difficulties we have, I think, is encouraging small businesses to talk to us directly rather than through their representatives. We do have representatives' consultative committees and we get lots of ideas from them, but a specific role I took on was trying to engage small businesses directly. I have been going out, talking at small business events about what we are doing in the Inland Revenue, but at the same time using that as an opportunity to get ideas from them as to what we could do. I used the opportunity of spending a week with a small business, following up from William Sargent, who is the Small Business Council Chair. He suggested an initiative in the DTI, that all senior officials should spend a week with a small business to get some commercial awareness of

how things work in the real world. I started my career in a small business and was very keen to follow this up at the Inland Revenue. I spent a week with a small business and one of the issues which they raised specifically with me, in fact, was not about tax, and I was there to listen to every issue across Government, not just from an Inland Revenue point of view. One of the issues they raised particularly was that a lot of regulations come out across Government and it takes a lot of time to find out if they apply to them. The actual implementation, once they have found out that it applies to them, is another side of it, but they need to understand what the regulation is about, does it apply to them, does it affect their sector, what is the purpose of the legislation, rather than just trying to read some fairly dry text to them, who are not experts in that piece of legislation. I attended a Small Business Service two-day event, which took people from across Government and also members of the small business sector and suggested that really what people need is some very, very simple, "see at a glance" guide, from this suggestion, of what the legislation actually says, which explains it to them in words of one syllable, will it affect you, what will you need to do about it? Also, the other side of that is explaining to the enforcer what the intention is of the legislation, because, by the time the legislation has hit the enforcement agency, often the purpose of the intention of the legislation has been lost and they are enforcing the regulation just word by word. This idea was taken up and looked at. The Small Business Service published in the last week the Government Action Plan for Small Business and it included that specific idea, and that was one which came from my week spent with business in the summer.

Q34 Mr Plaskitt: Do you have a specific tax example?

Miss Woollard: Yes. It is a particularly small one, I am afraid, but it is a tax example. I was with a group of innovators in Cambridge, just before Christmas, who were complaining about the Christmas party limit and saying it was unrealistic and really could we not do something about uprating it. I was able to use the opportunity of some small thresholds we were looking at, because we do have these constantly under review, to say, "Look, this is something that really we could uprate without it being a great cost to the Government," and that was accepted and taken through. That is a specific, albeit small, example.

Q35 Norman Lamb: Mr Martin, in response to questions from the Chairman, you were very open in saying that there were a large number of measures introduced in recent years which would have increased compliance costs to set against those which have worked in the opposite direction. Also, you said that you had carried out some sort of analysis of Regulatory Impact Assessments to try to reach an overall view of changes in compliance costs, and you indicated helpfully that you would be able to provide us with a copy of that analysis, or something to that effect. That is the case, is it, that you can do that?

Mr Martin: Yes, it is. From April 2001, which was when first we had a Public Service Agreement target to reduce the compliance costs for small businesses, we have kept track of measures in that way.

Q36 Norman Lamb: That analysis will include details of the measures that have gone in? You were able to provide a list in an Annex to your submission which was helpful to your argument that you were reducing costs, but also you could provide a list of those measures, which presumably is part of your analysis, which have gone in the other direction?

Mr Martin: Yes, indeed, that is correct. There are pluses and minuses, and we end up by netting them off against each other.

Q37 Norman Lamb: One of the difficulties we have is that clearly there are very different, divergent views about whether compliance costs are going up or down. We have heard from Mr Tailby that, if anything, the position is broadly neutral. You have indicated roughly the same. Expert witnesses to us have submitted a very different point of view. Also, just in terms of sort of anecdotal evidence, *Tolley's Tax Guide* has grown exponentially in the last six, seven years. That would suggest that there is a heck of a lot more tax and guidance that companies are having to cope with. Unless we have some idea of what the actual up-to-date compliance costs are, how on earth do you seek to comply with your PSA target of reducing it? Surely, you need to know what the problem is before you can measure changes?

Mr Martin: I do see very much the point that you are making, but, as I think Mr Tailby has implied, in answer to an earlier question, what we are doing here is, if you like, looking at changes to the system and seeing what effect the changes have had. I can see it would be very helpful if we had a clear baseline at the start and a clear baseline at the end and you were looking at total costs, but unfortunately our experience is that this is actually very difficult to arrive at, for the sorts of reasons I was mentioning earlier on.

Q38 Norman Lamb: Do you discount the Bath study, of the mid nineties?

Mr Martin: No. I think that the Bath people were looking at an area of the tax system where perhaps it is easier to isolate the costs of tax itself, but that, I am afraid, is only a partial part of the field, and certainly elsewhere it has proved difficult to come to the same sort of conclusion.

Q39 Norman Lamb: In terms of your PSA target to deliver reductions in compliance costs, I think you are focusing particularly on small business, it is a broader target for you. It is all pretty nebulous, is it not? How on earth do we measure whether you are succeeding in meeting that target?

Mr Martin: I think we are doing the very best we can in the circumstances.

Q40 Norman Lamb: There is no scientific way of measuring it, is there?

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Mr Martin: I am not sure whether you would call the way in which we are measuring it scientific or not, but I think that, in the circumstances, we have attempted to find the best way that we can of seeing what has been happening to costs in the tax system over, in the case of our target, a three-year period. We have thought about all this very carefully and really at the moment I do not see a better way that we could be using.

Q41 Norman Lamb: Do you meet your PSA target if you can say at the end of the period, “We have reduced compliance costs,” or is there any more challenging target than simply having to say, “We have managed to reduce to some degree compliance costs”?

Mr Martin: The answer to that is, yes, that is what the target is about.

Q42 Norman Lamb: It is pretty vague?

Mr Martin: Yes, it is vague. On the other hand, I think people will accept that the aspiration of reducing costs, if we can achieve it, is a valuable one.

Q43 Norman Lamb: You say in your submission that you are, and I quote, “monitoring proposed changes to both tax policy and implementation which could impact on compliance costs” and that this enables you, and I quote again, “to track the cumulative trend in compliance costs and to identify and tackle key risks in meeting targets for reduction.” Is this the analysis that we have talked about, looking at the Regulatory Impact Assessments and trying to make some overall assessment?

Mr Martin: Yes, it is. The fact that, as a regular matter, people are analysing the proposals that they are putting forward and attaching costs to them, it does allow us to see where costs are likely to fall and whether anything can be done to mitigate them. It seems to me that, by comparison with the position which obtained beforehand, where this work was not done in an organised and structured way, we are now in a better position because there is a discipline on people, when they are bringing forward proposals for change, to look specifically at the costs for business, for the outside world. I think that this enables it to be seen more clearly where costs are going to fall and, if it is possible, to do something about it.

Q44 Mr Beard: Going back to the Bath University report which has been mentioned already, the compliance costs for Pay As You Earn and National Insurance contributions per employee for a business with one to four employees has increased from £147 per employee in 1981–82 to £284 in 1995–96, a very substantial increase, almost double. Over the same period, however, the cost per employee for businesses with more than 100 employees fell, from £45 per employee in 1981–82 to £33 per employee in 1995–96, so there is a substantial difference in the trends. Have those differences in the trends continued?

Mr Martin: It is absolutely right that over the period that you have referred to the costs of smaller employers increased, whereas those of the largest employers fell, and there was a category in the middle of medium-size employers for whom the research seems to suggest that costs stayed about the same.

Q45 Mr Beard: A very slight fall, yes.

Mr Martin: Yes. I am pretty certain that the reason for that was that, during that period, larger firms were able to make substantial gains from progress in information technology, some of them perhaps from outsourcing their payroll operations to Payroll Bureaux. I think that is fundamentally the main reason why costs for larger firms did get better in that period. You asked about the trend, and I think it is true to say that the benefits of IT are becoming available now to smaller businesses further down the scale. I think there was a stage when Payroll Bureaux would accept only pretty large employers. I do not believe that is any more the case. I think small firms can now take advantage of this. I was visiting a small firm in Hampshire not very long ago which manufactured beds and they had around four or five employees. I asked the owner of the firm what she thought about payroll, did she have any concerns about payroll, and she said, quite simply, “No, I don’t. I get my accountant to do payroll for me. He uses one of these cheap packages, which are perfectly reliable, and, as far as I am concerned, it is not a worry.” I think that may suggest some difference between the situation that we are in now and the situation that we were looking at in the earlier period that you have quoted. It is my expectation, thinking about trends, that, to the extent that smaller firms have been able to take advantage of technology, costs for them will have reduced, and certainly some of the figures which Mr Patrick Carter uncovered in a review that he did for the Chancellor of the Exchequer,—

Q46 Mr Beard: Who was that?

Mr Martin: I am sorry. This is a businessman called Patrick Carter, who was appointed by the Chancellor of the Exchequer a year or two ago to look specifically at problems of payroll, and he came up with the fact, which I think he had researched with the Institute of Payroll Management, that for a small firm of up to four employees you could get payroll done annually for around £200–£250. That is a very striking comparison with the figures produced in the Bath report for, let us say, the mid 1990s, where, as you quoted,—

Q47 Mr Beard: It is almost a *per capita* cost?

Mr Martin: Yes. A firm of four employees, on the Bath figures, might be paying around perhaps £1,000 a year for payroll, on the evidence of that research, but Patrick Carter’s research indicated, I think we are talking about 2001, 2002, that Payroll Bureaux were prepared to provide this service for a firm of up to four employees for about £200–£250. There is a very big difference here. If I am right about

this then, to the extent that small firms are taking advantage of the technology options, I hope, the trend will show that things have got better for them.

Q48 Mr Beard: Are these technology options ones provided by you or provided by the private sector?

Mr Martin: A bit of both. The private sector typically provides software packages for people to purchase and run payroll on their own machine if they want to. Equally, it provides a service through Payroll Bureaux as well; effectively, you outsource your payroll. The Revenue provides electronic forms. We have a CD-ROM which is sent out to all employers, it is just a very standard CD-ROM thing, which has on it electronic forms that they can use on their own machine to fill in and then they can communicate the result to us electronically.³ The answer to your question is that, if you like, both sides are trying to do their best to encourage and help people to take advantage of options of this sort.

Q49 Mr Beard: What exactly are we talking about, when we are talking about compliance costs in this context, because various businesses will have accounts done for their own purposes, for their own commercial purposes? Presumably, compliance costs are anything which has to be done in the way of compiling figures over and above what will be done in their normal accounting practice. Why is it that the two cannot be squared, why cannot the requirements for taxation be the same as are required for normal accounting in a business?

Mr Martin: We have thought about this quite carefully, and we put out proposals to businesses for consultation about whether it would be the right thing to try to line up the tax system more closely with accounting, which, obviously, on the face of it, as you are suggesting, looks like a very rational and helpful idea. In practice, when we came to consultation, this was not all that well received by business representatives, including small firms. I think, fundamentally, there are some differences between tax practice and accounting practice, which, if you try to line up tax with accounting, might put people at a disadvantage. One example of this, I think, is commercial depreciation. If we suggested to people that their tax allowances should be based on commercial depreciation, as was part of the proposals that we put out in this consultative process, if you suggest to people that should obtain, then they will get a less generous result than you obtain by using capital allowances under our existing tax rules. If I could just summarise, I think the conclusion that everybody came to, as a result of the consultation, not the Revenue, I am talking here about the outside world, was that they were not all that keen on moving towards using, if you like, accounting practices for tax purposes, for the sorts of reasons I have given.

Q50 Mr Beard: Some of these compliance costs arise from that sort of resistance to change?

Mr Martin: I think that is right. You can put deregulatory proposals to firms, but in the end they will take a judgment about them in their own best interests, and they may well decide that they would rather not go down a path which gives them greater regulatory simplification, for the sorts of reasons I have alluded to.

Q51 Mr Beard: The Institute of Chartered Accountants in England and Wales say they do not believe that the existing system of Regulatory Impact Assessment properly reflects the cost of the obligations imposed on business of new tax policy, as frequently, and this is a quotation from them, "they are partial and appear to be merely a best guess of the costs involved." They told us also that once a proposal is implemented, again it is a quotation from them, "there is little evidence of any attempt to return to the original estimate and assess with the benefit of hindsight whether the change was cost effective when compared to the benefits achieved." How do you respond to those criticisms?

Mr Tailby: The RIAs are a Government requirement, so it is not something which is set up by the tax authority. I do not think it is right to say that they are partial, in the sense that they are a creature of the Revenue Departments. I think, in terms of follow-up, certainly there is work that we have done, in the context of a flat-rate scheme, to follow up and see the effect of the implementation of that, and I am aware of that personally. I would not agree entirely with what the ICAEW says.

Q52 Mr Beard: You would not agree entirely, but what would you agree with?

Mr Tailby: I think it is fair to say that we have not followed up every initiative where we have had an RIA, so I think they are right about that, but certainly we do follow up where we see a need to follow up, and, as I say, we did in the case of a flat-rate scheme very recently.

Mr Martin: I wonder if I could add some very brief points to what Mr Tailby was saying. The way that we operate the RIA process is that we do encourage very much the outside world to contribute to it. What happens normally is that we will produce a draft or a provisional Impact Assessment, that will be published, it will be looked at by people in the outside world, including the CBI, the accountants themselves, and they will be able to come back to us if they think that it is deficient or unrealistic in any way. I think, to be honest, I would contest what the ICAEW are saying. I do not believe they are right about this. The process is open and does take account of views of business. Also it is scrutinised extremely carefully by the Cabinet Office, the Treasury, the DTI Small Business Service and we are subject to audit by the National Audit Office, who can come in and have a look at the thing to see whether it does stack up or not. Really I do not think that the ICAEW are on to a good point here, and if they are I am surprised, because the process is such that outside commentators do get a chance to contribute to it and put in their views.

³ *Note by witness:* At present, employers can send PAYE forms to the Inland Revenue electronically on the internet, but not directly from the CD-Rom itself.

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Mr Tailby: There is another point, if I could come back, on the question of further research. We have commissioned a research programme whereby an independent research body will send its staff round with visiting officers and they will discuss with the businessmen the impact of the taxes. That would pick up new measures as well, so that would track new measures as they were being implemented.

Q53 Mr Beard: You say in your joint memorandum to us, paragraph 3.8, that both Departments are carrying out post-implementation assessments of changes that have been introduced. How many of these post-implementation assessments have been completed and do they cover the original estimates of both benefits and costs?

Mr Martin: In the case of the Revenue, this is a relatively new process but certainly we have completed two, and, yes, they look at all the elements of the original assessment. In other words, it is a complete review of what was originally in the assessment.

Q54 Mr Beard: What is the answer, what comes of it?

Mr Martin: In the two that we have looked at, it turns out that, in fact, we were being a bit pessimistic when we did the original survey. In other words, either the costs were less than originally we had thought they might be, or the savings look as if they are going to be greater, so, as it happens, from the ones we have done, it does turn out that there is evidence that we have erred on the side of caution.

Q55 Mr Beard: When you say two, is that two different companies?

Mr Martin: It is a couple of different tax proposals on which a Regulatory Impact Assessment has been written.

Mr Tailby: Just on the post-implementation reviews, we did one on the flat-rate scheme, which showed, I think it is fair to say, that we had been somewhat pessimistic in the savings that were going to be generated, but we have not published those.

Q56 Mr Beard: The Institute of Payroll and Pensions Management consider that in the last 10 years the role of the employer in correctly administering the tax affairs of their employees has changed dramatically. They say this has changed from the correct deduction of tax and National Insurance according to a tax code and a National Insurance Category letter to being responsible for three types of National Insurance payment, payment of tax credits, collection of Student Loans, four statutory payments and monitoring the National Minimum Wage compliance. Do you accept that more responsibilities are being placed on employers now along these lines?

Mr Martin: I think that what the Institute are saying is factually correct, and it is undoubtedly the case that the requirements to which they are alluding, like the National Minimum Wage and collection of Student Loan repayments, in a sense, are new requirements placed on employers. I think I would go back to the original point, that the Government

has objectives for the tax system which are not necessarily ones which reduce regulation. In the case of National Minimum Wage, that is not part of the tax system as such, but the Government had a clear social objective in introducing it and I think their judgment was that, yes, this would increase compliance costs but, in relation to the benefits which the Government saw for them, they felt that was justified. This is slightly in passing, but if I may, I think some of the perception of increased compliance costs relating to the tax system relates perhaps to some of these measures that, strictly speaking, are not really part of the tax system. For example, National Minimum Wage, collection of Student Loan repayments, a number of these statutory payments, like statutory sick pay, statutory maternity pay. I think probably it is fair to say that, if you look at the tax system as such, we are a part of this picture but we are not the whole of it. I can see why, for example, the Government decided that Student Loan repayments should be collected through the payroll. I am a parent myself and I find that, trying to collect money from my children, a direct application is sometimes rather a thankless task. I can see the reasons why these things happen, and they are things which the Revenue administers, for good reasons, I think, but they are not really part of the tax system as such.

Q57 John Mann: There are no suggestions that there are any administrative costs related to the National Minimum Wage for employers. Is it your evidence that if we look at a sector like, say, hairdressing, the biggest complaint from employers running new technology systems is, in fact, that the chap down the road is running a cash till, and naturally avoiding the legislation rather than the actual cost of the legislation?

Mr Martin: It is undoubtedly the case, and I imagine this would be reflected in the representations that are made to you, that small firms in particular are very concerned about the issue of unfair competition and I think this is obviously a major concern with them. I am not very well briefed on whether National Minimum Wage carries with it large compliance costs or not. On the face of it, I would not have thought that the compliance costs are very large in relation to National Minimum Wage.

Q58 Mr Beard: On that point of compliance costs on the other aspects of this, the tax credits, what is the nature of the compliance cost? In their details and their salary, and so on, employees are carried on IT storage, so I can imagine that has to be updated when a new situation arises, but thereafter you are not changing them every week and you are not counting the people every week. Where does the compliance cost come from in administering these tax credits?

Mr Martin: I think that probably it relates to the fact that an employer is having to engage in transactions, though, as you say, relatively simple transactions, with perhaps quite a large number of his, or her, workforce. I think you are right to suggest that the job itself fundamentally is not a difficult one. The

Inland Revenue will inform the employer about an award of tax credit, the employer will adjust his payroll, the tax credit will be paid, from time to time the level of the award may change and an adjustment has to be made. I think you are right to imply that, fundamentally, this is not a difficult task, and indeed the research we have done with employers has suggested that they do not find it difficult to operate tax credits. I think the compliance costs arise because you are doing this for possibly quite a large number of your employees. In relation, I think, to the original Working Family Tax Credit, I think that was being received by something between one and two million people in the country. The new tax credits are spread out over a wider field, there is a wider field of eligibility. I hope I am right in saying that the administrative burden perceived by employers is not, on the whole, one of complexity, but, in aggregate, actually it is quite a big task.

Q59 Mr Beard: Moving to self-assessment, it is clear, from the evidence that we have received, that there is a view held by very many people that the introduction of self-assessment has shifted administrative costs from the Revenue to taxpayers. What assessment has been made of the administrative burden which would fall on business with the introduction of self-assessment, and what has been the outcome in practice compared with the original assessment?

Mr Martin: I am aware that this is certainly the view of the representative bodies, that costs have fallen on them to a greater extent. I think, if I may say so, that they are neglecting some aspects of the change which worked in people's favour and which did reduce costs, in fact. I think any accountant would accept that, under the old system, which obtained before self-assessment, there was an awful lot of work which the new system swept away. It consisted of the fact that the Revenue would have to be sending out assessments, the taxpayer would have to appeal against them quite often, the assessments often would be sent out for the purpose of, if you like, trying to hurry things along, to get the taxpayer to submit his, or her, accounts. There was a very burdensome system of estimated assessments, appeals, and the new system has swept all that away. I would like to make the point that it did have benefits for taxpayers. It was introduced some while back, in the mid 1990s. I think some estimates were made at the time of the costs. I do not think necessarily they were very comprehensive or reliable ones. I am not aware that these have been revisited.

Q60 Mr Beard: In the past, before self-assessment came in, did businesses not do their own tax calculation to check what the Inland Revenue was going to say their liability was?

Mr Martin: Yes, I think that is absolutely right.

Q61 Mr Beard: What is the difference now, because probably it is the same calculation?

Mr Martin: I think, in practice, quite a lot of the work that is done under self-assessment was done perhaps in a different way under the previous

system. Certainly, if you look at income tax self-assessment, what happens under the new system is that you receive a form and you are obliged to fill in the form, but, in practice, a lot of people were obliged to do this under the old system, effectively to fill in a tax return. The fundamentally new element is that, under self-assessment, if you file your return after a certain date you are asked to calculate your tax. Certainly that did not occur under the old system. You can escape that either by filing before the end of September or by using the Revenue's electronic system, or a software package which will do the calculation for you and cut through any work which otherwise you might have. I think certainly you are right to imply that one needs to look rather carefully at the assertion that self-assessment has increased costs significantly overall.

Q62 John Mann: Is there any evidence that the proportionate expenditure on accountants has risen, particularly in the small business sector, over this period of time?

Mr Martin: No, I am not aware of any evidence that it has. I would not know of anything which suggests that.

Q63 Mr Plaskitt: On payroll costs, what evidence do you pick up of the compliance costs of handling Child Support Agency cases for employees who are entangled with that?

Mr Martin: I do not think the Revenue has got at all involved in this area of the system, because the Child Support Agency is still very much apart from our operations. It is run by the Department for Work and Pensions and I do not think that the Revenue, as a Department, or indeed our people individually in our local offices, get tied up very closely with CSA matters. I am sorry, I do not think we are involved.

Q64 Mr Plaskitt: I know it is not, but that is why I asked what evidence you pick up about it. I know it is not directly your responsibility, but you can look at this as rather end of the line. It is either the various bits of Government that are doing things which impact on employers, or we can look at it from the employers' end, when he, or she, sitting down doing the payroll, has got all of these things in front of them, part of which you are responsible for, but in terms of them feeling the burden of compliance it is the whole lot together. If we are going to get a complete picture and see where you fit as part of that, we must not ignore the other bits of it. Which was why I was wondering, when you are talking to people about payroll issues, do they not also say to you, "What about the CSA compliance?" That is a calculation which can vary, in some cases, very, very frequently. Do you pick up anything of that, is all I am saying?

Mr Martin: No. To be honest, I am afraid I am not aware that we do.

Q65 Mr Beard: In your memorandum you refer to the cash flow benefits to employers of collecting Pay As You Earn from employees which does not have to be paid over to the Revenue until the second half

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of the following month. Have these cash flow benefits been reduced at all as a result of tax credits, and have you had any complaints along those lines?

Mr Martin: The answer to your question is, yes, the introduction of tax credits has reduced cash flow benefits which employers otherwise obtained. I would like to put this into context by giving you some figures. The aggregate amount over the whole system which is paid out in new tax credits is going to be about £15 billion.⁴ The amount which employers collect on our behalf in Pay As You Earn tax and National Insurance is now upwards of £170 billion. Whilst I accept the point entirely that there is a cash flow effect from having to pay out tax credits, relatively speaking, it is not a large effect in relation to Pay As You Earn and National Insurance. In passing, I think I would note that there are one or two other things which have helped on cash flow. For example, the smallest employers are allowed to account to the Revenue quarterly for their Pay As You Earn and National Insurance, and recently we have raised the threshold, we raised it quite substantially, at which this applies. In other words, there is a larger field now of employers who are able to pay us once every three months, and obviously that does help with cash flow. Also, as part of introducing the move towards electronic payment of taxes, employers who pay over electronically are being given a further three days in which to do this, and that again, I think, is something which will help cash flow.

Q66 Norman Lamb: Can I ask a supplementary on the Regulatory Impact Assessment issues which we were raising earlier. Can I just understand, if there is a new tax proposal which is being considered by the Treasury, does the Treasury ask one or other of your Departments to conduct the Regulatory Impact Assessment process to determine the impact of that proposed measure? Is that the way it works, or does the Treasury do it? How does it work, the relationship between your Departments and the Treasury?

Mr Martin: In this case, the assessment would be conducted by one of our Departments. The Treasury would have an interest in it, and I think they look at these things pretty carefully, but we are the people, in our Departments, who would be doing that.

Q67 Norman Lamb: I am trying to understand how robust this system is, because, I have to say, I have doubts about the Regulatory Impact Assessment, I think often it is a paper exercise, from the evidence that I have seen. Can you point to examples of where you have conducted the assessment and you have concluded that the cost would be too high and the measure does not proceed?

Mr Tailby: Certainly I had one instance of that.

Q68 Norman Lamb: One, over how long?

Mr Tailby: This was very recently, where the proportionate compliance cost actually outweighed the Revenue benefit.

Q69 Norman Lamb: That is one case, in how long?

Mr Tailby: I have been in the Department for 18 months but, I have to say, in relation to the RIAs, these are done by the Department. Roger Halson's team is responsible for ensuring that those are done. They scrutinise all the Budget and other proposals, to check on the compliance burden and ensure that the RIA procedure is completed, and it is signed off by the Minister.

Q70 Norman Lamb: I appreciate that, but is there not a danger that it is self-serving, because it is the Department that wants to introduce the measure that conducts the assessment?

Mr Tailby: We have a PSA target to reduce compliance costs.

Q71 Norman Lamb: Yes, but we have determined already that is a fairly vague and nebulous concept. What about at the Revenue, have there been any examples where you have decided not to proceed, or where the Treasury has decided not to proceed, because you have come up with a negative Regulatory Impact Assessment?

Mr Martin: I can think certainly of one example, from relatively recent experience, it is to do with transfer pricing. As a result of a judgment which went against us in the European Court of Justice, Ministers decided that they wanted to change transfer pricing arrangements so that they would apply to not just international transactions but to transactions involving groups of companies inside this country. In other words, the transfer pricing arrangements are being extended to cover domestic transactions. In analysing the costs and benefits of this, it became clear that it would be a very substantial burden for smaller companies, smaller businesses. As a result, the Government decided that it will exempt from this new requirement all small- and medium-sized enterprises, and, in practice, 95% of businesses are not going to have to be involved or concerned with this new measure as a result of that exemption. I think there are some extremely exceptional circumstances in which a medium-sized business might have to be involved, but they are very exceptional. That is the most recent that I can bring to mind.

Q72 Norman Lamb: Can I come on to the issue of complexity of the tax system. I mentioned the example of Tolley's and how it has grown exponentially. There is a quote here from the Chartered Institute of Taxation, which says: "The sheer volume of tax legislation that has emanated from Parliament in recent years has created its own additional burden of tax compliance. A glance at a bookshelf containing the Finance Acts of recent years, compared with those of 20 or 30 years ago,

⁴ *Note by witness:* In fact, the amount of new tax credits which will be paid through the payroll will be much less than this figure; the larger part of new tax credits (in particular the child element) is paid direct from the Inland Revenue to the recipient. So the aggregate cash flow effect for employers is actually considerably smaller than I suggested.

shows how much extra legislation there is to cope with, and that is before adding the huge volume of statutory instruments and other guidance material that floods out.” The brutal truth is, surely, that tax has become vastly more complex than it used to be?

Mr Tailby: If I can deal with that, from a VAT perspective. I would agree that, yes, it has got more complex. I think one has to examine the reason for that. Certainly a number of the changes we have had to make have been to deal with avoidance schemes, where there has been a huge growth in the tax avoidance industry over the years and we have had to legislate to deal with that. I think that does add significantly to the complexity, and clearly that is unfortunate, but if businesses seek to avoid tax then I think one has to protect the Revenue.

Q73 Norman Lamb: It is not just those “for avoidance” measures though, is it, there is an awful lot of complexity which has been brought in by the Chancellor?

Mr Tailby: Some measures do introduce a level of complexity because actually what they are doing is introducing a relief. For example, Urban Regeneration reduced rates, it does introduce a level of complexity but actually it is for a long-term social benefit.

Q74 Norman Lamb: You say you think, you do not know whether actually it achieves that?

Mr Tailby: One hopes it will, but it is designed with what I would submit is the best of intentions, and one hopes that, once that has been introduced and the benefits flow, as businesses become more familiar with the introduction of the new measure, the compliance cost burden will reduce. So, yes, if you introduce a measure, it will give rise to a jump, but I think you have to look at why that measure has been introduced and if it is for a social reason or it is for combating fraud then I think that inevitably those are measures which have to be introduced to protect the Revenue or give the relief.

Q75 Mr McFall: On the point that Norman Lamb made originally about Regulatory Impact Assessment, as you know, the Chancellor in his Pre-Budget Report announced that he is minded to introduce strip stamps on spirits bottles. What role does each of your Departments have in advising the Chancellor on that?

Mr Tailby: The proposal to introduce tax stamps for spirits is part of the Government’s strategy to tackle alcohol duty fraud to reduce losses. The current estimate of the loss of revenue on spirits is something like £600 million per annum and that means that effectively nearly one in six bottles of spirits is illicit, in 2001.

Q76 Mr McFall: Is that your estimate, the Customs and Excise?

Mr Tailby: That is an estimate which is carried out by our analysis division, so, yes, it is.

Q77 Mr McFall: In 1999–2000, you started off with an estimate of £450 million and then it went to £500 million, and in a document produced in December on the means of tackling indirect tax losses you have downgraded that to £350 million, so it seems quite imprecise, it depends on the month, it depends on the figure?

Mr Tailby: I think it depends on the success of the strategy. Certainly the instructions I have are that at the moment we are looking at £600 million. I accept that imposing tax stamps on spirits is going to add to the regulatory burden, but that is being done to protect the Revenue, but I think you have got my point on that.

Q78 Mr McFall: It is the integrity of the figures that I am interested in, and I will be coming back to you on this if I have got a further opportunity. You mentioned £600 million fraud, that amounts to 200,000 bottles of spirits every day, that is 12 container loads a day being contraband. People in the industry just do not see that here, so I want to get an idea how you come up with this magic figure?

Mr Tailby: I do not have instructions as to precisely how that figure was arrived at. I can certainly offer to investigate that matter further and come back to you on it. I do know that the Economic Secretary is going to be having a meeting with the Scotch Whisky Association on 3 February.

Q79 Mr McFall: I arranged that meeting.

Mr Tailby: I did rather think that.

Mr McFall: A detailed note from you would be very helpful.

Chairman: A note of analysis would be very good.⁵

Q80 Mr Beard: The Institute of Payroll and Pensions Management have said to us that they believe this, that “many initiatives which purport to be better for business appear to deliver rather more in reducing the costs of central government than those of business.” They cite electronic filing and the move to contact centres as examples of this. The Institute of Directors say something very similar. How do you respond to it?

Mr Martin: In relation to electronic filing, it is certainly the case that this will help reduce the costs of Government and I would accept that entirely. At the same time, I think also it is very true that moving from a manual operation of your payroll to an electronic operation, for almost any size of firm, can produce a distinct saving. I think our reaction to that is to say that I hope there are clear benefits involved for both sides. I do not think that is an example of something where the Government has introduced a measure simply to make savings in Government costs.

Q81 Mr Beard: What about contact centres?

Mr Martin: I am a bit unsure about quite what point the IPPM are making.

⁵ See Ev 107

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Q82 Mr Beard: They say it is more beneficial to the Government than it is to them, for their members?

Mr Martin: I think the benefits of contact centres are that you can have a service available at almost any hour of the day, or certainly at longer hours than you might, by contacting in the traditional way a local office. I think the technology which we are putting in place should help to ensure that also you get a consistent service, in the sense that, if you ring up and ask a question, everybody should get the same answer to the question, from wherever they are ringing and whenever. I am struggling a little bit to

understand why the Institute feel that there is a disadvantage, if you like, for taxpayers. In fact, provided they are well operated, I think contact centres do have quite a lot of advantages attached to them.

Chairman: The Institute are coming before us too, so we will be able to ask them directly why they took that view. We are going to have to leave it there now. I think, collectively, you both offered us some further information, in formal, written notes, and we look forward to receiving those. In the meantime, thank you all very much indeed.

Wednesday 4 February 2004

Members present

Mr Michael Fallon, in the Chair

Norman Lamb
Mr John McFall

Mr Robert Walter

Witnesses: **Mr Neil Hamper**, Chairman, Taxation and Financial Affairs Committee, Federation of Small Businesses, **Mr Derek Brownlee**, Taxation Executive, Institute of Directors, **Ms Kate Upcraft**, Policy and Research Manager, and **Mr Norman Green**, Fellow, Institute of Payroll and Pensions Management, examined.

Q83 Chairman: Mr Hamper, welcome to the Sub-Committee. Could you introduce yourself and your colleagues, for the record, please?

Mr Hamper: I can only introduce myself really. Perhaps the others could introduce themselves, Chairman. My name is Neil Hamper. I am a chartered accountant and chartered tax adviser and Chairman of the Taxation and Financial Affairs Committee of the Federation of Small Businesses, and it is in that capacity that I appear before you today.

Ms Upcraft: I am Kate Upcraft. I am the Policy and Research Manager at the Institute of Payroll and Pensions Management, and I have brought with me a fellow witness.

Mr Green: I am Norman Green, a Fellow of the Institute. My day job is working as a Legislation Manager for a Payroll Bureau, supplying to employers.

Mr Brownlee: I am Derek Brownlee. I am a chartered accountant and I am a Taxation Executive at the Institute of Directors.

Q84 Chairman: Thank you very much. You are all very welcome. The Revenue Departments told us, in relation to the tax system as a whole, that the Government is committed to making regulation proportionate, targeted, comprehensible and easy to implement. Do you think it is meeting those objectives?

Mr Green: Easy to implement, I am not quite certain by whom. The issue certainly for employers is to operate it rather than implement it, and it is the operation of PAYE and the other associated issues which come with that, National Insurance, statutory sick pay, maternity pay, and so on, which create the issues. It is a very complex system and employers have to understand the whole of that.

Q85 Chairman: It is the comprehensibility which you do not think is being met yet as an objective. Anybody else, on that?

Mr Hamper: I would concur with that comment, that certainly it is far too involved and the burdens on small employers to implement the legislation are very difficult to co-ordinate.

Ms Upcraft: It terms of proportionality, whilst one can easily say that it is proportionate in terms of the way it affects taxpayers, if you are looking for an example of proportionality from the employer perspective you have only got to look at the

implementation of tax credits and the cash flow effect that has had on businesses, who are having to pay out tax credits and then recoup that money back, in terms of looking at how proportionate that is. Obviously, the type of business you are in affects the number of claimants you might have on your payroll and the significant amount of money therefore you might have to find up front to pay that sort of money to people.

Q86 Chairman: That is an example of where you think it is disproportionate, the tax credits example?

Ms Upcraft: Yes, and it is disproportionate because it is sectoral as well, and really it depends on the sort of business you operate in whether you are affected in that way. If you employ a lot of part-time, low-earning staff then you will be affected disproportionately by that type of legislation.

Q87 Chairman: Thank you. One of the other things the Revenue Departments have told us, at the beginning of this inquiry, which we found rather odd, they said "recent contacts with UK business organisations reinforce the view that the documentation needed for tax is generally needed for commercial purposes—and indeed the discipline imposed by tax is seen as beneficial to the business." Would any of you like to question that?

Mr Brownlee: To some extent, any business is going to have to record some information for financial reporting, for other purposes, but a large part of the reporting requirements for tax goes way above and beyond what most businesses would require. You have things, for example, where in the tax system you would need to discriminate between entertaining employees and entertaining customers. Now, from the commercial perspective, you may decide that is something you wish to record separately in any case, but equally there are many businesses who may decide it is not necessary to do so and they have no choice but to record that separately. That is a small instance. Probably the more problematic ones are where the tax system actually requires some indication of intent and where an accounting system would only record transactions.

Mr Hamper: One of the particular burdens, I think, is the P11(d) procedure, the benefit in kind legislation. It is driven mainly by two very good explanatory booklets published by the Department, the 480 and 490, which deals with motor expenses,

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but to expect small employers to know intimately all the rules and regulations covered there, with the exceptions, I think, is completely disproportionate, to try to run a business commercially. We talked about proportionality just now, and from the Revenue's own statistics it was calculated, a few years ago, that £288 per employee per annum was the cost of administering a payroll, whereas, for larger businesses, it is about £5 an employee. That is where the costs come in.

Q88 Norman Lamb: Just on the P11(d) point, do you have an alternative prescription for what you would do? Presumably, you are not suggesting that something is required?

Mr Hamper: The benefit in kind legislation, most of the benefit tax, if you like, comes on motor vehicles, and I should think the Treasury tax take there is infinitely larger on motor vehicles than on any other benefit. I wonder whether there is some way that the streamlining of some of the more obtuse types of benefit in fact can be knocked on the head on grounds of cost benefit to the Treasury, they would lose a little revenue but they would save an awful lot in bureaucratic administration. I think the car scenario is something which needs to be taken apart and examined anyway, because that changes quite frequently. Of course, now we have got CO₂ emissions, which is another burden, that a small employer has got to work out what the CO₂ emissions are of the cars which he has provided to his employees.

Q89 Chairman: Mr Brownlee, one of the things we are looking at is whether the burden actually has increased. You did a survey in 2003 showing, I think, that 78% thought it had increased. In fact, had you done a survey previous to that, are some of these different results, can you measure your own survey?

Mr Brownlee: This particular question had not been asked previously, certainly that I am aware of, and I suppose a note of caution I should put in there is that we did not actually put a time-frame, when we asked a question we said, I think, "over the past few years," which obviously some people will interpret different. Really, it was more illustrative than something particularly you could rely on to its absolute accuracy, I think.

Q90 Chairman: Did the survey identify particular burdens which had increased or just ask for this general feeling?

Mr Brownlee: That particular survey just asked for the general feeling, if you like. More recently we did a survey, the last one, and I am not sure whether it has been published or not, and that was very much, in terms of tax administration, picking up Pay As You Earn as being the main bugbear of business.

Q91 Chairman: Would you be able to supply that to us?

Mr Brownlee: Absolutely, yes.⁶

Q92 Chairman: Thank you. Mr Hamper, does your Federation have a view on whether the cost actually has gone up over the last definable period?

Mr Hamper: Most certainly so. My colleague here, on the left, emphasised the point about tax credits and Student Loans. Certainly these are burdens which are falling squarely on all types of employer. Again, of course, it is the small employer who gets that disproportionate burden.

Q93 Chairman: The tax credit burden is new. It may be that other burdens have gone. What I am trying to get a hold on is the overall burden. How can you show to us that the overall burden has increased over, say, the last five years, or 10 years, or whatever?

Mr Hamper: It is not one thing in isolation, it is a cumulative effect of patches which are put on a very creaky system to try to generate tax take. I think there are always real changes and refinements which are happening every year, they just build on this sort of overwhelming dump of legislation which is imposed on smaller boys.

Q94 Chairman: Ms Upcraft, in your memorandum you say that "there is no doubt", I think I am quoting you, "that the administrative cost has risen in the short term." What evidence have you got to demonstrate that?

Ms Upcraft: I have the evidence of talking to employers and having been one myself until last year and being absolutely certain in terms of the brand-new things we have been operating which are recent, the whole raft of statutory payments which came in last April, in terms of family rights, which were all brand-new. Yes, we have talked about tax credits and Student Loans, National Minimum Wage, the benefits in kind that we have mentioned, all of these are recent, as within the last 10 years' developments, and nothing in my perception has gone away in order to accommodate what we need to. It is interesting we have been talking about PAYE, and I do think that we need to be clear that in tax compliance there are very different taxes that we are looking at here. The financial reporting we were talking about, the rules and the disciplines around that, may well be for corporation tax sensible reporting rules that you would want to follow as a business, but PAYE is a completely different beast. What you need to do to run your business from your payroll point of view bears no relation to your statutory obligations, you would have simply a database of people to whom you paid money. All the other obligations which are built into the running of a payroll are statutory obligations and not just Revenue ones.

⁶ This document *The real impact of red tape: an IoD survey*, supplied by the Institute of Directors, has not been printed. An electronic version is available at www.iod.com.

Q95 Chairman: We are going to look at the PAYE process just a little later on. Your memorandum said, actually, in the last 10 years, is that just an arbitrary period you chose, or was there a survey 10 years ago?

Ms Upcraft: No, there was not a survey 10 years ago. We have chosen not to try to ask our members to quantify this and really to spend our time trying to lessen the burden. If you look just at the timetable, which my colleague here is passing me, various journalists have put together lists of what has been introduced over the last 10 years, and there is no doubt, when you look at that, the volume which has taken place.

Chairman: You are in no doubt about it.

Q96 Mr Walter: I wonder if I could raise with you the whole question of the measurement of the administrative costs of tax compliance. A joint memorandum which this Committee had from the Revenue Departments, Customs and Excise and the Inland Revenue, pointed out, and I am just quoting from them, because businesses do not generally manage their taxation activities in isolation from their other accounts work, reliably estimating tax compliance costs is problematical. They maintain that many costs perceived as taxation compliance are costs which, in fact, would be incurred anyway for financial management purposes within the business. Do you agree with that conclusion? I can see you are not agreeing, Ms Upcraft.

Ms Upcraft: I think it comes back to what I have just said, that it is lumping together what tax compliance is, which is a beast that you cannot put into a global format like that, there are compartments, and PAYE gets ignored as a compartment a lot of the time. It is a fairly soft target. It is an efficient way of gathering in, because the mechanism is there, money which wants to be collected for whoever wants to collect it. I do think we need to keep separate what accountants might be doing under other taxation needs, whether they be VAT or CT, from what is the day job of withholding tax, which is where we started from, when simply it was just tax and National Insurance.

Mr Hamper: One of the schemes we deal with also is the Construction Industry Scheme, which is a bolt-on to the PAYE type of administration. Then you are dealing with the construction industry, made up of many hundreds, I suppose, thousands, of small contractors. Again, if they take on sub-contractors themselves, they are in part of the CI Scheme. The current scheme we think is overly bureaucratic, and certainly that is a burden which has been made worse in the last three to five years.

Mr Brownlee: I have some sympathy for what the Revenue says, and it is almost impossible, I think, to get an objective feeling for what the cost of tax compliance is, whatever tax you are looking at. Therefore, it is almost impossible, I think, to analyse objectively to what extent it has increased over time. Certainly it is an anecdotal feeling in relation to corporation tax, and a lot of the other taxes, that it has increased. I think, if you are looking for objective evidence that actually you can go back and

trace the increase in the compliance problem, it is not there. I think part of the problem is that to collect that evidence would be itself a further burden on business and it is perhaps a Catch-22 situation.

Q97 Mr Walter: Moving on to that, there have been a number of surveys of tax compliance costs. I think the most commonly cited one is Sandford in 1989, and the Sandford conclusions were supported by some research which was published by the Inland Revenue in 1998, which was measuring the overall compliance costs of PAYE and National Insurance. According to that survey, the so-called Bath Report, the compliance costs of PAYE and National Insurance contributions per employee, for businesses with one to four employees, increased in real terms from £147 per employee in 1981–82 to £284 in 1995–96. That was true for companies and employers with up to 100 employees. Over 100 employees, the costs fell. For those with 101 to 500, just quoting the figures in the Report, it fell from £45 to £33, and if you were over 500 employees, from £28 to £23. In your view, have these trends continued, that the burden is increasing on the smaller employer and decreasing on the larger employer?

Mr Hamper: Certainly, exponentially, I think, with the introduction of tax credits, Student Loan repayments, and this sort of thing, there is an exponential increase in burdens there. The whole time, the PAYE machinery is having bits bolted onto it. The Chancellor increased last year the National Insurance rate by 1%. That in itself is another burden. If you have got an electronic payroll and you can administer it then some of the costs are defrayed that way, though you have to buy the software. If you are doing it manually, it is quite a big burden, and there are numbers of small employers who still do payroll manually.

Q98 Mr Walter: Obviously, it is anecdotal, but do you have any view as to the number of small employers who still do everything manually, with those sorts of wads of leaflets and tables, and all the rest of it, rather than now using a system on the PC?

Mr Hamper: It is very difficult to say. We have done limited research in that way, because obviously we are aware that the Revenue want to get e-filing up from April this year, so probably a survey slightly ahead of time will be directed to identify the small employers out there. We think most employers and small businesses of nought to five employees, at the micro end of it, a lot of those are not computerised. I would not like to give any statistics at this stage but perhaps we can come back to you later on in the year.

Chairman: That would be very helpful.

Q99 Norman Lamb: Following up quickly on that. Presumably, as the spread of IT covers more and more small businesses, down to the very smallest ones, there will be overall a saving on that side perhaps to counteract some of the complication that is happening in the other direction. Clearly, the larger businesses have benefited from the

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computerisation of payroll. Surely in time that will spread through more and more to the smallest businesses. Is that a fair point?

Mr Green: The computerisation itself, certainly, yes, but it does require a degree of understanding of the legislation in order to operate the systems.

Q100 Norman Lamb: Is it not contracted out more and more to specialist providers, who can just do it for a fee?

Mr Green: Yes, that does happen, and indeed the Carter Report actually encourages small businesses to look to intermediaries to deliver their payroll requirements.

Q101 Norman Lamb: Can I move on to Regulatory Impact Assessments and ask Mr Brownlee, in particular. The Revenue Departments very much have argued the case that Regulatory Impact Assessments are used to try to ensure that any regulatory change, in terms of tax, is proportionate and that it is not overburdensome, in terms of the impact on business. You have been critical of the RIA process in your memorandum to us and you say that there is not any evidence of these RIAs “having any meaningful impact in reducing the administrative costs of tax compliance.” Why do you think it is not working, and do you want to see it scrapped or improved?

Mr Brownlee: I think the principle of RIAs is very good and it is something, as a concept, we very much welcome. Very often, when we receive RIAs along with legislation, or draft legislation, they can be fairly thin, not really giving a great deal of back-up to the figures quoted. I think probably it goes back to the same issue I talked about earlier on, in relation to the difficulty in establishing the cost of compliance in general. If it is difficult to measure the compliance at the moment then to measure the potential cost of a change is equally quite difficult. Sometimes, for example, the full consequences of a change do not really emerge until legislation has been passed and people actually go through the mechanics of implementing it.

Q102 Norman Lamb: The Institute of Chartered Accountants have told us that they are based largely on guesswork?

Mr Brownlee: That will be for the Revenue to tell you how they come to it, to be honest. Certainly if we are presented with an RIA which says “This measure we estimate will cost business X million pounds” then frankly our response to that has to be based on, perhaps a guesstimate would be a nice way of putting it, but I think it is very difficult for us to form a view as to whether it is a reasonable view the Revenue is taking or not.

Q103 Norman Lamb: As an organisation, do you monitor the extent to which RIAs meet the Government’s own guidance, in terms of what they include within them?

Mr Brownlee: We do not actively monitor that separately from the legislation. We tend to monitor draft legislation and legislation which comes in, but

we do not monitor specifically RIAs. We have fairly limited resources and we have to target them and, to be perfectly frank, we have not targeted them at reviewing the quality of RIAs in the past.

Q104 Norman Lamb: You have criticised the process. What are your proposals for improving it, for making them more robust?

Mr Brownlee: I think it is very difficult to think of a way which would produce a robust system. Certainly, if legislation has exposed it in draft for businesses to look at it, that helps us form a view as to the impact it is likely to have. In terms of the cash cost of complying with that legislation, it is very difficult even for a representative body like us to form a view as to how much that will cost, because the cost of implementing it for one type of business may be different from another, and to extrapolate that up to the whole economy is very difficult.

Q105 Norman Lamb: What about the idea of making the process independent of the department which is introducing the measure?

Mr Brownlee: That may help. Certainly it might add a bit of rigour to the process, but, I have to say, I am not familiar enough with the process the Revenue itself goes through to say whether there would be a benefit there.

Q106 Norman Lamb: Are you consulted on estimated costs and anticipated impacts of changes, particularly with regard to tax, and are any of your organisations here consulted?

Mr Brownlee: I think it is typically the case when draft legislation is proposed that an RIA is attached to that, so, in that sense, we are consulted, but if you do not know how it has been calculated—

Q107 Norman Lamb: You are not consulted before the RIA is produced, you are presented with a completed RIA?

Mr Green: I am sorry, I have to say that I have been, but that has been in my capacity not as a member of the Institute. Also I chaired a British Computer Society’s payroll specialist group, and through that a Revenue statistician has come to me and asked for some information.

Q108 Norman Lamb: Did you get the impression that this was something which was starting to happen on a more regular basis, or was it a bit of a one-off?

Mr Green: That has happened only once. You asked for suggestions to improve them. If we can revisit the RIA once the legislation is in place, to see if they are getting it, or whatever—

Q109 Norman Lamb: How the outcome compares with what was assumed?

Mr Green: Yes, and indeed to learn from that, if there is a large gap between reality and the assessment, to find out the mistakes from that and learn to go forward.

Ms Upcraft: We know that there are very few post-implementation reviews done of legislation, and as a representative body we constantly have to push for those, to say, "Have you gone back to what we believed would be the impact and looked at it and shared with us and talked to us, as the business people, to see if what were your assumptions actually have panned out, given that we aren't often consulted in the construction of those estimates?". If we criticise them in the consultation process, they do not get revised, they are left as they are, and we would very much welcome the opportunity more often to go back to basics and say was this what we expected.

Q110 Norman Lamb: Given that it is often better to stop something that is bad before it happens, rather than try to get it repealed after the event, do you have any prescription for how the RIA process before legislation could be improved, and do you have any view on possibly trying to make it more independent of the department which is seeking to introduce it?

Ms Upcraft: I think independence would help, and I think involving business people in the construction of them, rather than just offering them up for consultation once they had been published, would be very useful. The whole consultation debate is something we have not even touched on yet, but it is a very frustrating area, to be presented with a *fait accompli* and then just be allowed to tinker as opposed fundamentally to using the skills of your industry to try to shape things from the outset and help.

Q111 Norman Lamb: You want to see a much greater involvement before the event?

Ms Upcraft: Working together, yes, indeed.

Q112 Mr McFall: I think, to Kate Upcraft. According to the Revenue Departments, "many of the checks and safeguards which add complexity to the tax system have had to be introduced to deal with tax evasion and avoidance." How much do you agree with that statement?

Ms Upcraft: Again, we come back to the corporation tax versus PAYE, and I would mention, I think, that where there are huge amounts of money at stake, and the corporation tax may be one area, we are looking at tax avoidance perhaps more so than on PAYE. Also I would come back to the business point, that if legislation offers businesses the opportunity to minimise costs then businesses will take opportunities, because that is the way that legislation instructed.

Q113 Mr McFall: There would be less evasion and avoidance if the Revenue did their business better with you?

Ms Upcraft: I think, as we talked about, as Norman mentioned, if we had involvement more up front, we would be able to assist more in the better drafting of legislation, to start with.

Q114 Mr McFall: So evasion and avoidance are the norm?

Ms Upcraft: That is a fact of life.

Q115 Mr McFall: How much is going on, give us a ballpark figure, zero to 100%?

Mr Hamper: I do not think anybody knows. That is a point I was just going to make. There is insufficient research done on evasion/avoidance.

Q116 Mr McFall: Sorry, but Kate Upcraft said, if the Revenue were better, this is in terms of rules, regulations, then there would be less, so you must have an idea?

Mr Green: Can I give you an example. If I wanted to give you £59 in your pocket, and assuming that you are a higher-rate taxpayer, it would cost a business £112.80, that is almost a 100% mark-up, so finding a tax-efficient way, NICs-efficient way, of giving you that money is clearly in the interests of the business to do that. Naturally, businesses will look to achieve that.

Q117 Mr McFall: In the light of what you are saying, I can imply that there is quite a lot of tax evasion and avoidance going on, because it is costing a heck of a lot of money to comply? Somebody give me a figure then, if there is a heck of a lot going on?

Ms Upcraft: There is a difference between evasion and avoidance, as well.

Q118 Mr McFall: Yes, so I want you to categorise it. Take avoidance first and take evasion next, so give us a ballpark figure?

Mr Hamper: I do not think it is possible to do that, quite honestly.

Q119 Mr McFall: We are just into anecdotes then, are we not, anecdotes of the fact that you have got to comply, with an excuse for people avoiding and evading?

Ms Upcraft: It would be very hard to do research though, would it not, to quantify tax evasion and avoidance, to give you an accurate figure?

Q120 Mr McFall: Yes, but we are evidential in this Committee. We do not want you giving anecdotes. That is why I am asking the question.

Mr Brownlee: Certainly, in terms of evasion, if people actually are ignoring the tax law as it stands then adding more tax law onto it is not necessarily going to deal with that problem. In terms of avoidance, I think there has been from the Revenue in recent years a perhaps innocent, perhaps wilful, blurring of the concepts of avoidance and evasion. Certainly a lot of the legislation which has come in, which has introduced complexity into the system, has been introduced by Revenue, they would say, for anti-avoidance purposes. Equally, there are some Revenue people whom I have spoken to who say that the single biggest thing which reduces avoidance, and, for example, when the Chancellor reduced the effective rate of capital gains tax to 10%, there was a significant feeling that avoidance of capital gains tax was reduced by that. To some extent, the complexity

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of the system feeds on itself, and as you introduce more legislation you will introduce perhaps unintended consequences and reduce the tax take by introducing what might be seen as a further tax loophole.

Q121 Mr McFall: If there is an added complexity to it from the Revenue, and there is tax avoidance, or whatever, if you give us some idea then we could have a relationship between the administrative compliance that is required by the tax Revenue and avoidance and evasion? That is what I am trying to get at here.

Mr Brownlee: It can be actually quite difficult, I think, to determine. If you are looking at tax then avoidance is complying with tax law and may be complying in a way which perhaps people did not anticipate at the time the legislation was introduced, but it is legal. I think the difficulty then is, in saying what is tax avoidance, if you have two alternative ways in which, say, a transaction can be treated, both perfectly legal, then who is to say that, by taking the one which produces lower tax, that is tax avoidance? Equally, you could say that is complying with the tax system as it stands.

Q122 Mr McFall: There is evasion and avoidance going on and we are not very sure exactly how much is going on. You have not a clue what is going on?

Mr Hamper: I would like to draw the distinction between evasion, which, in the shadow economy, is illegal, if you like, and avoidance, which is working within the laws as written. The more you write laws the more you create patches on a leaky bicycle tyre, that creates another leak and off you go with another six patches on it. This is what is happening with the law. We are trying to put it in absolute terms, every possible inch of tax take, or pound of tax take, which I think is not possible. The Chinese have a very good proverb, which says "Too many rules, too many crooks."

Q123 Mr McFall: That is why I want you to give me figures on it?

Mr Green: We are very unlikely to hear from any of our members that they are evading tax. They are unlikely to tell us that.

Q124 Mr McFall: But it is going on, it is like an elephant, you can see it yourself?

Mr Green: I am sure it is, yes.

Q125 Mr McFall: Maybe you can come back to us with figures on that. Do you accept that, where continually businesses seek out and exploit opportunities to reduce their tax bill unfairly, the Revenue Departments must protect the Exchequer?

Ms Upcraft: Certainly. I can accept that, but, in doing that, compliant businesses can be severely affected. The Construction Industry Scheme, I think, is a case in point. Has it really tackled the cowboy workers that it was brought in to tackle, whilst putting a large burden on the compliant workforce in the construction industry who were always compliant but have now had to deal with a

whole raft of regulations? One has to look at the proportionality, coming back to the first question, of how one does it and whether really it tackles what it sets out to do.

Q126 Mr McFall: Yes, but if the Revenue do not undertake their duty here, it is really distorting competition against the honest taxpayer, is it not?

Mr Hamper: Yes, indeed. The honest, compliant taxpayers, I think, always resent people that are being the Del Boys. When I talk to Inland Revenue officials about this, the feeling I get, and certainly talking to ex-Revenue officials that are on our side of the fence, if you like, on the professional side of the fence, is that 99% of businesses in this country are compliant. Therefore, you are seeking to achieve, with the scatter-gun approach, a 100% take from perhaps the 1%, that probably you are never, ever going to be able to achieve.

Q127 Mr McFall: Would you agree that businesses also can play a role in reducing compliance costs, and, if you do agree with that, what role can they play?

Ms Upcraft: Yes, they can play a part in reducing compliance costs by embracing technology, by looking to whether they feel that tax compliance is part of their core business, or whether they would be better off using an intermediary service. There are opportunities but also opportunities cost money. Certainly in the payroll arena it is a low-profile, low-spend priority for most businesses to look at that, because it does not add anything to the bottom line. It tends to be legislation which drives people to spend money to make the operation more efficient, or purchase software, or whatever else, because it is not a commercial part of the business.

Q128 Mr McFall: Research shows that the smallest 30% of firms pay around 75% of total tax compliance costs. Why is that, and what can the Government and business do to get that figure down, to get economies of scale?

Mr Brownlee: I think, probably that is just a function of the fact that the larger you are as a company the more likely you are to be able to either employ your own in-house tax specialists or outsource profitably. Probably it is just a fact that a significant amount of tax compliance is a fixed cost and only a certain amount will move necessarily with either the increasing size of the business or increasing profitability. To some extent, it is perhaps a fact of life for as long as you have one tax system for all firms.

Q129 Mr McFall: The Revenue told us that some of the perception of increased compliance costs relating to the tax system relates to measures such as the National Minimum Wage, the collection of Student Loan repayments and statutory payments, like statutory sick pay, which, strictly speaking, are not part of the tax system. Do you accept this distinction, is it a spurious distinction? I do not think you do, by your laughter.

Ms Upcraft: Tax compliance is a subset of Government compliance. The business world comply with tax, they comply with employment legislation, they comply with data protection legislation and they comply with Government legislation. We are looking here today, in isolation, at what the Revenue Departments ask us to do, which is a very small part of what my members have to do as their day job now to comply with what the Government asks them to do.

Q130 Mr McFall: Are there any other points?

Mr Brownlee: I take a slightly different view. I would not view complying with the National Minimum Wage as being part of what I would consider tax compliance. I do not think there is widespread confusion and that people are seeing these and thinking, if you include that with tax compliance there is a growing problem, if you do not then there is not. There may be some difficulties with perception, because so much of this new legislation is administered by the Inland Revenue, which gives a perception of it being involved with tax even when it is not, necessarily.

Q131 Mr McFall: I do not understand the reference to National Minimum Wage being part of tax compliance. Can you explain it to me?

Mr Brownlee: It is not, but I think some people may perceive it as being tax related simply by the fact that the Inland Revenue does the reinforcement, but certainly it is not tax compliant as I would understand the term.

Q132 Mr McFall: Do you agree with that, Mr Green?

Mr Green: Yes, indeed. It is because the Revenue have to police it.

Q133 Mr McFall: Going on to the IT part, the Revenue told us that the greater use of IT, and I quote, "undoubtedly has helped to restrain costs in relation to accounting and payroll." You note in your submission to us that the impact of developments in technology is less marked on the costs of tax compliance than in other business activities. Why is that the case?

Ms Upcraft: It is the point I came back to before, it is a low priority area. Spending money on IT in the payroll is not going to improve your bottom line, so until businesses are forced to do so by legislation they do not embrace it as fully as they would in some of their outward-facing, commercial operations.

Norman Lamb: Surely, that is costs?

Q134 Mr McFall: I will tell you what, if I go into my local garage, the guy who does my servicing, there are four of them work there, he has got a case history of the service he does on my car and he uses his computer to pay staff and do a lot of things, and he keeps telling me, the computer, although it is mucky because of his hands, that it is mucky and magic because it does everything for him. Here we have a small business with three or four people doing that. Why cannot other small businesses follow?

Mr Green: Can we make a distinction between him using that for the whole of the business and using it specifically for payroll and tax compliance?

Q135 Mr McFall: He combines that.

Mr Green: I appreciate that. One of the problems with the IT advances that the Revenue have done actually is in automating a paper system which was designed back in 1944 and is largely unchanged. Later things were added to it, but it is still a manual system and the Revenue will continue to maintain it so it will operate as a manual system. So the advantages that a business would gain naturally by saying "I want to computerise this, let's re-engineer the system," they have not taken, they have merely computerised a manual system.

Q136 Mr McFall: What can the Revenue do then?

Mr Green: They need to bite the bullet, if it was television, and turn off the analogue system.

Q137 Mr McFall: It is the Revenue's fault, is it?

Mr Green: I am sure it is ministers who need to make the decision.

Q138 Mr McFall: But it is the Revenue's fault, it was their situation with small businesses not being able to take advantage of IT?

Mr Green: Yes, they need to make the decision to do away with the manual system, and if we are being driven to electronic filing then they should bite the bullet and say that they expect all employers to have a computerised system.

Q139 Mr McFall: Why does my little guy at the garage feel it is magic to have this computer which helps him, he tells me it helps him?

Mr Green: I am not disputing that it is magic, and if people embrace it and they can use IT for the whole of their business it will be useful.

Q140 Mr McFall: What we are trying to get to here is, we had the Revenue people before us and this matter came up, it has not come up in your submissions to us, it has just come up in the questions, and I want to find out if the Revenue have got to do something on this, because if they have to then we could incorporate it in the report. Could you give us further information on that so maybe it could help us come to a conclusion on this, because obviously we will write to the Revenue and ask them if what you said has some authenticity about it?

Mr Green: Now, or would you like me to write to you?

Q141 Mr McFall: Could you write to the Chairman afterwards?

Mr Green: Yes, certainly.⁷

Mr Hamper: Could I pick up a point on that. The Revenue at the moment are paying, if you like, for people to sort out their payroll electronically, and that is being introduced at the small business level, £250 a year, taking away the gross sum of £825. To

⁷ See Ev 110

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a certain extent, I would have thought a better use of that sort of money would be perhaps to buy PCs, which you could probably pick up for about £350, or something like that, already pre-loaded with Inland Revenue software, and give them to small employers. Obviously, that will have ramifications, but I would have thought that was a way of targeting small employers. We do not know how many out there will not computerise, do not computerise, cannot computerise. Those that do computerise and use them, yes, they are magic. There is an awful lot that will never computerise until perhaps you have got another generation behind you, youngsters at school who have grown up with computers.

Q142 Mr McFall: The Government already gives £250, so that would buy the computer. What you are suggesting to us is that the Revenue could supply software so that small businesses could comply?

Mr Hamper: I think that would be a step forward, then you have got an initial capital cost in year one and perhaps you have got to tweak your software the following year and there is an add-on for that. Why should not the Revenue provide that, it is in their interests to get it right?

Chairman: I want to turn now to VAT.

Q143 Norman Lamb: We are told by Customs and Excise that something like 250,000 businesses out of the 1.7 million on the VAT register have chosen to be VAT registered without actually having any tax repayment benefit. Why is it that so many businesses choose to be registered without gaining a benefit from it?

Mr Hamper: It depends on who you are dealing with in the business sector. If you are making supplies to other registered traders and you are providing a mixture of goods and services, it is very much in your interests to be registered for VAT because you will recover your VAT on your inputs while charging it on to a registered trader who can recover that in output terms.

Q144 Norman Lamb: They are saying that these are 250,000 businesses, VAT registered with no tax repayment benefit?

Mr Hamper: They would not necessarily be repayment. They would be paying net output tax, so they would be making a cheque to Customs and Excise for the net output tax. They would claim their input tax and then value-add it, of course. That is why it is in their interests, if they are providing goods and services to other registered traders.

Q145 Norman Lamb: Mr Hamper, you put in your memorandum that for small businesses that are required to register they have a general impression that, and I quote, "the tax is generally administered with a reasonably light touch." In terms of compliance costs, is VAT less of a problem than other taxes which businesses are required to face?

Mr Hamper: I think our perception is, we had asked our members that and most people do not seem to have a quarrel with VAT. The early days of VAT, where the VAT inspector was considered to be sort of an ogre, I think, have long since gone.

Q146 Norman Lamb: The paradox is that VAT legislation and case law actually are very complex. Why is it, do you think, that businesses have less of a problem with VAT than with other taxes?

Mr Hamper: Because, again, I think probably the large majority of business transactions are straightforward and usually it is legislation-driven and case law-driven when you have got the complexities of the case. When VAT came in, in 1973, it was a very simple tax, it was known in the accountancy profession as the Cinderella tax, because there was not really much in it for accountants. With the passage of time and obviously wanting to deliver Government objectives, there were concessions and changes in rules, and this sort of thing, which has made the tax now a very, very complex tax. I think, again, by increasing complexity, sometimes you deny the opportunity to take tax.

Q147 Norman Lamb: Yet your members find it a reasonably straightforward tax to deal with?

Mr Hamper: As I say, 95% of the business transactions are straightforward transactions.

Q148 Norman Lamb: Is it simply because of the nature of the transaction, they are very different from payroll taxes, for instance, or do you think there are any lessons to be learned for other taxes from the experiences with VAT?

Mr Hamper: I would like to have been able to say that VAT today is a simple, straightforward tax, but unfortunately it has been complicated over the passage of time, and it seems to be driving itself more and more in the direction of direct taxes, which are highly complex. I think there are lessons to be learned from value added tax.

Q149 Norman Lamb: You think that the compliance cost problems are increasing with VAT, do you?

Mr Hamper: Again, at the periphery. There are certain particular parts of VAT legislation which are highly complex. There is what is called partial exemption, you have also got the construction industry, VAT on property, land and property and construction, which are very, very complex areas and really are outside the knowledge of most small businesses. I think usually there is quite a lot of tax at risk in that area on large developments, this sort of thing. I will defer to other people on that point.

Q150 Norman Lamb: If I could turn to Self-Assessment. The evidence from both the FSB and the Institute of Directors is critical of Self-Assessment and the suggestion is that all the benefits of it have gone to the Treasury rather than to the businesses having to deal with it. The Revenue, on the other hand, believes that view neglects the fact that Self-Assessment has swept away a very

burdensome, old system of estimated assessment and appeals. Do you accept that some aspects of the change have worked in businesses' favour? Perhaps Mr Brownlee, to start with?

Mr Brownlee: I think most of the benefit unquestionably has fallen on the Revenue. Although we raised it in the memorandum, certainly it was not intended to be a criticism of Self-Assessment as such.

Q151 Norman Lamb: So you support Self-Assessment?

Mr Brownlee: Self-Assessment, actually we do not have a great deal of objection to the principle, but I think it is undeniable that the benefit in administration has been primarily to the Revenue rather than to companies. It is true that under the older system you would have assessments, I think it could be quite problematic in some instances. My feeling was, when I was in practice, that those companies which used to have the administrative burden under the old system, the pay and file, are now more likely to be inquired into under Self-Assessment than those which had a fully straightforward pay and file position or, more likely, not to have inquiries. So I do not think, from that perspective, there have been any perceptible savings to business.

Q152 Norman Lamb: Do you have anything to add to that, Mr Hamper?

Mr Hamper: Yes. I am talking about personal tax here, Self-Assessment, as opposed to corporation Self-Assessment, if you like, which is a different angle. The old system did not work because it became a very loose system of assessments, which were driven by the Revenue, appeals procedures, and this sort of thing. Having been a practitioner for 30 years, I felt that if the rules had been much more tightly enforced, after the Keith Committee Report about direct taxes, that in itself would have tightened up the old Schedule D system of raising assessments and getting them right the first time, by forcing people to comply with the taxation. Because it did not work, Self-Assessment was introduced, the taxpayer was the driver on that side of it. From my point of view, it has not helped at all. It has driven most of the benefits to the Inland Revenue, except we have both got this compliance burden of my profession, and I speak from personal experience. The rush up to 31 January is horrendous, it knocks out most of my staff. A colleague of mine last week said he resents having his liberty taken away from him in January. He used to go to Barbados or skiing in January, he is a chartered accountant, now he goes nowhere.

Q153 Norman Lamb: We are expected to feel sorry for him, are we?

Mr Hamper: No. I was just trying to give an illustration there. Equally now the Revenue staff have got this problem and burden of sorting out the Self-Assessments. They are computerised but still it means that their troops at the coal face have got to sort out all the junk that has been coming down to them over the last few weeks from our side of the

fence, and that seems to me to be a rather inefficient use of resources. You have got a bunching, pre-31 January, in the business community, and you have got a post-31 January bunching in the Revenue, where they have got to dragoon their resources perhaps off other compliance issues to tackle this.

Q154 Norman Lamb: How would you address that?

Mr Hamper: The Fed. mentioned in its submissions last year one way to address it. If you take most small businessmen, the only sort of income they have got is Schedule D, they may have little bits of building society interest, which is taxed at source, but most of their other sources is quite small. If you were to drive the tax return from the basis of filing within 10 months of your accounting year end, so if you had a junior end you would file by the end of April, this would cause a smoothing effect, although probably now most small businesses are going to 31 March, for other reasons that were driven by Self-Assessment changes. Assuming that most small businesses are still throughout the year then I think there would be a smoothing of returns being filed.

Q155 Norman Lamb: Tax credits. The Revenue has said that the research they have done with employers, and I quote, "has suggested that they do not find it difficult to operate tax credits." Is that a view which you accept? That is to Kate Upcraft.

Ms Upcraft: It would have been the case if what was due to be delivered last April had been delivered, in fact. Because the IT system to support the 'payment via employer' regime, which is what our members have to operate, was not robust when it was launched, it has been a very difficult year for employers to try to get money to claimants, the 1.5 million people that we are paying through the payroll.

Q156 Norman Lamb: Is there any sign that is improving now, or are the problems continuing at a high level?

Ms Upcraft: The problems are continuing. There is a slight improvement but we remain very concerned about what will happen in April when we get to the first renewal and reconciliation process and how that will impact on employers. We feel that last year might have been a piece of cake compared with what we might be facing in the year ahead.

Q157 Norman Lamb: Do you think the IT still has not been properly or adequately sorted out?

Ms Upcraft: It is a different IT release now. Obviously, we are moving from the first year of payments to a new piece of software which is in place to deal with renewals, so we have to wait and see and hope that the confidence which the Revenue have is well placed.

Q158 Norman Lamb: Fingers crossed. In terms of steps that can be taken to reduce administrative costs, are you satisfied with the efforts that the Revenue Departments are making generally to reduce the cost of tax compliance? I do not expect

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you all to answer that, but do you think that enough is being done, in other words, by the Revenue Departments?

Ms Upcraft: We feel that a lot of initiatives which are being launched at the moment are, to us, very one-sided. They appear to deliver significant resource savings for central government but we do not see them as win-win situations for employers. Just to give you a small example, we go live this tax year with the requirement to pay our remittances electronically for large employers every month to the Inland Revenue. When we say, by the same token, presumably, payments coming out of the Revenue to us that we are due, repayments, compensation, will be paid electronically, we are told, "No, we don't have plans to do that at all." So we have to comply, for reasons which we quite understand, of security and flow of funds, but we do not see it being a level playing-field and where we have imposition we see that there should be a similar win for business.

Q159 Norman Lamb: That is one suggestion you have put forward which would ease the burden for businesses, but if you had to put forward perhaps two or three suggestions of the most significant steps that could be taken to reduce the administrative burden, what would you put forward? Just moving on to generally reducing the compliance burden of tax, what do you see as the most significant steps which could be taken to reduce that burden? It may be that it is something which relates to tax credits.

Mr Hamper: That is part of the bolt-on. I think, wherever you look, there have been bolt-ons, and really you have got to look at the whole field of payroll accounting and burdens there and look at what can be removed, almost sort of onion-skin, layer by layer, I think, on that. There is no one specific thing you can do to slim down this rather large, creaky machine.

Q160 Norman Lamb: Are there any other suggestions, key changes which can be made? You all sit there and complain that the compliance burden has gone up, but we need to hear suggestions from you about how things could be improved, so it is your opportunity?

Ms Upcraft: Do something about statutory sick pay. It has been in for 20 years, it is largely unaltered and it delivers nothing for employers. They get no money back for administering it and we run the scheme for the odd few people who transfer out onto incapacity benefit. Why not move to National Minimum Sick Pay, like you have National Minimum Wage, allow business to work to rules which say "This is the level of sick pay"? Rather than have a huge mechanism in place to run what is called a statutory sick pay system, rules largely not understood, particularly by small employers. I think probably Mr Hamper will agree, it is one of the most complex areas for small business, trying to understand that. Because the policy for SSP sits with one government department and the implementation sits with another, that fundamentally will be one of the big wins for me. Look at the departmental divisions of policy versus implementation, so that actually we can see where it

is worth a department pursuing something, because not only do they own the policy but they want to deliver the implementation.

Q161 Norman Lamb: That is a very helpful suggestion. On dealing with National Insurance, are there any measures which could be taken, particularly with small employers perhaps, for reducing the administrative burden? I am not sure of the details but I understand that with VAT there is some scheme for small employers whereby you can pay an amount rather than having to go through complex calculations. With National Insurance, perhaps with temporary employees who come and go and for each one you might have to make separate calculations, is there any way of having a scheme whereby employers could offer to pay a set amount in respect of those marginal cases to avoid the costs involved?

Ms Upcraft: Fundamentally, that comes back to cumulative tax, having one tax as opposed to two separate ones, one that is pay period and one that is cumulative.

Mr Green: Or at least have National Insurance cumulative. There is a big difference between income tax and National Insurance, as employers have to get National Insurance right. Income tax, the PAYE system is designed for employers to collect it roughly correctly and the Revenue then sort out the precise figures at the end. We do not have that in National Insurance, the employer has to do it exactly. If we had something, as you are suggesting, which matched the basic rate income tax which an employer has to apply if he takes somebody on and does not know their tax history, a simple figure to operate, that would make it much easier for employers.

Mr Hamper: One thing, really. I tend to regard National Insurance as a piggy-back tax. National Insurance provides benefits so it has got to be contrasted to tax, which is the Exchequer raising, if you like. The National Insurance scheme provides benefits, it has its own rules for contribution payments and the payments of benefits. Piggy-backed onto that is sort of direct taxation itself, where it will increase by 1% employers' National Insurance, for example. What would help enormously would be perhaps if National Insurance could go back to being what it was, I know this is a prayer from on high, go back to being a National Insurance contribution and the rest of it bolted back on to the direct tax system.

Q162 Mr McFall: We are in dreamland?

Mr Hamper: Indeed, but you asked for our views and I think those are our views. I do not think I would like to bolt the National Insurance entirely onto direct tax, because there is that concept that you contribute for benefits.

Mr Green: Yes. On the other hand, we have now seen National Insurance, the contributory principle, move away from actually having to contribute. Your entitlement to benefit starts when you reach the lower earnings limit, you do not contribute until you reach the employer's earnings threshold.

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Q163 Norman Lamb: Yes, so the link is broken there?

Mr Green: Yes.

Q164 Mr McFall: Can I ask, have you made some of these representations to the Inland Revenue already on these particular points?

Ms Upcraft: Yes.

Q165 Chairman: I just want to pick up, finally, the point on electronic filing which Mr Green made. Do the Federation and the other Institutes support that, that the Government should bite the bullet and move towards electronic filing for business, as you said, switching off the equivalent analogue?

Mr Green: For clarification, the Revenue has said electronic filing is coming, it is large employers the next tax year, medium-size employers the following year and then, presumably, 2009–10, all employers, apart from those who can object on religious grounds, I believe.

Q166 Chairman: Your point was, that should not proceed, or that it should?

Mr Green: That is happening, as far as the ‘end of year’ filing requirement, it is electronic for everybody. If then we are assuming that employers

have to file electronically, why not assume that they operate a computerised payroll system? In that case, we should get away from having what the Revenue have done, which is merely to computerise the existing manual system.

Q167 Chairman: Do the Federation and the other Institute agree with that?

Mr Hamper: I think, the present PAYE system operated by the Revenue, the machinery is so old it is in danger of falling over through ill-health and old age. Really I think they need to get their own IT sorted to provide the service which they expect us to provide to them.

Mr Brownlee: That specific point is not something that we have discussed in any depth with members. We tend to prefer incentives for companies to change behaviour rather than to mandate them, but it is not something I have covered specifically with members.

Q168 Chairman: Our hour is up. Thank you all very much for attending. We look forward to receiving the latest research, if that could be forwarded to our Clerk as soon as it is available?

Mr Hamper: Yes; absolutely.

Chairman: Thank you very much.

Wednesday 25 February 2004

Members present

Mr Michael Fallon, in the Chair

Mr Nigel Beard
Angela Eagle
Norman Lamb
Mr John McFall

Mr James Plaskitt
Mr David Ruffley
Mr Robert Walter

Witnesses: **Mr Nigel Eastaway**, Chairman, Technical Committee, Chartered Institute of Taxation, **Mr John Whiting**, Tax Partner, PricewaterhouseCoopers, Chairman, Tax Policy Sub-Committee and Past President of the Chartered Institute of Taxation, **Mr Robert Maas**, Member of the Tax Technical Committee, and **Ms Anita Monteith**, Consultant to the Tax Faculty, Institute of Chartered Accountants in England and Wales, examined.

Q169 Chairman: Could I welcome our witnesses? Would you please introduce yourselves?

Ms Monteith: I am Anita Monteith from the Institute of Chartered Accountants of England and Wales Tax Faculty.

Mr Maas: Robert Maas. I am also representing the ICAEW Tax Faculty. I am a partner in a firm of chartered accountants and most of my experience is in small businesses.

Mr Whiting: John Whiting, representing the Chartered Institute of Taxation; also a partner in PricewaterhouseCoopers. I suppose I represent the large firms.

Mr Eastaway: Nigel Eastaway. I represent the Chartered Institute of Taxation as chairman of the Technical Committee.

Q170 Chairman: The Revenue departments told us right at the outset of this inquiry that recent contacts with UK business organisations reinforce the view that the documentation needed for tax is generally needed for commercial purposes and indeed the discipline imposed by tax is seen as beneficial to the business. What is your view on that?

Mr Maas: Surprise. Most of the complaints are not about having to do accounts, which is what you need to run the business, but about having to do compliance work in order to comply with the specific tax legislation.

Mr Whiting: I would echo Robert's surprise. I go with the Revenue's comments to a certain extent because obviously there is a great deal of cross over in what is required commercially as against what is required for tax. Undoubtedly, there is work required for tax, whether you are looking at the obligations for the employer or, to talk of one thing that is currently under discussion, the changes that we have afoot on transfer pricing and capitalisation which will undoubtedly see businesses having to do things just for tax purposes that they would not do commercially.

Q171 Chairman: Does the proposition that there are benefits from the tax system for business mean that there are overall benefits?

Mr Whiting: I suppose you have to accept that if the taxman is happy with the business that gives it a certain ring of veracity, whether you are talking to

the VAT man or the Inland Revenue. I could say that auditors also provide that function. I think you would find most businesses saying they could get along perfectly well without having to report to the taxman but they do realise that they have to do it from time to time.

Q172 Chairman: Robert Maas, back in 1999 you said that Britain's tax system had become detached from the principles of good revenue raising and was run increasingly on lines that suit the convenience of the Treasury, the Inland Revenue and Customs and Excise rather than that of the taxpayers. What did you mean by that?

Mr Maas: I have not got a clue but I would probably say the same thing still. I probably meant that when new legislation is introduced very little thought seems to be given as to the administrative effect that legislation is going to have on taxpayers and their advisers. This is particularly true with Inland Revenue legislation. When we have had discussions with the Revenue on new legislation they never bring anybody along from their compliance division. You are talking to the policy people and compliance is looked on as an utterly separate issue to be dealt with after legislation has been enacted. By that time, it is much too late to get the administration right because the administration is determined by the legislation.

Ms Monteith: We have had two very good examples of that in recent years. The first would relate to income tax self-assessment where the tax calculation form, if you were to work out your own tax, has been designed primarily so that it is acceptable to the Revenue's computer which makes it terribly difficult for anybody trying to understand how their income tax payable is calculated and almost impossible to follow through. Another very good example more recently is tax credits. We have had numerous discussions on the policy side and the Revenue are now being very helpful, together with the Tax Credits Office, in trying to iron out the problems that we now see with delivery of tax credits and practical problems. It is being done after the event. Had the system been properly thought through in a practical sense in advance, we would not have seen nearly as many problems as we have.

Q173 Mr Ruffley: I think it is your paper where, on the working family tax credit point, you refer to employers being made into unpaid benefit payers. I intuitively think that is wrong but can you quantify that for us? Small or medium sized business? You tell me the assumption is the number of employees—say, 50. What kind of cost is that adding annually?

Ms Monteith: I cannot quantify it because the system is not yet completely in place. All we have seen so far is the first phase of the tax credit system being introduced, whereby people are being paid amounts based on estimates. Already, you would expect with six million people in the tax credit system that a large number of those will be employees. Somebody has to physically put through the tax credit award. I do not know how long that takes. It would be very interesting research if somebody were to commission it, but I think we will see a lot more problems at the end of this year when the renewals process begins. It is not a simple system to understand and I think it is the employer that an employee would go to first to get a better explanation of the paperwork that has been sent to him.

Q174 Chairman: Is that the end of this fiscal year?

Ms Monteith: Yes. It will start in April and run on for several months.

Q175 Angela Eagle: You were trying to describe a system by which you could have pre-cooperation between those who are going to have to comply and the people who are collecting tax in order to introduce something that is as convenient as possible for everybody. That would lead to it being a much longer process to make changes to the tax system and presumably there would have to be some kind of joint committees that would look at the practical issues of how to do it. How do you see that structure? What would be an ideal structure for you to create in that circumstance in order to make tax changes as practicable as possible? There are two sides to that coin because it would take beneficial changes as well as changes that you may regard as not beneficial at all much longer to evolve through the system and be able to be introduced.

Mr Whiting: Your point is absolutely correct. It might take longer but good consultation—and to be fair there is a lot of good consultation that happens at the moment—does take time, but the result is better, more practical law. It is happening to a large extent at the moment and very often the things that create the worst administrative burdens or cause the problems afterwards are the ones that are rushed through because there just has not been time to sort out the practical wrinkles. You ask how would all this be supervised or controlled. There is at the moment a code of practice on consultation which to a certain extent governs this. I would take it a little further and put in a modest proposition of my own for what became known as a sort of Tax Practice Committee, which could be an all party group—it depends how far you would take it—involving members of the profession, industry and everybody that had oversight of the administrative

development of the tax system. You can develop this as much as you would wish. It might be a body that worked in parallel to the existing Tax Law Rewrite looking at the language of the tax system, but to have a body charged with the oversight of the development of the tax system administratively that had possibly oversight of the consultative process I think would be a positive step. It would not handicap the tax authorities from taking action quickly if they needed to because it could be announced that something will apply but there would still then be time to do some of the administrative working out as to how it would apply.

Mr Maas: I think your assumption that it will take a lot more time and delay legislation is not right. I think the problem is that the Revenue do not look at administration at the right time. If, when they put out a consultation document, they said at that stage, “We must involve people in compliance as well as involving people from policy” what you would get is that the problem would be identified at the stage where legislation is formulated. A lot of the problems simply would not happen. These problems do not happen because everybody is deliberately building problems into the tax system. They happen because nobody thinks of what the problems are going to be. If people thought much earlier about how they were going to administer this tax rather than just getting the framework in place, it would not take much extra time.

Mr Eastaway: Self-assessment is an interesting example because there was a lot of very good discussion through the Revenue’s hosted self-assessment consultative committee. That was almost entirely devoted to policy matters. When things like the statement of account were first produced and most of the members on the non-Revenue side were having difficulty in understanding what it was supposed to be, we were told that it was already cast in stone as far as the computer was concerned and no changes were possible. It is this difficulty of liaising between the policy makers on the one hand and those who have to work the system on the other.

Q176 Angela Eagle: Do you accept that if you were trying to do that you would have to somehow separate your opinions about policy from the administrative practicalities of putting into effect a tax change that perhaps you did not like, because clearly you have to be able to separate the two in order to achieve administrative savings without presuming to change policies that are decided elsewhere?

Ms Monteith: Yes, I would agree.

Q177 Angela Eagle: Do you think that is possible?

Ms Monteith: It is possible. An example with tax credits is the role of people like us, the agents, in the tax credit system that has not been thought through in advance. When the computer system was built, nothing was built into it to link up with something. You have a special form which allows you to talk to the Revenue about income tax matters but there was

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nothing equivalent built into the tax credit system and that has caused a huge amount of wasted time. That is an administrative issue. There is no policy.

Q178 Chairman: Robert Maas, I read one of your quotations probably very unfairly from back in 1999 but that was five years ago. What is your view on the change in the administrative cost? Which aspects of the tax system do you think have become more burdensome? Do you think the burden has increased?

Mr Maas: Inevitably, the legislation has become a lot more complex over recent years, whatever the reasons, and complexity itself has to bring administrative costs with it. It is hard to separate out. The Inland Revenue and Customs and Excise lean over backwards to try really hard to explain the taxes and to help people to comply. I am not sure to what extent that is the real issue because the reality, particularly for the small business, is that as things get more complex people want to get on running their business rather than trying to understand the tax system. However helpful the Revenue and Customs are, people feel a need because it is a complex system to turn to outside advisers and that is where the costs really start to mount up when people are forced to buy in advice.

Mr Whiting: I think the honest answer is we do not know the costs of administration. In my own particular practice area of employer/employee issues, there was a study done some years ago by Bath University which was very telling. My perception is the costs would only have increased over the last five to ten years simply because of the additional burdens the employer has to undertake to comply with the responsibilities. It might be very telling to undertake a similar study today.

Q179 Chairman: In your evidence you have not just suggested we carry out another study. You have helpfully suggested a conclusion for us: that we endorse the proposition that the tax system has imposed a disproportionate burden. Do you think there is evidence that the burden is disproportionate?

Mr Whiting: Looking at it from an employer's point of view, many small and large employers would start to say—and I suppose if I am being fair not just purely tax, because it depends how you could such things as statutory maternity pay, sick pay, national minimum wage and, one might say, which side of the fence do tax credits fall on—that the additional burdens that are falling on the employer are arguably disproportionate to the basic compliance responsibility that an employer should have and needs to have for their employees' tax affairs.

Q180 Mr Walter: Customs and Excise and the Inland Revenue sent a joint memorandum to the Committee for this inquiry and it says, "Many costs perceived as taxation compliance costs are in fact those which would be incurred anyway for financial management purposes. Because businesses do not generally manage their taxation activities in isolation from their other accounts work, it can be

difficult for them to determine where activities are solely related to taxation . . .". What they are telling us is that reliably estimating tax compliance costs is problematical and they maintain that many costs perceived as taxation are those that would be incurred anyway. Do you accept that?

Mr Maas: No. It may be confusing two issues. If you look at where the costs arise, the costs arise to a degree in day to day administration like a lot of the costs imposed on employers arise in having to change their payroll systems and all of these sorts of things. A much bigger chunk of the costs arises in employees who are a bit lost as to understanding the system. That is a hidden cost that Customs and Excise and the Revenue do not build into their figures at all. The reality is that, from the point of view of staff relationships, employers want to help their staff to understand their deductions. That is very heavily burdensome. The other big area, and perhaps the biggest, area of cost for the small business is in the context of the impact. A very good example of this is VAT. Most small businesses, when they do their monthly VAT returns, the cost is not huge if you have bookkeeping systems. The problem comes when they want to do something a little out of the ordinary because the penalties for getting it wrong are so draconian that they are virtually forced to go and buy advice on these things. When the Revenue and Customs look at costs, what they are actually costing is the day to day costs, whereas the much bigger part of the costs is the cost of seeking advice on specific areas.

Mr Whiting: Could I give a separate example, which is capital allowances? I agree with the Revenue and Customs contention up to a point because if a business is thinking of capital investment it is going to go through a certain number of routines, but because of the capital allowance systems and indeed because of some quirks in the VAT recovery system, a lot of their evaluation and decisions on this will be influenced by tax treatments. So there will be some extra work to go in to decide exactly what and how they will buy, when they will do it, lease versus buy, all influenced by tax. How much of that they would go through anyway and how much of it is definitely driven by tax is very hard to say. At each of those stages and then into the recording when they have to keep records separately to calculate the capital allowances, in some of it, there is undoubtedly an additional burden because of the way the tax system is there. If, for example, we just had tax deductible depreciation, that would undoubtedly save a great deal of work when it comes to capital investment.

Q181 Mr Walter: The accounting standards for depreciation are not the same as the capital allowances, so you are saying there are two parallel sets of books.

Mr Whiting: In effect, you have two parallel sets of books, tax depreciation versus accounts depreciation. There are some good reasons for that because of the investment incentive nature of many of the capital allowances, but from the Inland Revenue and the Customs point of view, yes, I agree

with your point, but my point is that I am afraid the tax system does impose extra routines, extra records and extra work in that particular area.

Q182 Mr Walter: Can I move to the disproportionate effect this burden has on smaller businesses? If I go back to the submission that Customs and Excise and the Revenue made to us, they quote, "The most commonly cited tax compliance costs survey is Sandford *et al* (1989) . . ." and they go on to talk about the Bath research project in 1998 which you referred to. According to the Bath report, the compliance costs of PAYE and National Insurance per employee for a business with one to four employees increased in real terms from £147 in 1981–82 to £284 in 1995–96. Over the same period cost per employee for businesses with more than 100 employees fell slightly, from £45 to just £33. Have these trends continued with a widening gap between small and large employers?

Ms Monteith: I was involved in the research in the Bath project. I think it is almost a trick question because we can only give anecdotal evidence. The work does need to be redone in some way. I would suggest that it is done on a much more condensed scale. You could look at particular hot spots that were identified without having to redo the whole project again. The anecdotal evidence we have is that there are still big problems around things like casual staff who are brought on to payrolls for a short period of time. I am sure the costs of that type of employee will have gone up just because the tax law has continued to get more difficult. You have to be very careful now when you take somebody on your books. You need to know whether they are an employee, whether they are self-employed and what the ramifications of that are going to be.

Q183 Mr Walter: Would that affect smaller businesses rather than larger businesses or would it affect them all?

Ms Monteith: I think larger businesses have better access to professional advice. The people they employ to run their payrolls know what they are doing. If you take a pub, for example, the landlord is already working through until 11 or 12 o'clock every night and yet, because of the margins they have, they cannot afford to employ a qualified person or somebody that might know the detail of how you deal with casual bar staff or a student that you take on for a couple of weeks in the summer. That sort of information is very easy for people like us to come by because we know what we are looking for and what we are doing, but for a very small employer who has no time it is an additional burden and I think it has become more difficult for them.

Mr Maas: One of the obvious things is computerisation because it is clearly a lot cheaper to run a payroll for 100 people than for two people. It is not economic in most cases at all to do it by computer if you only have two staff.

Mr Eastaway: I suspect that the cost per head is coming down for the substantial employers because of the increasing sophistication of the computer back-up systems they have; whereas it is going the

other way for the small employer with three or four people where he now has to cope with things like student loan repayments, statutory sick pay, maternity pay and things like that. It is getting more difficult and more expensive at the smallest end, the benefits of knowing the problem and the answer of it are not there and the computer back-up is not appropriate.

Q184 Mr Walter: I suspect the answer to the question is yes.

Mr Whiting: I think we would say yes.

Ms Monteith: It would have been made worse by tax credits because at the smallest end you are going to find people being employed on the smallest wages usually.

Q185 Norman Lamb: Going on to the process of creating new legislation on tax and in particular the issue of the regulatory impact assessment, both institutes in the submissions have been critical of the way the system works at the moment or the inadequacies of it. Mr Maas, you said that they are partial and appear to be merely a best guess of the costs involved. Mr Whiting, you have put forward a suggestion that the Chancellor or sponsoring minister should be required to confirm that the provision will reduce the administrative burden on business and if it is not the case to explain any increased burden and explain why it is justified. What evidence do you have that it is not working well at the moment and do you have any other recommendations for how it can be improved and made more robust?

Mr Maas: I am not sure we have specific evidence. We are puzzled that we have never seen a regulatory impact assessment where we think the costs to the employer or the costs to the taxpayer have been exaggerated. We have seen an awful lot where we think they have been significantly under-estimated. I do not know what the answer is. Both the Revenue and Customs have said to us they do a lot of work to get it right, but they have never sought to explain to us the underlying methodology. That may be the problem. It may well be that the things they regard as costs are different to what we regard as costs.

Mr Whiting: I would echo everything Robert has said. One can come up with the example of the recent stamp duty land tax where there was very little effort at regulatory impact assessment but it is only when the forms start to come out, with the additional bureaucracy that is required, when you start to realise the additional costs. It may seem trite to say that one self-assessment form has to be filled in, but it does have to be filled in. Somebody has to do it and potentially somebody has to pay somebody to do it. All this extra burden comes along and I stick by what I put in the submission I helped write, which is that it would be a good challenge to the Chancellor or sponsoring minister to confirm that this is not going to add unnecessarily to the administrative burden. Fundamentally, I am saying recognise that any tax measure has two costs. There is the value on the cheque that you write and the cost of all that has to go in to decide that figure and hand over the cheque.

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Q186 Norman Lamb: How do you feel about some measure of independence being introduced into the regulatory impact assessment process, because it seems to me that whilst it is being done by the department that wants to introduce it it is likely to be self-serving. Do you see any merit in looking at some sort of independence introduced into the process?

Mr Whiting: Very much so. It could only be positive. One assumes you might be thinking about the National Audit Office or something similar and I know the Chancellor has asked the National Audit Office to look at the current pensions proposals. It is all about the independent view which I personally think would be constructive.

Mr Maas: I am not sure it would be cost effective on a general basis but it would be very interesting if the NAO were to take one or two RIAs and say, "This is what the Revenue initially produced. How accurate was it?"

Q187 Norman Lamb: It is looking back after it has been introduced to see what the impact has been which does not happen at the moment.

Mr Whiting: Yes, which would be interesting. In a sense, it is two separate exercises but it would be interesting to look retrospectively, to build up a body of experience as to how well we are doing.

Q188 Norman Lamb: Again on the process of introduction of new legislation, are you consulted on the estimated costs of the anticipated impact of tax changes? I am thinking in particular of the nought rate on corporation tax and the consequent problems that have occurred over IR591. Is there a process of consultation?

Mr Whiting: Sometimes. We have alluded to consultation already and to be honest the consultation is usually in terms of the measure of the technicality. One tries to put in comments on the administrative impact but perhaps the focus is primarily on the technical working or not working. We will always express a view when we are responding to consultations as to the administrative burden this creates and whether fundamentally it is workable.

Q189 Norman Lamb: Had you been consulted on this 0% business, would you at that time have recognised what the implications of it were?

Mr Whiting: We did. We were not consulted prior because it was a Budget day announcement but in the submissions we made—and I suspect most professional bodies made—we pointed out precisely what was going to happen. There is a strong element that we are tempted to say, "We told you so."

Q190 Norman Lamb: Now we have the new tax complication in a sense to try and address the problem.

Mr Whiting: Yes.

Mr Eastaway: Although we do not know what it is because there has been no consultation on it.

Mr Whiting: We have not been consulted on the solution. We are expressing suggestions and views but we have not been consulted, even though one might say that the solution is to remedy the original cause of the problem.

Ms Monteith: Earlier this year, we saw an example of a practical problem that has come out of the 0% rate of corporation tax, where Customs and Excise were unable to meet their own turn around times for new VAT registrations. That was caused by people incorporating and so requiring new VAT registrations in much larger numbers than usual and Customs had to put a note on their website apologising for the delay, which I believe was running at about six to eight weeks at the time, which was another administrative cost passed to the taxpayer and we had identified that in advance.

Mr Maas: This is very serious, not simply on the costs, but what seems to happen is that the Treasury are not looking at the knock-on effects of what they are introducing. The administrative burden and delays created by suddenly unexpectedly finding an administrative burden have risen and cause huge problems for business.

Mr Eastaway: It is an interesting example because the tax system is obviously used in many ways to influence behaviour. A zero rate of corporation tax obviously influenced the behaviour of a vast number of businesses incorporating. There is an administrative cost for incorporating, getting everything reprinted, new systems and things like that. Now the goal posts are apparently to be moved, there may be lots of businesses that would rather disincorporate and go back to being partnerships or sole traders. That in turn is going to have some considerable administrative costs and indeed, under the current legislation, there could be substantial tax costs of doing so. We have just put in a paper suggesting that there ought to in equity be some roll over provisions for disincorporation in the same way as there are for incorporation for those who have made the wrong decision because the playing field has been de-levelled again.

Q191 Mr Ruffley: Apart from the transitional costs of going back and disincorporating, you seem to imply there could be other tax nasties lurking there. Could you give an example?

Mr Eastaway: If you had a business with substantial goodwill, for example, on incorporating that can be rolled over. On disincorporating, there would be a disposal and that could give rise to a substantial capital gains tax liability on the disposal.

Q192 Norman Lamb: This distortion of the tax arrangements has resulted in a substantial extra burden on businesses?

Mr Eastaway: Yes, an extra tax burden.

Q193 Angela Eagle: If we could disengage the law of unintended consequences, I am sure large numbers of us would want to do it immediately. There is a view that there is always a cat and mouse game between the tax authorities and people who are trying to minimise their tax liability. This game is

played constantly, sometimes and often within the limits of the law and partially without. Clearly this is an issue about complexity but complexity can involve benefits, credits or payments to businesses, as well as disbenefits. In the argument about tax compliance costs, aiming for a simplified benefit system also might mean that there are fewer beneficial tax credits which companies would welcome as well as there being less complexity. Is that a price that you are willing to pay?

Mr Maas: There are two types of complexity. You can get things that do have benefits, where the taxpayer weighs up if they are prepared to put up with complexity to accept benefits. The government incentives, enterprise investment schemes and so on, are where you go into the scheme and say, "In order to get benefits, I have to accept that it has to be a complex scheme because there is scope for avoidance if it is not complex." There is another type of complexity where you do not have the choice, where there normally is no benefit. It is simply a way to raise money. Again, I do not think any of us are saying that we think you may want to get rid of complexity *per se* because we live in a world where there is a lot of tax avoidance and the government has to be conscious that there will be tax avoidance. They have to try to block it in advance but there is more than one way to skin a cat. It depends how you introduce the provision because in most cases it is possible to bring in an anti-avoidance provision without creating uncertainty and undue complexity.

Q194 Mr Beard: According to the Revenue departments many of the checks and safeguards which add complexity to the tax system have had to be introduced to deal with tax evasion and avoidance. Do you accept that where businesses continually seek out and exploit opportunities to reduce their tax bill unfairly, the Revenue departments have a duty to protect the Exchequer?

Mr Whiting: Yes.

Q195 Mr Beard: Is that not where some of this complexity comes from?

Mr Whiting: We would always accept that some of the most complex legislation which can be some of the most difficult to manage is in the area of anti-avoidance, though by no means exclusively. Some of it can come very often from particular things that have come in where the tax authorities have tried to make sure they have ring fenced the potential benefit. Robert mentioned the enterprise investment scheme and there are screeds of legislation that have to come in to make sure that is properly regulated. You might say that is to stop people exploiting it; you might say it is to make sure it is properly defined. It depends which end of the telescope you are looking at, but you might also say that if we had not had the tweak or the benefit we would not have been in this position. My summary answer to you is yes, one accepts that anti-avoidance has to go on. Of course it does. It does create more complexity and there is an argument that if we wrote better, simpler law to start with, we might not have to go there to that extent.

Ms Monteith: Some anti-avoidance legislation is very widely drafted. There is an example at the moment that was published two weeks ago on partnership losses. It seems from what has been published so far that it would have a much wider impact than I would have thought was originally targeted. I think it is targeted at film schemes but as it stands it seems to me it could hurt some very small, family businesses who are genuinely seeking the backing of parents or friends.

Q196 Mr Beard: Mr Whiting, in your submission you say that one of the key burdens that the tax system places on business is when they act as employers. Do you agree with other witnesses such as the Institute of Directors who consider that the most significant tax compliance costs are those imposed on employers in administering the tax affairs of their employees? I have a similar question for Mr Maas. You say something very similar to that but you emphasise that many of the most complex areas of tax affecting employees are subject to constant change. What is your view on how compliance costs have changed over the last ten years in this respect?

Mr Whiting: I would accept and re-emphasise the point I made. That is the biggest burden for business as employer rather than just business as business. They do have to manage a lot of their employees' tax affairs and help them take on related matters. We have alluded already to things that are quasi-tax, the statutory returning to pay, sick pay, minimum wage, student loan repayment, which have all been additions to the burdens in recent years. At the same time, the basic PAYE and national insurance, which both started out as very simple levies—national insurance was a very simple, flat rate levy and PAYE by no means applied to all employees—have necessarily become more complex partly because life is more complex but also because things have been added to the system. They now have to cope with more benefits and a range of things that originally they did not have to. My perception, backed up by many discussions with clients, is that the costs of the employer compliance is steadily going up.

Q197 Mr Beard: Has not some of that cost been offset by computerisation over ten years?

Mr Whiting: I think it has made it manageable. Without that computerisation, it would have been thoroughly unmanageable because the response is: who is paying for the computerisation. My own firm has an employee service centre in Birmingham partly geared up to manage staff matters but partly to make sure that we have a major concentration of expertise and computer power to deal with all the employees we have. That is just my firm, PricewaterhouseCoopers, so yes, computerisation helps but we still have to pay for it.

Mr Maas: I endorse what John has said. With the small business I do not think computerisation is helpful. The costs to the very small business have increased considerably. There is a bit of a dilemma here because, for example, a P11D that has been with us since 1978 has suddenly become a very

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complex form because the Revenue have said, "We do not think employees will be able to cope with the legislation and therefore we will force employers to do things that normally the employee would have done in the past, because there is a better chance of him getting it right."

Q198 Chairman: Your point in your submission is that it has been made more difficult because these provisions have been constantly changed.

Mr Maas: I think it has. There are extra burdens coming in all the time.

Q199 Chairman: Could you give us an example of these constant changes that have made life much more difficult?

Mr Maas: Cars and national insurance are very good ones. There have been huge changes in national insurance over the last five or six years. National insurance, to be honest, is a bit of a mess now.

Ms Monteith: It is not just people who get company cars; it is people who are paid mileage allowances for using their own car on their employer's business. We have the old fixed profit car scheme that has been drafted into legislation for income tax. For national insurance, it was not possible to mirror the rules exactly because national insurance is calculated differently on a periodic basis, so the rules are nearly the same, but not quite.

Q200 Angela Eagle: I wondered why the national minimum wage was an extra burden in terms of administration.

Mr Whiting: Because records have to be kept to prove that you have paid.

Q201 Angela Eagle: You would keep records of employee pay anyway. The only difference is that you have to pay at a minimum level so that might get you into a national insurance contribution scheme if you were paying so low that you were not even paying your employee any contributions at all. Why is that a burden, because you have mentioned it several times in other contexts?

Mr Whiting: Because it is something that the employer has to track and manage.

Q202 Angela Eagle: Do they not track wages anyway?

Mr Whiting: They track wages anyway but it is something that they have to keep an eye on. I have a number of clients in the hotel, catering and restaurant business. You may say that they are paid low wages. It is a low wage environment but for them to monitor to be sure that they are complying with the requirements of the national minimum wage regulation and to face inspections by the Inland Revenue to check that they have, you may say this is all necessary to make sure that they have paid the right amount, but I am afraid there is an extra administrative burden there for the employer.

Ms Monteith: I think the extra piece of information you will need is detailed time sheets of how many hours worked in a given period of time.

Q203 Angela Eagle: Would you not keep those for paying wages anyway?

Ms Monteith: You do it on an *ad hoc* basis. Most of these people are not business people. They are running small businesses but in the catering industry, where people are coming and going and you may have half a dozen different staff who have done a couple of hours each during the week, you are hard pressed to operate proper PAYE. For minimum wage legislation, you are going to be keeping in detail who they were, how many hours and how much you have paid them.

Q204 Angela Eagle: Would you not do that anyway, unless you were paying them under the counter?

Ms Monteith: You just keep the total.

Q205 Mr Beard: All three of you have mentioned this question about the differences between national insurance and income tax causing specific difficulties. What are these difficulties and how easily can they be overcome?

Mr Maas: We have a system at the moment with benefits in kind, for example, where certain benefits in kind are treated as pay and attract class one national insurance. Other benefits in kind are treated as benefits and attract class 1B national insurance. It is very hard to work out the logic of what falls into what. It is for historical reasons because things that the government decided to counter first fall into class one and then they said, "Why not bring all benefits into national insurance" and the things they did not want to counter earlier are now class 1B. Nobody has said, "Why do not we revisit the things we call pay and see if we can call them benefits, like everybody else does?" There is still quite a lot of differences at the margin between what is pay under national insurance rules and what is pay under PAYE rules.

Q206 Mr Beard: You note in your memorandum that the introduction of tax credits has created an unacceptable burden on small employers in particular. When we put this question to the Revenue, this is what they answered: that they had done research with employers and this suggested that they do not find it difficult to operate tax credits. What is your response to that?

Ms Monteith: Surprise.

Q207 Mr Beard: This was serious evidence; it was not flippant.

Ms Monteith: Neither is my answer. We have had far more e-mails from our members on the subject of tax credits in the last year than I can remember on any other subject. The introduction of tax credits is equivalent to the introduction of self-assessment for income tax. It has been brought in far more quickly with far less consultation or advanced planning and that is what has caused the problem.

Q208 Mr Beard: The tax credit depends on the pay the person is getting. For most people, that does not vary much from week to week. I can see the problem of setting it up but why is it a continuing problem thereafter?

Ms Monteith: The tax credit somebody is getting at the moment will be based on their circumstances at the moment and their income for 2001–02. After the end of this tax year, they will be faced with the renewal documentation to fill in. Depending on the circumstances of the individual, if we took somebody who married perhaps part way during the year, they will have two separate sets of circumstances that will apply. The main problem that they will be faced with is the need for annual income when compared with chunks of the year for circumstances. Those people will have to fill in two sets of forms at the end of this year and declare their annual income as it was for 2003–04 in full on both forms. That is going to be very confusing for an employee and the first person they will ask about that will be their employer.

Q209 Mr Beard: Why is it a problem? If you are an employer, you know how much you have paid someone over the last 12 months.

Ms Monteith: It will be a problem for the employer because they probably will not know very much about the tax credit system themselves at that point. All they will be doing is operating on start and stop notices that they have received from the Tax Credits Office during the year. Of course, the individual circumstances of the tax credits payment will vary depending on how much income their partner has had. The employer will not normally have access to that information. To give sensible advice, the employer will have to know about something that might be confidential. Perhaps an individual does not want their partner to know how much income they get. There are so many difficulties that we have not begun to see.

Q210 Mr Beard: Are you sure you are not magnifying them? I can see the problem of putting the information in to begin with but thereafter it goes on for 12 months and you review it and do it again. Why is it such a big burden?

Mr Whiting: Whether you are saying it is just an annual exercise or whether it is something that happens every week—I take your point that it will not be an every week change for every employee—it is something extra that the employer has to manage. I have heard the Revenue say that the employer only has to cope with one form, a start or stop notice, but that is one form more than the employers I talk to tell me they want to cope with.

Q211 Mr Beard: Any form is probably more than they want to cope with.

Mr Whiting: Indeed. We are talking about adding to the burden. They have to track the amounts that they pay so that they are comfortable that they are recovering the right amount. I would echo Anita's point on the way that employers inevitably are being drawn into being a sort of first level advice and

information department because they are there, because they are available to be asked about tax credits even if they are nothing to do with them. It is adding to the burden.

Q212 Mr Beard: According to Customs and Excise 250,000 businesses out of the 1.7 million on the VAT register choose to be registered for VAT with no tax repayment benefit, which suggests that they see the benefits of VAT registration as outweighing the compliance costs because of the benefits brought to their orderly conduct of business.

Mr Maas: That is right. A lot of people register for VAT voluntarily because there is a perception that big businesses will not deal with them unless they are VAT registered. A lot of people register for VAT voluntarily because if all your customers are VAT registered they do not mind you adding VAT and therefore you get a benefit by reclaiming input tax. I do not think people want to be registered for VAT because they get repayments. That is not generally why people register.

Mr Whiting: I would endorse that wholeheartedly. It is a truism saying being VAT registered says something about you and something about the legitimacy of your business.

Q213 Mr Beard: Mr Maas, in your memorandum you say that through the flat rate scheme for VAT customers there has been achieved a simplification and a reduction in the compliance burden. In terms of compliance costs, is that less of a problem than other taxes businesses are facing? The implication is that VAT is less of a problem in general than other taxes.

Mr Maas: The day to day coping with VAT is less of a problem because VAT tends to be a simpler tax than the other taxes. When problems arise, VAT problems tend to be more significant than the problems with other taxes.

Q214 Mr Beard: What are the lessons that can be learned that could be applied to other taxes if that is the case with VAT, if it is generally a simpler tax?

Mr Maas: I am not sure there is a lesson because they are very different taxes, and the nature of VAT is a tax on transactions. If you carry out the same transaction again, again and again then the tax becomes simpler because once you have done it one or two times it becomes repetitive. Where you carry out a different type of transaction then you are in a different world. Income Tax operates on a very different basis.

Q215 Mr Beard: Mr Whiting, you note in your evidence that the move to self-assessment places an additional burden on taxpayers. Again, the Revenue have told us that self-assessment swept away what was a very burdensome system of estimated assessments, appeals and returns of various documents. Do you accept generally that some aspects of the change did work in businesses' favour?

Mr Whiting: The points to which the Revenue allude, yes I would accept that. I am on record as saying that self-assessment was, in many ways, a

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necessary modernisation of what was an archaic system with—it is quite right to point to the estimates, appeals and the postponements. That is particularly true for individual taxpayers, I have to say, rather than necessarily the corporate, business taxpayers. However, it has to be recognised that self-assessment has gone on and developed—if we are talking about businesses—into areas such as transfer pricing, which now all has to be self-assessed, and we are seeing more rules coming in there, so there are additional burdens going on business.

Q216 Mr Beard: Do you know of any tax system in the world where people do not complain?

Mr Whiting: Yes, Brunei. They do not have any.

Chairman: We have explored a lot of the burdens and so on, and we want, in the last few minutes, to look at practical ways of reducing the costs.

Q217 Norman Lamb: Are the two institutes satisfied with the efforts that are currently being made by the Revenue departments to reduce the administrative burden of tax compliance? Secondly, if you had to identify one thing that you could do to reduce the burden, which is not being done at the moment, what would it be? What would be your headline measure?

Mr Whiting: I can answer on the headline measure very quickly, which is something we have talked about already, which is to bring PAYE and National Insurance as close as is possible together, given the basic differences of weekly versus—

Q218 Norman Lamb: You would like to see a study done on the implications for actually merging the two?

Mr Whiting: I would like to see a study done on the implications of actually merging the two, but as a minimum step I would want to iron out all the differences between the two.

Q219 Norman Lamb: Is your instinct to support the ultimate merger of the two?

Mr Whiting: My instinct would be to support the ultimate merger, but I—like everybody else here—live in the real world and I know the political difficulties; I understand the practical difficulties of still having a contributory principle underlying National Insurance. So one accepts the great difficulties. If you ask me for a contribution to the administrative simplification of the tax system, that would be my answer. In terms of the two revenue-collecting agencies—are they doing their best? Well, we have already talked about the impact assessment and we could, I think, see more attention to that. I would also come back to the fact that it would be nice if they or somebody would sponsor a Bath University-type study Mark II, which would give us all the hard data that I think a number of us are groping towards.

Mr Maas: I think the Revenue and Customs are doing their best to cope with the administrative problems that they recognise people are faced with and they are faced with. My headline thing would be

what I started with; I think if the Revenue were to involve their compliance people, and Customs were to involve their compliance people, at a much earlier stage in developed legislation a lot of the administrative problems would not happen.

Q220 Norman Lamb: A final question for Mr Whiting: you note in your submission that while there is a similar code of administration and enforcement for many of the direct taxes, this is not the case with indirect taxes. You say there would be benefits for both the tax authorities and for business in bringing in a common regime for taxes such as VAT, the Landfill Tax, Insurance Premium Tax and the Aggregates Levy. Could you just set out how you would see that common regime working?

Mr Whiting: It is something my successor, as President of the Chartered Institute of Taxation, Penny Hamilton, has put forward. She christened it the Indirect Taxes Management Act—ITMA for short—

Q221 Norman Lamb: Do you agree with it?

Mr Whiting: I do because what it would then give is the common framework, just as on direct tax. We have largely a common framework on running that. There are crossovers between a lot of the indirect taxes that would not necessarily apply in all cases, but people dealing with the indirect taxes could, at least, look towards a similar system of managing them and enforcing them.

Q222 Norman Lamb: Can you just demonstrate by way of a simple example how you could bring the administration together?

Mr Whiting: To have common appeal procedures against all of them, common interest procedures and common ways of Customs & Excise enforcing them.

Mr Maas: If I can help, Customs have developed a fairly standard procedure and what happens when they bring in a new tax is they take those basic rules and say “Right, let’s adapt it to this new tax”. What happened as a result of that is that you get a whole lot of slightly different rules, because not only did they adapt it to fit the tax but also they said, “When we originally thought of these rules three or four years ago we didn’t think of this. Therefore, for the new tax, let’s improve it but they don’t go back and say that should be improved for VAT as well”.

Q223 Mr Ruffley: We have not talked about the big one, which we know Gus O’Donnell is looking at, which is merging the Inland Revenue and Customs & Excise. Do you, Mr Whiting, think that would deliver any benefits in terms of reducing the compliance cost of Revenue collection? Are you for it or against it?

Mr Whiting: I am instinctively for it if we are talking about merging the tax sides, because I recognise that Customs & Excise is in many ways two distinct bodies or has got two distinct roles. I am for it if that

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means that you can, to use the parlance, do some joined up thinking and approach to tax. So I, personally, do see benefits in it, yes.

Q224 Mr Ruffley: Do you think the Government should do it?

Mr Whiting: My *caveat*, because you are expecting me to put a *caveat* on it, is that both bodies have an awful lot on their plate; they have struggled with a great deal of change in recent years, so a bit like aiming for bringing PAYE and National Insurance

together, I might set it as an aspirational goal but I would not be forcing it simply because I would not want to see both bodies struggling under—

Q225 Mr Ruffley: It could be a shambles for the first two years, could it not?

Mr Whiting: Which, of course, tax advisers might greatly enjoy.

Chairman: It was a recommendation of this Committee, actually. Thank you, Mr Ruffley, and thank you to our witnesses today for a number of very positive suggestions. Thank you for helping us with our Inquiry.

Tuesday 9 March 2004

Members present

Mr Michael Fallon, in the Chair

Mr Nigel Beard
Mr Jim Cousins
Norman Lamb

Mr John McFall
John Mann

Witnesses: **Mr Philip Gillett**, Group Taxation Controller ICI, Chairman CBI Taxation Committee, **Mr John Hampton**, Senior Personal Tax Manager BT, Chairman CBI Personal Taxes Sub-Committee, and **Mr Mervyn Woods**, Head of Tax Policy CBI, Confederation of British Industry, examined.

Q226 Chairman: Mr Gillett, good morning and welcome to the Sub-Committee. Perhaps you can introduce yourself and your colleagues for the benefit of our shorthand writer.

Mr Gillett: My name is Philip Gillett and I am chairman of the CBI's Tax Committee. I am also Group Tax Controller of ICI plc. My colleague is John Hampton and he probably knows his title better than I do.

Mr Hampton: I am Senior Personal Tax Manager of BT and I chair the Personal Taxes Sub-Committee of the CBI.

Mr Gillett: My other colleague is Mervyn Woods, who is head of the Tax Department of the CBI.

Q227 Chairman: At the CBI?

Mr Gillett: Yes.

Q228 Chairman: You are all very welcome, thank you for coming to assist us with our inquiry. We had a memorandum from the Inland Revenue which stated: "Many costs perceived as taxation compliance costs are in fact those which would be incurred anyway for financial management purposes." Do you agree with that, Mr Gillett?

Mr Gillett: I agree a significant proportion of the costs are indeed the costs which would be incurred by any reasonable business manager, but I have to say there are an awful lot of other costs which are imposed by the tax system, the basic compliance costs, the cost of adjusting from basic financial accounting to Corporation Tax computations and obviously an awful lot of work has to be done in areas like transfer pricing which I can talk about at greater length if you wish, but there are an awful lot of other costs that are imposed by the tax system.

Q229 Chairman: What we have been trying to get a handle on is whether the cost of tax compliance is actually growing. You say it is growing. What is the evidence for it?

Mr Gillett: I think it has to be very anecdotal. One of the typical things that has happened is transfer pricing. Transfer pricing, as I am sure you are aware, is the legislation that requires associated companies to charge arm's length prices between themselves when they are dealing with each other. At the moment that only applies to international transactions, the aim being to ensure that each country has its fair share of the profits of any particular transaction within the group. We are just

about to introduce transfer pricing legislation for intra-UK transactions. This is something that has been forced on us from Europe, although very few other Member States have decided to impose domestic transfer pricing as yet but we will be forced from 1 April as it is at the moment to look at all the transfer pricing within UK groups so we will have to look at all the goods that are transferred from one UK company to another associated UK company, all the financial transactions within the group to ensure that all the prices charged are at arms length. That of course has absolutely nil tax benefit because if we are required to increase the transfer price on one side of the transaction we will increase the transfer price on the other side of the transaction leading to a completely nil gain for the taxpayer and for the Inland Revenue. That is just a typical example of the sort of problems that we are now facing.

Q230 Chairman: That is an example of a burden that is going to grow. Can you pick out for us any other aspects, which other taxes would you say are the most burdensome which have really grown already?

Mr Gillett: I think the key ones are in the payroll and employment areas and it is probably best if my colleague John Hampton talks to those because that is an area where there has been an enormous explosion of burden in the last few years.

Q231 Chairman: What is the growth of the burden of pay roll taxes?

Mr Hampton: It has been quite significant because of the changes that have been made over the past few years. Originally PAYE was introduced in 1943 as a general system of tax deduction at source. That was the situation in which we kept ourselves for a number of years but over recent years we have seen a significant growth in payroll burdens by the introduction of tax credits being paid by the employer and by student loans and of course there has also been an increasing burden in terms of the National Insurance Contributions because you are running two imposts side-by-side on the same income stream.

Q232 Chairman: Right. In your document on *Is the Tax System a Help or a Hindrance?*, which I think you published last year, you include a table comparing the United Kingdom with other countries and you put Ireland at the top for

simplicity and ease of compliance and you put the US as the most difficult and you rank the UK down there next to the US but you say beneath the table objective database comparisons are not possible, so where did this table come from?

Mr Gillett: This is very much a table of the survey of members and their views. It is inevitably very, very subjective. I think the problem with the table much more so is not just the fact of the complexity of the UK tax system but that we perceive and our members perceive that the situation is getting worse whereas in many other countries it is getting better and they are actually better at recognising there is an issue and they are trying to work in a more efficient manner. So it is very subjective.

Q233 Chairman: If it is not data based how do you know it is getting worse?

Mr Gillett: Maybe you can help them.

Mr Woods: How do we know?

Q234 Chairman: If it is not data based, how do you know it is getting worse?

Mr Woods: We know that in the UK it is getting worse for the very reasons we have just given, for instance the transfer pricing, the inevitability of further changes if EU law overrides UK law and the whole thrust of the employment tax side which Mr Hampton has referred to. All these are changes which have happened since the CBI last gave evidence to this Committee in 1999 where at that time we were concerned about potential growth, and now that growth has actually occurred.

Q235 Chairman: So although it is not data based this is a proper survey? You went out to your members and asked them to rank the six countries, did you?

Q236 Mr Woods: The members of our Tax Committee, tax experts that is, were asked to rank how they would place these countries in terms of how they as tax experts perceived the compliance burden.

Mr Gillett: Because we deal obviously with a wide range of countries as part of our normal work.

Q237 Chairman: What is going on in Ireland? What aspects of the Irish system make it the best to deal with?

Mr Gillett: I think they have a more relaxed approach to things. They have a much lower tax rate these days, which obviously helps from a different perspective. They have legislation which is very similar to ours but eliminating or without certain quite key aspects like transfer pricing. They do not have transfer pricing.

Q238 Chairman: You have made your point on transfer pricing. Is there anything else that the Irish do that we could fairly easily copy here?

Mr Gillett: In general they have a slightly simpler tax system. In a number of areas it is quite interesting to look at Irish legislation. It follows ours almost word

for word in some areas but then just misses out the more complex bits that we have added over the years. It is generally a simpler system.

Q239 Chairman: If you look at the other end of the scale, the United States, you say that is the most difficult but that is one of the strongest economies in the world. Is there any evidence that although it is very difficult it is actually hindering the US economy?

Mr Gillett: I think it is a very interesting angle to look at. All we can do is comment on what the tax system is like. I do not regard myself as professionally competent to comment on whether it is the most successful economy in the world or why it should be but I do know the tax system is horrendous, and it is horrendous for all sorts of reasons. The entrepreneurial spirit that lives in America lives in particular in the tax planning industry there and as a consequence they have a whole series of tax planning ideas and counteracting legislation and as a consequence it has become extremely complex over the years, so perhaps the complexity of their legislation is a product of their entrepreneurial spirit.

Q240 Mr Cousins: Just to follow up that last question, what feature of the United States' tax system is it that your members do not like?

Mr Gillett: I think there is no single feature because in many ways it is a system that has similar bases to ours in terms of what it is trying to achieve. It is just that every area you look at shows the complexity of what you are trying to do. If I can give just a simple example, if you buy a company in the UK and you sell it ten years later, obviously for your capital gains calculation you look at the base cost: how much did I pay ten years ago and possibly inflation since then, and that was your allowable deduction in calculating the capital gains basis. In the United States you take your base cost that you bought the company for ten years ago and then you add in or take away any dividends that have come out, any money that you have put back in by way of loan, an amazing series of adjustments you have to make in order to arrive at your allowable base cost to carry out your capital gains calculation. It in some ways makes the system overall a bit more logical. That is the wrong expression for it but it certainly has some logic going for it. However, it makes it a much more complex system altogether and that is just one example. In every single area you look at in the US system you will find there are intricacies that do not exist in ours.

Q241 Mr Cousins: Of course there are much more rigorous attempts at enforcement in the United States.

Mr Gillett: Certainly the relationship between the IRS and the taxpayer in the States is a much more aggressive confrontational relationship. I think that tends to be a very negative feature. One of the things that happened in recent years in this country is we

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had the Hartnett Report.⁸ There is plenty of judicial precedent that says no taxpayer has to organise his affairs so as to make them pay the maximum amount of tax to the government. There is a lovely comment from Judge Learned Hand in the States that there is “no patriotic duty to pay more tax”. That is quite a well-established principle. Of course you have the situation where any director of any company has obligations to the shareholders and to the company, and not a moral duty to pay more tax to the government. Having said that, personally I am not a fan of the tax planning industry. I do not think it is a particularly constructive way of going about things, but it exists, it is a fact of commercial life.

Q242 Mr Cousins: Yes. Of course, we do not apply those principles to benefit fraud though, do we?

Mr Gillett: I think it is a question of what is fraud and what is planning and that is a very difficult grey area. If we are talking about tax fraud, in other words just not disclosing income, that is a crime and it is quite clear that it is.

Q243 Mr Cousins: I think you would agree it would be wholly wrong, would it not, to class one set of activities which were by their nature not different to some other set of activities fraud in one case and not fraud in the other?

Mr Gillett: The difficulty is in choosing which is illegal and which is not. If you have bad law then if people wish to exploit that bad law, that seems to me to be legal. I may not approve of it but it is legal. On the other hand, if you do not disclose income that is clearly against the law and that is fraud.

Q244 Mr Cousins: What about the costs of tax planning and professional advice; are they rising?

Mr Gillett: I do not think I have a comment to make on that at all because it is not something I know about too much. We do not use a great deal of external advisers for my own particular company.

Q245 Mr Cousins: What about your colleagues? What about Mr Woods? You are the policy man.

Mr Woods: Yes but we do not actually get involved in tax planning. Our relationships are with government in the UK and Brussels.

Q246 Mr Cousins: You have no views?

Mr Woods: I think it is a question of how the costs of professional advice in the tax area are rising or falling. The costs must inevitably be rising.

Q247 Mr Cousins: Can you put a figure on that?

Mr Woods: It is undesirable that firms should have to incur the cost of taking professional advice to understand what their obligations are. That goes without saying. That is the whole thrust of our paper.

Mr Gillett: It depends if you are talking about tax planning or tax mitigation techniques or just taking tax advice. You might have an area like the transfer pricing area where there is a need to take a great deal of professional advice just to understand how you are going to go about things.

Q248 Mr Cousins: If you could produce considered thoughts on how one can distinguish between tax advice, tax mitigation and tax planning, I would look forward to that with great interest.

Mr Gillett: It is an area which has been attracting a great deal of discussion.

Q249 Mr Cousins: Some of the great theologians have wrestled with these issues for many centuries but if you could crack it!

Mr Gillett: I wish we could.

Mr Woods: What we are clear about is the sort of examples that John Hampton has mentioned about the extra burdens cast on employers through the payroll are areas where for instance firms which do not have in-house professionals will have and have had to take external professional advice at whatever charge out rate those professional firms charge for providing that advice because the matters are so inherently difficult that they cannot deal with them themselves as ordinary small businesses.

Q250 Mr Cousins: Let's take an example there because Parliament in a sense might quite welcome your advice on some of these payroll cost issues. For example, have you done any work—this is the subject of some parliamentary debate at the present moment—on the compliance cost implications of, say, introducing a local income tax?

Mr Woods: We have not, no.

Mr Cousins: That is something I think that Parliament would welcome some advice on. There is a great deal of concern about whether the introduction of a locally variable income tax would raise compliance costs. I think the Committee would probably welcome that.

Mr Beard: Every party would.

Mr Cousins: Every party would.

Norman Lamb: We have seen it work very well elsewhere, Nigel!

Q251 Mr Cousins: It is not really sufficient. I have given you an example of local income tax which is very much on the political agenda. Well, that begs a few questions, it is something politicians talk about, let us put it like that, and you are not really able to say, “Well look, we have looked at this and our advice to you would be whatever.” That is something you should do because if you are really to advise Parliament properly then you have got to be proactive, have you not? You cannot constantly be saying, “We do not like this proposal and we do not like that proposal.” You have got to be able to say,

⁸ *Note by witness:* This was designed to improve relationships between the Inland Revenue and large businesses. It moved from a hide and seek situation to an adult commercial relationship designed to find the right amount of tax to be paid. A key feature of the new approach is risk assessment and assessment of taxpayers as good or bad risks allowing resources to be deployed accordingly.

“You might be thinking about this and this is what we think about it”, and a local income tax, following on your points about administration of student loans and the tax credit system would be—

Mr Gillett: I think that may well be a very valuable way forward. The only point I would make in response, which may sound a little defensive, is with something like 500 pages of new tax legislation every year which we are trying to get to grips with and trying to help Inland Revenue and government make that effective in delivering policy, there is simply a limit as to how much work we should do on things that may or may not come about. I think it would be a very, very interesting subject and a very helpful contribution to the debate.

Mr Cousins: Absolutely but a clear business view on the compliance costs of, say, a local income tax would be very helpful to Parliament and might head off the need to generate more hundreds of pages at a later date.

Chairman: John would like to come in.

Q252 John Mann: Just to clarify, because you have touched on a very important issue dear to my heart about costs of professional advice, are you saying that your perception is that the costs of professional advice are weighted for smaller businesses more towards advice on these, shall we call them, payroll issues than on advice on tax efficiency?

Mr Gillett: I would not have said that that was the majority of the money but it is an expanding area where advice is required, especially for the smaller companies. Obviously companies like ourselves have in-house resources.

Q253 John Mann: For those who are outsourcing, what kind of percentage of the burden of the outsourcing is coming from advice related to these payroll-related issues?

Mr Woods: I think, as we said in our paper, this is a study that was last conducted by Bath University and they spent considerable time and governmental resource on that study and we would hope that the Committee would encourage a repeat exercise so that we could all benefit from a comparative figure.

Q254 John Mann: When was that done?

Mr Woods: I think it was done in 1999. It is in our paper. I cannot remember the date offhand.

Mr Hampton: 1998 it was.

Q255 Mr Cousins: What would your view be about how things have changed since then?

Mr Woods: What has changed significantly on the particular area that Bath was looking at on the employment tax side is the point Mr Hampton has referred to, the huge increase in the numbers of topics which employers have to take account of these days.

Q256 Mr Cousins: Do you have a formal view as an organisation about the relocation of enterprise activities notionally in tax havens? Is it anything you have ever considered?

Mr Gillett: I am not quite sure I understand the question.

Mr Woods: Are you asking about the compliance costs of relocation or is this a policy question?

Q257 Mr Cousins: A policy question to you. You are the policy man.

Mr Woods: Relocation from tax havens? Some countries allege that the UK is a tax haven. Indeed, it is a charge we often face when we meet in Brussels with colleagues and we hear that other Member States say that the UK's tax regime is positively haven-like compared with some of theirs. What we would say is that it is in fact the UK maintaining its international competitive position.

Mr Cousins: I see, so that is your approach really to tax havens. Thank you. No, that is fine.

Q258 Mr Beard: You note in your memorandum that decisions by the European Court of Justice are increasingly having an impact on the UK's own tax regime forcing changes. Is this a significant problem in practice and, if it is, can you give us some examples of it?

Mr Gillett: It is a significant problem and it is becoming more of a significant problem. I cannot quite remember the numbers but there have been an increasing number of tax cases going to the ECJ in recent years, an accelerating number, not just from the UK, from many Member States, and something like over 90% of them have been won by the taxpayer. Even for those that have not been won by the taxpayer, including a case that ICI was involved in, still the European Court of Justice decided UK law was not compatible with European law. As a consequence of these various cases effectively they are just holding that the domestic law is not in line with European law and this means that changes have to be made. From the perspective of the government response to any of these cases, they can do one of two things. If it has been found there is discrimination between the treatment of a UK resident and another EU resident, the government can respond either by levelling up to produce the same benefits for all EU residents or by levelling down. In some cases there is a levelling up and in our case there was a broadening of the definition of groups for various purposes, but obviously there becomes a limit where there is too much tax at stake. Transfer pricing is merely the current embodiment of the problem. The difficulty with the ECJ is that it creates a lot of uncertainty because there is no logical method in which they look at issues. It is just whatever case comes up so it is very much an isolated issue here and an isolated issue there and then it is a question of uncertainty as to how should the Government respond. We are sitting here with legislation in which there is the quite widespread belief that there are many provisions on our statute books which are not compatible with EU law. We do not know when a case might be taken that would state that they were illegal. We do not know how that process will evolve and we do not know what the Government's response will be. There is a lot of uncertainty. There is uncertainty as to timing and

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uncertainty as to response, so that is very, very damaging. In the transfer pricing case the UK Government has decided to protect UK revenues because it has decided that transfer pricing legislation is necessary.

Q259 Mr Beard: We will come back to transfer pricing in a moment. What is the CBI suggesting the Government has got to do in practice?

Mr Gillett: What we believe the Government should do is take a much more holistic view of the UK tax system. Rather than sitting there waiting for a case to come along and knock down a particular part of the UK system and then putting a piece of sticking plaster in place (which is inevitably painful and imposes additional burdens on the tax paying community) they need to take a much broader look at the whole system and say is there a way of evolving a system which is truly compatible with European law. One of the key cases that is likely to come up soon is a case involving Marks & Spencer which is all to do with definitions of a group for group relief purposes. At the moment the UK definition is effectively limited to UK-resident companies. Obviously there is an argument which says if you cannot include French-resident companies or German-resident companies that is discriminatory legislation. In fact the tax-paying professional community believes that Marks & Spencer is likely to win and on that basis if they do win the UK government then has a choice; it can expand group relief to all European Member States or it can deny group relief altogether. That would be very, very bad news for the competitiveness of British industry. What we would encourage them to do is to think in advance rather than wait for the case to hit and then to try and handle the situation in a sticking plaster manner and to look at the whole system and see if they can devise any EU-proof group definition. If you can do that you can then build things like the transfer pricing legislation, thin capitalisation legislation, and many other aspects of the UK system around an ECJ-proof group definition, so we would encourage them to have a more holistic view.

Q260 Mr Beard: To help our understanding of the issue, can you give an example, perhaps the ICI example to which you have alluded, where there is this incompatibility between UK tax law and the European law?

Mr Gillett: The ICI case is a very subtle case involving group definitions.

Q261 Mr Beard: Any case that illustrates the issue.

Mr Gillett: A simple problem is the question of how we treat foreign dividends. At the moment in the UK we tax dividends coming from overseas companies into a UK company, we tax that dividend in the UK and give credit for any overseas tax that has been borne with a very, very complex calculation (which we can talk about) but we do not tax dividends from UK companies. A UK company dividend to another UK company is tax exempt. I think there is a strong view that that is clear discrimination. It is against

freedom of establishment and as soon as somebody takes a case on the subject, the UK will be forced to change the law. We believe that they should be examining and I think they are examining (but we obviously want those conversations to go deeper) those situations now and building a much more comprehensive holistic response to the ECJ rather than the sticking plaster approach at the moment which usually leads to extra costs for business, the transfer pricing legislation is very, very difficult administratively.

Mr Beard: We will come back to transfer pricing in a minute.

Q262 Chairman: We will always come back to transfer pricing, I suspect!

Mr Gillett: I am sorry, it is a current topic.

Q263 Chairman: I want to be clear before Mr Lamb comes in on the Marks & Spencer GNO case, if that is won by Marks & Spencer and lost by the Revenue does it not therefore follow that eventually we will be driven to an EU-wide corporation tax regime?

Mr Gillett: I think it is a very interesting developmental question. My personal view is if the Member States of Europe just allow the ECJ to carry on the way it is doing at the moment and respond the way I expect them to respond, we will end up with 15 or 25 minimalist tax systems which will be uncompetitive for the EU as a whole as against the rest of the world. There is an argument that says how uncomfortable do things have to get before the Member States start talking to each other sensibly about some sort of European-wide proposals. There are some European-wide proposals out there but obviously an alternative way forward is for Member States to try and address the issue now and to be looking at ECJ-proof systems. We do believe they exist; it is just there is a reluctance for governments to change legislation in advance of them being forced to.

Q264 Mr Cousins: Can I just say that that is a very powerful statement that you have made that leads you towards tax harmonisation.

Mr Gillett: It is quite frightening.

Q265 Mr Cousins: You obviously realise that?

Mr Gillett: It is quite frightening that we spend a lot of time talking about the tax veto, and certainly it is my personal view that the tax veto is largely illusory when we have already given up significant rights effectively to the ECJ to declare large parts of our legislation incompatible with EU law.

Q266 Chairman: The progress of these GLO cases one by one following Marks & Spencer is going to drive us towards that, is it not?

Mr Gillett: It is.

Mr Woods: Can I just make a statement. The accusation is sometimes trundled around that the ECJ is leading to back-door harmonisation and that is why we are suggesting the approach we are putting to the Government to which Mr Gillett referred of having discussions now to see how we can make our

own system as EU-proof as possible which will enable the UK to maintain its competitive edge, and that is why we urge consideration of all the issues at the earliest possible opportunity.

Mr Cousins: Mr Woods, when you read the record of this you will see a striking difference of tone between what Mr Gillett has said and what you have just said.

Chairman: That is no bad thing. Who is next? Nigel Beard?

Q267 Mr Beard: The evidence you have given us says that “there has been a step-change”—you have referred to it already—“in tax related employer compliance burdens” and that “many, many of these relate to payroll administration and arise from the move to deliver the Government’s social welfare measures via employers rather than via the public service.” Do you agree with other witnesses, such as the Institute of Directors, who consider the most significant tax compliance costs for business are those imposed on employers in administering the tax affairs of their employees?

Mr Hampton: Sorry, sir?

Q268 Mr Beard: You have said that in what I quoted in your evidence. Do you therefore agree with the Institute of Directors that the most significant tax burdens that have been put on employers are those to do with the tax affairs of their employees?

Mr Hampton: Certainly there are very significant compliance costs.

Q269 Mr Beard: Are they the most significant ones?

Mr Hampton: If you look at significance in terms of the fact that every employer has to comply with the burdens that you are talking about, then numerically they must be the largest because they apply to every single business and employer up and down the country. Other burdens which may be very high in themselves will not necessarily apply to every business. For instance, the transfer pricing costs Mr Gillett referred to, there is an element of that that could arise in relation to share options.

Q270 Mr Beard: But out of this, if this is broadly the case and you are agreeing with the Institute of Directors, which is the most burdensome of these new duties that you have as a result of the Government’s social welfare agenda?

Mr Hampton: That is a difficult question to answer for two reasons. We are only beginning to see the additional costs of administering student loans because that is something which has only just got underway. We certainly saw what looked like significant costs arising from the introduction of Working Family Tax Credit, but I believe that the burden there has probably been reduced by the fact that the Child Tax Credit element is now paid by the Inland Revenue rather than being paid via the employer.

Q271 Mr Beard: Is this attitude arising because once this is brought in you have a whole host of people who are getting these things whereas in the routine

course of events there will be one or two added people who get Working Tax Credit? Is this a complaint about the induction costs of this system or is this envisaging that sort of burden going on forever because if it is the latter what exactly is the burden? You are computer aided and it is a matter of one change. People are not changing their eligibility to Working Tax Credit week by week, it is a definite change at a definite time, so where is the burden arising?

Mr Hampton: Large companies certainly are computer aided, I could not disagree with that for a moment. The real problem here comes with the small and medium sized employers who certainly do not have in-house facilities. They have a vast number of compliance obligations which they themselves are not experts in, they have to get help, and as the changes go on the burden becomes progressively greater.

Q272 Mr Beard: Again in your memorandum you note some concern about the PAYE and National Insurance Contribution differences and you have raised them with the Inland Revenue and they have not been fully resolved, you say, including the different bases for tax and the National Insurance Contributions? So what progress has been made in minimising these differences between NIC and PAYE?

Mr Hampton: We are certainly working with Inland Revenue officials to try to find areas where there can be a “trueing up” of definitions or where practices can be changed so that there is not the divergence that there was between the two systems in the past.

Q273 Mr Beard: Is this just a quarrel between experts and one set of experts preferring one solution and another set preferring another and neither will give way?

Mr Gillett: The problem is that they are different.

Q274 Norman Lamb: Do you favour merger as an organisation?

Mr Gillett: As regards merger of PAYE and National Insurance we have not conducted a survey of our members so we do not have a view on that. All we are saying is if the two were at least levied on the same basis without some very silly differences life would be a great deal easier.

Q275 Mr Beard: Why is there an argument that they should be different?

Mr Gillett: Obviously the Government argue from a very sound argument that National Insurance should only be on employment-type earnings but there are differences in how these employment earnings are defined for PAYE purposes and NIC and that is where I am afraid I do not really understand the policy for those differences.

Mr Hampton: Would it be helpful if I were to give you an example, sir?

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Q276 Mr Beard: Yes.

Mr Hampton: If you take an employee's contributions to an exempt approved retirement benefit scheme, those contributions are fully deductible for income tax purposes but they are not deductible for the purposes of calculating employees' Class 1 National Insurance Contributions. That means at its very simplest anybody operating payroll has to carry out two calculations in order to establish the amount on which the impost is to be levied.

Q277 Mr Beard: I can see that these differences are irritating but are they a real burden? Is it just tidiness that is bringing this to the fore or is this a real burden?

Mr Hampton: I would say individually they are not much of a problem but there is such a multiplicity of differences that it does become very burdensome. For instance, there is sometimes difficulty in determining whether a particular item of earnings is liable to Class 1 National Insurance Contributions or Class 1A National Insurance Contributions. You have got to be pretty skilled in both the statute law and in case law sometimes in order to determine which charge applies. The Inland Revenue have been very good in giving guidance but someone who is running a relatively small business does not have the time to go through the 34 pages of guidance on Class 1A National Insurance Contributions.

Q278 Mr Beard: Is sufficient effort being put in by the CBI and Inland Revenue to sorting these problems out?

Mr Gillett: Define "sufficient".

Q279 Mr Beard: Sufficient means getting them sorted out in reasonable time.

Mr Woods: If I could comment on that, we have asked the Government and indeed take every opportunity of our meetings with the relevant officials in the Inland Revenue to raise these particular subjects and I am happy to say in a number of areas progress is being made not least because some of the issues we have identified have come up in terms of the Hartnett Report that we talked about earlier. Our view is that anything we can do to work with officials to reduce the frictional interface costs of tax compliance must be good for both sides and we take every opportunity to follow up that lead. I think it is fair to say that that is the spirit of the Hartnett Report. It has not all happened yet is what we are saying in terms of our submission.

Q280 Mr Beard: You mentioned earlier the Bath University report on compliance costs of PAYE and NIC and the report actually says that per employee for a business with one to four employers it increased in real terms from £147 per employee in 1981–82 to £284 in 1995–96. Over the same period for businesses employing over 100 people the compliance costs fell. Have those sorts of trends continued since 1995–96?

Mr Hampton: Without having more up-to-date figures it would be very difficult to answer that question. The only thing that I could say is that in

the face of the increasing complexity electronic media have enabled large businesses at least to keep our heads above water, but there is a very strong feeling that for smaller businesses it has become much more difficult.

Q281 Mr Beard: You say keep your head above water. That trend implies that you are swimming quite strongly and you are reducing the compliance burden quite substantially for large companies.

Mr Hampton: Yes but, as I say, since that report was published there have been further burdens added. Since that report was published we have had the introduction of Working Tax Credits, we have had the introduction of paternity pay, we have had the introduction of student loans. We would not have been able to cope with those had we not had the assistance of electronic media.

Q282 Mr Beard: You note again in the evidence you have given us that self-assessment "constitutes an enormous movement of function from the Inland Revenue to taxpayers." When the Inland Revenue came to see us they told us self assessment swept away what was a very burdensome system of estimated assessments and appeals. Do you accept that in some respects the change did work in businesses' favour?

Mr Gillett: It certainly swept away unnecessary paperwork because in many ways it changed the order in which bits of paper were issued and the estimated assessment and appeal process really was just a waste of paper. What it has done, however, is to push the burden of compliance on to the taxpayer. In some cases that is exactly how it should be. We should be trying to make a full and correct return but once you get into the more intricate areas—and again I have to mention transfer pricing especially in the UK domestic context—the burden that will be put on taxpayers for no additional tax revenue is really very significant so it is pushing the burden on to the taxpayers.

Q283 Mr Beard: In the past ICI did not give all the numbers to the Inland Revenue and say, "You calculate our tax burden"; you calculated your tax burden so that you knew what you were talking about, so what is the difference?

Mr Gillett: The difference is in the area where you need to adjust your basic financial figures. Transfer pricing before self-assessment was done by means of Revenue direction. What happened was you submitted your tax computations, which were financial accounts adjusted for tax purposes, and then if the Inland Revenue felt that your transfer pricing between associated companies overseas was wrong then they would raise a specific direction that had to be approved at Inland Revenue board level. In that situation—and as I say transfer pricing is one of the most difficult areas, it is a very subjective area, there is no right transfer price—the Revenue used to issue a direction, you had the debate, and you agreed on whether any additional tax should be payable. Now the burden for arriving at the correct transfer price involves providing lots of documentation

which justifies that that is the correct transfer price and all that burden rests on the company. Of course in many cases you are talking about different parts of a process and you have got the basic element of a process which is done in the UK, and it is then moved to another element of the process done in the Netherlands, and you have to value what is transferred at the point of transfer. I always say it is a bit like trying to value a camshaft halfway down the production line at Ford's.

Q284 Mr Beard: You do accept that the introduction of self-assessment has not been a transfer of burdens one way?

Mr Gillett: No, it has certainly eliminated some silly little things.

Q285 Mr Beard: You say also on self-assessment that it "gives the Inland Revenue a significant degree of assurance of taxpayer compliance, which has not, to date, been fully reflected in regulation." How does self-assessment provide this greater assurance of taxpayer compliance?

Mr Gillett: Simply because it does put the burden on the taxpayer to do his best to find the right answer.

Q286 Mr Beard: And he was not doing that before?

Mr Gillett: Most of us were trying very hard but there is no doubt at all that when you are simply responding to an estimated assessment, you appeal against it and then provide some computations, at no point are you writing a confirmation, as we all do now at the bottom of our income tax assessment saying "I confirm to the best of my belief this is a complete and correct return" and that focuses the mind. Companies like ICI have always tried to produce the right answer, but there is no doubt at all some people have been forced to address these issues and I think be more rigorous in their application.

Q287 Mr Beard: How would you like to see that reflected in regulation, which is what you mention in the passage I quoted?

Mr Woods: I think we mention section 765 in our paper as an instance, without going into a great deal of detail, where companies can be guilty of criminal offences if they have not sought Treasury consent to certain financial transactions. Most of the transactions concerned now fall outside of that section, certainly as regards the European transactions because it would be contrary to EU law to have one law within the UK and one relating to EU transactions.

Q288 Mr Beard: Why does that worry you if it is irrelevant?

Mr Woods: Because it still applies to non-EU transactions and what we believe is, if the Revenue need the information about these transactions, that information can be provided as part of the self-assessment process and that is what we have suggested be the way that the legislation is framed.

Q289 Mr Beard: What was the response?

Mr Gillett: The response is rather difficult. The Revenue maintain they need section 765 for protection of the Exchequer but since there is no published guidance as to when they will give consent and when they will not give consent, it is rather difficult to know precisely what their concerns are. We believe the solution to 765 is for them to actually highlight what the specific issues are, to bring those before Parliament and enact proper counteracting legislation. Section 765 dates from the days of exchange control. It is an exchange control provision and you have to get consent to do certain transactions, which holds up business processes and causes some people to do business processes in an inefficient manner in order to avoid having to seek consent. As I say, it is a very old-fashioned provision but it is typical of the regulation which we believe could be abolished.

Q290 Mr Beard: Now for this vexed question of transfer pricing. Can you explain to us what the transfer pricing issue is?

Mr Gillett: The basic existence of transfer pricing legislation is to ensure that related companies deal with each other at arm's length and specifically across international borders to make sure that each country gets its fair share of the profit on whole group transactions. The recent German case of *Lankhorst Hoyer* which went to the ECJ was actually about thin capitalisation, in other words the proportion of debt to equity that was financing the company but one of the comments made was that it was illegal under EU law to apply restrictions on international transactions that were not also applied on domestic transactions. No other Member State to my knowledge has actually enacted transfer pricing in response to this but clearly the implication is that unless you make transfer pricing applicable to all related-company transactions then the international transfer pricing legislation is illegal under EU law and that is the concern, that there is a threat to the Exchequer.

Q291 Mr Beard: When you say international you mean between the EU and America rather than between two EU Member States?

Mr Gillett: That is the problem. It would obviously be illegal under EU law between two EU Member States. How far you can then translate that through the various double tax conventions that we have entered into as to whether or not that also means it is illegal as regards us and the US is the next stage of legislation which is where it really gets quite complicated. The problem with this is if you are applying domestic transfer pricing legislation that you are having to do is to ensure that all transfer pricing between our UK group companies is at arm's length. That is very easy to do when you are transferring goods from company A to company B but how about management services when you have the group managing director who does things on behalf of the whole group? Should you charge out his costs to other group companies and, in particular, should the parent company make an

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arm's length profit, if so should it have a 10% mark up or a 15% mark up or a 20% mark up? These are things that you should be considering and it is for no net benefit because if you are making charges between two UK companies it increases the profits of one company, decreases the profits of the other one by the same amount, so there is no net gain. One of the little irritations at the moment is that that affects dormant companies. Many large groups like ourselves have dormant companies, they have been there for years, they exist for name protection purposes, their history goes on and you cannot really get rid of them very easily. Their balance sheets tend to consist of share capital £1 million, loan back to parent company £1 million. We do not have to do a tax return for those normally but under the new legislation we will have to say we have a £1 million interest-free loan to our parent company, we will have to impute interest on that and make a tax return for that company. At the same time our parent company will get a notional deduction so there will be no difference in the amount of tax paid. Instead of submitting something like 30 tax returns which we submitted last year for our UK group, we will have to submit in excess of 100 tax returns.

Q292 Mr Beard: Are you saying we are gold-plating the European regulations or that the others have just not got round to enacting them yet?

Mr Gillett: Perhaps we are a little bit ahead of the game. It is very difficult for me to comment but it is interesting that other European nations have not felt the need to act as swiftly as we have.

Q293 Norman Lamb: You specifically referred earlier to the fact that this was being forced on us by the EU but in your paper you specifically say there is no express ECJ ruling on this issue and that other countries are not following our lead. Have you received specific legal advice to support your contention that it is not necessary to introduce it on an intra-state basis?

Mr Gillett: We have not sought our own legal advice on that subject. All we are saying is that the *Lankhorst-Hohorst* case, which is the relevant case, relating to thin capitalisation (which is the amount of debt and equity that you have to finance a company) did not relate to transfer pricing, it was a side comment from ECJ that effectively said you should not impose restrictions on international transactions that you do not also impose on domestic transactions.

Q294 Norman Lamb: So your argument effectively to the British Government is do not rush into this, there is no apparent reason to be doing it, particularly ahead of other countries?

Mr Gillett: Our recommendation to the Government is to look for a more holistic solution that looks at things like the group definitions because if you can find an ECJ-proof group definition you can then put transfer pricing around the outside of that group and it becomes less of a problem and becomes much more sensible.

Mr Woods: And you deal with other things such as the anticipated outcome of the Marks & Spencer case at the same time, so you can deal with a multitude of anticipated decisions coming out of the ECJ in one go rather than tackling each one individually *seriatim*.

Q295 Mr Beard: Would you have to get the Commission to agree that definition?

Mr Gillett: What we are trying to do is talk directly to the Commission and talk to people at the Commission who are looking at these aspects and to talk to other Member States through various affiliated organisations so those Member States talk to each other so they can all come up with a system that is ECJ-proof. We believe the Danish system is reasonably ECJ-proof. We have not got specific legal advice. We are encouraging the Commission to work on that so they can assess whether or not that system is legal. The Commission has stated that when we get an ECJ decision it will go out to Member States and explain what those decisions mean in the context of domestic legislation. What we are trying to encourage the Commission to do is to go out and not just say, "That provision is illegal", but to say, "That may be illegal, but you can do this."

Q296 Mr Beard: What progress is being made in solving this?

Mr Gillett: It is slow but I think progress is being made. I think we are now quite well engaged with members of the Commission and I think there is a will to do something there. The issue is are the Member States willing to engage that closely with the Commission?

Q297 Chairman: Is there anything else you want to say briefly on your specialised subject of transfer pricing? We are going to move on to some more specific suggestions for how we reduce the burdens. Is there anything else you want to say?

Mr Gillett: No.

Q298 John Mann: The research suggests that the smallest 30% of firms pay around 75% of the total tax compliance costs and you related that earlier. Are the Government doing enough to address this imbalance? What do you think they should do specifically?

Mr Gillett: It is the personal tax burden.

Mr Hampton: Yes. I certainly think that one of the biggest problems is the fact that in Income Tax and NIC you have got, as I have already said, two imposts running side-by-side on the same subject matter. What has to be done in order to get that right does consume an inordinate amount of resource.

Chairman: But the question was about the imbalance, the fact—

John Mann: The imbalance of small firms.

Chairman: The smallest 30% of firms are paying 75% of the total burden.

Q299 Mr McFall: In 1998 the Inland Revenue suggested that there could be strong economies of scale here.

Mr Gillett: I think probably those numbers suggest precisely that, that if you are a large company—I am sure our payroll department is not that much larger than that of a very much smaller company.

Q300 Mr McFall: Could you give us an indication of where you think the economies of scale could come in small firms?

Mr Gillett: I am interested to see how the small firms could achieve such economies of scale unless we are talking about group-type schemes. Obviously the way they achieve economies of scale is by using external outsourced providers and like any computer system, as long as the system is relatively straightforward, outsourcing is very effective. The problem comes when you get complexities and you have to get manual intervention into the system. As soon as you do that to handle things that change regularly or move around at that point the economies and advantages of using outsourcing start to become a little more questionable because things go wrong apart from anything else and it is much more difficult. Outsourcing is how the economies of scale can most easily be achieved but you do need relatively straightforward systems to make that work efficiently.

Q301 John Mann: What about the point made to me by the Fellowship of Hairdressers about computerisation of what is the largest section of small business (with 80,000 businesses) that the good companies are keen to computerise and do computerise, the problem is the companies who choose not to computerise because they would rather run cash tills and actually avoid taxation.

Mr Gillett: Obviously it is very difficult for me to comment on specific issues such as that. Certainly we are concerned about companies being forced to computerise in order to fit in with the system. It sounds like a very good idea but if you are a very small organisation and you are forced to spend part of your limited cash flow on investing in a computer system that seems to me to be a restriction of their business and making them more uncompetitive. However clearly computerisation is the great secret.

Q302 John Mann: Presumably you would support the moves the Government has made to fiscally incentivise computerisation with a 100% write off against tax?

Mr Gillett: I think that is the most effective way of doing it but we obviously are concerned about forcing small businesses to do things which otherwise they cannot all afford to do. Not all small businesses make profits.

Q303 John Mann: But we hear an awful lot about this burden of red tape and yet here it is possible to computerise at no cost—no real cost—to the business.

Mr Gillett: I am not sure about no real cost. What you are saying is a 100% allowance. That will save them 30 or 40% depending on what their tax rate is and of course if they do not make profits then they will get no relief whatsoever.

Mr Hampton: Or indeed if they are a small charity or something like that, then a tax write-off really is not a lot of use to them.

Q304 John Mann: If we take an industry such as the hairdressing industry which is 80,000 strong then where is the big problem in the incentivising of computerisation?

Mr Gillett: I think we are all in favour of computerisation. It is a question of forcing companies to do it. What you are giving them is a tax write-off so they are still having to pay 60 or 70% of the cost or perhaps even more, depending on what the tax rate is. If it is a small company, the 100% write-off is not worth that much. If they are not making profits the 100% write-off is worth nothing. That often happens in start up periods. So, as I say, we are very much in favour of computerisation and very much in favour of incentivisation but it is not a complete answer because we do not believe it is right to force businesses to computerise in order to be able to take part in the PAYE system.

Mr Hampton: The point we were making about the slight differences between the imposts which create the difficulty, obviously if they are eliminated then that is one less complexity that has to be taken into account. Getting the basic system right is always the objective. Computerisation is a very helpful tool to deal with the system that then arises but obviously the better the underlying system the better the end result for everyone and the least costly.

Q305 Mr McFall: Back to the point Mr Cousins made to you, looking for initiatives from industry, what you are describing to me suggests a Catch-22 situation here. With 30% of firms paying 75% of the total cost you come and bleat at government because there is that situation and then the suggestion is, “Oh, you can computerise”, and you say, “Not really because it is going to cost people.” We are never going to get out of the situation unless initiatives arise and, frankly, I do not see many small companies in business to make no money. They are there to make money and if there are strong economies of scale being suggested here is it not the case of investing for the future where they can reap rewards? There need to be some initiatives from industry to help small businesses.

Mr Gillett: I cannot deny that it is the right way to go to computerise. It is just a question of whether it is right to say you cannot be in business unless you computerise. That is a more difficult question.

Q306 John Mann: One final question, my constituency I think has the average number of businesses, which is 2,000, which I suspect is about the same for the constituencies of most Members of Parliament. With 2,000 businesses in terms of complaints about the cost of tax compliance, how

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many would you anticipate that the average MP, average in terms of size of constituency, should be receiving?

Mr Gillett: I do not think it is a subject I can comment on. I suspect that you receive very few because the usual attitude is people who want to be in business are in business, and their prime concerns are commercial concerns and things that are imposed on them by government are just, "That's the way life is." So I would not have thought you actually get very many complaints but it does not stop it being a problem.

Q307 Chairman: Just coming back to John Mann's earlier question, is there not more government can do? When we went to Holland to talk to the Dutch Finance Ministry there was much discussion there about whether government could encourage similar types of software or approved software packages for processing some of these costs, or even the hardware, that government could steer and lead changes without necessarily saying every business has to go out and buy a computer. What more is there government could do to modernise work in very small companies?

Mr Gillett: Government has been working very hard in terms of trying to computerise the operations within the Revenue. The Revenue is seen as the government department which has more contact with the public than any other and therefore obviously is the prime target for computerisation. I think the Government has been doing a great deal. We would always encourage it to do more especially in terms of standardised packages or tax compliance work. That seems to be a very good step forward but obviously the Government has had problems with computerisation systems in that systems of that size take some time to get working properly.

Q308 Chairman: Finally from me the Government has helpfully announced that they are going to try and define the coming into effect of employment law changes to only two points in the year—1 April and 1 October—which seems to me one of those eminently sensible ideas and you wonder why somebody had not thought of it before. Have you asked them to do the same with some of the payroll tax changes, for example, the Minimum Wage changes in October, I do not know when some of the student loan variables kick in but I suspect it is not always 1 April. Has the CBI pushed for a common implementation date for some of these payroll changes?

Mr Gillett: I would say in general it is not a major issue. Most of the implementation dates are on an annual basis, there are some that come in in October, so it is not perceived as a major issue in terms of implementation apart from there are so many things to implement. What we are very keen to do is to look at the whole legislative process. Obviously it was not that many years ago we used to have a Budget which was about expenditure and a Tax Bill in the autumn which was about tax changes. That was obviously abandoned and I do not think it worked quite as smoothly as it should have done, but it would be

good to have a legislative timetable that gave an opportunity for more thought to some of these changes. So much of it seems to be rushed through. It is all about the timetable and getting everything ready for April and therefore you sometimes get things put into the Finance Bill that have not perhaps received the depth of consultation and discussion that might have been more appropriate.

Q309 Norman Lamb: If I could turn to the Tax Law Rewrite Project, you identify two issues in your memorandum, and this all dates back, of course, to 1995 and the first point you make is that it was not agreed in 1995 that new legislation coming through would comply with the same rules and so you have had a whole series of Finance Bills provisions written in the old style. The second issue you raise is the fact that the remit of projects did not include any assessment of whether the policy judgments upon which previous law was based were any longer relevant or whether there were other cost/benefit justifications for getting rid of old legislation. Is this not an enormous missed opportunity and does it not amount to rather a waste of time?

Mr Gillett: I hope it does not amount to a waste of time but we certainly do believe that it is regrettable that new Finance Bills are not written in "new speak" because it is a whole load of old style legislation which needs to be rewritten. We have always been supportive of the Tax Law Rewrite Project, we have no doubt at all that life would be easier if the tax legislation itself was easier and more straightforward. Again if I can refer to one of the classic situations of how this happened in the 2000 Budget, the Government announced measures to deal with what were called mixer companies This was to do with double tax relief on foreign dividends, a very complex issue. After much debate they changed the policy part way through the Budget but they had drawn up legislation for the initial proposal and then announced a different proposal and some of us would have said what you properly should have done is start from scratch and write some different legislation because it is a totally different policy. What they did was to try and amend what was announced on Budget Day and one official described it to me as having been asked to design a bungalow, they were then asked to build an additional three storeys and three outhouses and the plumbing and electricity did not quite tie up. What we have is a dreadful piece of legislation. I have been practising tax law for many years and the only way of handling this legislation is you feed a number in at the top of the calculation and something drops out the bottom. I have no idea whether it is right or wrong, it just goes through a calculation. I have no understanding of the principles involved in arriving at that number and therefore I find it very difficult to make judgements about how I should pay dividends.

Q310 Norman Lamb: Those provisions clearly failed to meet the test of the Rewrite Project. Have you made representations to government on your

concerns about the limitations of the value of this Rewrite Project and, if so, what has been the response? Have you made any progress?

Mr Woods: When the process started these points were registered, but it was made clear to us these were the confines within which the process was being set up and taken forward and therefore we have accepted that as being the parameters within which we have to operate. We have done our best. In fact, we have put a huge amount of resource into the Tax Law Rewrite programme itself because we want it to be as successful as it can be within its parameters. As I said, we did when it started protest about these things, but unfortunately we cannot win every argument.

Q311 Norman Lamb: Just to be clear, you would make a plea to government, first of all, that new legislation was done in the same way, according to the same principles as the Rewrite Project and the other legislation, and, secondly, that they ought to be looking at a whole mass of legislation and finding what they can get rid of which is no longer relevant?

Mr Gillett: We make technical tax proposals every year, some of which are to change things which we think are sensible to improve the position, but it is also a complete review that we try and put through every year and these are issues which really should be improved and changed. As I say, it is about changing the system. You have to change the system as well as the language.

Q312 Norman Lamb: Turning to the issue of the Regulatory Impact Assessment, the Revenue says that this is the basis upon which they test the compliance cost of any proposed bit of legislation. You cast doubt on the value of it. You put forward a suggestion that new tax legislation coming before Parliament should have a certificate showing the results of prior consultation. Do you want to expand on that? Could you also comment on whether you think there is any value in making the process of Regulatory Impact Assessment independent of the department that is seeking to introduce the provision? It seems to me that it is likely to be self-serving if it is produced by the department that wants to introduce the measure, in this case the Revenue.

Mr Gillett: In terms of Regulatory Impact Assessments, I am sure the officials involved try their very best to produce reasonable answers and I would not wish to comment on whether they are biased or not in what they are producing. The problem of course is that although they are very able officials and very able civil servants, unless you are on the receiving end on this and working in business it is very difficult to understand what is actually involved. They do on occasions consult on specific RIA type issues but that is very, very rare. It seems to me these numbers tend to appear from wherever the Revenue get numbers from. There has been a growing atmosphere of more consultation on new legislation over the last few years. There is absolutely no doubt that apart from things like the double tax relief legislation (which was something of a

consultative disaster) there has been an improvement in the consultation process and the approach we try and take is if government decides to try and implement a particular policy then it is not our job to challenge that policy. It is our job to try and ensure that the policy is achieved in the most effective and efficient manner within business with the least impact on business, which I think can help Revenue officials focus the legislation better.

Q313 Norman Lamb: Are you suggesting that consultation forms part of the Regulatory Impact Assessment process? You are not suggesting scrapping that?

Mr Gillett: No, no, I think there should be a Regulatory Impact Assessment. We just think it would be better informed were it done much more in consultation with industry. We have had good consultation in terms of policy and policy implementation and we have had some very effective consultation there, but in terms of the compliance burden the Regulatory Impact Assessments tend to appear from nowhere as far as we are concerned and we do not always understand the numbers.

Q314 Norman Lamb: In the United States the Congressional Budget Office introduces an element of independence to the process. Do you have any view about whether you would like to see something similar in this country?

Mr Gillett: If I can express a personal view—it is not something the CBI has thought about—from a personal viewpoint I have no reason to doubt the integrity of the officials involved. I have always found dealing with Inland Revenue officials extremely good and I do not see a need to have any complex independent—

Q315 Norman Lamb: You just want better liaison?

Mr Gillett: I think it would be better if there were proper liaison with business. I wonder how Revenue officials can really understand what it means to business in terms of impact. It just seems very difficult for them to understand and appreciate the practical difficulties of implementing some of this stuff.

Mr Woods: There also is no clear process of *ex post facto* checking to see whether the RIAs were justified in practice or whether the figures were incorrect.

Q316 Norman Lamb: Ought there to be a principle that after X period of time—a year or two years—you go back to look at the impact of the new provision to see what its effect has been?

Mr Hampton: It is to see whether it works or not, whether the stated policy objectives have been achieved.

Q317 Norman Lamb: Finally you have acknowledged there have been improvements in terms of consultation on new provisions but are there any other changes you would like to see to improve consultation to ensure that we get the best provision possible at the start?

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Mr Gillett: I think there has been significant improvement. I think the RIA is the key area, especially talking in the context of administrative burden, where we feel there has not been a lot of understanding. It is inevitable that it is very difficult for officials to produce an RIA without talking to business. That I think is the key area where we would like to see an improvement. In general as regards implementation and policy that is a process which continues to improve. There is always room for improvement but it does continue to improve.

Mr Woods: We take it that your question was not addressing the parliamentary aspects of consideration of legislation which we touch on in our paper? That is an old point that has been around and we have made before.

Q318 Chairman: Finally from me before we let you go, you ask in your memorandum for an Annual Report to Parliament on how the various tax definitions and thresholds and ceilings have been reviewed and updated in line with inflation. What is the response from the Revenue on that suggestion?

Mr Gillett: I think I would describe it as limited. I think the sort of point we are making is once upon a time benefits were only assessed on people earning more than £8,500 a year and this was deemed to take out the vast mass and obviously only the wealthy were taxed on benefits. It also had the effect of eliminating a great deal of paperwork and compliance burden but the £8,500 has been allowed

to remain there and it is still there as the limit so instead of the minority of employees having to be responsible for having P11Ds and various forms, now it is the majority of employees. That £8,500 has been left there.

Q319 Chairman: Your argument is that it would be more obvious it had been left there if there was this annual table?

Mr Gillett: Yes, and another one is expensive cars. If cars are beyond a particular cost you have to list out every single individual car and claim capital allowances on each one rather than the normal capital allowance policy where you throw all the costs into a pool, calculate a number and it is a very easy tax deduction calculation. Again this was initially introduced so that directors could not drive around in Rolls Royces having been substantially paid for by the taxpayer, but the limit stands at £12,500 and is obviously outdated and now for the majority of cars owned by companies we have to list out pages and pages of each individual car. Whether there is a good, sound policy reason for that it is difficult to ascertain but again it would be much clearer if somebody said there is a clear policy reason for that, it is staying at £12,500, and that is why we are doing it. It might as well not exist at the moment because it has obviously become fairly irrelevant.

Chairman: I think we are going to leave it there. Can I on behalf of the Sub-Committee thank you very much indeed.

Wednesday 21 April 2004

Members present

Mr Michael Fallon, in the Chair

Mr Nigel Beard
Mr Jim Cousins
Angela Eagle

Norman Lamb
Mr James Plaskitt
Mr Robert Walter

Witnesses: **Rt Hon Dawn Primarolo**, a Member of the House, Paymaster General, **John Healey**, a Member of the House, Economic Secretary, HM Treasury, **Mr Robin Martin**, Director, Better Regulation, Inland Revenue, and **Ms Jen Little**, Policy Manager, Business VAT, Customs & Excise, examined.

Q320 Chairman: Ministers, can I welcome you to the Sub-Committee again. Perhaps you could introduce yourselves and your team.

Dawn Primarolo: Good afternoon, Chairman. To introduce myself, I am Dawn Primarolo. I am the Paymaster General, Minister covering the Inland Revenue. Robin Martin is from the Inland Revenue and he is Director of Better Regulation. John Healey is the Economic Secretary to the Treasury covering Customs & Excise and Jen Little is the Policy Manager, Business VAT.

Q321 Chairman: Thank you very much. Thank you for your joint memorandum to the Sub-Committee. In that memorandum, you say at paragraph 1.5 that, "the Government is committed to reducing tax compliance costs where this can be done consistently with its other objectives". How do you prioritise those objectives when they conflict?

Dawn Primarolo: Perhaps we could do it by example as well as that would help the Committee.

John Healey: I think across the piece controlling and reducing, where we can, compliance costs is a very high priority. Sometimes it is the principal objective of tax reform and tax design on the basis that if we reduce the costs to business, we are likely to have a more vibrant enterprise and that is particularly true for new and small businesses. You will see that across the tax design piece it is often particular provisions that are there to try and simplify the system and reduce the costs to small businesses. An example in my area would be the VAT flat-rate scheme, which was designed specifically and principally to reduce the complexity and, therefore, the costs of the VAT system to companies with a turnover of less than £150,000 a year. We have got other objectives and clearly the tax system can be used to pursue other objectives, whether that is protecting or raising revenue, whether it is correcting certain market failures, whether it is pursuing fairer policies or protecting the environment, and it will always be a major consideration or concern in the decisions or the design of the tax policy and indeed it is delivering now. It, therefore, features strongly in the internal assessment that we do, it features strongly in any external consultation that we do and it features strongly in the regulatory impact assessments that we produce, but in the end when there is a tension

between those potential aims, then clearly it is a question of judgment and balance, one that we take and others will judge.

Q322 Chairman: Has that balance changed over time? Do you give reducing compliance costs a higher priority now than you did five years ago?

Dawn Primarolo: I think it is probably fair to say, Chairman, that yes, we give a higher priority and I think it is in approaching the agenda as laid out, the various balancing, whether it is protection of revenue, policy objectives, intervention where business wants to see that, or tackling non-compliance, taking note of what the PAC said when it wants us to bear down harder on non-payment of which we are very mindful, so it is difficult to pull it out. To give an example currently, for instance, on self-assessment. For some time, since the introduction of self-assessment, there has been the question of the form, its length, complexity, supporting guidance and regulation and whether everybody who was in the net needed to be there or whether there were other ways we could deal with it, so the introduction now of the short return and the direct result of taking many taxpayers out of self-assessment is a result of us concentrating specifically around that area of policy on compliance costs. Another example would be if we look at the changes on transfer pricing, requirements to the change in the legislation, and given that our focus is particularly on small business, on compliance, because often the disproportion of costs, that led us to run alongside each other the policy desirability of making the changes and requirement for vehicle ruling, but to do all that we possibly could, whether it be by exemption or whether it be by putting in countermeasures to remove particularly small business, but as many businesses as we could from the system which did not actually need to be in it in the first place. In those examples we are taking compliance costs very high up in policy. It would be fair to say that in other examples we are driving forward policy as a higher priority and the tax credits would be an example of that and you might want to return to that because we have obviously visited that. In the period that I have been Minister, I think it is fair to say, Chairman, that whilst it was always there, we are pushing ahead and trying actually to bear down on it in a more systematic way.

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Q323 Chairman: Thank you, that is helpful, and we will come to tax credits a little later on. As this inquiry has been unfolding, what we seem to have discovered is that there really are not any up-to-date figures for the administrative costs of tax compliance. Is that satisfactory and how do you know what priority to give it if you do not really know what the burden is? All the studies we have seen seem to be very out of date and various witnesses have said that they simply do not know what the costs of administrative compliance are, certainly from business.

John Healey: It is not ideal. In an ideal world, we would be able to say, "This is the cumulative total cost of complying with the tax regime for this or this business". Our principal problem is disentangling the obligations which flow from tax legislation and, therefore, the requirement to comply with taxation from the costs of normal business administration. Because there is such a significant overlap, actually disentangling those in research in analytical terms is the principal problem, so if you, as sometimes we have done, try to pin this down through research in order to establish some baseline from then to work and you go to companies, you may find that they will say, "Well, my costs of complying with the tax regime are the full costs of what I pay the accountant or the bookkeeper", when clearly that is not the case because there will be a combination of the two. Somebody else may say, "Well, I fill out my VAT returns at night and, therefore, there is zero cost", because they see themselves doing it in their own spare time and not being a cost to business. Now, in circumstances like that, it is very difficult to give a consistent analysis which gives you the sort of baseline which would allow at all, I think, the ideal situation which is where we knew where the compliance costs lay and we were able then to track changes over time from having established that baseline. That is compounded of course, I suppose, by a principle that we try to follow where of course if we are introducing changes or new taxes, the degree to which we can design the reporting requirements to fit with the business information and reporting administration processes and practices anyway, then the lower the compliance costs, but clearly the greater the overlap, the more difficult for this particular purpose it is.

Q324 Chairman: Have you established a baseline?

John Healey: No. You will recall, Mr Fallon, that in the 2000 Spending Review, at that stage we were, I think both departments, but certainly Customs, set a PSA essentially to try to do just that and we have worked hard at trying to do that and found, as I think some of your other witnesses have indicated, that it is difficult, well nigh impossible to disentangle, as I explained, what are the principal costs which flow from complying specifically with tax legislation from the normal practices and processes of running a business and to do that in a consistent way which allows you confidence that you have got normalities across the piece.

Q325 Chairman: The difficulty for us is that the evidence from your officials, both from Customs and Revenue officials, was that the position was broadly neutral, that the increased costs had been matched by other policies and objectives in terms of savings. Both Customs and the Revenue said that to us, that broadly the effect was neutral. If you do not know what the baseline is, how can you really be sure that the total administrative cost is not increasing?

John Healey: The short answer is you cannot be sure.

Q326 Chairman: Well, what is your view?

John Healey: They said that their best guess was that it was broadly neutral over the last year, couple of years, particularly, I think he said, if you take out some of tax-avoidance measures.

Q327 Chairman: But over five years or broadly neutral over ten years, 15 years? Do you think the burden has increased? Do you accept it has?

Dawn Primarolo: Well, I think if we take the period from when the regulatory impact assessments started and we were measuring policy and its development, we can demonstrate there through the regulatory impact assessments. I think the wider question in having a baseline was to say, "Beyond that, are there hotspots currently in the system?" What we have done to address it is a number of different attacks on the central point. The central point is that, wherever possible, whether we can reduce compliance costs, whatever the baseline is, we should be looking to simplify and reduce compliance costs where we can.

Q328 Chairman: But you do not know what the baseline is. That is the problem for you, is it not?

Dawn Primarolo: Well, I think what we need to do with the regulatory impact assessments as we develop policy, and we have seen since 1997 and particularly since 2001, saying, "Here are the compliance costs. Here is the impact, here is the benefit and we can measure it there", that we also attempt to measure it, for instance, when we undertake simplifications of the tax system, and, for instance, the current one on pensions enables us to do a complete reassessment and a regulatory impact assessment on the whole re-writing of a policy area to make sure that balance is right. Then we have got to work with business on particular, if you like, hotspots, areas which they consider to be ones that they want to see progress on, so we are responding very much here, given the difficulties business and other advisers are having, and saying, "Let's deal with the perceived problems", at the same time as we are trying to work towards a general agreement about what compliance costs may or may not be with the tax system.

Q329 Chairman: The problem you have is presumably this divergence of view. Business and the tax practitioners are all saying that they think, they perceive the burden to be increasing and your

officials are saying they think it is broadly neutral. Now, we have got quite a wide difference of view, so does that not bother you?

John Healey: Well, there may be a difference of perception, but that is because nobody has an evidence base to say definitively one way or the other what the position is, and, to be honest, as Ministers, we are as frustrated as you obviously are in trying to scrutinise this as a select committee, and it is true to say that many of the costs which are not perceived as tax compliance costs are actually costs which would be incurred anyway by a business in the normal run of financial management and reporting.

Q330 Mr Beard: But the University of Bath's project in 1996 seemed to get fairly widespread acceptance and that somehow must have disentangled some of these costs. Could that exercise not be repeated?

Dawn Primarolo: Well, firstly, we are applying the recommendations from the Bath study and I think the information on this was provided to this committee. Secondly, we then followed that up specifically with the Carter Review in looking at what else could be done. We have had the regulatory impact assessments continuing and we need to see the post-implementation evaluations as well, we have got the simplification processes and we are working in detail in areas where businesses particularly flag up problems, so at this point in time we think that there is a sufficient amount of pressure in the system to drive us to sustain an objective where we should always ensure that the compliance costs are reasonable and proportionate. We could never say there would not be another study and we need to reflect on that, but at the present time the policy levers are sufficient, in our view, to deliver that and are working. The Government has also developed a much more extensive programme of consultation with business anyway in the development of policy and again if we take something like the Savings Directive and all of the work that went on with the City and the work to develop the regulations, again that all had at its very heart making sure the rules would work, that they were reasonable and that they were proportionate. As I said, at the moment I think that there is enough in the system, but I would never say never, of course not, and it may be appropriate at some stage to return.

John Healey: I think it is fair to say too that you have heard from some of the business organisations which express some sympathy with the departments in trying to gather such evidence and pointed out in passing of course that those attempts to do so make slight increases in compliance costs for the businesses and concerns. It is not a straightforward exercise, this, unfortunately.

Chairman: No, I understand that, but let's look at it in a little more detail.

Q331 Norman Lamb: Just to follow up on Nigel's question, the Bath study was carried out in 1998 and I think it had been commissioned in 1996, so presumably their work covered that two-year

period. Is there not quite a strong case for revisiting that and commissioning a new study to assess where we have got to in the intervening years?

Dawn Primarolo: I think not at the moment. I think if we look at the international comparisons and the work which has been done with regard to regulation and performance of the UK economy, we see that the UK economy comes out very high in all of the recent studies. Given that of the 31 recommendations from the Bath report, of which seven were for the employers anyway, the overall majority of those have been implemented. Given that there is rather large change currently, we have already had the Contributions Agency move into the Inland Revenue and we have got the development of the single department following on from the O'Donnell Review—

Q332 Norman Lamb: But that very change, does that not in a sense reinforce the case for a new assessment, as it were, to establish the baseline which the Chairman talked about so that you can then properly try and measure it, and I do understand the difficulties of measuring it?

John Healey: What it does is it underlines the case that Dawn is making here which is that actually it is a new approach rather than a new attempt to assess which is required because we have been trying this. We have been trying this and we have run up consistently against the problem we have just discussed, which is that the high degree of overlap means that it is difficult to isolate in a consistent way, produced as reliable information from a range of businesses, those costs which are there as part of running a business and those costs which are there isolated and identified as the costs of complying with tax legislation.

Q333 Norman Lamb: On the new approach, as it were, you have talked about the regulatory impact assessment. I remember going on a seminar put on by the Cabinet Office and they were talking about the progress which had been made in developing this whole process and their assessment, this was about a couple of months ago, was that we have made quite a lot of progress here, but there is still quite a long way to go and not all departments are actually complying with the Government's own rules about what the assessment should include. Are you satisfied that in your departments the system is working properly and it is adequately assessing the costs of any new measure?

Dawn Primarolo: The answer to that question is yes and that the checks and balances are in place to ensure that happens with full involvement, for instance, with the Cabinet Office and making sure that we are complying with the rules, with consultation with the Small Business Service, proper integration and consultation around policy issues which fall into account in the regulatory impact assessment and, on top of that, we have got the NAO where the Better Regulation Task Force has taken a series of regulatory impact assessments and then

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looking at those in isolation. The Revenue and, I think, Customs have had regulatory impact assessments considered in that way.

Q334 Norman Lamb: Does this involve going back and looking at what has already happened to determine whether the regulatory impact assessment has been proved to be correct?

Dawn Primarolo: Well, there are two processes and one which needs to be much more marked. The first one is that the process requires information to be collected, so once we have the regulatory impact assessment and the policy is implemented, information is still having to be collected, rightly so, and fed back into ongoing policy development in that area, and that takes place and the regulatory impact assessments have that within their requirements. I think the second area is the question of post-implementation evaluation, review, whatever one might like to call it, of those regulatory impact assessments. Now, some have been subjected to that and for others obviously it takes time for the policy to come through.

Q335 Norman Lamb: Is it your objective to do that on a systematic basis across the piece?

Dawn Primarolo: Yes, I think we have to see that as we build up, if you like, our corporate knowledge to add to all of the discussions about exactly what we mean by compliance costs because this really is at the very heart of it. Some would call it the obligations of business and, wherever possible, we try and align the information we require with the information that would be collected for other reasons by a business to conduct its business, so it will enable us to do that.

Q336 Norman Lamb: What about introducing some element of independence to the regulatory impact assessment process because there is a danger that a department, wanting to introduce a measure, is somewhat self-serving in producing an assessment which will confirm what it wants to confirm?

John Healey: There is already. The answer, from Customs' point of view is like Dawn has given you already. Because the regulatory impact assessments are now at the core of our attempt to deal with this question of compliance costs rather than establish a baseline, the aim is to make them as systematic and as thorough as possible, so there are. To pick up the independence point, frankly, our best regulatory impact assessments require a contribution from outside interests and Dawn has mentioned the Small Business Service, the Cabinet Office oversees it and also from industry, and sometimes both Revenue departments will produce partial RIAs as part of consultation on that and then produce, in the light of some of the industry contributions to that, the fully-fledged RIA alongside the legislation. Therefore, there are contributions from outsiders and they are reviewed independently by outsiders, the Small Business Service, the Better Regulation Task Force and, as Dawn said, the National Audit Office who, incidentally, regard this as a rigorous framework for trying to approach this problem. Then there is the post-implementation assessment or research which,

as Dawn has suggested, is the important, sort of final part of the jigsaw. Now, here I think in many respects the two Revenue departments are breaking ground across government. You mentioned that there were some questions in some departments about the quality of the RIAs. What we now aim to do because this is at the heart of the cost of compliance concern, the challenge that we have got is to make sure that once we have had a regulatory impact assessment, and in Customs there were nine in the course of 2003 principally around the Finance Bill 2003, we will now go back to all of those and, as Dawn says, it requires a certain time-lag before you can get the implementation and, therefore, start to assess and analyse the impact, but we will go back to all nine RIAs and we will check back over the accuracy of the assessment, the estimate that we produced at the time, so that will be a continuous process. We produced five this year in relation to this year's Finance Bill and in due course we will do the same again.

Q337 Norman Lamb: And that will all be published, the assessment after the event?

John Healey: What we aim to do in Customs is to report on that post-implementation research and assessment for the first time in our annual report towards the end of this year.

Q338 Norman Lamb: But will the actual individual assessments be published or will it be a general assessment?

John Healey: We have not taken that decision, but we will publish the results of the work that we have done and we are at the moment looking to do that in our annual report.

Q339 Chairman: Will the Revenue do the same, go back over its assessments?

Dawn Primarolo: Yes, we will also be looking to see frankly what your committee says as well and take decisions on these issues.

Q340 Chairman: The whole problem with these assessments is that of course they do not measure the actual cost, but they only measure the change that is proposed by a new piece of legislation or regulation. They do not measure the actual cost which exists at the time.

Dawn Primarolo: What do you mean by "actual cost which exists at the time"? I believe they do. Could you be more specific?

Chairman: I thought the assessment measured the change that was proposed, the cost of the change rather than the cost of the original legislation.

Q341 Norman Lamb: That is what it does.

Dawn Primarolo: It measures the change and then the ongoing costs of that change or the ongoing savings of making that change and at the point of change it evaluates all the elements which are necessary to achieve that.

Q342 Norman Lamb: The Institute of Chartered Accountants said that when you look at the costs in doing your RIAs, you are looking at the actual costs on a day-to-day basis and you are not looking at the much bigger issue of the cost of seeking advice in specific areas. Now, is that correct or do your RIAs acknowledge that there is often a massive cost in seeking independent professional advice?

Dawn Primarolo: The regulatory impact assessment, in looking at the initial costs, makes an allowance for the advice and support that a business may need to get, should it do that. Where we start getting into difficulty is where a business wants to tax-plan in a big way, that is their choice, but we need to be clear as to whether we count that as compliance cost. We would count the advice given to them and what has been said to me is that that is part of the initial costs.

Q343 Norman Lamb: Finally, you mentioned earlier the PSA targets and when I questioned Mr Martin in an earlier session, he accepted that the targets were pretty vague. He said that the target of reducing compliance costs was met if you were able to say at the end of the period, "Well, we have reduced it to some extent", however much that might be and just some reduction counted as meeting the target. Do you accept that they are pretty vague and would you, therefore, conclude from that that they are pretty much meaningless?

Dawn Primarolo: By their nature, because of the discussions I know you have had as a committee with the advisers and looking at the evidence and some of the difficulty of actually starting from the baseline, which all of us perhaps are haunted by and would like to establish, nonetheless, I think we should have a target that shows that we are reducing compliance costs and if we look at the period of the regulatory impact assessments in this Spending Review, I think it is £28 million overall, of which 12 are specifically for small business, and that is specifically our target as well. We are reducing it for all, but recognising it is disproportionate, so whilst I might share your frustration, wishing that it would certainly be easier for us as well, what I think is very important is (a) we have a target which is actually saying that we have got to drive it down—

Q344 Norman Lamb: So it is worth having this even though it is of relatively limited value?

Dawn Primarolo: Would you not agree it is better than nothing where we allow it unchecked at the same time as we put pressures and requirements in the system?

Q345 Norman Lamb: But you accept your officials' view that it is a vague target of necessarily limited value?

John Healey: I would not accept that at all, but I would accept that it is not quantified, though I would argue very strongly that it is important to have a PSA. After all, departments have a premium on PSAs. It signals both the serious intent and concentration of the Department on this area and focuses the mind and the work of the Department in doing so. Now, as Dawn says, it is important it is

there and it is also important that it clearly is looking for a reduction, a demonstrable reduction, albeit one that we have not been able to quantify, which, looked at from the point of view of the year 1999–2000, we were indeed looking to do because we thought we might be able to establish baselines.

Q346 Mr Plaskitt: You are talking about targets to show a quantifiable reduction. Do you think you are going to be able to get agreement with all the business groups on how you are going to be sure that what you have measured has genuinely shown a reduction? You were talking earlier about the difficulties of measuring what constitutes compliance costs, so if the target is to prove a reduction, is there going to be agreement on everyone's behalf that what you say is a reduction actually is?

John Healey: What we will not get from the RIA process is a quantification and the quantity of cost compliance. What we should get is a quantification of the cumulative change, at least from those measures which are covered by the RIA. Now, generally, as we discussed a little earlier, our estimates in the RIA are developed drawing on information, intelligence and sometimes contributions from industry, and generally the RIAs are broadly accepted by business. Where they are not, we have a discussion about those and the post-implementation assessments and research that we now plan to put in place systematically I think will help settle those sorts of concerns, so I hope we are going to get an increasing confidence in the RIA process and an acceptance or consensus behind the sort of figures that they will demonstrate, as Mr Fallon said, demonstrating essentially measure by measure the change in the compliance that there is.

Q347 Mr Plaskitt: So you feel confident that everyone will sign up to the targets, accept the definitions and accept the results that come out?

John Healey: Well, I think it helps when the Better Regulation Task Force, which is business-led, I think it helps when the Small Business Service, which is business-led, it helps when the NAO, which is generally regarded as independent and fair-minded, are prepared to review an RIA and accept the figures and methodology that underpin them, so that sort of already established approach, which we can build on further, yes, in the end does give me a confidence that we can achieve some degree of broad acceptance of the figures that we will look to build up.

Q348 Mr Plaskitt: In the consultations with business that you already have, and you have referred to them already in the course of evidence, are there occasions when business comes forward to you making proposals for specific changes in compliance or aspects of compliance and can you give us examples of ones that were taken up?

John Healey: Yes, the VAT flat-rate scheme, both its introduction and its reform in PBR 2003.

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Q349 Mr Plaskitt: In your memorandum to us, you referred to compliance savings achieved as a result of the regulatory impact assessments and you have measured them at £28.61 million. Given the difficulties of measuring in this area, how have you come up with such a precise figure?

Dawn Primarolo: Those are the figures from the regulatory impact assessments which go through this check and balance. You keep coming back to how we are going to get agreement, so we have tried to broaden that from just the Department, so that is where the figure comes from.

Q350 Mr Plaskitt: I know where the figure comes from, but how were you able to measure it to that degree of accuracy?

Dawn Primarolo: Because of the guidelines which are laid down about how we are to prepare and cost for the regulatory impact assessments. There is one about to be revisited, a company car tax reform in 2002, looking at the initial evaluation findings, which will be published soon, which will show that with the one-off cost to implement the change to the tax calculations, the evaluation now shows that employers are actually saving more than was originally allowed for in the impact assessment, and obviously what we then have to do is look at that to see whether that tells us something about the assumptions that we were asked to follow in reaching that original regulatory impact assessment—

Q351 Mr Plaskitt: I have still got the same puzzlement, I am sorry, but £28.61 million is an extremely precise figure. If the impact of some of the RIAs can be measured with that degree of accuracy, why across the piece is there a problem in everyone deciding how these things are going to be measured? I still do not understand that.

Dawn Primarolo: Well, that is two separate questions. The question for the regulatory impact assessments is that, as departments, we are required to follow the Cabinet Office's assessments about how we compile a regulatory impact assessment and some of those are quite precise and that is what our regulatory impact assessments do. Separately and very much what the dialogue with business has been about, and we have ourselves engaged with business, asking them to be specific with us about compliance costs for running tax as opposed to running the business or the other options, that is where the issue of what amounts to a compliance cost is without agreement and I think what is interesting is that it is not because business hold one view and we hold another, but there is a genuine view on both sides that whilst there is, and I think this was in the evidence to you, a perception of growing compliance costs, when we ask them specifically to demonstrate that to us, that moves the debate elsewhere to what I call the "hotspots", and then we do engage with business on those specific issues to try and resolve them, self-assessment, VAT flat rate, and developing policy now, for instance, on transfer pricing or the pensions simplification.

John Healey: Perhaps I could reinforce that. It is different, but it is more straightforward because for a new requirement, a new piece of legislation it is possible and easier to say that in order to comply with the requirements of this, what additional work, what formal activity and, therefore, what cost is a business likely to have to undertake, or indeed if there is a cost-compliance reduction, in what ways and to what extent and at what cost will there be a saving to what a business currently does? So when you are looking at the increment, either positive or negative, it is easier to distinguish than it is from the overlapping costs of what already is business as usual, and that is why the RIA is a process which is clearer cut, though it remains an estimate, a best estimate at the point of its publication and hence the importance of going back once implementation is in place to do post-implementation assessment and research into that.

Q352 Mr Plaskitt: Is the £28.61 million the sum total of what was saved by RIAs or merely the measurable amount of what was saved by RIAs?

Mr Martin: I think the truth is that some RIAs are able to be more precise than others. It depends on what you are looking at. If you have got good information, you can be precise and you can be certain that you are producing a figure which will stand up to almost any scrutiny, whereas in others you may not have enough information to be able to reach a very good figure at all, so I think the answer to your question is that that £28.61 million is an aggregation of all the figures in the table we have produced for the committee and, if you like, they are figures of rather different value. Some of them we would be confident we have got very good best information about and others perhaps not, so the £28 million is, to an extent, a mix of different things and of course it is a mix of pluses and minuses as well.

Q353 Mr Plaskitt: Therefore, it cannot be a precise figure because some of its constituent parts are imprecise?

Mr Martin: Yes, that is right because in some cases we or indeed business only have imprecise information.

John Healey: It is important to stress that RIAs are the best estimate based on the best information available. Now, that is why we are striving to improve the process, but they are at that stage a best estimate. I think it is fair to say that we generally do not get the direction of the costs wrong. If we think a particular instrument or policy change can reduce costs, we may under or overestimate the scale of that, but we do not generally get it going in the wrong direction. There is one important point to add, Chairman, to what Mr Plaskitt has been asking about which is that of course the cumulative figures which have been added together are based on the RIAs and it is true of course that the costs of compliance for companies also will alter from operational changes, not just legislative changes which may be covered by a regulatory impact assessment. If I can give you an example in both

directions, when Customs introduced the national advice service, it changed the way that businesses got accurate information from Customs and it, therefore, had, if you like, a positive impact on the costs of compliance for traders dealing with VAT and our other regimes. By the same token, when EU accession takes place at the beginning of next month, there will be an increase in the cost of compliance for business from an operational change and extra information required, for instance, through the Intrastat surveys of business, so there are changes to the cost of compliance to businesses which are not exclusively confined to the legislative changes that we cover with the RIA process. For that reason, within Customs we are now starting to apply the same sort of RIA process internally to major operational changes which do not have a legislative dimension, but nevertheless potentially may have an impact on the costs of compliance and we are essentially using the same methodology and the same approach.

Mr Walter: On that particular point, I am looking at the document that Mr Plaskitt got that figure from and what I would pick up from it is that what we have got here is actually an estimate because if you read the introductory notes to the document, it says that a number of boxes in the table show the figure zero and that this may mean that the costs or savings are small or negligible as opposed to nil, so they are not zero. Therefore, it would have been far better, I would have thought, if you had actually said that these were estimates rather than precise figures in giving us what in the end is £28.61 million.

Q354 Angela Eagle: On that point which Robert Walter has just made, there is an interface between European Union legislation and things that really the Government is not doing directly which still impact on compliance costs. When our committee visited Holland, the Dutch Government and the people we spoke to on the business side reckoned that the costs of EU legislative compliance were about 50% of their compliance costs. Have you got any kind of structure in place or are you planning to have a structure in place which takes account of that because clearly if you reduce UK compliance costs in our tax system by 25% and EU costs go up by 25%, there is no difference whatsoever in how it feels if you are on the receiving end?

Dawn Primarolo: The wider question of the impact of European regulation on British business has been raised a number of times by the Chancellor and he has raised with the current Presidency that there is an agreement between the current Presidency, which is the Irish, the next Presidency, which is the Dutch, the following one, which is Luxembourg, and ourselves to use the consistency of four presidencies working on the same principles to develop at the European level ways of tackling the very point that you are making with regard to assessments of the impact of possible regulation changes before they are made and where they counter the objectives of competitiveness and growth, in a sense exploring them and trying to develop at that level a more systematic approach like regulatory impact

assessments. Therefore, I think, firstly, at the European level, and I think the committee would already have it, but if not, we can certainly send the statements and the statement of objectives that the four presidencies agreed to. Then at, if you like, the UK domestic level, if we take, for instance, the changes as a result of the ECJ *Lankhorst* case, which is going through now with the changes in the Finance Bill, transfer pricing as a result of that, again there we took steps as a Revenue department to see what is going to be the impact of the requirements, how we mediate them and what we need to do to keep any compliance arising from this to a minimum or to try and balance it in another way, and I think some of your witnesses touched on this. They were not very keen on what had to be done, though they did not know what else could be done, but they agreed that what the Revenue had done was to have extensively consulted on it and used exemptions where we could to remove business from the obligations, put in place protections where there were particular problems and then we looked at the tax system and asked whether there was something we could do which would assist business in another area given that they now have a problem in this area, and that was the management expenses, so actually we are trying to work at both levels and use the tax system. It is very crude, and I would freely admit this as we are trying to work through this, in how we balance the tax system across different requirements, not just in one requirement. That is a bit of a long answer, but it is quite a complex situation.

John Healey: I would add two points to that, if I may. The first is that it is certainly the case that the Chancellor has been pushing this, but the Paymaster General, particularly in the tax field, has been equally pushing in Europe for this and I think it is fair to say that there is beginning to be a greater concern and focus on cost compliance to business of some of the Euro measures which perhaps has not been done in the past. Secondly, where there are significant EU tax legislative changes required, generally they need to be transposed into the UK system and generally they will require legislation in the UK and, therefore, they will generally be picked up in the RIA process if that is the case.

Q355 Angela Eagle: There is just one other thing about the focus on small business. Much of the voice of business tends to be dominated by larger companies by its nature and the paradox in this is that some of the biggest effects of just even ordinary payroll requirements for income tax purposes, PAYE, actually impact on very, very small businesses. Are you satisfied that you have connected yourselves into the voice of small business in an appropriate way and that their particular concerns are heard above the general din that the global companies bring to bear on all of these things because clearly the effects on them could be much more catastrophic than on, and I hesitate to say it, Shell or someone like that? Do you think you have

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got your ear in the right place when it comes to the competing voices of business and the lobbying and demands they make about this issue?

Dawn Primarolo: Yes, and you are quite right in identifying the different drivers and when you see the different demands on the tax authorities, I always think it is interesting that when we reach the stage of taking Budget submissions, companies do not always worry about complexity when it is a relief they want in the system or there may be policies which are driven by smaller businesses and different ones by larger businesses. In a sense it goes back to the very first question asked in this session about how to balance those competing issues. With the small business teams that we now have, plus the requirements, the regulatory impact assessments' major focus is supposed to be on small businesses and the teams that prepare those can push, and do, the policy development teams around issues, plus the Cabinet Office, plus the Better Regulation Task Force and the consultations we do, yes, I think there is this ability for us to hear that and to try and settle it. Whether it is always settled, in the end the Minister has to take the decision on the balance between the compliance requirements, but yes, we do and we are seeing that again, for instance, in the disclosure requirements. Clearly where we have substantial avoidance, that is bad for all taxpayers because of the failure to collect. Looking at the rules for disclosure, there was an issue around inhouse and out of house, promoters out of a company and inside, and there were two problems. One is not having too much compliance on companies that had advice internally, but of course then the other thing was to make sure that there is not a disadvantage for those who do not have the inhouse capacity as opposed to those who were buying in schemes, and that very much then comes where you get several policy areas bearing down and entirely different views depending on the size of the company about what the response should be.

John Healey: From Customs' point of view, I would say that we are getting better, but we could get a good deal better still. We have a number of formal consultation forums with business, including the Small Business Forum and we have heard recently from the Small Business Champion. We are trying one or two other things which is to try and get a sort of indication of assessment that we were discussing earlier on. We are setting up now an extranet, discussion groups, if you like, which are open and targeted particularly at small firms and to international traders, suppliers as well as advisers, and we also have just completed a pilot on sending a researcher in on assurance visits to firms so that they are able to see how tax affairs are managed in practice, they are able to see where costs may be reduced, and clearly there has been as much of a focus on small business as there has been on the larger ones. If we assess that as being a good approach, we will roll that out more widely later this year.

Q356 Mr Cousins: I wonder if I could follow my colleague directly on that point and, taking her point about the position of small business relative to very

large business, a point put to me by, for example, the North East Chamber of Commerce is that because of the different assessment periods and pay thresholds, reconciling National Insurance with PAYE from a very small, one employer/one employee company can really be quite onerous. I wondered if that was a point that you recognised and were trying to address.

Dawn Primarolo: Yes, the Carter Review was set up specifically to look at the issues around PAYE and National Insurance and, in particular, where improvements could be made. There are sort of two options to this. There is the actual compliance itself and the mode of compliance and then there is the policy and whether the policy could be driven closer together.

Q357 Mr Cousins: Exactly.

Dawn Primarolo: Now, on the policy side, and we have just done another National Insurance Bill which I think is just completing its final stages in the Lords and will come back to the House of Commons soon, it is almost through the process, where we have aligned again as much as we can, and bringing the Contributions Agency into the Revenue has helped in that and we are building steadily on that. There are some pretty important fundamentals about how National Insurance works and how tax works, corporate tax in particular, which makes further alignment very complicated, or we do not see a way forward in that area at the moment, so the Carter proposals, and I think you may have found this on your visit to the Netherlands—

Q358 Mr Cousins: Typically, I was not on that visit.

Dawn Primarolo: Well, what it was particularly looking at was how technology could assist and in the Carter proposals the Government is putting forward and will be investing a considerable number of hundreds of millions in incentivising small and medium-sized businesses to file electronically early and there will be cash payments to them to assist in that, encouraging them to use intermediaries, where that would be available, for their payroll which would be desirable, I think, particularly with the point you are making about the very small companies, and ways of ensuring that can be done as smoothly as possible and as accurately as possible. We have not given up on those areas, we are still progressing on them and we are still bringing forward policy change, but we are aware of, and we are committed to, the existence of PAYE and the National Insurance system, but equally we have an obligation, wherever possible and continually, to scrutinise it, to see whether that could be streamlined, to reduce compliance requirements and, in particular, to help small and medium-sized businesses.

Q359 Mr Cousins: Thank you for that. A point made to us by the Small Business Forum to this Committee was that 3% of small businesses are targeted each year for scrutiny by the Revenue of their self-assessment forms, and that the costs of that process are considerable, and that there are

secondary costs of rising fee insurance provisions that people have to make which go with that as well, because the entire small business community is now obliged to consider taking out fee insurance because of the existence of this. I wonder if you could confirm those facts and if you do acknowledge there are both direct and secondary costs that mount up?

Dawn Primarolo: Certainly the question of secondary costs is there as an investigation or further inquiries are made by the Revenue. That would be true of any company. Decisions on how to do that—it is not done on a random basis but on a risk assessment basis and I think here again we see coming into play the question of how do we ensure proper compliance with the current rules in the system. You will remember it is not very long ago that the PAC criticised on a snapshot the outstanding tax still to be collected and when one looked at where it occurred. So I would accept that clearly if an investigation is triggered there are associated costs. I go back to the point I was making at the beginning, it seems to me incumbent on the Revenue through better guidance, better support, the use of our business support teams, to ensure businesses understand their obligations and therefore are complying with them and therefore the risk is reduced.

Q360 Mr Cousins: You will agree with me that those risk assessment guidelines are not transparent, they are not published, and therefore that does not enable people to calculate their own liabilities for exposure to both the direct and secondary costs of compliance. That would be a step forward, would it not?

Dawn Primarolo: With respect, the whole point about having a risk assessment is to try and work out where the flashpoints, where the difficulties, are in terms of those not complying. To publish our strategy about how we go about finding out would actually enable people to be somewhere else rather than in our risk assessment group.

Q361 Mr Cousins: Minister, you are really missing the point here. If there was transparency about the areas that were being targeted, it would enable people to manage their own affairs better.

Dawn Primarolo: Okay. Can I say I disagree and agree with your point. I disagree that the way forward is to actually say, "This is where the risk areas are". I do agree on transparency and support, that the obligation, which is part of the question of compliance costs, is that businesses are fully informed and supported in understanding what their tax obligations are and therefore complying with them, and there is no risk on the tax authorities. You can certainly see that both in the proposals to help them with costs on intermediaries, in the use of the Small Business Service, in the use of our small business teams, in the improved guidance that is offered, in the changes we have made to employer packs, in the offers that businesses can come to the Revenue and ask if they are experiencing difficulties. Yes, all of that must be transparent so people know

their obligations, and that should be the way to deal with it. The question of risk assessment is actually about pursuing those who are not complying.

Q362 Mr Cousins: I wonder, finally, if I could draw your attention to some evidence which has become available in this country from the United States about how big business operates. I am just looking at some evidence from the Senate Committee on Government Affairs in November 2003 at which the big four accountancy firms gave evidence to them. Of course it is our big four as well; there is a transatlantic bridge in such matters. Of the big four accountancy firms one, KPMG, had over 500 tax avoidance schemes on sale. The big four together generated £1 billion in fee income and saved people £85 billion in taxes, and this has been followed more recently by the General Accounting Office report that 60% of large US corporations pay no federal taxes whatsoever. If we consider the Government's own anti-avoidance proposals, we see we are only now setting up an avoidance intelligence unit at a total cost of £1½ million. It seems like trying to fight an elephant with a peashooter.

Dawn Primarolo: I share—and John might want to touch on this—your concern about the illustration with the continuing assault on the tax system from aggressive avoidance schemes which cost a great deal of money. We have tried various approaches for dealing with this and you will see in this Finance Bill there are a lot of measures—I was going to count them up but it will take time—which are specifically to do with anti-avoidance measures, of which gilt strips and manufactured dividends are but two. The traditional way that all governments have responded is by anti-avoidance. The problem with anti-avoidance legislation is (a) that it is imposed afterwards because you have to see it first and (b) there is a danger of building complexity in compliance, which is what we are here to discuss today. We investigated whether we would have a general anti-avoidance rule, we have investigated whether or not we would have what are called mini anti-avoidance rules, and settled finally in this Finance Bill on the disclosure requirements. There is a whole section which will require promoters to register their schemes with the Inland Revenue and that leaves them then open to challenge much more rapidly. What is important is we have to try and establish is that using reliefs in the tax system is one thing, using the tax system to produce ends which were not intended in any shape or form is another and should be dealt with firmly. I think you will find there was a statement from the head of the American revenue collection identifying that discussions had also been held with counterparts in the Revenue, Customs, recently about how we might investigate taking that forward internationally as well. So I think you will find certainly from the compliance point of view the proposals here will go some way, and the Chancellor has made it clear he is absolutely determined to deal with this, and we will deal with it in a way which protects revenue but continues to

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focus and keep alive the question of “with the appropriate and proportional compliance necessary to deliver”.

John Healey: You will see in the Finance Bill provisions which take a similar approach in indirect taxation.

Mr Cousins: Indeed, I hope to discuss some of them next week.

Q363 Mr Beard: The Institute of Chartered Accountants in England and Wales said when they gave evidence the following: “When new legislation is introduced very little thought seems to be given as to the administrative effect that legislation is going to have on taxpayers and their advisers”. It goes on, “When we have had discussions with the Revenue on new legislation they never bring anybody along from their compliance division. You are talking to the policy people, and compliance is looked on as an utterly separate issue to be dealt with after legislation has been enacted. By that time, it is much too late to get the administration right because the administration is determined by the legislation.” What is your response to that? How is the administrative impact of proposed legislation taken into account in policy formation?

Dawn Primarolo: I would disagree with that, both at policy formation, and I have given the example for instance of the changes on transfer pricing, and the very heavy involvement of the relevant Revenue teams in expressing views particularly with regard to compliance costs which may exist on small businesses. The other example I gave was discussions with the City of London on the development of the discussions around the Savings Tax Draft Directive. Then regulations themselves are consulted on. There is a committee—and I have forgotten its full name, it is sometimes called the Hartnett Committee—with regular dialogue between business and the Department about implementation of policy. As never before, the Revenue consults, and Finance Bills are often very substantially made up of policy changes that have been consulted on widely over a considerable period of time before including the draft clauses and before they come to the House for agreement through the Finance Bill and the Committee Stages. I think we should always be looking to improve on that but I think it comes back to the role of the Revenue departments is to protect the taxpayer, collect the revenue and ensure compliance with the rules as they exist, and where they are required to do so, when we are intervening for market failure reasons, to develop rules that assist business with compliance. The Department does its best—I would never be complacent and say there is never room for improvement—but to say it is just not done I do not accept.

John Healey: That is not the case in Customs either. On the sort of policy areas that the Institute was talking about there, we would always pull together a team within Customs which would be a mix of those administering the taxes and some operational people as well as the policy people. Even on some of our major avoidance measures we would do the

maximum degree of external discussion and consultation which we could, so we did it this last year in the provisions to deal with benefit fraud and joint and several liability, and we have done it this year with this year’s Finance Bill provisions on abusive VAT groupings. So there is both the operational and insurance expertise as well as the policy expertise inside, and there is also ample opportunity for external experts and industry and traders to have an influence on policy areas like that.

Q364 Mr Beard: The Institute of Chartered Accountants is not a negligible body, why would they be ignorant of the sort of things you were outlining just now? Is it that the Department is not doing enough to make people aware of what is happening in this respect?

Dawn Primarolo: Given that I disagree with the point they are making in terms of understanding the policy process, it is certainly incumbent—and I think probably John would say the same but it was directed specifically at the Revenue—and I certainly would be expecting my officials to speak with them as a matter of urgency to find out exactly what the issue is here and whether there is a general point on how we progress with policy. I certainly, as I have said, do not accept that.

Mr Martin: I think sometimes, Mr Beard, they do not see what is going on behind the scenes. If I may use one example: as the Paymaster General said earlier, we have done a great deal of work on self-assessment, and as you may or may not know we are publishing a shorter self-assessment return, and that has involved a great deal of consultation with practitioners such as accountants, small businesses but also with our own staff, our own front line staff, and we have asked them what is the best practical way of doing this, but this sort of activity is not necessarily evident to the outside world.

Q365 Norman Lamb: But that could be communicated to the outside world.

Dawn Primarolo: It could be, yes.

Q366 Mr Beard: The Institute of Payroll and Pensions Management told the Committee that one of the most complex areas for small business is statutory sick pay where responsibility for policy sits with one government department and the implementation sits with another. Given this departmental division, how can you ensure that the administrative effect of policy decisions in this respect is more fully taken into account?

Dawn Primarolo: The employers deal directly with the Revenue. There may be two departments in terms of policy and operation but the employers have one point of contact only and that is the Revenue, that is the operational arm. That is where the representations are made, and that is where we would deal with the issues concerned around SSP. In the same way, for instance, with the minimum wage, the DTI has the policy arm—or indeed student loans where the policy is elsewhere but the implementation is in the Revenue. I do not think I could make a bid for the Revenue to take over everything. What we

need is one point of contact where the operational and particularly the compliance issues are dealt with, and that is sorted.

Q367 Mr Beard: In their evidence this was the chief source of complaint, statutory sick pay. It is one of the most complex areas for small businesses to try to understand. Are there any proposals to look at this question of statutory sick pay and its impact on how firms find it difficult to operate?

Dawn Primarolo: If you will forgive me, I am not actually fully aware of that, and perhaps I could respond to you in writing on future developments, rather than delay the Committee now.⁹

Q368 Mr Beard: Right. There is a whole galaxy of organisations here. The Institute of Directors told us that they were “not aware of any steps which have been taken to reduce the administrative costs of tax compliance, although there are some actions which may have an impact on the area.” It tends to follow the other two. They obviously do not know what is going on. Are you not concerned that although you have outlined what you are doing, that is three bodies who do not know what it is?

Dawn Primarolo: I am quite concerned about that. The Institute of Directors put out a press release on Budget day welcoming the decision on, for instance, the tax credits. To my recollection, the Institute of Directors have also welcomed other steps, for instance, the excellent liaison and discussions with the City around various financial issues. I could equally send quotes back. What I think this represents is the breadth, the complexity, of the entire field of the tax system and what all the different things, different bodies, expect it to be able to do at any one point in time, and how Ministers in the Revenue departments have to balance at every point those objectives.

Q369 Mr Beard: It has made these hearings very confusing because we have a real polarisation of views between the measures you are talking about and these bodies are coming along and making these complaints.

Dawn Primarolo: Indeed, and indeed you will find yourselves in the same position as we do as Ministers, which is that we have a general assertion which is made about complexity or problems and then we ask for the specifics, and then the consequences of some of those specifics take us to areas where companies decide they would rather not go.

Q370 Mr Beard: Can I bring the Institute of Payroll and Pensions Management back on to the stage. They consider that “a lot of initiatives which are being launched at the moment are . . . very one-sided. They appear to deliver significant resource savings for central government but we do not see them as win win situations for employers . . . There is a requirement for large employers to pay remittances electronically every month to the Inland

Revenue, but there are no reciprocal plans for payments from the Revenue to employers to be paid electronically.” That is the example they have cited in that.

Dawn Primarolo: Indeed the vast majority of large employers already pay electronically, and in the arrangements which were being made for secure payment and receipt of those remaining payments which came in by cheque we considered the electronic payment to be required. The number of payments which are made the other way is quite small and there would be cost benefit analysis issues for the Revenue. In fact there is the BACS system too. This perplexes me slightly as well because I have forgotten the report but I have seen a reference where to pay by electronic transfer is cheaper than issuing a cheque.

Q371 Mr Beard: They are not complaining about paying by electronic transfer, but when the Inland Revenue pays them you cannot do it that way.

Dawn Primarolo: The Government has directed its resources at this point in time to small and medium sized companies through the Carter proposals by paying up to £825 in order for them to use their intermediaries and to electronically transfer. I have to say in terms of spending Government money at the present time (because all Government departments have to live within their limits) the priority, as you would expect, is to give the maximum assistance where we can to small and medium sized companies.

John Healey: Can I say, I do not accept that either. When you are look at deferred accounting or payment systems, generally they work very much in favour of the business rather than the Government. I also do not accept that you cannot have developments which bring savings and benefits both to business and Government, principally, as Dawn has been saying, around the introduction of e-transactions. There is clearly the opportunity in our field of indirect taxation, and that is true of the new exports system, the beginning of the e-VAT system and also the simplified import system.

Q372 Mr Beard: All these facts should be checkable. Can the Inland Revenue pay them electronically in the same way as they can pay the Inland Revenue? You are saying they cannot?

Dawn Primarolo: Not at this time, no.

Q373 Mr Beard: Lastly with the Institute of Payroll and Pensions Management, they told us in the last ten years the role of the employer in correctly administering the tax affairs of their employees has changed dramatically. This has changed from the correct deduction of tax and national insurance according to a tax code and national insurance letter to being responsible for three types of national insurance payment, payment of tax credits, collection of student loans, four statutory payments, which for clarification are SSP, SPP, SAP and SMP, and monitoring National Minimum Wage

⁹ See Ev 121

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compliance. Do you think this is the nub of the concern in some of these organisations, that they have had these extra duties put upon them?

Dawn Primarolo: It may well be. The policy benefits of the National Minimum Wage set in the wider framework are beyond challenge and it works very effectively, and if we go through each one of the areas that you have identified there are overwhelming policy, social and economic reasons why as part of our responsibilities and communications that would exist. One of the interesting things is that the role surely of Government, which comes back to where we started, is wherever possible to ensure the compliance costs are minimal and where we can relieve them as tax authorities we should. That is done but it never appears as a balance sheet. It never says, "All of this has been done on this side", we just see the cumulative effect on the other side, and it is the balancing of the objectives across all the policy areas which is important.

Q374 Mr Beard: As businesses they are only seeing this side.

Dawn Primarolo: There has been quite a bit of reform around PAYE, the Bath Report recommendations being applied, specifically then setting up the Carter Review and implementing those proposals including, at some considerable cost to the taxpayer, upfront funding, cash payments to businesses to help them with the transition, easing different things in the tax system in other areas in recognition as we have done over a whole range of areas to assist business. So when we look at the totality of how business has been assisted by this Government, whether it be the rate of corporation tax, whether it be the research and development tax credit, whether it be reforms in the company taxation system as well as reforms in national insurance and the changes there, we can see the direction of the Government is clear in terms of supporting business and in terms of tackling compliance with specific policy objectives. We are not backing away from that. If those organisations are saying we should not have SSP, we should not have—

Q375 Mr Beard: They are saying this is the source of some of their complaints.

Dawn Primarolo: But there are other things and a great many changes which have been made in Finance Bills year on year since 1997 which have benefited all these businesses as well. It is not a one-way street.

Q376 Angela Eagle: When we visited Holland we found out that they were going to make electronic filing compulsory but after a period of time in which to allow people to prepare for the change. Given the advantages in compliance costs and simplification of electronic filing, should we not be thinking of doing the same thing here?

Dawn Primarolo: Yes, I think we certainly need to, and we have, with the self-assessment, with the mandatory filing for large businesses, the changes

which Carter will bring in in terms of electronic filing. If we look at the Dutch experience, most of their reductions in compliance costs are as a result of that. I have to say this does not have universal favour with business, putting it mildly. Therefore, whilst those are objectives which we will increasingly move towards, we need the investment on the Revenue side in terms of technologies which work, and on the business side they need appropriate time to plan and arrangements made for investments. So that most certainly is the future and it will make it a lot easier for everybody.

Q377 Mr Walter: If I can deal with tax credits. I am sure we all in our constituency surgeries have to deal with the problems of tax credits. The Institute of Chartered Accountants in their evidence to us said that the introduction programme was unsatisfactory. I think that might be understating it. "Coupled with an unreliable Inland Revenue computer system and Helpdesk, [it] has resulted in thousands of incorrect start and stop notices being issued, and in many cases issued too late for employers to action." In the Budget, the Chancellor announced that, "having accepted the case for the Inland Revenue to pay the working tax credit directly to employees, we will consult now with employers on detailed implementation." What factors basically led the Treasury to this decision? Why do you not accept responsibility for paying working tax credits from the outset?

Dawn Primarolo: When the Government moved from family credit to what was then the working families tax credit, which was paid by employers, and then on to the working tax credit, we were specifically trying to achieve a number of policy objectives. One was to remove the stigma of receiving assistance as people moved from unemployment into employment. Secondly, to help retention rates in businesses. Thirdly, to name but three, to ensure that more people were attracted to returning to work. If we look at both what business has said about the effects of the working tax credit, moving to working tax credit, and indeed the IFS, we have some assessments which demonstrate that has worked and continues to work. Of course at the time there was a great deal of discussion about the compliance costs for business and whether the policy objectives—and this was very much the debate I had as the Minister—in achieving that and the assessments which were made on the compliance costs to businesses were correctly balanced. The policy objectives are very substantially there now and it seems correct—and I will come back if you want to what happened last year but that is a separate issue. Frankly, I think the pendulum has moved and what we sought to achieve has been achieved and we should disengage now from that system with employers moving at a speed they consider appropriate for them, and that is what we are doing. So it goes back very much to the balancing act which Mr Fallon mentioned right at the beginning about the various policy objectives we have for delivery.

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Q378 Mr Walter: Let us leave the policy objectives of the taxpayer on one side, what do you think are the savings in compliance costs for business as a result of changing?

Dawn Primarolo: Changing now? Back?

Q379 Mr Walter: Yes.

Dawn Primarolo: Forgive me, I am doing it from memory, but—

Mr Martin: £90 million.

Dawn Primarolo: £90 million per annum.

Q380 Mr Walter: When is this going to come into effect?

Dawn Primarolo: We thought it was necessary to consult with employers in order to disengage from the system in the same way as when the system was originally established. I do not have a fixed date. It is when an orderly transfer can be made and that is very much part of the discussions we are having now with the employers and the payroll.

Q381 Mr Walter: This tax year? Next tax year?

Dawn Primarolo: It certainly should be achieved by the next tax year, whether or not it can be achieved before is something we need to look at.

Q382 Mr Walter: So we could be looking at April next year?

Dawn Primarolo: Indeed, we could be.

Q383 Mr Walter: How confident are you that the switch-over will take place satisfactorily given what happened last year?

Dawn Primarolo: Well! We are already in this financial year. As you will be aware, the actual design of the software—how can I put this delicately? The computer system did not work as specified, which caused considerable difficulties both for employers and for claimants. A great deal of work has been done through this year, and in fact I seem to remember I was at a Treasury Select Committee hearing on this and no doubt there will be one about the same time in the same month this year to look back over the last year in terms of advice

we have taken, changes we have made to the system. The system is operating and therefore I think we can make that transfer now.

Q384 Norman Lamb: Are there not problems with the new software?

Dawn Primarolo: Not currently. Not unless you are going to tell me something.

Q385 Norman Lamb: It is just what I have heard.

Dawn Primarolo: That is the problem. It is whether it is fact that concerns me.

Q386 Mr Walter: You are going to test the software before—

Dawn Primarolo: The word is “we test it to destruction” first.

Q387 Mr Walter: Assuming you are right, then everything will be hunky-dory next April, I think I have deduced that is the date we are looking at. What happens if people suddenly discover they are not getting the tax credits, they are going to go to their employer and say, “This is not working, why am I not getting it?” What is going to be the responsibility of the employer once you have switched over?

Dawn Primarolo: Employers now—and all tax credit claimants are informed of this—know if there is an issue with payments of the tax credits, even if it is the working tax credits through their employer, they should go to the Revenue, not their employer. That is a requirement and that is what will happen in the future. The contact centres are extremely popular, are very busy and we are not finding any reluctance at all by people who want to make enquiries about their tax credits, whatever that is, to make that call as the first point of contact. I see no reason why that would not continue into any changes to the system with regard to the working tax credit.

Q388 Mr Walter: I look forward to our session next year.

Dawn Primarolo: I think you might be seeing me slightly before then!

Chairman: Ministers and your officials, thank you very much, we have to leave it there. Thank you very much.

Written evidence

Memorandum submitted by The Institute of Chartered Accountants of Scotland

SELF ASSESSMENT OF BUSINESS PROFITS

1. Corporation tax self assessment (“CTSA”) was introduced in 1999 and brought with it certain simplifications to corporate tax compliance—for example, by removing the need for notices of assessment to be issued to most companies, and obviating the need for many such assessments to be appealed. These changes have been generally welcomed. For unincorporated businesses, the earlier introduction of income tax self assessment (“ITSA”) had had a broadly similar impact.

2. While self assessment removed part of the pre-existing administrative burden and simplified some aspects of the compliance process for many businesses, it introduced additional burdens and costs for businesses whose tax returns are subject to detailed enquiries. Where cases have been selected for enquiry by reliable risk assessment techniques and adjustments are subsequently found to be necessary, the system cannot be criticised; however, it works harshly against those businesses chosen for enquiry, especially those chosen at random, where no discrepancies are found.

3. Some businesses attempt to control their compliance costs by insuring against the cost of professional fees that would arise on a tax enquiry. We understand that a relatively small proportion of businesses insure in this way, but for those who do it is iniquitous that the Revenue has published guidelines stating (with questionable authority) that the premiums on such insurances are not deductible for tax purposes.

4. A broad effect of self assessment was to transfer a substantial burden of administrative work, and related risk, from the Inland Revenue to businesses. Companies are required to self assess their own tax liabilities, including those which relate to a number of particularly complex areas of tax legislation (controlled foreign companies, thin capitalisation, transfer pricing, loans to participators for close companies, etc). Unincorporated businesses carry similar responsibilities to self assess.

5. The net effect is that the administrative tax compliance responsibilities carried by UK businesses have been increasing over recent years, and are still increasing, with no signs of abatement. Greater use of technology and the development of specialist tax software over some fifteen or twenty years have helped some businesses and their tax advisers to restrain cost increases. Nevertheless, most businesses have seen substantial increases in the costs that they incur to ensure compliance with the tax legislation and avoid the imposition of potentially expensive penalties.

6. CTSA introduced a requirement for large companies to pay their corporation tax liabilities by quarterly instalments. These quarterly instalments are paid partly during the accounting year to which the liability relates, and partly after the end of the year, with interest being payable on balances underpaid. As a result, large companies have to undertake work to estimate their tax liability for the current year, and to monitor their actual performance against the estimated figures, to mitigate the interest payable on underpaid quarterly instalments. This results in significant compliance costs for many such companies.

7. Unlike a number of European countries (such as the Netherlands and Germany), the UK has a corporate tax system that contains no provisions to enable a group of companies to represent a fiscal unity. Each member of a UK group must self assess its own corporation tax liability, and submit its own corporation tax return. The absence of a facility for a consolidated tax return makes UK compliance costs higher than the costs of tax compliance in some other European countries.

8. In spite of widespread calls for simplification of the UK tax system, and the Government’s apparent wish to modernise the tax system, additional complexities are added by almost every annual Budget. The latest proposed tax changes, announced in the Pre-Budget Report on 10 December, include the extension of transfer pricing legislation to transactions wholly within the UK and the removal of the existing group provisions relating to thin capitalisation—measures expected to add massively to the tax compliance costs incurred by large businesses.

9. The complexity inherent in UK tax is rendering the entire system unworkable. For many businesses, there is uncertainty as to what should be self assessed, and local office Revenue staff are sometimes unhelpful, biased or simply wrong when asked for advice; it is not uncommon for individual Revenue officials to admit that they are unable to answer questions because they have had no training on new regulations and reliefs announced, and are unaware of what is in their own manuals.

10. Even for business managers that know and understand the tax system, there are acute uncertainties which make it impossible for them to self assess with confidence. For example, the settlements legislation has been the subject of recent debate among the Revenue and leading professional bodies, and yet there is still widespread disagreement on its interpretation. Similarly, the IR35 legislation suffers from similar uncertainties that make it inappropriate in a self assessment regime. The current trend seems to be for the Government to promote even greater levels of uncertainty, as generated for example by paragraph 5.91 of the Treasury’s recent Pre-Budget Report which hints at possible new anti-avoidance measures against small businesses; such threats can only damage business confidence, and are likely to increase tax compliance costs by encouraging businesses to seek more professional advice.

11. Within the computation of business profits, the compliance work relating to capital gains can be particularly tortuous. Sometimes this is the result of gradual and almost imperceptible changes in Revenue attitude, such as its use of the discretion available to extend the three-year reinvestment period allowed for rollover; 20 years ago it was commonplace for the time limit to be extended by several years, whereas nowadays a modest extension of only a few months can be denied. Gains on property disposals can be difficult and costly to compute, especially where there have been alterations or additions to assets over the years. A recurrent theme is that it is now virtually impossible to ascertain 1982 values for assets owned since that time.

12. Many businesses regard new tax reliefs with scepticism, knowing that it often requires a disproportionate cost and effort to claim the benefits of them. This can be especially harsh for small businesses, which are frequently the intended targets for such reliefs. Many business managers require professional advice in order to determine whether or not they can benefit from incentives announced by the Government; the thresholds which distinguish between small, medium and large companies sometimes affect the availability of allowances, and can make the situation even more obscure and therefore more costly.

13. A more positive picture emerges from certain large groups of companies, who find the Revenue taking a welcome commercial attitude and business focus in its Large Business Office (“LBO”), its “ringmaster” arrangement for groups, and its group-wide review process. Some groups speak very highly of the Revenue’s new compliance relationship strategy, where Revenue staff are involved in an element of real-time working with taxpayer businesses and are prepared to give opinions.

14. Recent changes to the system for dealing with applications to the Inland Revenue for tax clearance on certain transactions have led to improvements in the system, and have in many cases led to reduced costs and increased certainty in dealing with such transactions.

15. The greatest problems and inefficiencies in tax compliance seem to arise where separate branches of the Revenue and other Government agencies are involved. Difficulties often become apparent where different Revenue area or district offices need to liaise in relation to the tax affairs of a business or group; we believe that some of these problems might be overcome if the Revenue were to extend the “ringmaster” role to more taxpaying businesses. Problems arise when the District Valuer has to be consulted, and some such instances might be avoided if the capital gains legislation were modernised so that it was no longer necessary to establish valuations as far back as 1982. The processes for collection and recovery of tax are not always well co-ordinated, and errors by the Revenue can cause unnecessary costs for businesses.

16. There is a fear among businesses that electronic submission of tax returns will be imposed increasingly by Government. Businesses in general see little benefit likely to accrue to them as a result of this trend, which appears to be designed largely to accelerate the transfer of further administrative burdens from the public sector to business rather than to achieve any overall benefit for the UK economy.

17. The prospective adoption of International Accounting Standards (“IAS”) by companies is giving rise to new uncertainties in relation to the computation of assessable profits. Major areas of concern include the treatment of debt portfolio provisioning within the financial sector, and the implications of capitalisation of software costs. If areas of doubt regarding the tax treatment of IAS-based accounts are not addressed by the Revenue in the form of new and authoritative guidance, businesses will incur additional costs in seeking professional advice on such matters.

PAYROLL

18. Payroll, including the administration of PAYE income tax and national insurance contributions, is generally the most complex and burdensome aspect of tax compliance falling on smaller businesses. A lot of valuable management time can be diverted away from the primary purposes of developing the business and earning profits, and devoted instead to sorting out complicated payroll issues and trying to avoid errors in compliance.

19. In spite of the fact that businesses are forced to act as unpaid tax collectors, they are also exposed to punitive penalties if they fail to apply all the complicated payroll regulations correctly. We are aware of instances where the complexity of payroll has persuaded small businesses not to take on employees, and of other cases where it has been instrumental in decisions not to embark on new business ventures.

20. Where large groups of companies have been at the receiving end of the LBO’s “ringmaster” approach, the improved quality of service from the Revenue has sometimes proved helpful in other areas, particularly in relation to PAYE audit issues. This suggests that payroll-related problems faced by businesses might be resolved more easily if the quality of advice and support from the Revenue could be improved.

21. The introduction of working tax credits and child tax credits has increased the administrative costs incurred by employers in relation to tax compliance. Employers must calculate the tax credits due and ensure that these are correctly accounted for through the payroll, and also need to monitor the cash flow impact of tax credits in case they result in a requirement for payroll funding from the Revenue. The complexity of the tax credits regime leads to increased administrative cost in managing payroll, and often contributes to distressing and sometimes costly confrontation between employers and employees.

22. Recent changes to national insurance rates and thresholds, and the extension of the scope of employers' national insurance to cover most taxable benefits in kind, have made the operation of payroll and the completion of forms P11D even more difficult and time consuming than hitherto.

23. It is not only small businesses that have payroll-related problems. The new share scheme legislation is tortuous for any company to follow, triggers a need for a disproportionately high level of professional advice, and is currently responsible for the postponement of many *bona fide* commercial reconstructions and reorganisations. The costs of this in terms of damage to the economy cannot be estimated but are likely to be substantial.

24. The move towards electronic lodgement of payroll returns may add significantly to the tax compliance costs falling on many employers. There has been well publicised criticism of the unfairness that the burden of mandatory e-filing can impose on the very smallest employers, but there are also costly problems for larger businesses. Certain large employers who were at the forefront of the Revenue initiative some ten years ago to submit payroll data on magnetic media are now faced with massive increases in costs; not only do they need to replace systems which Revenue-imposed changes have rendered obsolete, but also the cost of transmitting data electronically can far exceed the pre-existing cost of delivering the same on magnetic media.

25. The "subsidies" which the Revenue has offered to encourage small employers to e-file early are in many cases derisory compared with the capital investment required to establish e-filing. Even the licence fees for the necessary software can far exceed the incentives offered.

CONSTRUCTION INDUSTRY

26. No other sector of industry is disadvantaged by administrative tax compliance burdens as much as the construction industry. Changes made to the construction industry scheme ("CIS") in 1999 have not worked well, and a further review is now taking place. The present system of certificates and vouchers is cumbersome and expensive to operate. The difficulties of resolving status are immense, and contractors are burdened with the responsibility of determining status and liable to penalties if they get it wrong.

27. There are significant uncertainties regarding what is included within CIS and what is not. To date the legislation has failed to take account of technological developments like CCTV, modern heating and air conditioning systems, temperature regulation and environmentally friendly developments. It proves difficult, time-consuming and costly for contractors and sub-contractors to ascertain which services are within CIS and which are excluded.

OTHER ADMINISTRATIVE ASPECTS OF TAX COMPLIANCE

28. VAT is a costly tax to administer. Smaller businesses cannot be sure that they are making appropriate choices (eg regarding special schemes) and meeting all their compliance obligations without seeking professional advice. Many businesses, large and small, find it necessary to seek advice on a transaction-specific basis because of the complexity of the rules (eg in relation to composite supplies).

29. The requirement to deduct tax from interest payments, and the new tax legislation arising from the European Savings Directive, impose very substantial compliance obligations and related costs on many businesses in the finance sector.

30. Change in itself can impose heavy additional compliance costs on businesses as they have to become familiar with new rules and obligations. They need to consider how each change will impact on them, what procedural adjustments need to be made, and what tax costs and compliance costs may arise. New tax law is frequently accompanied by doubts regarding its interpretation and typically this may take years to resolve, causing businesses to seek additional professional advice in the meantime.

31. Change can be particularly damaging to businesses when it is made without appropriate care and attention. For example, within the past year the new share scheme legislation and stamp duty land tax have both been implemented with undue haste and with insufficient consultation, causing immense transitional problems and consequential costs.

Memorandum submitted by the Institute of Payroll and Pensions Management

BACKGROUND

The Institute of Payroll and Pensions Management (IPPM) is the leading representative body for payroll and public sector pension professionals in the UK. We have around 5,000 members across all industry sectors including a large number of student members studying for the industry's benchmark qualifications. The IPPM Policy and Research team are actively involved in working with and lobbying many government departments, but primarily the Inland Revenue to both develop new, and refine existing, legislation that will impact upon employers and their employees. Our strapline sums up our message: "we don't simply pay people because paying people isn't simple".

1. The extent of the administrative cost of tax compliance placed on business

1.1 There is no doubt that the administrative cost of tax compliance has risen in the short term. In this submission we have considered changes that have been implemented in the last 10 years, which has perhaps seen the greatest volume of changes than in many preceding decades.

1.2 Whilst that period has also seen major steps forward in the development of technology the impact of this on tax compliance is less marked than perhaps in other business activities where for example the use of the internet and e-mail have changed the face of business operations. Although the vast majority of large employers (over 250 employees) use a computerised payroll system to calculate pay and tax this accounts for only 0.6% of the UK's PAYE schemes (IR figures November 2003). Ninety-eight per cent of the PAYE schemes in the UK employ less than 50 people and for this group there is still a significant use of manual payroll.

1.3 As an indication of costs at the lowest end an IPPM member who provides a payroll service for parents with single employees, who are nannies, charges an annual cost per employee of £188 to cover the costs of monthly pay, tax and NI calculations, P11D and End of year return completion and tax credit administration (source Nannytax).

1.4 To gauge the extent of basic employer obligations, which do not vary regardless of size, one only has to look at the IR booklet E13 "Day to Day payroll" which outlines the processes for taking on, maintaining and terminating employment.

1.5 The introduction of Tax Credits, WFTC/DPTC in April 2000 and WTC in April 2003, significantly decreased the cash flow advantage for business in deducting tax and NI on pay day and not being required to pay this over until 19th of the subsequent month. This cash flow advantage was quoted in the Bath report in 1996 as being of a level that it effectively subsidised the payroll operation for large employers. Let us consider a large employer scenario:

- If one assumes an average daily rate of tax credits at £12.42 (NAO report by the Comptroller and Auditor General November 2003, gives average WFTC weekly award as £87 for 2002–03).
- Large retail employer with a 60,000 employee payroll.
- Average 4,000 tax credit claimants on payroll receiving WFTC.
- Employer pays out over £18 million in WFTC pa which was previously held as a remittance to the Revenue until 19th of the month.

1.6 The problems with the introduction of WTC have exacerbated this cost.

- There is significant record keeping.
- The volume of amendments to awards is much higher than anticipated (regulations provide for a maximum of three changes per pay period, employers have seen as many as 15).
- The poor standard of paperwork produced by the NTC system and the lack of a robust audit process for overpayments has led to many phone calls and written correspondence from employers to IR.

1.7 The increases in National Insurance in April 2003 were significant for employers and were coupled with rule changes on deferment of NI for company directors. Correct application of the rules around NI for company directors continues to be one of the "top 10 issues" uncovered during PAYE audits which points to their complexity for business.

1.8 Online filing of Year End returns becomes mandatory for large employers in 2005 and for all employers by 2010. Businesses who have already converted or are about to do so have seen significant costs in the initial set up of this new technology. Over 11,000 businesses must convert for 2005 (*Source: IR November 2003*) and many will transfer from a variety of magnetic media (tape, CD-ROM, Floppy Disk). They already view these as "electronic" returns and see little benefit in the outlay in moving to online filing. Early converters (bureaux and large employers) were limited to embracing EDI (Electronic Data Interchange), which had high set up and maintenance costs. One local authority member has seen the cost to produce his year end return rise 18 fold to £1,500 as he has moved from magnetic tape to EDI. (*Source: Suffolk County Council*)

1.9 Going forward lobbying by the industry and a desire for IR to contain their costs has led to the Internet channel being developed to cater for all but the very largest employers (up to 150,000 P14s for 2004–05). This has much lower set up costs.

1.10 To realise the full benefit of savings from online filing employers with significant staff turnover are encouraged to transact electronically in all their dealings with IR. Again this has been largely by EDI for the early converters. A range of forms can be exchanged but the service for NTC is not reliable at present because of the ongoing IT problems with Revenue systems. Those using the Internet channel to transact daily are hampered by the capabilities of their payroll software. As End of Year returns are the only mandatory element, there has been a slow start to offering in-year changes as an integrated part of payroll systems. This means the vast majority of employers still have to handle these manually even though they are transmitted electronically.

1.11 Point 1.10 illustrates another hidden administrative cost of tax compliance. As the volume of legislative changes has grown over the last 10 years so the rate of technical development of payroll products has slowed. Providers are fully committed in their development resources to delivering the legislative changes and are less able to offer business enhancements that will deliver efficiencies within business. Employers are often therefore unable to realise the full ROI on these products or realise any real value added benefits that they would expect from product enhancements which will help them run their business and maximise efficiencies.

1.12 Suppliers have also been levying surcharges to annual payments for systems, as they have been unable to contain the cost of development required for legislative changes in the annual charges. And employers themselves are incurring additional costs when these updated systems are delivered as the volume of testing that they need to undertake has dramatically increased over recent years.

1.13 New areas of business for IR in the shape of National Minimum Wage monitoring have also increased administrative costs. Employers are obliged to monitor salary levels over an averaging period and often are required to deal with such complications as the accommodation offset. For service and retail industries operating at the NMW margins this is a significant piece of work.

1.14 IR also has an administrative and monitoring role in respect of Statutory Sick Pay. SSP has largely gone unaltered in the complexity of the scheme since its inception 20 years ago. What has of course changed completely is the ability for business to recoup any of the costs of paying SSP. When the recovery figure was reduced to zero the complex rules (some 72 pages of guidance from IR alone) should also have been swept away and replaced with the concept of National Minimum Sick Pay (see Recommendations for Action). The cost of SSP has also increased this year as the link between the earnings threshold for SSP and SMP has altered such that employees can now return from maternity leave and become automatically entitled to SSP.

1.15 New initiatives to combat tax avoidance of course also impact on businesses who had always been compliant for example:

- The Personal Service Company legislation IR35 has led to an increase in status disputes and investigations.
- The Settlements legislation S660 is leading husband and wife partnerships to need to take professional advice.
- In addition, the Construction industry Scheme has introduced a huge administrative burden for the building trade but one wonders if it has really tackled the “cowboy” element.

1.16 Where new legislation has been introduced which crosses departmental boundaries eg Employment Act 2002. Small inconsistencies in the statutory payments regime have made compliance by business more difficult. For example, Statutory Adoption Pay is paid at a different level to Statutory Maternity and Paternity Pay.

2. *How has the administrative cost of tax compliance changed over time?*

2.1 In the last 10 years, the role of the employer in correctly administering the tax affairs of their employees has changed dramatically. Formerly a business only had to concern itself with the correct deduction of tax and NI according to a tax code and NIC category letter. Today an employer is potentially responsible for:

- Three types of NI (Class 1, 1a and 1b).
- Payment of tax credits.
- Collection of Student Loans.
- Four statutory payments (SSP, SPP, SAP, SMP).
- Construction Industry Scheme tax.
- Monitoring National Minimum Wage compliance.

These are of course only the obligations administered by the Inland Revenue. In addition, employers are obliged to:

- Deduct Attachment of Earnings Orders issued by the Court Service and Local Authorities—with differing rules for Scotland of course.
- Deduct Child Support Orders issued by the CSA.
- Monitor compliance with the Working Time Regulations and Data Protection Act.
- Provide regular data to the Office of National Statistics.
- Answer a mountain of manual correspondence from government departments and agencies in relation to their employees' earnings and personal circumstances.
- Very often the information needed to complete these enquiries is held within the government departments' various computer systems, but system and legal constraints mean that all the people who need it cannot access the information. The employer therefore has to supply the information again but in a different format.
- Again the restrictions of government departments to be able to provide and receive electronic formats for these enquiries adds to the work that is undertaken by the employer (or their agent).

2.2 The costs of administration have also been affected by a number of other factors—employment trends, the impact of Europe and government policy initiatives. We will consider each of these in turn.

2.2.1 Employment trends—the increase in multiple employments and more frequent job changes during an employee's working life add to the difficulty in ensuring the correct amount of tax is deducted through PAYE and that, where appropriate, the complex rules around aggregated earnings are applied so that benefit entitlement is maximised.

As salary levels become constrained by a low rate of inflation, business has had to become more imaginative in its remuneration packages in order to remain competitive. This has seen the rise of flexible benefits and salary sacrifice schemes all of which fall to the payroll department to administer to ensure the correct amount of tax and NI are deducted. The large number of benefits complicates this where tax and NICs treatments are not aligned (see Recommendations for Action). Equally, the use of incentive and third party awards has increased with a need to make these tax efficient.

Downsizing continues to be a fact of life and as a consequence termination payments become ever more frequent and complex.

As more business is done globally there is an increased need to send employees abroad and bring foreign nationals into this country with all the complications this entails in cross-border tax, NI and pensions arrangements.

Developments in technology and the desire to improve work-life balance have led to an increasing number of employees working from home with the affect this has on provision of equipment, travel costs and household expenses.

2.2.2 Europe's legislative programme now shapes as much of the UK's legislative programme as domestic issues. In recent years, employers have had to cope with the implementation of the Working Time Directive, Part-Time Workers regulations and Discrimination Legislation to name but three.

2.2.3 Government policy initiatives of course drive the legislative agenda. With a new Government in 1997 the last few years have naturally seen a high level of activity affecting employers.

The drive to eradicate child poverty and link Welfare to Work spawned Tax Credits, many of the Working Parents changes in Employment Act 2002 as well as initiatives such as parental leave and legislation to support childcare provision by employers.

Environmental concerns led to NICs changes as a result of the climate change levy and a new structure for company car taxation, rules on works buses and cycle to work days.

Steps to support the voluntary sector have resulted in tax breaks for Payroll Giving and the millennium Children's Promise.

Attempts to plug the pensions savings gap saw employers forced to set up stakeholder pensions in all but the tiniest of businesses and construct a payroll deduction process even though to date most schemes remain without any members.

The desire to boost the UK's productivity has led to the Government encouraging the provision of shares. Businesses are now having to administer SAYE, SIP, ESOPs and CSOPs all with complex scheme rules and approval processes.

3. *What steps have been taken to reduce the administrative cost, and are these working?*

3.1 Sadly, it seems to business that in comparison with the additional burdens placed upon it, steps to reduce compliance costs are thin on the ground. Many initiatives which purport to be better for business appear to deliver rather more in reducing the costs of central government than those of business, for example:

- 3.1.1 The move to online filing will significantly reduce IR resources in correcting EOY returns. Whilst there are benefits to business if they can afford (and have the software capability) to move to full online communication with IR, the main benefits are to IR and to the individual taxpayer who should see their tax and NI affairs more speedily resolved each year. Employers will only realise any benefits if they embrace the other online messages available to them and then only if there is a significant turnover in the company which generates large numbers of in year and new year tax code changes and forms for starters, leavers, plus WTC and student loan deductions.
- 3.1.2 The requirement to remit electronically will incur transaction costs for business through the use of CHAPS or BACS and yet will again save IR in processing cheques. Unfortunately, the requirement to E-pay does not extend to the Revenue paying employers. Small employer compensation for SMP and refunds of overpayments will continue to be made by cheque we understand.
- 3.1.3 We fear that all the new statutory payments that have been introduced will go the same way as SSP where recovery has now been reduced to zero and SMP compensation for all but the smallest employers has reduced to 92%.
- 3.1.4 The move to area management/contact centres and away from the network of local tax offices has reduced overheads for the Revenue but is usually seen as a retrograde step by employers who report inconsistent advice, delays in handling correspondence and poor telephone service.

3.2 On the positive side, the establishment of the Employer Programme within IR has seen the focus on the often-neglected area of PAYE shift into a higher gear. The team has made concerted efforts in the areas of improved guidance—the replacement of the annual employer pack with a CD-Rom has been well received, as have the help books. The wider remit of the Better Guidance Project should also bring employer benefits.

3.3 The establishment of the Modernising Payroll Processes for Customers Programme to bring together such areas of work as online filing, Business Support Teams and IR PAYE systems is welcome. If it delivers all that has been promised there should be real benefits for employers, we hope that this important strand of work will not be constrained by lack of IR resources.

3.4 A start has been made in tackling the area of student taxation where procedures are out of step with current employment practices. We hope to see this work brought to a swift conclusion.

3.5 The introduction of Tax Credits led to the establishment of advance funding for small employers with insufficient PAYE remittances to cover their outlay on Tax Credit payments. This was a necessary part of handing over the payment of a state benefit to employers. Unfortunately, since the introduction of WTC this year funding has gone wrong on a number of occasions. Given this affects the smallest employers who can ill afford such mistakes this is regrettable. With the introduction of statutory payments this year (SAP, SPP and SMP) the concept of advance funding was extended to these areas too. Employers welcomed this but as we have pointed out the mechanism for claiming the funding is cumbersome and different to the process used for tax credits. This appears a poor example of joined up government to the outsider.

4. *Recommendations for Action*

4.1 *More joined up and meaningful consultation across government departments.* The introduction of the Work and Parents changes in April 2003, that fell out of Employment Act 2002, were an example of how five government departments worked well together and with both employer and employee representative groups simultaneously to deliver a sound legislative process, and a workable business process in a short lead time. In contrast the DTI's "No-nonsense Guide to Government rules and regulations for setting up in business", was written in isolation and is very superficial: for instance it makes no mention of paying tax credits to employees.

4.2 *A review of where policy and administrative responsibility falls between two government departments.* For example, DWP own the policy for such areas as statutory payments, the administration of which falls to the Inland Revenue. This makes reform constrained by differing departmental priorities. For example we have pointed out the huge gains to business if the complex rules around SSP were scrapped. IR are in complete agreement but sadly as SSP policy falls to DWP who don't have the problem of policing the current scheme there is no appetite to make this a priority—an issue we have recently highlighted to the Minister for Work. We would like to see SSP replaced with National Minimum Sick Pay along the lines of the National Minimum Wage so that employees without an occupational sick pay scheme were still protected but without the administrative overheads for the employer of the current scheme.

4.3 *A better understanding of which government departments interact with business and a co-ordinated approach.* For example, employers have many interfaces with DWP and yet as it is structured into various agencies relationships have to be established with each part separately. We had hoped that the establishment of a consultation co-ordinator in each department would have remedied this but early signs are not encouraging. One almost feels the Minister for Small Business needs a wider remit to assist business generally.

4.4 *Ensuring that Government initiatives deliver wins for both business and Government* as of late it feels very one sided. Delivering some of business' "wish lists" would build bridges such as Tax/NICs alignment and uprating of out of date limits (relocation expenses, luncheon vouchers, P11Ds).

4.5 *Allowing business to make an administration charge for the payment of tax credits.* This would be deductible from PAYE remittances on a per claimant basis in the same way as currently exists for Attachment of Earnings. This would compensate for the high overheads this policy has placed on business.

We hope that you find this submission useful in your deliberations and would be happy to supplement it with oral evidence if required.

30 December 2003

Memorandum submitted by the Institute of Directors

THE INSTITUTE OF DIRECTORS

The Institute of Directors (IoD) is a non-political organisation of individual members founded in 1903, which now has nearly 54,000 individual members in the United Kingdom. The membership is drawn from right across the business spectrum. Over 75% of *The Times* Top 1,000 companies have IoD members on their boards, but the majority of members (some 60%) are directors of small and medium-sized enterprises, ranging from long-established businesses to start-up companies. The organisations from which our members are drawn employ over 10 million people in the UK, ie over 40% of the workforce.

1. INTRODUCTION

1.1 The IoD welcomes the Inquiry by the Treasury Sub-committee into the administrative costs of tax compliance.

1.2 Even those businesses which may have a relatively low tax burden in terms of tax payments are still subject to the administrative burden of tax compliance, and it is important that the impact of the administrative burden is not overlooked.

1.3 In the IoD's Budget Survey in 2003, we asked members whether the amount of time and money their business had spent on tax related paperwork had increased, decreased or stayed the same over the past few years. Seventy-eight per cent said it had increased. Only 1.2% felt it had decreased.¹⁰

1.4 Tax law is complex and changes frequently. Successive Finance Acts add complexity onto an already complicated system and require more onerous and intrusive compliance regimes to support the new provisions. Fundamentally the administrative burden of tax compliance follows the complexity of tax law and until the volume and complexity of tax law is reduced little progress will be made in tackling the administrative burden it imposes.

1.5 It is difficult to precisely measure the administrative cost of tax compliance to business. Our response contains both anecdotal and survey evidence from IoD members which we hope will be of interest to the Sub-committee.

2. DIFFICULTIES IN MEASURING THE ADMINISTRATIVE COSTS OF TAX COMPLIANCE

2.1 It is very difficult to ascertain the true administrative costs of tax compliance for a number of reasons. For example, most businesses do not routinely collect information on the total administrative costs of tax compliance. It may be possible to easily identify the cost paid to a firm of accountants to prepare a Corporation Tax Return, for example, but not to identify the cost of staff time in preparing the information the accountants will need.

2.2 Equally, in many cases there is a "grey area" between what constitutes tax compliance and what constitutes tax planning. For example, when within a group of companies there are some which have taxable profits and some which have losses, it is standard practice to prepare the necessary elections to set-off the losses against the profits to ensure that only the net profit is taxed. Should this be considered "tax planning" or "tax compliance"?

2.3 Even after identifying what is "tax compliance" there is a further distinction: the ongoing burden of complying with the tax rules, and the setting up or amendment of systems and procedures when tax rules change. Given the volume of tax legislation, invariably changes are required every year. This may be changes to the accounting system (to record new information required) or updating existing tax software.

¹⁰ *Budget 2003: Survey of IoD Members*, IoD, March 2003.

2.4 The Inland Revenue publishes statistics detailing the cost of collection for each of the taxes it is responsible for. It would be illuminating to see the equivalent figures for the costs incurred by the taxpayer, although how this could be collected without imposing another burden on business is a difficult question.

3. THE EXTENT OF THE ADMINISTRATIVE COST OF TAX COMPLIANCE ON BUSINESS

3.1 Although there are a significant number of taxes in operation which affect business, they can broadly be categorised as:

- *Employer taxes*—taxes levied on the Employer or administered by the Employer
- *“Profit” taxes*—taxes levied on the “profits” of the “business”
- *VAT*
- *Industry Specific taxes*—taxes levied on a particular industry
- *Other taxes*—including transactional taxes such as Stamp Duty and Stamp Duty Land Tax

4. EMPLOYER TAXES

4.1 For many employers, the greatest amount of time and effort taken in tax compliance is incurred in dealing with “Employer Taxes”. Employers are responsible for administering the Pay As You Earn (PAYE) system which collects Income Tax and National Insurance Contributions (NICs) from employees, and for administering Employers’ National Insurance Contributions, as well as student loan repayments and some tax credits.

4.2 A significant proportion of time and expense in running any business payroll is tax administration, although larger businesses in particular can mitigate the time and expense by outsourcing or automating the process. Nonetheless, for “non-routine” items, such as reimbursing employee expense claims, or establishing taxable “benefits in kind” some form of manual intervention will always be required.

4.3 To put the administrative burden of employer taxes into context, our recent “red tape” survey of members found that approximately 40% of members found administering PAYE a “significant” or “major” cost in terms of time and cost.¹¹

4.4 Small businesses in particular find the compliance burden onerous. One member reported that “*We recently received a £400 penalty notice from the Inland Revenue for non-return of a P11D(b) form. I accept fully that we did not send them a completed P11D(b) form, but sent everything else—including the P11D for our sole PAYE employee! I didn’t know that a P11D(b) existed!*” The system is so complex that even those who try to comply can still be penalised.

4.5 The level of complexity on employer taxes is significant. For example, the Inland Revenue’s “Pre-Review Questionnaire” which is to be completed by a business prior to a Revenue visit, runs to 114 questions and 27 pages—and has further supplementary questionnaires for certain issues.

4.6 Naturally, this questionnaire only has to be completed by each business when it is visited by the Inland Revenue, which may be relatively infrequently—but every business has to be sure that it is adhering to the law. If it takes the Inland Revenue’s own tax specialists 114 questions to determine whether the nuances of tax law are being complied with, it will take the typical businessman, who is no tax expert, much longer.

5. “PROFIT” TAXES

5.1 Business profits are either taxed under Income Tax or Corporation Tax rules. Most businesses need only submit tax returns once each year for each business entity, but that does not mean that tax compliance need only be done once each year. For example, large companies are required to calculate quarterly payments on account for Corporation Tax. In effect, this requires a calculation to be performed each quarter on the estimated tax liability for the year.

5.2 Many businesses do not prepare tax computations for “profit” taxes but rather engage accountants to do so for them (in a survey in 2001, 74% of IoD members used external accountants for this purpose).¹² Typically it is only the largest of companies which can employ in-house tax specialists to prepare the computations “in-house”. As there is often an external cost for tax compliance, it should be easier to quantify the cost of complying with “Profit Taxes” than with others.

5.3 We do not have recent figures from IoD members on the cost of complying with “Profit Taxes” however anecdotal evidence is that the cost has increased over time. To some degree this must be related to the introduction of Self Assessment for individuals and companies.

¹¹ *The Real Impact of Red Tape*, IoD, to be published.

¹² *Accountancy Services*, IoD, September 2001.

6. VAT

6.1 Even those businesses not subject to Value Added Tax must at the very least track “taxable supplies” in order to ensure that they are in fact below the VAT threshold. The threshold is relatively low (£56,000 per annum in the current year).

6.2 The compliance burden of VAT varies from business to business. For example one member, in the travel sector, stated that VAT was the most onerous of all taxes for his business to comply with due to the Tour Operators’ Margin Scheme. At the other extreme one member (a sole trader with relatively few, but high value, transactions) considered that complying with the VAT regime took only 1 hour each quarter.

6.3 Some attempt has been made in recent years to mitigate the compliance burden (eg introducing the flat rate accounting scheme). These are welcome, but we do not have any evidence of significant take up.

7. INDUSTRY SPECIFIC TAXES

7.1 Some sectors, such as the Life Insurance and Oil and Gas sectors, are subject to modified rules for the taxation of their business profits. In addition, there are other taxes which affect specific industries, for example Aggregates Tax, Landfill Tax, Climate Change Levy, Insurance Premium Tax, Petroleum Revenue Tax and Supplementary Charge. Most of these taxes are relatively new, and as such demonstrate an increased burden in compliance terms.

8. OTHER TAXES

8.1 Stamp Duty Land Tax, as a transactional tax, impacts businesses at the time of acquisition or disposal of property. It remains to be seen how onerous the administrative requirements of the new regime are, but the move to self-assessment does move an additional burden onto business (even if, in practice, most will pass the returns on to their Solicitor to deal with).

8.2 Clearly, the administrative tax compliance burden will be higher for a business which undertakes frequent property transactions than for one which only encounters the tax when it renews its lease, for example.

9. STEPS TAKEN TO REDUCE THE ADMINISTRATIVE COSTS OF TAX COMPLIANCE AND THEIR EFFECTIVENESS

9.1 We are not aware of any steps which have been taken to reduce the administrative costs of tax compliance, although there are some actions which may have an impact on the area. Fundamentally tax compliance is administratively burdensome because the tax rules are complex; simplifying the rules is the most effective way of reducing the administrative burden.

9.2 *Self-Assessment*

9.2.1 The move towards Self-Assessment (first seen in Income Tax, now in Corporation Tax and Stamp Duty Land Tax) shifts some of the burden of tax compliance from the Inland Revenue onto the taxpayer. Self-Assessment should reduce the cost to the Inland Revenue of tax compliance but it is difficult to see any positive impact from the perspective of the taxpayer in this regard.

9.2.2 The recent announcement that all intra-group transactions within the UK must be brought within the self-assessed transfer pricing regime will add a further layer of regulation and administration for many corporate groups.

9.3 *Regulatory Impact Assessments*

9.3.1 In theory RIAs should be able to capture the impact in administrative terms of the measures they accompany. However we do not think that there is any evidence of RIAs having any meaningful impact in reducing the administrative costs of tax compliance.

9.4 *Tax Law Rewrite*

9.4.1 The Tax Law Rewrite should marginally reduce the administrative burden of tax compliance by making the law clearer but its impact is reduced by the volume of new legislation being introduced and the fact that it is only able to rewrite existing law, rather than simplify.

5 January 2004

**Memorandum submitted by the Tax Faculty of the Institute of Chartered Accountants
in England and Wales**

ADMINISTRATIVE COSTS OF TAX COMPLIANCE

INTRODUCTION

1. We welcome the opportunity to comment to the Treasury Sub-committee on the administrative costs of tax compliance further to the call for written evidence published on 14 November 2003 at http://www.parliament.uk/parliamentary_committees/treasury_committee/tc141103_51.cfm. We would also be happy to give oral evidence at a Sub-committee meeting.

WHO WE ARE

2. The Institute of Chartered Accountants in England and Wales (“ICAEW”) is the largest accountancy body in Europe, with more than 125,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

3. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy (which includes taxation).

4. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter “TAXline” to more than 11,000 members of the ICAEW who pay an additional subscription.

GENERAL COMMENTS

5. We believe that it is extremely important to consider the cost of the obligations imposed on business when seeking to implement new tax policy. We do not believe that the existing system of Regulatory Impact Assessments (“RIA”) properly reflects these costs. Frequently, RIAs are partial and appear to be merely a best guess of the costs involved. Furthermore, once a proposal is implemented, there is little evidence of any attempt to return to the original estimate and assess with the benefit of hindsight whether the change was cost effective when compared to the benefits achieved.

6. In 1999 the Tax Faculty published “Towards a Better Tax System” in which we set out Ten Tenets by which all new legislation should be judged. A copy of this is attached for the committee’s reference¹³, or see http://www.icaew.co.uk/taxfac/index.cfm?AUB=TB2I_43160,MNXI_43160. Whilst this paper is now over four years old, and we have supplemented it in other publications, our conclusions are as valid now as they were then.

7. The costs of compliance include the costs of:

- Employing individuals skilled in handling the relevant areas.
- Substantial time input for managers, owners and directors who must try to understand the welter of legislation imposed upon them.
- Professional fees either for advice or for outsourcing.
- Continuous additional anxiety that there may be unknown errors for which penalties will be imposed.
- Lack of certainty.
- Distraction from the prime purpose of business—namely making a profit.

8. As far as we are aware, there has been little detailed research into the costs of tax compliance. In 1996, the Centre for Fiscal Studies at the University of Bath was commissioned jointly by the Inland Revenue and Contributions Agency to research the costs to business of PAYE and National Insurance compliance. The project, which included many of the costs described above, took in excess of a year to complete and cost hundreds of thousands of pounds. To date, there has been little evidence that its findings were acted upon. It remains of great concern that the overall compliance cost per employee ranged from £5 for large employers to £288 for small employers.

¹³ Not printed.

9. These results will now be considerably out of date, and for example, pre-date the introduction of self assessment. The scope of this current Sub-committee inquiry far exceeds this research project. We suggest that at the very least the previous research is repeated and the results compared. This would enable the Sub-committee to determine more accurately how the administrative costs of tax compliance in this area have changed over time.

10. Further research should also be commissioned to produce quantitative and qualitative data in other areas. We would be happy to help the Committee scope such projects in further detail.

11. We have identified several areas where steps have been taken to reduce the administrative cost of tax compliance, although this has not always been successful—see paragraphs 18, 19, 20, 22, 24, 31, 32 and 33.

SPECIFIC COMMENTS

Payroll procedures

Tax credits

12. Many employers see themselves as the unpaid collectors of taxes for the Government. Many of the most complex areas of tax affect employees and are subject to constant change.

13. Since the introduction of new tax credits on 6 April 2002, employers must now also deal with paying social security benefits under the guise of tax credits. The complexity of the system alone creates an unacceptable burden on small employers in particular, who had to cope with a revised new tax credits system from 6 April 2003. The introduction programme was unsatisfactory and, coupled with an unreliable Inland Revenue computer system and Helpdesk, has resulted in thousands of incorrect start and stop notices being issued, and in many cases issued too late for employers to action. We anticipate further problems for employers when employees have to complete renewal applications starting in April 2004. The employer will usually be the first contact point for an employee struggling with this area.

Staff changes

14. The current system of form completion can take hours of payroll staff time to implement. This is particularly a problem for businesses which use a large number of casual staff. The system is so complicated to operate that it increases the temptation for small businesses to make cash payments. Anecdotal evidence suggests that many small businesses, in particular within the catering industry, find the system so cumbersome that they pay wages in cash, leaving the “employee” to sort out any tax due. Clearly this amounts to evasion but the system does little to encourage compliance. Larger businesses will adopt other unorthodox practices. We have come across one large hospital which keeps a list of around 5,000 nurses which may work for the hospital. If a nurse has submitted a time sheet for the month, then hours worked are paid. If not, then the nurse has a nil wage packet. At the year end an unnecessarily large number of employees are shown on form P35, since many nurses will be shown as employees even though they have not worked during the year at all. Nevertheless this practice is followed as it is quicker than issuing endless P45/P46 forms as such staff leave and rejoin. Whilst this particular arrangement is a sensible practical solution, it also imposes a further administrative burden on the employer who must bear the cost of distributing 5,000 P60 forms each May, many of which are blank and for which there is no forwarding address.

Notices of coding

15. Notices of coding have traditionally been used to ensure that employees pay the correct amount of tax on their employment income, so that as a result, many employees do not have to complete self assessment tax returns. The notice of coding is very successful in keeping large numbers of taxpayers out of self assessment but the price is that it creates complexity. These notices may have many constituent parts which employers will frequently have to explain to staff at the cost of their own time. Different rates of tax applied to different sources of income make the process even more opaque. Similar problems exist where different rates of tax relief are allowed.

Benefits and £8,500 limit

16. The £8,500 limit for determining which benefits are taxable has not been increased for many years. This results in an additional compliance burden where many more forms P11D must be completed than were originally intended.

Overseas travel expenses

17. It is now common for employees to make business trips overseas. As a result of representations from our members in business, we have previously suggested that the compliance costs would be reduced if a scale of daily allowances could be agreed for subsistence in different countries. The administrative burden is greatest in developing countries where obtaining receipts is not customary.

PAYE settlement agreements

18. Whilst PAYE settlement agreements were introduced to relieve some of the administrative burden from employers who would otherwise have to report small benefits, the cost is now prohibitive for many, following the imposition of Class 1B national insurance contributions.

Dispensations

19. Dispensations are an excellent means of relieving the burden of reporting expenses related to employment. We have had reports from employers who have had difficulty securing these, particularly for small companies. This area should be reviewed to consider how it could be extended and in particular made more accessible to owner directors.

Compulsory electronic filing

20. Compulsory electronic filing is being introduced for all employers over the next five years. Whilst for many businesses this may become the natural choice, there will be others for whom the change is more difficult and is not cost effective. In particular, micro employers (only one or two employees) may find it simpler to continue to use the existing simplified scheme. Computers do not always make a process quicker for the user. Furthermore, experience shows that the Revenue's ability to produce software to cater for those wishing to undertake tasks such as filing on-line has not been good.

21. We have said before and repeat now that coercing taxpayers to use government on-line systems on pain of fine is unacceptable. Whilst we welcome the financial incentives to encourage smaller corporate employers to file and pay by internet, government on-line systems should be sufficiently easy to use, comprehensive and permanent that taxpayers use them as a matter of choice, not so bad as to make it necessary for government to make their use obligatory.

National insurance*Income determination*

22. National insurance and income tax are both calculated on income. Whilst steps have been taken in recent years to harmonise definitions, there remain many differences between the definitions of income on which national insurance contributions and income tax are calculated.

23. The self-employed taxpayer may also calculate income differently for income tax and for Classes 2 and 4 national insurance purposes. For example, the accounting profit net of depreciation is used when applying the lower exemption limit for Class 2, whereas profits after capital allowances are used as the basis for income tax.

Periodic calculation used for NIC

24. The periodic calculation used for NIC (weekly/monthly) creates calculation difficulties. Since 6 April 2002 reimbursement by an employer for the use of an employee's own car for business has been charged to income tax only where the amount reimbursed exceeds 40p per mile for the first 10,000 miles and 25p per mile for any additional miles. It was originally intended that the same rules would apply when calculating Class 1 national insurance. However, the periodic calculation made this impossible and 40p is used for all miles. Whilst this works to the taxpayer's benefit, the different calculations create an additional burden.

More than one source of earned income

25. Where a taxpayer has more than one job, the application of the additional 1% NI charge in excess of the upper limit, introduced with effect from 6 April 2003, is extremely complex. Few employers will be skilled in this area resulting in the incorrect amount of NIC being paid by many employees and much time being wasted with the calculations.

26. A similar problem arises for the small entrepreneur who starts his own business at the same time as being in employment. All employments and self employments are considered together when determining how much income is chargeable at the additional rate.

27. The practical application of the additional charge has been ill thought through and there is little help available to small businesses and employers facing this problem.

Corporation tax

Size definitions

28. There are many instances throughout the Taxes Acts where the definition of a small, medium or large company is used. There are also many different ways of defining these limits. Sometimes the Companies Act definition is used, sometimes, the level of taxable profits and sometimes the EU definition for State Aid.

29. These differences create additional work for businesses, particularly in marginal cases.

Quarterly payments

30. The abolition of Advance Corporation Tax resulted in a new system of quarterly payments being required by large companies. This requires a company to pay instalments based on its predicted profit for a year. Interest is charged or credited on under or overpayments. Whilst the interest rates purport to be commercial, this is not the case. As we said at the time the new regime was introduced, a system requiring such payments to be based on the previous year's profits would relieve the administrative burden on companies who currently have to make predictions or suffer a financial penalty.

Flat management companies

31. A published, formal *de minimis* exemption should be given where virtually dormant companies such as "flat management companies" receive small amounts of bank interest. The administrative cost of declaring small amounts of income is considerable. We are pleased to note that this issue is under consideration as part of the recently-started consultation on the taxation of trusts.

Value added tax

Cash basis

32. Smaller businesses may adopt a cash approach to determining VAT payable in each period. A cash basis is easier for many non-accountants to understand. However, the cash basis cannot be used to determine taxable profits for either income tax or for corporation tax. A year end accrual is therefore often necessary, creating an additional compliance burden for small businesses who may not have the necessary accounting knowledge or appreciation of the problem.

Flat rate scheme

33. Businesses have been encouraged to adopt the new flat rate scheme for VAT. In order to determine whether it is beneficial, actual calculations are needed and a calculator is now available. The Government has stated that the scheme is revenue neutral, which implies that there must be both winners and losers. Few businesses will want to be in the latter category. Nevertheless, the intention of Customs is to simplify the compliance burden, which we think they have achieved.

VAT registration by Charities

34. This is an area fraught with difficulty for most charities. The complexity of the rules requiring registration causes administrative confusion and is of concern.

Capital gains

Taper relief

35. There are now two regimes for taxing capital gains; corporation tax applies to companies' gains and capital gains tax rules to individuals and trusts.

36. Capital gains tax taper relief was introduced in 1998 with significantly different rates applying to business and to non business assets. These rules have changed several times since then, but the changes are not retrospective. This results in an additional compliance burden where business assets are disposed of today and complex time-apportionment calculations are needed.

Further issues

Statements of account

37. Income tax statements of account continue to cause frustration. Taxpayers were originally promised a simple statement similar to that used by credit card companies, but little progress has been made resulting in a considerable waste of time.

Student loans

38. Since the introduction of student loans, employers have had to handle their recovery. We understand that many employers have spent large amounts of administrative time on this area.

Statutory Sick Pay, Statutory Maternity Pay and Statutory Paternity Pay

39. SSP, SMP and SPP are all extremely complex. Many small employers will only have to deal with this part of the tax system once or twice in their working life. The administrative cost of tax compliance is inevitably substantial.

6 January 2004

Memorandum submitted by the Association of British Insurers

ADMINISTRATIVE COSTS OF TAX COMPLIANCE

1. INTRODUCTION

1.1 The Association of British Insurers (ABI) represents more than 96% of insurance companies operating in the UK. The ABI is therefore ideally placed to respond to the inquiry by the Sub-committee into the Administrative Costs of Tax Compliance.

1.2 There are four main areas of tax compliance for insurance companies:

- Corporation tax computations and enquiries thereon;
- Value Added Tax returns and compliance visits;
- Reporting of Gains from Life Policies and compliance visits;
- Construction Industry Scheme reporting.

1.3 These four areas are the biggest and involve the highest level of input and management time. Our response therefore concentrates on these areas. There are other aspects of tax compliance such as employment and pension scheme reporting and compliance visits, but these have not changed significantly in recent years. However due to the impending changes to the pensions tax regime we also comment on the compliance costs related thereto.

2. CORPORATION TAX COMPLIANCE

2.1 The corporation tax computation for a life insurance company has been subject to almost constant legislative change since 1988. Unfortunately this constant change has not been to simplify the existing legislation. This steady stream of change has thus increased the cost of compliance with tax reporting obligations. As well as this the Government implemented the self assessment regime for companies in 1999. This has shifted a significant portion of the compliance burden from the Inland Revenue onto companies. It is estimated that the cost of corporation tax compliance has increased over the 14 years by 50%, adjusting for the increase in comparable costs due to earnings and RPI increases. This is despite the fact that technological advances on software systems have allowed significant reductions in manual time spent on compliance. Thus on a like for like basis our costs on compliance have increased by 50%.

2.2 The Government has taken no steps to reduce the compliance burden that is placed on companies. Indeed the recent consultation into the reform of Corporation Tax and the consultation on the draft legislation to be included in the Finance Bill 2004 on Transfer Pricing, will have the effect of significantly increasing the compliance burden for large companies. This is because Transfer Pricing is being introduced for all transactions between group companies, not just those where the group company that is counterparty to the transaction is located outside the UK. It will be necessary for a UK Group to obtain documentary evidence of comparable prices for transactions between unrelated companies, in order to support the transaction prices adopted by the group in filing its tax returns. To gather such evidence will involve considerable management time and additional fees to advisers, which is currently not necessary for UK tax returns.

3. VALUE ADDED TAX COMPLIANCE

3.1 For insurance companies, the majority of their supplies are exempt from VAT. So they are obliged by the legislation to agree with HM Customs & Excise ("Customs") a method by which they can recover the VAT attributable to their taxable supplies (a partial exemption method). Due to the nature of insurance business, it is necessary for an insurance company to agree a special method with Customs as the standard method is inappropriate. On its own this makes the cost of compliance with VAT for insurance companies, greater than for other companies of similar size. However Customs can notify the company that they intend to withdraw the method from a future date, without offering a method to replace the one being withdrawn. This has the effect of significantly increasing the compliance burden due to the time that can be taken to agree a replacement method.

3.2 The Pre-Budget Report indicated that Customs will be allowed to terminate a special method from a particular date. It is stated that this will enable sensible negotiations of new fairer methods to take place in a timely manner. However we are aware of many instances where insurance companies have proposed alternative methods to Customs that give a fair result, only to have those methods rejected for no particularly good reason as still not providing a fair result. The proposed new basis of applying the updated method from a retrospective date will place an additional burden on insurers and increase their costs of compliance. The legislation does not allow an insurer to appeal against Customs refusal to accept a new method. If the taxpayer were allowed to appeal, this would allow a tribunal to determine whether Customs were acting in a fair manner.

4. REPORTING OF GAINS FROM LIFE POLICIES

4.1 When a policyholder takes cash or other benefits from their policy, the insurer is required by legislation to provide both the policyholder and the Inland Revenue with a certificate setting out details of any gain that has arisen. The insurer has invested huge sums in order to be able to issue these certificates and to compute the gains. These gains while being chargeable to tax only give rise to a liability if the policyholder is a higher rate taxpayer, or because of the gain becomes one. According to statistics produced by the Inland Revenue only 5% of the UK population are higher rate taxpayers. In 1998 the total tax collected from gains from life policies was about £25 million. Against this has to be set the cost to the insurance industry from maintaining systems to calculate the gains and produce the certificates, and the cost to the Inland Revenue of auditing the systems. It is our belief that the cost involved is disproportionate to the tax raised.

5. CONSTRUCTION INDUSTRY SCHEME REPORTING

5.1 The Construction Industry Scheme was introduced to minimise tax leakage from the construction industry due to failure of some contractors to fully declare their income. The scheme operates to compel a contractor or deemed contractor working on a building to deduct tax from payments to sub-contractors unless they can provide the appropriate certificate that exempts the contractor from the need to withhold tax.

5.2 Insurance companies hold significant property investments to support their liabilities to policyholders. In many cases, such property will have been constructed by a builder for the insurance company. Insurance companies also engage builders to carry out property repairs in the event of damage to their property. In these instances the insurance company will be deemed to be a contractor for the purposes of the Construction Industry scheme and is thus required to operate the scheme. This involves obtaining certificates from contractors and deducting tax from payments where the certificates are not produced. The costs of administering the scheme for insurers are therefore very high, as operation of the scheme is not a central part of the business of an insurance company. Insurers will in the main, be dealing with major building companies and so the risk of any tax loss is minimal.

6. PENSION SCHEME COMPLIANCE

6.1 Pensions account for the majority of business for life companies. The procedures for administering the tax compliance regime for pensions are well established and understood. The cost though is significant.

6.2 The Government announced a completely new regime for pensions in the Pre-Budget Report. This is likely to cause significant cost for insurers in altering their systems to be able to deal with the new regime. It is also important that the new regime and tax reporting requirements are simple to operate so that they are cost effective for both providers and pension scheme members.

7. SUMMARY

7.1 Insurance companies have seen a significant increase in their costs of complying with their tax obligations over recent years. The introduction of self assessment for corporation tax for companies has played a significant part in this increase. The approach of Customs to the partial exemption methods of insurers has also contributed to an increase to the cost of compliance. In the reporting of gains from life

policies and the operation of the construction industry scheme, insurers incur significant administration costs for very little tax benefit to the Inland Revenue. The introduction of a new pensions tax regime has the potential to increase costs significantly. It is therefore important that the new regime and reporting requirements are as simple as possible.

January 2004

Memorandum submitted by PricewaterhouseCoopers

ADMINISTRATIVE COSTS OF TAX COMPLIANCE

INTRODUCTION

1. This memorandum is submitted to assist in the Treasury Sub-committee's enquiry into the administrative costs of tax compliance. Comments submitted are brief and illustrative rather than attempting what might become a full analysis of the tax code. We would be happy to attend a Sub-committee meeting to give oral evidence.

GENERAL PRINCIPLES

2. As a preliminary point, it should be recorded that all businesses will accept that they have a responsibility to comply with the requirements of tax law and to pay their taxes. Running a business of any size brings with it responsibilities and tax is one of those. It is, after all, sometimes remarked that taxes are the price paid for living in a civilised society and in a way those taxes help generate and police the rules of society under which businesses can operate and hopefully prosper.

3. At the same time, the tax authorities need to recognise that a business's main objective is going to be to carry on that business. Their aim, in most cases, is to make a profit and, for all but the smallest, to give employment and opportunities. Businesses do not exist in order to pay taxes nor, are businesses run so as to avoid paying taxes.

4. In other words, both "sides" need to recognise that taxes are important but are not the be all and end all of a business's existence. In particular, this means that the tax authorities, and the Government, have a clear responsibility to levy taxes that place as light an administrative burden as possible on businesses. It is not just the absolute amount of tax taken that matters; the amount of effort it takes on the part of business taxpayers to comply with their responsibilities is also important.

5. One of the major burdens placed on businesses by the tax system is the responsibilities that come from acting as employers. This is a theme that we return to later in our memorandum.

THE CURRENT POSITION IN GENERAL

6. In recent years, there has been a noticeable switch in the tax system from an assessment regime to self-assessment. Some taxes—notably of course VAT—have always existed on self-assessment. But the switch to self-assessment for corporation tax and income tax during the 1990s marked a subtle but significant shift of work and responsibilities, which has just been continued with Stamp Duty Land Tax. Whilst a move to self-assessment is in many ways a correct one in that it emphasises to the taxpayer their responsibilities (and in the UK was in many ways a much needed modernisation of the tax system) it does place additional burdens on the taxpayer. This has not always been recognised by the way the tax system is run. The simplest way to illustrate this is to consider the work that has to be done over an arguable or contentious item. The taxpayer—often through their tax adviser—will need to research a situation and prepare a tax return on the basis of some uncertainty. In the end they have to take what might be termed a filing position—but the work that they do does not necessarily protect them from subsequent tax authority enquiry. Nor does the tax authority, particularly for the direct taxes, offer a clearance/rulings system except in very limited situations. These might reduce the amount of work needed or at least give certainty.

7. The sheer volume of tax legislation that has emanated from Parliament in recent years has created its own additional burden of tax compliance. A glance at a bookshelf containing the Finance Acts of recent years compared with those of 20 or 30 years ago shows that there is much more legislation to cope with—and that is before adding in the huge volume of statutory instruments and other guidance material. Whilst many of the initiatives that translate into new provisions in Finance Acts are to be applauded, or anti-avoidance legislation accepted as necessary, all new legislation, directly or indirectly, imposes its burden on business. A business will want to understand a new provision, or at least have an assurance from its tax adviser that they need not worry about it. To give two recent examples of this:

- (i) The new rules for giving a tax deduction for expenditure on intangibles contained in Finance Act 2003 Schedule 29 extends to 143 paragraphs. Whilst the basic rule is clear, understandably many businesses had to analyse (or ask to be analysed) all the provisions so as to be certain of their position.
- (ii) Capital Gains Tax on shares held by employees might not seem an obvious topic to concern the business itself but many businesses have had to spend time and effort analysing and then explaining the impact of the taper relief rules to their share-owning employees, in particular the impact of the vagaries of the various changes to the definition of business assets.

8. The administrative burden created by the tax system is not restricted to that involved in completing a tax return. Evaluating which provisions do not apply is also a concern. To give an example, many businesses will feel that they should be entitled to the enhanced deduction for research and development expenditure. But because of the restricted definition of what constituted research and development for these purposes, many have spent time analysing only to fail to generate a valid claim. (It is accepted that recent announcements may lessen the numbers of businesses so affected.)

THE EMPLOYER'S BURDEN

9. One of the key burdens that the tax system places on business is when they act as employers. Again employers will accept that they have a responsibility towards their employees but the burdens imposed by PAYE and NIC regulations are considerable and increasing. PAYE started out as a simple mechanism to help the Government's cash flow and reduce the overall administrative burden of operating tax for employees. NICs in the meantime started out as a simple flat rate deduction. What has happened over the years is that both systems have become considerably more complex and (although the position is much improved of late) do not operate on exactly the same definition of "income". Whilst the systems work well for a static workforce paid primarily in cash (as opposed to being given some benefits-in-kind) many employers have faced increasing difficulties with mobile and changing workforces, and with benefits (particularly in shares) being given to employees.

10. The well-known study by Bath University of employer's compliance costs came up with a figure of £288 per annum per employee for small employers but a modest £5 for large employers. These figures were based on the burdens of over 10 years ago; since then the employer's burden has increased considerably. Even large employers—who at the time made a "profit" from their payroll administration costs through the cash flow benefits of "holding" PAYE/NIC—will surely now be out of pocket. Perhaps it would be timely to commission a similar study of the current position?

11. Employers, crucially, do not just have to cope with the tax system. Recently they have had to deal with the new Tax Credits regime and if the changes in April 2003 reduced the employer's burden, it has done nothing to compensate them for the efforts that they have had to put in under Working Families Tax Credit or continue to do so under Working Tax Credit. Minimum wage regulations, student loan repayments and other burdens, whilst not directly a product of the tax system, are often perceived as such by employers.

12. It is worth noting in passing the case of *Meredith v Hazell* (42 TC 435), a case in which an Oldham solicitor claimed a deduction, to be covered by a withholding from his PAYE receipts as an employer, for the costs to him of operating the PAYE system on behalf of the Inland Revenue. He lost his case but it would be interesting to speculate on the drive for a simpler system that might have occurred had he won.

13. A fuller analysis of this part of the burden imposed on business and how it has developed, together with suggestions for improvement, are contained in a paper by John Whiting "*Employment Taxes—Where are we going?*", a record of the Hardman Memorial Lecture published in *British Tax Review* of Spring 2002. This can be made available to the Sub-committee if it would be of interest.

DO REDUCTIONS IN ADMINISTRATIVE BURDENS WORK?

14. It is clear from a number of pronouncements by the Chancellor and the tax authorities that the administrative burden imposed by the tax system is recognised. Efforts have been made to reduce burdens and these are to be applauded. However, not all seem to achieve their objective. To give some examples:

- (i) There seems to be an increasing tendency to have differing rules for corporation tax as against income tax. Thus an unincorporated business increasingly finds itself with fewer deductions against its taxable profits than an incorporated one. The rules on deductions for intangibles referred to earlier in this memorandum are one example. This divergence causes additional problems if only because of misunderstandings and the need to constantly re-examine how a business should be carried on.
- (ii) Reductions in rates do not always carry with them a reduction in administrative burden. The starkest example is the nil "starter rate" for corporation tax introduced for the smallest companies. Whilst that may reduce or eliminate a corporation tax bill, it does not mean that the smallest company can ignore corporation tax—computations still have to be carried out.

- (iii) The VAT flat rate system is a good initiative and is certainly helping a number of small businesses. But it was probably introduced in a slightly overly cautious manner—perhaps understandably, but it is notable that in the recent Pre-Budget Report easings and reductions in rates are foreshadowed to encourage more businesses to take advantage of the system.
- (iv) Too often the tax system looks to compulsion rather than encouragement. Large employers are about to have to file their employment returns and make their payments of PAYE/NIC electronically. Whilst undoubtedly e-filing is the way forward, surely the ethos should have been to look at such matters from the point of view of the employer/business and design a system to appeal to them rather than to look at it from the Inland Revenue’s point of view and leave the control with them, enforcing the system with penalties.

WHERE NEXT?

15. As already mentioned, it is gratifying to see that the problems of the tax administration burden are increasingly acknowledged. Steps taken to alleviate this include such measures as:

- The whole Tax Law Rewrite project (though this has only a marginal impact as it does not simplify the underlying tax code).
- The publication of many of the Inland Revenue’s and Customs & Excise’s manuals which give much better guidance to taxpayers.
- Assistance given to the smallest businesses by the tax authorities.
- The much improved quality of guidance material available to business (though the quantity, again particularly for employers, is daunting).

16. The most recent set of tax announcements is of course the Pre-Budget Report. It would be interesting to try and compile a full “burdens analysis” of this package. This might show such matters as:

| <i>On the positive side</i> | <i>On the negative side</i> |
|--|---|
| Acceptance of accounts drawn up under IFRS as qualifying for tax purposes (but was there a choice?) | Many tax issues arising from IFRS remain to be clarified |
| Extension of VAT flat rate system. | The imposition of UK/UK transfer pricing and thin capitalisation rules. |
| Confirmation of the simplification of the Construction Industry Scheme (but why weren’t many of these steps taken in the recast of the CIS in 1999?) | More restrictive definitions of management expenses. |
| Pensions tax simplification (subject to how the £1.4 million limit will operate). | Review of VAT grouping rules. |
| Extensions to the Research & Development Tax Credit. | |

So overall the PBR probably delivers a “positive” on the administration of tax burden, though inevitably the perception will differ from business to business.

SOME THOUGHTS ON IMPROVING THE POSITION

17. It is easy to pick out specific tax provisions that create administrative burdens and criticise those. What is difficult is making a significant improvement in the position. It would undoubtedly be a welcome step forward if the Sub-committee were to endorse the general proposition that the tax system is imposing, particularly on employers, an increasing burden that is in danger of become disproportionate.

18. There should be a general drive to harmonise and streamline within the tax system. Employers will always point towards the benefits of combining PAYE and NIC. Whilst the political difficulties inherent in such a move are acknowledged, perhaps a proper study of this and a commitment to harmonise as far as possible would be a good starting point?

19. One key principle that would help in connection with new tax law is if there was a requirement on the Chancellor, or sponsoring Minister, to confirm that the provision being introduced will reduce the administrative burden on business (or taxpayers generally) and, if this is not the case, explain why the increased burden is justified. Clearly there will be occasions when increased burdens are inevitable and in such cases a proper explanation of them would be helpful. (Regulatory Impact Assessments are often published with tax proposals but these do not quite meet the recommendations suggested here. Whilst they may well mention the cost or yield of the provision, they do not highlight increased administrative costs nor is there any requirement to justify the increases.)

20. If the need to simplify and streamline the tax system is accepted, there is then a question as to how such work should be carried forward. It is suggested that serious consideration be given to the creation of an over-arching body to be charged with the responsibility for this work: a Tax Practice Committee to

monitor the development of the tax system, look for opportunities for simplification and generally contribute to the process of reform. There would be a certain parallel with the work of the Law Commission (which does not see its remit as extending to tax) but the TPC's remit would be specifically orientated to the administrative side of the tax system (and not tax raising). It might in time subsume the work of the Tax Law Rewrite project.

6 January 2004

Memorandum submitted by the Chartered Institute of Taxation

ADMINISTRATIVE COSTS OF TAX COMPLIANCE

INTRODUCTION

1. The Chartered Institute of Taxation is pleased to submit a memorandum of evidence to assist in the Treasury Sub-committee's enquiry into the administrative costs of tax compliance. We have kept our comment deliberately brief rather than attempting what might become a full analysis of the tax code. However, we would also refer the Sub-committee to two research projects sponsored by the CIOT. These are included as appendices to this memorandum,¹⁴ and can also be accessed on our website as follows:

- (a) VAT: Working together towards a better professional relationship: www.tax.org.uk/showarticle.pl?id=1852&n=
- (b) Self-assessment income tax returns—the filing behaviour of tax advisers and their clients: www.tax.org.uk/showarticle.pl?id=1938&n=

In addition, we would be very pleased to attend a Sub-committee meeting to give oral evidence.

GENERAL PRINCIPLES

2. As a preliminary point, it is worth stating that all businesses—or at least all those that intend to operate legitimately!—will accept that they have a responsibility to comply with the requirements of the tax law and to pay their taxes. Running a business of any size brings with it responsibilities and tax is one of those. It is, after all, sometimes remarked that taxes are the price paid for living in a civilised society and, in a way, those taxes help generate and police the rules of society under which businesses can operate and, hopefully, prosper.

3. At the same time, the tax authorities need to recognise that a business's main objective is going to be to carry on that business. Their aim, in most cases, is to make a profit and, for all but the smallest, to give employment and opportunities. Businesses do not exist in order to pay taxes nor, in the vast majority of cases, are businesses carried on so as to avoid paying taxes.

4. In other words, both "sides" need to recognise that taxes are important but are not the be all and end all of a business's existence. In particular, this means that the tax authorities, and above them the Government, have a clear responsibility to levy taxes with as light an administrative burden as possible on businesses. That does not just mean the absolute amount of money taken from business but, importantly, means the amount of effort it takes on the part of business taxpayers to comply with their responsibilities.

5. To add a small gloss to the Sub-committee's Terms of Reference, one of the major burdens placed on businesses by the tax system is their responsibilities that come from acting as employers. This is a theme to which we return later in our memorandum.

THE CURRENT POSITION IN GENERAL

6. In recent years, there has been a noticeable switch in the tax system from an assessment regime to self-assessment. Some taxes—notably of course VAT—have always existed on self-assessment. But the switch to self-assessment for corporation tax and income tax during the 1990s marked a subtle but significant shift of work and responsibilities, which continues today with Stamp Duty Land Tax. Whilst a move to self-assessment is in many ways a correct one in that it emphasises to taxpayers their responsibilities (and in the UK was in many ways a much needed modernisation of the tax system) it does place additional burdens on the taxpayer. This has not always been recognised by the way the tax system is run. The simplest way to illustrate this is to consider the work that has to be done over an arguable or contentious item. The taxpayer—often through his tax adviser—will need to research a situation and prepare a tax return on the basis of some uncertainty. In the end they have to take what might be termed a filing position—but the work that they do does not necessarily protect them from subsequent tax authority enquiry. Nor does the tax authority, particularly for the direct taxes, offer a clearance/rulings system except in very limited situations. Easier clearances/rulings might reduce the amount of work needed, or at least give certainty.

¹⁴ Not printed.

7. The sheer volume of tax legislation that has emanated from Parliament in recent years has created its own additional burden of tax compliance. A glance at a bookshelf containing the Finance Acts of recent years compared with those of 20 or 30 years ago shows show much extra legislation there is to cope with—and that is before adding in the huge volume of statutory instruments and other guidance material that floods out. Whilst many of the initiatives that translate into new provisions in Finance Acts are to be applauded, or anti-avoidance legislation accepted as necessary, it has to be understood that, directly or indirectly, all the new legislation imposes its burden on business. A business will want to understand a new provision, or at least have an assurance from its tax adviser that they need not worry about it. To give two recent examples of this:

- (i) The new rules for giving a tax deduction for expenditure on intangibles contained in Finance Act 2003 Schedule 29 extend to 143 paragraphs. Whilst the basic rule is clear, understandably many businesses had to analyse (or ask to be analysed) all the provisions so as to be certain of their position.
- (ii) Capital Gains Tax on shares held by employees might not seem an obvious topic to concern the business itself but many businesses have had to spend time and effort analysing and then explaining the impact of the taper relief rules to their share-owning employees, in particular the impact of the vagaries of the various changes to the definition of business assets.

8. The administrative burden created by the tax system is not simply restricted to that involved in completing a tax return. Evaluating which provisions do not apply is also a concern. To give an example, many businesses will feel that they should be entitled to the enhanced deduction for research and development expenditure. But because of the restricted definition of what constituted research and development for these purposes, many have spent time analysing, only to fail to generate a valid claim. (It is accepted that the recent announcements may lessen the numbers of businesses so affected.)

9. It is worth noting the taxes that business has to concern itself with. These are listed in Annex 1.

THE EMPLOYER'S BURDEN

10. One of the key burdens that the tax system places on business is when they act as employers. Again employers will accept that they have a responsibility towards their employees but the burdens imposed by PAYE and NIC regulations are considerable and increasing. PAYE started out as a simple mechanism to help the Government's cash flow and reduce the overall administrative burden of operating tax for employees. NICs in the meantime started out as a simple flat rate deduction. What has happened over the years is that both systems have become considerably more complex and (although the position is much improved of late) do not operate on exactly the same definition of "income". Whilst the systems work well for a static workforce paid primarily in cash (as opposed to being given benefits) many employers have faced increasing difficulties with mobile and changing workforces, and with benefits (particularly in shares) being given to employees.

11. The well-known study by Bath University of employers' compliance costs came up with a figure of £288 per annum per employee for small employers but a modest £5 for large employers. These figures were based on the burdens of 10 years ago; since then the employer's burden has increased considerably. Even large employers—who at the time made a "profit" from their payroll administration costs through the cash flow benefits of "holding" PAYE/NIC—will surely now be out of pocket. It would be timely to commission a similar study of the position now.

12. Employers, crucially, do not just have to cope with the tax system. Recently they have had to deal with the new Tax Credits regime and, if the changes in the Finance Act 2003 reduced the employer's burden, it has done nothing to compensate them for the efforts that they have had to put in under Working Families Tax Credit or continue to do under Working Tax Credit. Minimum wage regulations, student loan repayments and other burdens, whilst not directly a product of the tax system, are often perceived as such by employers.

13. It is worth noting in passing the case of *Meredith v Hazell* (42 TC 435), a case in which an Oldham solicitor claimed a deduction, to be covered by a withholding from his PAYE receipts as an employer, for the costs to him of operating the PAYE system on behalf of the Inland Revenue. Sadly for many employers, he lost his case but it would be interesting to speculate on the drive for a simpler system that might have occurred had he won.

DO REDUCTIONS IN ADMINISTRATIVE BURDENS WORK?

14. It is clear from a number of pronouncements by the Chancellor and the tax authorities that the administrative burden imposed by the tax system is recognised. Efforts have been made to reduce burdens and these are to be applauded. However, not all seem to achieve their objective. To give some examples:

- (i) There seems to be an increasing tendency to have differing rules for corporation tax as against income tax. Thus an unincorporated business increasingly finds itself with fewer deductions against its taxable profits than an incorporated one. The rules on deductions for intangibles

referred to earlier in this memorandum are one example. This divergence causes additional problems if only because of misunderstandings and the need to constantly re-examine how a business should be carried on.

- (ii) Reductions in rates do not always carry with them a reduction in administrative burden. The starkest example is the nil “starter rate” for corporation tax introduced for the smallest companies. Whilst that may reduce or eliminate a corporation tax bill, it does not mean that the smallest company can ignore corporation tax—computations still have to be made.
- (iii) The VAT flat rate system is a good initiative and is certainly helping a number of small businesses. But it was probably introduced in slightly too cautious a manner—perhaps understandably, but it is notable that in the recent Pre-Budget Report easings and reductions in rates are foreshadowed to encourage more businesses to take advantage of the system.
- (iv) Too often the tax system looks to compulsion rather than encouragement. Large employers are about to have to file their employment returns and make their payments of PAYE/NIC electronically. Whilst undoubtedly e-filing is the way forward, surely the ethos should have been to look at such matters from the point of view of the employer/business and design a system to appeal to them rather than to look at it from the Inland Revenue’s point of view and leave the control with them, enforcing the system with penalties. (It is notable, for example, that it is left to the Revenue to dictate which payment systems are acceptable—whilst one can understand the Revenue wishing to protect their position, is this the right starting point?)

WHERE NEXT?

15. As already mentioned, it is gratifying to see that the problems of the tax administration burden are increasingly acknowledged. Steps taken to alleviate this include such measures as:

- The whole Tax Law Rewrite project (though this has only a marginal impact as it does not simplify the underlying tax code).
- The publication of many of the Inland Revenue’s and Customs & Excise’s manuals which give much better guidance to taxpayers.
- Assistance given to the smallest businesses by the tax authorities.
- The much improved quality of guidance material available to business (though the quantity, again particularly for employers, is daunting and tells its own story).

16. The most recent set of tax announcements is, of course, the Pre-Budget Report. It would be interesting to try and compile a full “burdens analysis” of this package. This might show such matters as:

| <i>On the positive side</i> | <i>On the negative side</i> |
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| Acceptance of accounts drawn up under IFRS as qualifying for tax purposes (but was there a choice?) | Many tax issues arising from IFRS remain to be clarified |
| Extension of VAT flat rate system. | The imposition of UK/UK transfer pricing and thin capitalisation rules. |
| Confirmation of the simplification of the Construction Industry Scheme (but why weren’t many of these steps taken in the recast of the CIS in 1999?) | More restrictive definitions of management expenses. |
| Pensions tax simplification (subject to how the £1.4 million limit will operate). | Review of VAT grouping rules. |
| Extensions to the Research & Development Tax Credit. | |

So overall the PBR probably marginally reduces the administrative burden, though inevitably the perception will differ from business to business.

SOME THOUGHTS ON IMPROVING THE POSITION

17. It is easy to pick out specific tax provisions that create administrative burdens and criticise those. What is difficult is making a significant improvement in the position. It would undoubtedly be a welcome step forward if the Sub-committee were to endorse the general proposition that the tax system is imposing, particularly on employers, an increasing burden that is in danger of become disproportionate.

18. There should be a general drive to harmonise and streamline the tax system. Two particular areas demand attention:

- (i) Employers will always point towards the benefits of combining PAYE and NIC. Whilst the political problems in such a step are acknowledged, surely it is time for a proper study of this and at the very least to a commitment to harmonise as far as possible?

- (ii) Whilst there is a similar code of administration and enforcement for many of the direct taxes, this is not the case for the indirect taxes. There would be benefits for both the tax authorities, as well as business and tax advisers, in an “Indirect Taxes Management Act” to bring in a common regime for taxes such as VAT, Landfill, Insurance Premium Tax, Aggregates Levy etc.

19. One key principle that would help in connection with new tax law is if there was a requirement on the Chancellor, or sponsoring Minister, to confirm that the provision being introduced will reduce the administrative burden on business (or taxpayers generally) and, if this is not the case, explain why the increased burden is justified. Clearly there will be occasions when increased burdens are inevitable but surely it should not be too much to expect a proper explanation of them? (Regulatory Impact Assessments are often published with tax proposals but these do not quite meet the recommendations suggested here. Whilst they may well mention the cost or yield of the provision, they do not highlight increased administrative costs nor is there any requirement to justify the increases.)

6 January 2004

Annex 1

ADMINISTRATIVE COSTS OF TAX COMPLIANCE

A SUMMARY OF THE TAXES APPLYING TO BUSINESSES

TAXES APPLYING TO ALL BUSINESSES

- Corporation tax (incorporated) or Income tax (unincorporated)
- Capital Gains tax (or Corporation tax on chargeable gains)
- VAT
- Business Rates

- | | | |
|---|---|-------------------------------------|
| <ul style="list-style-type: none"> PAYE/Income tax National Insurance Contributions Tax Credits Student loans Statutory Sick Pay Statutory Maternity Pay Statutory Paternity Pay Statutory Adoption Pay | } | For those businesses with employees |
|---|---|-------------------------------------|

TAXES APPLYING TO ALL BUSINESSES THAT MAKE PARTICULAR TRANSACTIONS

- Stamp Duty/Stamp Duty Reserve Tax
- Stamp Duty Land Tax
- Customs Duties
- Climate change levy
- Vehicle excise duty

TAXES APPLYING TO SPECIFIC TYPES OF BUSINESS

- Petroleum Revenue Tax
- Excise Duties
- Betting Duties (and the various replacement profits taxes)
- Insurance Premium Tax
- Air Passenger Duty
- Landfill Tax
- Aggregates levy

Memorandum submitted by HM Customs and Excise and the Inland Revenue

1. GOVERNMENT POLICY ON THE COSTS OF TAX COMPLIANCE FOR BUSINESSES

1.1 The Revenue Departments welcome this inquiry by the Treasury Sub-committee into the administrative costs of tax compliance. The Government believes a strong entrepreneurial base is an essential driver of growth and prosperity in a modern economy. Its vision is that anybody with the talent, potential and drive to succeed in business should have the opportunity and support to do so, regardless of their background, in a culture which values and supports entrepreneurship. A thriving and dynamic small business sector is also key to economic flexibility, as new businesses can bring new or improved products and services to consumers, increasing competition and challenging existing businesses to improve their own performance.

1.2 There are many responsibilities associated with being in business, of which tax compliance is only one. As well as dealing with their tax obligations, businesses must fulfil obligations such as record keeping and accounting for banks and financial backers. If they are employers, it is right that they ensure safe and secure workplaces for their employees, as well as administering, for example, pension schemes on their behalf. Businesses also have administrative obligations to their customers and suppliers, and duties of care to the environment in which they operate.

1.3 The Government aims to deliver a modern and fair tax system. As set out in the 2003 Pre-Budget Report, this is a system which provides incentives to work and save, adapts to changes in business practice and the global economy, and raises sufficient revenue to allow the Government to pursue its objective of providing world class public services. The tax system can play a vital role in correcting market failures, promoting fairness and delivering social or environmental objectives.

1.4 The Government needs to ensure that revenue is collected. Not only do losses of tax through, for example, evasion or avoidance threaten the revenue base, they also distort competition against the honest tax-payer. It is right therefore that the Revenue Departments should establish and maintain robust control of the tax system, and that business should play a part in achieving this.

1.5 Recent surveys indicate that, in international terms, the overall UK regulatory requirement is lower than in many competitor countries. The OECD, in particular, has rated the UK as having the lowest barriers to entrepreneurship of any major economy. Nonetheless, the Government remains committed to reducing tax compliance costs where this can be done consistently with its other objectives. The Government is reducing such costs through means such as simplification and by providing better support or guidance and considering well-targeted exemptions.

1.6 Where regulation is necessary, the Government is committed to making it proportionate, targeted, comprehensible and easy to implement, and to communicating effectively with business. Decisions are informed by a regulatory impact assessment to demonstrate that the benefits justify the potential compliance costs.

1.7 Since 1997 the Government has introduced new deregulatory measures for business. The 2003 Pre-Budget Report set out how the Government will continue to pursue further deregulatory measures and simplify the regulatory framework for businesses while recognising businesses' desire for stability and certainty in the regulatory environment. Both Inland Revenue and Customs and Excise have Public Service Agreement targets to reduce compliance costs for compliant businesses.

1.8 Businesses can also play a role in reducing tax compliance costs. Many of the checks and safeguards which add complexity to the tax system have had to be introduced to deal with tax evasion and avoidance. Where some businesses continually seek out and exploit opportunities to reduce their tax bill unfairly, the Revenue Departments must protect the Exchequer.

1.9 So, there can be several conflicting drivers which affect tax compliance costs. The Government's central aim is to strike the right balance between these, making compliance easier and less costly for those who want or are trying to comply, with better targeted assurance activity aimed at the non-compliant. This allows the majority to get on with running their business with the minimum of intervention.

2. UNDERSTANDING AND MEASURING TAX COMPLIANCE COSTS

2.1 Businesses face certain responsibilities in order to operate in a modern society including financial accounting, health and safety and employment requirements and compliance with the taxation system.

2.2 Tax compliance costs include collecting data, keeping records, filing returns, making payments on the due date, liaising with the relevant tax authority and, in particular, dealing with their enquiries. Businesses may also incur costs at their own discretion through the use of tax planning and other devices designed to reduce their liabilities.

Benefits From the Tax System

2.3 There are strong commercial reasons for businesses setting up and maintaining accurate accounting and record systems. Tax compliance costs can therefore be minimised by tying tax requirements as closely as possible to normal commercial practices. Recent contacts with UK business organisations reinforce the view that the documentation needed for tax is generally needed for commercial purposes—and indeed the discipline imposed by tax is seen as beneficial to the business.

2.4 Anecdotal evidence from business advisors supports the view that Value Added Tax (VAT) can have a beneficial effect on business administration and record keeping. Indeed, of the 1.7 million businesses on the VAT register, 250,000 choose to be VAT registered with no tax repayment benefit. These businesses appear to see the benefits of VAT registration as outweighing the compliance costs.

2.5 Tax may also have a beneficial impact on business cash flow. Where it is collected on behalf of Government and paid over in stages the business has free use of the money during the time it is held. For example, Pay As You Earn (PAYE) tax may be deducted from employees at the end of one month and not paid over to the Inland Revenue until the second half of the following month.

Measuring Compliance Costs

2.6 Reliably estimating tax compliance costs is problematical. A business may incur costs directly or pay an intermediary such as an accountant to deal with its tax obligations, often as part of a more general accounting service. So, if asked to give a figure for compliance costs, the method businesses use to calculate the figure can vary considerably, from including the full costs of an accountant or book-keeper, to zero because they complete the necessary paperwork in their own time and so do not believe this to be a cost.

2.7 Many costs perceived as taxation compliance costs are in fact those which would be incurred anyway for financial management purposes. Because businesses do not generally manage their taxation activities in isolation from their other accounts work, it can be difficult for them to determine where activities solely related to taxation—as opposed to other obligations to backers or bankers and necessary accounting activity in running the business—begin and end. This means that estimates of compliance costs can vary significantly and are subject to wide margins of error.

2.8 For these reasons, the Revenue Departments, in assessing progress against their Public Service Agreement targets, have adopted an approach based on Regulatory Impact Assessments to evaluate measures to reduce compliance costs. This is outlined in more detail in Section 3.

2.9 Details of recent research into compliance costs are in Annex A.

3. INLAND REVENUE AND HM CUSTOMS AND EXCISE'S APPROACH TO REDUCING COMPLIANCE COSTS

3.1 The need to reduce taxation compliance costs of businesses is specifically recognised in Government objectives and by both Inland Revenue's (IR) and Customs and Excise's (HMCE) Public Service Agreement (PSA) targets.

3.2 The Revenue Departments' current PSA Targets on compliance costs are:

- IR: To deliver reductions in compliance costs of small business.
- HMCE: To improve customer service by . . . delivering reductions in the costs of compliance for businesses.

3.3 IR's objective is to create an environment for small businesses in which they are aware of their obligations and able to obtain the information and support they need to meet those obligations at the minimum cost. Four main strands of work contribute to delivery of this strategy:

- simplifying the regulatory framework;
- streamlining administration, for example through their e-business programme;
- educating and supporting small business; and
- working together with other Government Departments.

3.4 HMCE's policy approach to delivering compliance cost reductions is principally through transformational e-business strategy, and initiatives designed to make it easier for businesses that want to comply to do so while tackling those businesses which are seriously non-compliant. HMCE has a five point plan to deliver its target which includes:

- a new research programme to understand compliance costs better;
- new policy proposals to reduce compliance costs;
- greater support for compliant businesses;
- partnerships with the professions; and
- e-business changes.

3.5 In a jointly developed approach, the two Departments are monitoring proposed changes to both tax policy and implementation which could impact on compliance costs. This enables them to track the cumulative trend in compliance costs and to identify and tackle key risks in meeting their targets for reduction.

3.6 Assessment of progress against the targets is made using the cumulative effect on compliance costs of changes made during the three year PSA period, the current period starting in April 2003. The impact of these changes is quantified using Regulatory Impact Assessment (RIA) methodology following published Cabinet Office guidelines.

3.7 An RIA is a tool used to develop policy decisions and assess the impact of the policy decision in terms of the costs, benefits and risks of a proposal. It provides a clear statement of the policy objectives and the issue and sets out the problem to be addressed. It then identifies the options, pros, cons, risks, benefits and costs of each option and specifically addresses the impact of the options on businesses. Ministers are required to sign the RIA stating that they are satisfied that the benefits of the final proposal justify the costs, if any. (See Annex C for an example of a recent RIA).

3.8 RIA methodology is, by its very nature, based on estimates of the anticipated impact of changes on compliance costs and is not sufficient in itself to be a completely accurate measure of progress. So both IR and HMCE are carrying out post-implementation assessments of changes that have been introduced. This is designed for two purposes. First, to provide assurance that the figures used to assess progress against the PSA target are reasonable estimates. Second, to build up a database of the impact of different types of change on businesses, to inform future estimates of the impact of similar or related changes.

3.9 Additionally IR and HMCE have developed jointly a compliance costs calculator to help policy officials completing RIAs to assess the compliance costs effects of their policies. This approach ensures that consistent values are applied for time taken or saved by businesses.

3.10 However, Cabinet Office guidelines require only evaluation of costs associated with *significant regulatory changes*. Costs that result from administrative or operational change are not required to be assessed. Nor is the cumulative impact of successive minor regulatory changes. To ensure these costs are fully assessed and reflected in the overall picture, the Revenue Departments are developing additional forms of assessments based on RIA methodology.

3.11 In addition, HMCE are piloting a new approach where an independent researcher accompanies an HMCE officer on a planned visit to a business. The researcher observes the visit and asks additional questions to gather detailed information on how the business manages their taxation affairs in practice. This approach is intended to enhance HMCE's ability both to identify areas where compliance costs might be reduced and to assess the impact of proposed changes on businesses by having a better understanding of how they carry out their taxation affairs in practice. If the pilot study proves successful, HMCE intend to roll out the method across a broad range of businesses.

3.12 Both Departments have also put in hand work to identify further new areas where compliance costs might be reduced for smaller businesses. This has included IR taking part in an initiative where senior officials spend a week with a small business to increase the official's commercial awareness and help them understand the difficulties and costs of dealing with government.

3.13 Informal research has been conducted to home in on "hotspots" identified in existing work as sources of compliance costs, and to use this information to try and understand in depth the issues identified.

3.14 Both Departments also have in place a number of active communication channels to allow ongoing consultation with businesses, trade bodies and intermediaries such as accountants. There are a number of standing groups such as the Joint Value Added Tax (VAT) and Customs Consultative Committees and the IR Better Regulation Consultative Committee. In addition, IR has set up a Business Tax Forum to enable IR and business to develop a shared understanding of the changing commercial environment and discuss mutual concerns. IR also has several consultative groups covering a range of employer issues. HMCE has an active Small Business Forum consisting of professional advisors where issues relating to small businesses are identified and resolved. Both Departments operate a programme of "Working Together" where officials and accountants meet to resolve tax issues.

3.15 HMCE are also using extranet systems to facilitate ongoing consultation with traders and professional tax advisors. This method allows more of a dialogue with interested parties without the expense or disruption of a formal meeting. It also allows a wider range of contacts to be reached.

3.16 Formal consultation exercises in line with Cabinet Office guidance continue to be used by both Departments to solicit views from those affected by proposals wherever possible. In combination, these extensive contacts provide many opportunities to validate and inform estimates of the effects of changes on business.

4. WHAT INLAND REVENUE AND HM CUSTOMS AND EXCISE ARE DOING TO REDUCE COMPLIANCE COSTS

4.1 Both Departments continue to seek opportunities for simplification of the regulatory requirements by consulting with customers and implementing necessary changes in a way that minimises compliance costs. Some recent examples include:

- raising the threshold for quarterly payments of Pay As You Earn (PAYE) to £1500;
- simplifying employee share schemes;
- the highest Value Added Tax (VAT) registration threshold in the EU; and
- a range of self-help schemes, targeted primarily at small businesses, to make the administration of VAT easier and less costly.

4.2 IR and HMCE also aim to streamline the administration of the tax system making it more efficient and comprehensible. By maximising on-line availability of core services and encouraging take-up of those services and the wider use of technology they expect to deliver compliance cost savings. For example:

- on-line filing and payment facilities for Self Assessment (SA), PAYE for employers and Corporation Tax (CT), and cash incentives for smaller employers to encourage e-filing;
- the introduction of a new HMCE e-business strategy designed to simplify contact between business and taxpayers; and
- the development of shorter and simpler income and corporation tax returns.

4.3 Providing timely, accurate and up-to-date information and support by preferred delivery and communication channels is another approach by which both Departments expect to reduce compliance costs. Examples of that include:

- the introduction of IR business support teams and HMCE business advisers;
- an HMCE National Advice Service; and
- new help for employers including Employer Talk events and an improved annual Employer's Pack in CD-ROM format, providing forms, guidance and calculation tools.

4.4 IR and HMCE are also working with other Government Departments and Agencies to deliver integrated information services, minimising the need for contact with separate Departments. Examples of these initiatives include:

- Business Advice Open Days which are free events attended by an average of 1,500 people and designed for small and medium sized businesses to obtain information and advice from a wide range of Government Departments and Agencies;
- the introduction of businesslink.gov, a cross-government web based service to provide a single point of contact that will make it simpler and easier for people to find out what they need to develop and run their business.

Annex B contains a list of key measures.

January 2004

Annex A

RECENT RESEARCH

Recent surveys indicate that, in international terms, current UK regulatory requirements are lower than in many competitor countries. The OECD, in particular, has rated the UK as having the lowest barriers to entrepreneurship of any major economy (Table 1). It is not just a question of volume as, compared internationally, UK businesses face fewer regulations than in many other countries.

Recent surveys such as the Small Business Service (SBS) Omnibus Survey 2001 suggest cash flow and sales are of greater concern to sole traders than taxation. And over half of all respondents who considered tax an issue could not cite any specific areas without prompting, suggesting that it is the perception of the tax system in general rather than anything more concrete that is at issue.

The SBS survey also asked whether it was the level of tax or administrative requirements that were most onerous (Table 2). For Value Added Tax (VAT), Pay As You Earn (PAYE) and National Insurance Contributions (NICs) opinions were evenly split, but for Income Tax (IT) and Corporation Tax (CT) the majority gave more weight to the level of tax than to administrative requirements. This is perhaps unsurprising given that VAT and PAYE are generally recorded and paid more frequently than IT and CT. In the 2002 VAT Business Needs Survey, only 32% agreed with the statement that VAT was unnecessarily costly, with 47% actively disagreeing.

Other studies have sought to research the incidence and level of compliance costs. Some have sought to do this by assessing the time spent away from running the business (Table 3).

The most commonly cited tax compliance costs survey is Sandford *et al* (1989), whose work showed that compliance costs fell disproportionately on small businesses across all main heads of tax (Table 4). Sandford's conclusions are supported by research published by Inland Revenue (IR) in 1998, measuring the

overall compliance cost of PAYE and NICs. The survey found that costs were not evenly distributed among firms, with the smallest 30% of firms paying around 75% of the total costs, suggesting strong economies of scale (Tables 5a and 5b)

Customer surveys conducted by both Departments show that the majority of businesses would feel less obliged to rely on professional advisers, and so could reduce compliance costs, if they were provided with clearly signposted gateways to consistent and easily understood advice. They see getting the basics right by providing more timely information, advice and service as the most important area for action.

Table 6 lists other recent relevant research.

There is little recent international research on comparative analytical work on compliance costs. This is possibly because it is difficult to make meaningful comparisons across national systems and in view of the relatively high costs of large-scale national compliance costs studies.

Table 1

INTERNATIONAL COMPARISONS OF SCALE OF REGULATORY BURDEN

| <i>Year</i> | <i>Organisation</i> | <i>Key Findings</i> |
|-------------|---------------------|---|
| 2000 | OECD | Study of administrative burdens placed on business start ups, the degree to which administrative systems were difficult to understand and follow, and barriers to competition. The UK was judged to have the lowest barriers to entrepreneurs |
| 2003 | OECD | UK found to have the lowest administration cost and fewer regulations for entrepreneurs than any other EU country |
| 2001 | Growthplus | The UK found to be the most entrepreneur-friendly environment in a comparison of nine European countries and the USA |
| 2001 | European Commission | UK was ranked jointly with Ireland, as the cheapest and fastest place in the EU in which to set up a business |
| 2002 | The Economist | UK ranked as top of the 1997–2001 “Entrepreneurial Framework Index” of 60 countries that are low on red tape |

Table 2

NATURE OF CONCERN WITH THE TAX SYSTEM
(SMALL BUSINESS SERVICE, OMNIBUS SURVEY, 2001)

| <i>Tax type</i> | <i>% of respondents concerned about level of tax</i> | <i>% of respondents concerned about administrative burden</i> |
|-----------------|--|---|
| VAT | 48% | 47% |
| PAYE/NICs | 50% | 49% |
| IT | 79% | 22% |
| CT | 92% | 25% |

Table 3

TIME SPENT DEALING WITH GOVERNMENT REGULATIONS

| <i>Year</i> | <i>Body</i> | <i>Findings</i> |
|-------------|--|--|
| 1999 | Natwest Small Business Research Trust Survey | Small businesses with 10–14 employees typically spent 31 hours a month complying with Government regulations and paperwork. |
| 2000 | Forum of Private Business | Small businesses spent an average of 2.6 hours a week dealing with employment regulation, 1.8 hours on VAT and 1.7 on PAYE/NICs. |

Table 4

COMPLIANCE COSTS AS A PERCENTAGE OF TAXABLE TURNOVER 1986–87
(SANDFORD *ET AL* 1989)

| <i>Size</i> | <i>Respondents</i> | <i>VAT%</i> | <i>PAYE%</i> | <i>CT %</i> | <i>All taxes %</i> |
|-------------|--------------------|-------------|--------------|-------------|--------------------|
| Small | 9 | 1.48 | 1.39 | 0.79 | 3.36 |
| Medium | 28 | 0.28 | 0.19 | 0.15 | 0.62 |
| Large | 17 | 0.05 | 0.08 | 0.04 | 0.17 |

Where size is defined by annual turnover, small (up to £100,000), medium (£100,000—£1million) and large (over £1 million)

Table 5

(a) PAYE/Payroll

| <i>Date</i> | <i>Scope of research</i> | <i>Carried out by</i> | <i>Comments</i> |
|-------------|--|---------------------------------|--|
| 1998 | Compliance costs of PAYE & NICs—quantitative | Bath University (Prof. Collard) | Analysis of compliance costs on PAYE/NICs as at 1995–96 compared with a similar survey conducted in 1981–82. As a proportion of GDP aggregated costs were very similar to those in 1981–82 |

(b) Details from Bath Report showing variation in costs per size of business in terms of employee numbers

| <i>1981–82 size band : number of employees</i> | <i>1981–82 costs £ (adjusted to 1995–96 levels)</i> | <i>1995–96 equivalent size band</i> | <i>1995–96 costs £ per employee</i> |
|--|---|---|---|
| 1–5 | 147 | 1–4 | 284 |
| 6–10 | 98 | 5–9 | 136 |
| 11–20 | 96 | 10–49 | 84 |
| 21–50 | 73 | 10–49 | 84 |
| 51–100 | 43 | 50–99 | 47 |
| 101–500 | 45 | 101–500 | 33 |
| 500+ | 28 | 500+ | 23 |

Table 6

OTHER RELEVANT RESEARCH

| <i>Date</i> | <i>Scope of research</i> | <i>Carried out by</i> | <i>Comments</i> |
|--------------|--|--|--|
| 1990 onwards | Several studies including <ul style="list-style-type: none"> — Compliance costs of business taxes— CT, VAT, SA and Business Rate — Modelling the impact of taxation on the small business economy — Survey of literature on compliance costs and follow on survey (for SBS) | Manchester Business School Chittenden, Kauser Poutziaris International Small Business Journal 21(1) 2003 | An attempt to link up tax and compliance cost effects on the full range of taxes experienced by small businesses. Issues over grossing and sample size make estimates doubtful. Literature survey over past decade. |

Annex B

WHAT INLAND REVENUE AND HM CUSTOMS AND EXCISE ARE DOING TO REDUCE COMPLIANCE COSTS

The Revenue Departments' key measures are as follows:

(a) *Regulatory Reform including simplifying the regulatory framework*

- the abolition of Advanced Corporation Tax which simplified the corporation tax rules and gave a £1 billion cash flow advantage to business;
- the simplification of employee share schemes, giving employers ongoing compliance cost savings of £9 million per annum;
- the reform of company car taxation, giving employers ongoing compliance cost savings of £20 million per annum;
- raising the threshold for quarterly payments of Pay As You Earn (PAYE) to £1,500, allowing more small employers to benefit from the reduced costs of quarterly rather than monthly payroll accounting, and giving ongoing compliance cost savings of £6.5 million per annum;
- rewriting direct tax legislation with a better structure and simpler language to make it easier and clearer to use, eg the Capital Allowance Act 2001 and the Income Tax (Earnings and Pensions) Act 2003;
- the introduction of the National Insurance Contributions and Statutory Payments Bill in November 2003, to streamline the administration of tax and NICs;
- the highest Value Added Tax (VAT) registration threshold in the EU, so that the smallest UK businesses can avoid the complexities of VAT if they wish;
- a range of self-help schemes, targeted primarily at small businesses, to make the administration of VAT easier and less costly, and which cumulatively could save an average of around £700 per year per business. These include:
 - cash accounting;
 - annual accounting; and
 - the VAT flat rate scheme which recent research shows is valued for the simplification it provides and the time and money it saves small businesses.

These help the smallest businesses and the newly registered to reduce their VAT compliance costs, improve their cash flow and manage their entry into the VAT system. For the smallest businesses there is also protection from automatic penalties.

- the Simplified Import VAT Accounting scheme providing savings to thousands of businesses by reducing the cost of complying with import VAT rules. Current estimates are that these savings will total up to £80 million per year;

-
- betting reforms with Gross Profits Tax, a tax on bookmakers' monthly profits, replacing the tax on stake money. Also bookmakers with an annual turnover of less than £600,000 are now allowed to account for tax on a quarterly basis instead of monthly improving cash flow. Bingo duty has now been replaced with a gross profits tax;
 - the implementation of the recommendations of the Carter Review on payroll including electronic filing of employers end-of-year PAYE returns and cash incentives for smaller employers to encourage e-filing;
 - modernisation of the Construction Industry Scheme (CIS), reducing the regulatory burden on the industry and helping it to get the status of its workers right;
 - radical simplification of the tax rules for pensions;
 - consultation on further reforms to the corporation tax system in order to produce a regime that is modern, competitive and reflects the realities of the business environment;
 - measures to ensure that companies choosing to adopt International Accounting Standards to draw up their accounts will not have to submit a second and separate set of accounts to the Inland Revenue (IR);
 - a third re-written direct tax Bill covering trading, property, foreign income, savings and investment income under the Tax Law Re-write project.

(b) *Improved administrative processes (including new e-services)*

- the introduction of payment of direct tax by debit card;
- the merger of IR with the Contributions Agency so that customers now have to deal with only one organisation for tax and NICs matters;
- on-line filing for Self Assessment (SA), PAYE for employers and Corporation Tax (CT);
- on-line payment facilities for SA and CT, providing an increase in speed and convenience;
- national Business Managers for 1,000 largest VAT traders providing a single point of contact on all indirect tax matters;
- a Review of Links with Business, examining how the tax system operated for bigger businesses, and how it could be improved;
- the appointment of IR Case Directors for the largest companies, providing a single point of contact on direct tax matters;
- simplifying SA for both taxpayers and agents and reducing the costs of compliance. A short tax return for some taxpayers is being piloted and work is going ahead to simplify the main return;
- the development of a simplified self assessment return for companies with less complex affairs;
- a step change in the online SA services for the self employed, including the introduction of a new facility for customers to notify changes of circumstances online, saving time and inconvenience;
- a re-design of PAYE processes and employer End of Year work;
- the introduction of a new HMCE e-business strategy based around identified customer need, offering benefits in cost and time savings and quality of service. Savings will accrue from a number of aspects including: convenient access to services through greater choice of access and 24 hour availability; integration of data across tax regimes so that businesses only have to supply information once; the use of online calculators and the introduction of a new e-VAT service (including registration, declaration and payment) due for release in March 2004.

(c) *Education and Support*

- the introduction of IR business support teams who offer workshops for employers and the newly self-employed on a wide range of issues and one to one help and support with payroll;
- HMCE advisers for businesses seeking to develop, or engage for the first time in, international trade;
- an HMCE National Advice Service via a single low-cost telephone number handling just over 2 million calls;
- IR production of an improved annual Employer's Pack to include a CD-ROM providing forms, guidance and calculation tools;
- IR Employer Talk events across the UK attended by around 10,000 employers each year; and
- initiatives for small businesses identified at being at risk of filing IT and VAT returns incorrectly to help them minimise mistakes and file on time.

(d) *Joint and Cross Government activities*

- Business Advice Open Days (BAOD) which are free events attended by an average of 1,500 people and designed for small and medium sized businesses to obtain information and advice from a wide range of Government Departments and Agencies;
- the introduction of a single form for registering self employment with IR and HMCE and a Starting up in Business Pack sent to everyone who registers as self-employed;
- IR and HMCE linking with the Department of Trade and Industry and representative bodies to deliver business rescue which can help viable businesses with good prospects survive temporary cashflow difficulties;
- the introduction of businesslink.gov, a cross-government web based service to provide a single point of contact that will make it simpler and easier for people to find out what they need to develop and run their business;
- IR and HMCE are working closely and at different levels with tax professionals, small business representatives groups and other intermediaries across the regions, to draw on their knowledge of issues with the system and to work with them on potential solutions. They are also working with partners across government to gain a better understanding of business needs and influence changes;
- extension of BAOD coverage to target small businesses located in Enterprise Areas, and to engage businesses owned by under-represented groups;
- A Memorandum of Understanding (MOU) was signed between HMCE and the Small Business Service in March 2003 which provides a framework for collaborative working in support of small businesses.

Annex C

REGULATORY IMPACT ASSESSMENT (RIA)

Bingo Duty

1. *Title*

This is a Regulatory Impact Assessment (RIA) for the proposed modernisation of the taxation on the playing of bingo.

2. *Purpose and intended effects of the measure*

(i) *Background*

In Budget 2002, the Chancellor of the Exchequer announced that following the successful reform of betting duty he would review the scope for moving bingo taxation to a gross profits system. This change will affect 688 licensed bingo clubs.

The current bingo duty system was introduced in 1969. In recent years there has been increasing evidence that the tax on players' stakes could be restricting bingo companies' ability to compete and grow their businesses.

In its white paper "A Safe Bet for Success", the Government outlined plans to deregulate gambling and increase competition within the sector. Since the taxation of bingo was structurally different to the taxation of betting, the football pools, and casinos, there was a case to examine whether the taxation of bingo could be aligned to minimise tax and competition distortions.

The work carried out by the Nottingham Trent University and Nottingham University business schools for the reform of betting taxation demonstrated that abolishing taxes on turnover and replacing them with taxes on gross profits would be beneficial because they are "more allocatively efficient than a revenue equivalent turnover tax, the price faced by consumers will be lower, betting turnover higher and the overall tax burden as a proportion of gross profits faced by firms will also be lower"¹⁵.

(ii) *Objectives*

In deciding the final shape of a replacement gross profits tax regime for bingo the Government had to balance its four objectives for reform, which were to:

- simplify the structure of bingo taxation, and reduce compliance costs for bingo companies;

¹⁵ *An economic analysis of the options for taxing betting* (2000), a study conducted by Nottingham and Nottingham Trent Universities.

-
- reduce or eliminate the burden of tax currently falling on bingo players, and ensure that they get a better deal out of playing bingo;
 - provide the right environment for the bingo industry to maintain its role in local communities, and to reach its maximum growth potential; and
 - ensure that any reforms are affordable, and that the bingo industry continues to make a fair contribution to general tax revenues.

3. Consultation

Following Budget 2002, the Government held regular meetings with the bingo industry and in August 2002 published a consultation document entitled *The Modernisation of Gambling Taxes: Consultation on the Abolition of Bingo Duty*. This sought the industry's views about gross profits tax rate, the VAT treatment of participation fees, the definition of gross profits, and the timing of reform.

The consultation revealed broad industry support for the Chancellor's plans. The prevailing view from those who replied was that the Government should introduce a 15% gross profits tax and abolish VAT on par fees. The industry also believed that a bingo company's gross profits should be the difference between what players pay to play bingo minus the value of winnings paid out.

4. Outcome

The Budget 2003 announced the Government's decision to abolish the duty on bingo players' stakes and money added to the prize fund by bingo operators and replace it with a 15% tax on bingo companies' gross profits.

This change will be introduced on 4 August 2003.

5. Compliance cost benefits

The new tax system is simpler than the current system because bingo companies will no longer have to calculate the duty on added-prize money. This will reduce the time necessary to calculate the tax due and simplify business record keeping. The Government estimates this will save each bingo company, on average, half an hour per month for each club it operates.

As there are 688 licensed bingo clubs (owned by 150 bingo companies), this will save 4,128 hours per year. For those clubs owned by the smaller bingo companies, the manager is likely to complete the duty returns, while the larger companies are more likely to use accountants. It is estimated that around 130 companies will fall into the former category, while the remaining 20 will use accountants. The Office of National Statistics (ONS) estimates that the value of a middle manager's time is £38.37 per hour, while an accountant will earn on average around £19.34 per hour.¹⁶ Using these figures the Government calculates that this simplified tax calculation will save around £120,000 per year.

Bingo companies will benefit further because they will only have to calculate their tax monthly rather than weekly as at present. This will save a further 1.5 hours per month per club—12,384 hours in total, a cost saving of around £350,000 per year using the above time value figures.

Therefore the Government believes the annual compliance savings from the abolition of bingo duty will be around £470,000.

Of course, there will be a one-off transitional cost of revising accounting systems and training staff. The cost of these changes to individual bingo companies will depend upon the size of the bingo company, the complexity of accounting systems, and whether these changes will require other changes, for example reprogramming bingo equipment.

Based on information from the two major companies, the Government estimates that the cost to them in total will not exceed £500,000. Based upon a survey of several of the remaining 148 bingo companies, the Government estimates that amending their accounting systems and training the appropriate staff will not, on average, cost each bingo company more than £500. In addition the Government estimates it will take 30 hours to reprogram each controller unit that runs the industry's bingo equipment. There are 500 of these and ONS estimates that a computer programmer's average hourly wage is £16.40. Therefore the Government estimates the cost for these 148 companies will be around £320,000.

Consequently the Government believes the total transitional costs will not exceed £850,000.

¹⁶ Source: ONS figures adapted from the 2002 New Earnings Survey, and calculations from the 2002 New Earnings Survey.

6. *Fiscal benefits*

In addition to the compliance savings, the industry will also benefit because the Government has decided to reduce the level of bingo taxation. The savings will be £25 million in the first full year of the new tax.

7. *Competition assessment*

The Government does not believe this reform will have a significant impact upon competition within the licensed bingo industry.

The Government sees no reason why this proposal should have a disproportionate effect on small businesses. However Customs will be consulting with the Small Business Service prior to implementation.

8. *Securing compliance*

To help bingo companies to comply, Customs and Excise will hold seminars to explain the new tax and publish new guidance to accompany its introduction. If bingo companies have any specific queries about the new tax they will be able to contact Customs' National Advice Service.

There are no specific anti-avoidance provisions in this legislation.

9. *Monitoring and evaluation*

The Government reviews its taxes annually and will consider any comments it receives from businesses about how the tax is working.

10. *Summary*

This reform continues the Government's policy of modernising gambling taxes. In the first full year it will reduce the tax cost on the bingo industry and players by £25 million. In future years this change will reduce compliance costs by around £470,000 per year because it will simplify the tax structure and reduce the frequency with which bingo companies must calculate their tax liability. These benefits significantly outweigh the one-off transitional cost of adjusting to the new system.

11. *Declaration*

Regulatory Impact Assessment (RIA) Statement of Ministerial Approval

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

John Healey, Economic Secretary to the Treasury

Memorandum submitted by the Federation of Small Businesses

The Federation of Small Businesses is the UK's leading non-party political lobbying group for UK small businesses existing to promote and protect the interests of all who own and/or manage their own businesses. With over 182,000 members, the FSB is also the largest organisation representing small and medium-sized businesses in the UK.

The FSB is disappointed that the consultation period was a long way short of the 12 weeks that is the Cabinet Office recommended minimum for consultation. The consultation was only announced on 14 November and responses sought by 6 January. Given that this covered the Christmas and New Year holiday period this left only 4 or 5 working weeks. This response is not therefore as full or as detailed as it might have been, and we would hope to be able to support it with oral evidence.

The terms of reference are to examine:

- The extent of the administrative cost of tax compliance placed on business;
- How this has changed over time; and
- What steps have been taken to reduce the administrative costs and whether they are working.

This evidence will look at those questions from the viewpoint of a small business—in current terminology probably the point of view of a micro business with no more than 10 employees—in which the burdens of compliance are mostly placed on the shoulders of a single owner/manager. The vast majority of businesses in the UK are of this type.

1. THE COSTS

1.1 Tax compliance for the small business includes:

- Income or corporation tax on the profits;
- In the case of businesses with turnover above the threshold, the collection and recording of VAT;
- The operation of PAYE for employees;
- The administration of other payroll responsibilities, including tax credits, student loan repayment, statutory maternity and sick pay;
- The operation of the Construction Industry Scheme for those in the construction industry;
- For some small companies, calculations and paperwork relating to the personal service company legislation (IR35);
- Business rates;
- Such other taxes (Insurance Premium Tax, Aggregates levy etc) as may apply; and
- Capital gains tax on the disposal of business assets.

2. TAX ON PROFITS—SCHEDULE D, CASE I

2.1 There has been little administrative change for limited companies: rates of tax have been reduced and audit thresholds have been raised, but most of the other changes (goodwill, substantial shareholdings) have been more concerned with big business, as are most of the changes likely to spring from the currently ongoing CT reform process. Small companies will however be pleased that they are being largely exempted from the revised transfer pricing rules. They will not be pleased by the new and so far undefined threat posed by the Pre-Budget report.

2.2 For unincorporated businesses matters are less happy. There are issues both of routine compliance and of the impact of an Inland Revenue enquiry.

2.3 Self Assessment did nothing to make life easier for small businesses. The Self Assessment tax return is much more complicated than its predecessor. Reports have from time to time told us how many MPs could not complete their own returns, but the return for a small business is more complicated than that. In practice most small businesses do not complete their own returns, but rely on professional help, usually from their accountant. Increasing use of tax and accounting software has probably been the main factor in keeping down the cost of this help.

2.4 Very small businesses with an annual turnover of less than £15,000 (and there are a lot of them, many of them not full time) mostly use the three line entry on the tax return. It seems likely (and the Inland Revenue's work on businesses this size seems to support the thesis) that this is a recipe for errors.

2.5 At the same time there is a legal requirement in S.42 of the Income and Corporation Taxes Act 1988 for the accounts of a trade to be computed "in accordance with generally accepted accounting practice", which to all intents and purposes means that home made accounts will not comply with the requirements of the Act.

2.6 A major problem for small business is the Inland Revenue enquiry regime. The Revenue targets some 3% of small businesses every year, using risk analysis but not revealing the factors that they take into account. Because of the tight rules for enquiries under Self Assessment, the new enquiry regime is seen by most tax advisers as more intrusive and more bureaucratic than its predecessor because of the inevitable demand to see (at least) all business records, which for small businesses may well mean private financial records as well. This was intended as an auditing regime rather than an investigative one, so that there should be no preconception that any taxpayer being enquired into is guilty. Most practitioners do not believe that this is the case.

Furthermore there is no room in the Self Assessment system for an informal approach, which in the past would sometimes clear up apparent problems without a need for formal action.

2.7 It also appears (from anecdotal evidence and from unpublished and unreviewed research) that enquiries into small businesses under Self Assessment yield substantially less tax to the Inland Revenue than investigations under the old system, and indeed show a very low level of cost effectiveness.

2.8 The cost on professional time of an enquiry can be very substantial, often far more than the tax recovered. Most smaller tax practitioners do not have professional fee insurance, because they find it too expensive, and in many cases they do not charge the client the full cost of their work: or they do not do the work that they should because they know they cannot recover the cost.

2.9 There is a further cost to an Inland Revenue enquiry, and that is psychological. The vast majority of enquiries do not in fact reveal deliberate fraud but because most taxpayers do not understand the system and believe the Inland Revenue to have draconian powers, a tax enquiry remains a severe source of stress.

3. TAX CREDITS

3.1 Many of the self-employed qualify for tax credits because of their low level of earnings. Clearly the system was not designed for them and the low take up rate among the self employed reflects the need (because of the time limits) to make protective claims in order to meet the deadlines. Many small businesses draw their accounts to 31 March or 5 April for the sake of simplicity, and that means that very few have last year's accounts prepared by the July deadline.

4. VAT

4.1 Many smaller businesses are not required to register for VAT, and for those that are there is a general impression that the tax is generally administered with a reasonably light touch: indeed small businesses are more likely to complain of competitors who they believe to be undercutting them by evading VAT.

5. PAYROLL MATTERS

5.1 It seems to have become the practice for the Government to place new burdens on the Inland Revenue, and for the Revenue to pass them on to the employer. The list of new burdens in recent years includes:

- Tax credits, which have been restructured and where the implementation of the system has led to well known and substantial problems. Nobody outside the Inland Revenue is convinced that these have been solved and that next year's round will be any easier. In the last year or so this has been by far the main complaint for the small employer;
- Deductions of earnings for Child Support awarded by the CSA;
- Collection of student loan repayments;
- The administration of stakeholder pensions; and
- The national minimum wage.

All of these have added to the complexity of the PAYE system. Even before most of these were introduced there was a survey carried out for the Inland Revenue which showed that for very small businesses the cost of administering the payroll could amount to £288 per head, where for large employers the figure dropped to £5.

5.2 It is to be hoped that increasing use of the internet for PAYE, and an increasingly sophisticated internet service on offer from the Inland Revenue, will ease these problems. In the meantime this requires more learning for the smallest employers, who cannot afford to recruit trained staff and must perform train themselves.

6. CONSTRUCTION INDUSTRY SCHEME

6.1 The "new" scheme is universally unpopular to the extent that its replacement is being negotiated. It has crucially failed to work in the real world and has caused substantial cash flow problems for people at many levels in the industry, but especially at the lower intermediate levels.

7. PERSONAL SERVICE COMPANIES

7.1 It is true that the personal service company (IR35) legislation affects only a minority, but it would be right to remember that most of the people affected do not choose to operate through limited companies. The agencies through whom they obtain work insist on it. There is some genuine evasion of tax but the scheme adopted is clearly a sledgehammer to crack a nut and it requires long and complex calculations of deemed salary on an annual basis: once again placing a burden on small businesses.

January 2004

Memorandum submitted by the Confederation of British Industry

EXECUTIVE SUMMARY

1. The CBI welcomes the Sub-committee's review of the administrative costs of tax compliance.
2. We believe:
 - that compliance burdens are an important element of the UK's competitiveness;
 - that the cost of the tax compliance burdens on business is growing;

- that existing measures to remedy compliance problems and prevent their increase are inadequate.
3. We would welcome the opportunity to give oral evidence to the Sub-committee.

PART I—INTRODUCTION

1. This paper is the CBI's initial written response to the House of Commons Treasury Sub-committee inquiry on "administrative costs of tax compliance". We welcome the Sub-committee's review of this important topic.

2. The CBI is Britain's largest international business organisation representing over 200,000 companies through direct and trade association membership, covering all sections of the British economy. Our objective is to enhance the competitiveness of British business.

3. The range of tax compliance issues is too vast to be addressed comprehensively in this paper. We therefore focus on a selection of topics which will illustrate the following themes:

- Why compliance burdens are important;
 - The growing cost of business tax compliance burdens;
 - Failures of existing measures to remedy compliance problems and prevent their increase.
4. Our selected illustrative topics are divided into the following parts which we follow in this paper:
- General issues;
 - Corporation tax burdens;
 - Employment tax burdens;
 - Indirect tax burdens.

PART II—GENERAL ISSUES

WHY COMPLIANCE BURDENS ARE IMPORTANT

THE UK'S INTERNATIONAL COMPETITIVENESS

5. The CBI shares the Government's ambition to put the UK at the forefront of locations for businesses and to encourage entrepreneurship:

*"... [to create] the best possible location for investment and facilitating decision making that is driven by commercial factors rather than by tax considerations..."*¹⁷

*"... A strong entrepreneurial base is an essential driver of growth and prosperity in a modern economy. The Government's vision is that anybody with the talent, potential and drive to succeed in business should have the opportunity and support to do so, regardless of their background. Measures to enhance enterprise and boost productivity announced in the Pre-Budget Report include: reforms to reduce the regulatory burden on enterprise..."*¹⁸

The size of the taxation burden on business is a vital factor in the UK's ability to compete in the increasingly challenging global market place.

6. UK tax burdens comprise both the amounts of tax levied on business and the costs to business of complying with the UK tax regime and are an integral part of UK competitiveness—the relative cost of doing business in and from the UK. We believe it is essential to minimise all components of UK tax costs in order to improve competitiveness and we have long advocated paying attention to the mechanics of implementation of tax policy. Compliance burdens include the costs of managing tax changes themselves.

THE UK AS A PLACE TO DO BUSINESS

7. The CBI's recent report on "*the UK as a place to do business—is the tax system a help or hindrance?*" (Annex A¹⁹) makes very clear that, in terms of international competition, the UK needs to address adverse trends both from within and outside. It is a matter of concern that the CBI/MORI survey of executives referred to in the report found that more respondents viewed the UK tax system today as "poor" than viewed it as "good". This concern is reinforced by CBI members' views on the increasing complexity of UK taxes as shown by Exhibit 30 on page 22 of the report.

¹⁷ Review of Links with Business, Inland Revenue, November 2001, paragraph 1.

¹⁸ 2003 Pre-Budget Report Press Notice PN1.

¹⁹ Not printed.

THE HARTNETT REVIEW

8. Illustrative of the importance of compliance is the recent Inland Revenue Review of Links with Business, led by Mr Dave Hartnett, which considered in some depth the channels of communication between companies, particularly large corporates, and the Revenue on operational policy, that is administration of the tax system by officials and, reciprocally, compliance by taxpayers. That review and subsequent follow-up action are welcome recognition by the Government that day to day tax compliance remains an important issue which needs to be kept under constant review. In the Review the Government said:

“ . . . it is vital for the Government’s strategy on large business taxation that the administration of the tax system keeps pace with the changing business environment and the legislative programme, so that it is forward looking and supportive to business . . . ”

We agree and welcome the opportunity to participate in ongoing dialogue.

9. Action to help business and officials understand each other better and to reduce frictional interface costs is beneficial to both sides. We suggest, for instance, that making public the material used to train and inform officials would improve business and professional understanding of official thinking. All of this is, of course, complementary to the need to improve tax legislation and tax legislative procedures referred to below.

THE GROWING COST OF BUSINESS TAX COMPLIANCE BURDENS

THE COST OF THE INCREASED VOLUME AND COMPLEXITY OF NEW TAX LAW AND REGULATION

10. Representations to Government by business and professional bodies have, over the years, expressed mounting concern about the increasing volume and complexity of tax legislation. All changes to tax law create compliance burdens in that they have to be analysed and taken into account either directly by businesses themselves or by means of professional advice. Indeed as layer upon layer of regulation is added so the whole process of understanding the interrelation between tax provisions becomes more difficult requiring ever more professional advice.

11. New tax regulations are added annually because dedicated Parliamentary time is set aside for the Budget and Finance Bill debates. In addition the annual nature of the Budget/Finance Bill programme seems to create its own sense of urgency which often precludes more measured consideration of the case for and shape of the changes being introduced. Frequency of change not only creates uncertainty but creates concomitant new compliance and systems costs. All this contributes to the growing tax compliance burden overall.

12. Unfortunately the problem is compounded by the lack of opportunity for Members of Parliament to receive direct evidence on the pros and cons of the form of particular tax changes (as well as underlying policy). This has been described in detail by the CBI and others on previous occasions.²⁰ The compliance costs of new proposals are one aspect of the evidence which business would like to be able to give directly to Parliament when it is considering tax changes.

THE EU DIMENSION—ANOTHER SOURCE OF NEW COMPLIANCE COSTS

13. Since the CBI gave evidence to the Treasury Sub-committee in 1999 (see Annex B²¹) it has become apparent that basic EU treaty Law as now interpreted by the European Court of Justice (“ECJ”) is increasingly impacting on the UK’s own tax regime and forcing change. This creates another dimension in uncertainty and in the compliance costs of change, not only for indirect taxes but also for direct taxes relating to both corporate and employment activity. There are two aspects to this—the uncertainty arising from the random order in which cases are taken to the ECJ for decision and the uncertainty of how the Government might respond to the resulting ECJ decisions. We explain some immediate compliance concerns later in this paper.

14. In addition to new interpretations of basic treaty law new EU tax Directives and Regulations on both direct and indirect taxes create new changes and compliance costs as and when introduced into the UK.

THE NEED FOR COMPREHENSIVE OR SELECTIVE REVIEWS OF TAX COMPLIANCE BURDENS ON BUSINESS

15. In order to identify the full extent of the tax regulatory burden on business a comprehensive review needs to be conducted. We hope that the Sub-committee will be able to conduct this or suggest that it be done. This review would need to address existing burdens, ways of eliminating or reducing them and ways of minimising future new burdens. It would involve examining policy aims against the costs and burdens of their associated compliance regimes. If a comprehensive review is not possible then individual studies,

²⁰ *Recommendations on the Development of Tax Legislation*—The Special Committee of Tax Law Consultative Bodies, September 1993 (one of several papers on improving tax legislation and procedures). *Making Tax Law*—The Institute for Fiscal Studies, March 2003.

²¹ Printed in the Treasury Committee’s Sixth Report, *Inland Revenue*, HC [1998–99] 199, page 56.

picking up the topics we identify in this paper, would, we hope, be started at the earliest possible opportunity. One early candidate for such a review is the tax compliance position of employers. Employers' resources spent on tax compliance, including social welfare delivery, are not available for wealth and job creating activities. Rationalisation and minimisation of burdens would help meet a government aim of boosting enterprise. These burdens impact on all employers and form a correspondingly important part of the overall compliance burden.

FAILURES OF EXISTING MEASURES TO REMEDY COMPLIANCE PROBLEMS AND PREVENT THEIR INCREASE

THE TAX LAW REWRITE PROJECT

16. In 1995 the then Financial Secretary to the Treasury said:²²

“... I have been struck by the widespread and heartfelt feeling that tax law has become so lengthy, complex and impenetrable that something has to be done ...”

In order to address the situation the main proposal announced was:

“... to rewrite over about five years most of the primary legislation on the Inland Revenue taxes in simpler, more user-friendly language, which will be easier for everyone to understand ...”

“... when complete [this] will reduce the compliance costs which the tax system imposes, ..., on every business and taxpayer in the country ...”

This was a clear acknowledgement by government of the damaging overall costs of complying with UK tax legislation and the need for measures to tackle it.

DEFICIENCIES IN THE TAX LAW REWRITE PROJECT

17. Unfortunately the five year plan has proved unachievable and other problems have surfaced. First, it was not agreed in 1995 that all new Finance Bill provisions would be written in the new Tax Law Rewrite style. This means that new provisions still written in old style have continued to be added to the existing mountain of legislation, even, in some cases, where the existing legislation was already rewritten by the Project. Second, as we pointed out from the outset, the Project addresses only one aspect of tax overkill. The remit of the Project does not include consultation on the policy behind existing legislation with a view to repeal where the policy objectives are no longer valid or the legislation does not provide a sufficient cost/benefit case to warrant its retention either in its current form or at all. An example of continuing obsolete compliance burdens is Section 765 ICTA to which we refer below.

18. All this suggests that the Project will only ever be able to address a part of the compliance burden.

REGULATORY IMPACT ASSESSMENTS

19. Other measures introduced by government to address compliance burdens include Regulatory Impact Assessments for new legislation. Unfortunately it is not always evident on what information they are prepared or that they are properly addressing business' real compliance issues.

20. This suggests that a different approach is needed to make compliance as simple and least burdensome as possible.

A NEW APPROACH TO COMPLIANCE—A COMPLIANCE HEALTH CHECK

21. One way of doing this would be for each new piece of tax legislation to come to Parliament with a certificate showing the results of prior consultation with business on how best, in compliance terms, to achieve the policy objective. This would bring the business view into the compliance cost equation in a way not achieved by the current Regulatory Impact Assessment process.

BETTER CONSULTATION WITH BUSINESS

22. Another remedial measure involves better consultation with business on substantive and compliance proposals themselves.

23. In our 1999 evidence to the Treasury Sub-committee (Annex B²³) we urged, at paragraph 19, that tax compliance should be the subject of ongoing dialogue between business and the Government involving not just the Inland Revenue, Customs and Excise and the Contributions Agency but also the Better Regulation Unit.

²² *The Path to Tax Simplification*, Inland Revenue, December 1995, Foreword.

²³ Printed in the Treasury Committee's Sixth Report, *Inland Revenue*, HC [1998–99] 199, page 56.

24. Since then there has, with some important exceptions such as the proposed Double Tax Relief reforms in 2000, been better consultation on many direct tax issues but this process is not yet wholly satisfactory. We remain concerned that so long as the legislative process itself remains unchanged so the problem of too much and too burdensome tax regulation will grow. Many of our 1999 concerns have, if anything, become worse rather than better. We also regret that more Finance Bill space is not found for the wide range of annual Technical Budget Proposals which we submit to the Government which would help alleviate some of the burdens and which should inform the overall consultative process.

NEED TO TAKE ACCOUNT OF THE BROADER REGULATORY PICTURE

25. One aspect of compliance on which business has made repeated representations is the need to consider the capacity of firms to cope with multiple regulatory demands competing for finite manpower and systems resources. For example, strong representations were recently made by the CBI for certain tax changes not to be considered until the impact of the mandatory introduction of International Accounting Standards in the EU in 2005 had been fully taken into account.

26. We are pleased to be involved, now, in discussions with cross Departmental officials and others on this but there is still a need, in our view, for a routine joined up approach to compliance as well as policy, initiated by the Government itself.

RATIONALISATION AND CONTINUOUS UPDATING OF THRESHOLDS AND CEILINGS

27. Another simple compliance-reducing measure, not properly addressed at present, would be to ensure that the multiplicity of tax definitions, thresholds and ceilings are rationalised, and kept up to date by regular review to see if they remain adequate to deliver particular exemption or other policies. Introduction of an annual report to Parliament with the Budget listing the relevant items and confirming that they have been reviewed and updated in line with inflation would be a useful new discipline.

PART III—ILLUSTRATIVE CORPORATION TAX BURDENS

CORPORATION TAX REFORM—THE IMPOSITION OF TRANSFER PRICING ON WHOLLY UK TRANSACTIONS AND THE CHANGES TO THE THIN CAPITALISATION RULES

28. One of the major current tax compliance concerns of business is the Government's decision, in response to its interpretation of recent decisions of the European Court of Justice and EU treaty law, to impose transfer pricing rules onto wholly UK transactions. These rules have previously, since their inception, applied only to international cross-border transactions. Along with this change, transactions hitherto within the UK's specific thin capitalisation regime are to be incorporated into the new transfer pricing regime.

29. We have explained in depth in our formal responses to the Government's August 2003 "*Consultation Document On Reform of Corporation Tax*" and to the Inland Revenue Technical Note of December 2003—"*Corporation Tax Reform: The Next Steps*", (attached as Annexes C²⁴ (paragraphs 17-30 & 45-57) and D²⁵(parts II & V)) that we believe that these changes, if they proceed as currently proposed, will create significant and unnecessary new compliance burdens and damage UK competitiveness.

30. There are two aspects of these proposed reforms to which we want to draw the Sub-committee's particular attention:

- The extension of compliance burdens to many more taxpayers and to many more transactions.
- The inevitability of further costly and competitively damaging changes to UK tax law unless counteracting steps are taken.

THE INCREASED COMPLIANCE COSTS OF THE TRANSFER PRICING AND THIN CAPITALISATION PROPOSALS

31. Whilst we are pleased that SMEs are, generally, to be exempt from the new rules we remain concerned that the proposals will bring larger businesses, including wholly UK associated businesses which do not have any cross-border transactions, within the transfer pricing net. In addition, groups which have previously had to comply with the transfer pricing rules only for their international cross-border transactions will now face all the burdens of applying these rules to their wholly UK transactions. The concomitant compliance burdens will, if the proposals are not amended, typically include the costs of identifying, reviewing and recording all relevant transactions and then self-assessing them for tax purposes. For a large number of companies this will require the taking of professional advice to ensure proper compliance. All this increases compliance costs for businesses even though it is not intended to raise additional revenue for the Exchequer.

²⁴ Not printed.

²⁵ Not printed.

THE DORMANT COMPANIES BURDEN

32. A simple example of how the proposals will create new self-assessment burdens is that it appears that companies will have to produce tax and Companies Act returns and audited accounts for thousands of dormant companies hitherto allowed to rest in peace for tax and company law purposes.

ALTERNATIVE COMPLIANCE APPROACHES

33. There is no express ECJ ruling that the UK must introduce UK to UK transfer pricing and indeed most other EU member states are not currently intending to introduce similar legislation. By rushing to introduce this legislation in this way the UK is increasing its compliance costs and making itself that much less competitive with its international rivals. We believe these costs could be avoided by alternative compliance procedures utilising assessment by the Inland Revenue itself for cases where significant tax is at stake rather than imposing across the board self-assessment by companies whether or not there is significant tax at stake. Our formal responses to the Inland Revenue contain further detail on our suggestions (see Annexes C²⁶ and D²⁷).

FURTHER COSTLY EU DRIVEN CHANGES LIKELY

34. At present the Government is adopting a piecemeal approach to ECJ decisions. In other words, as and when it believes those decisions, whether or not arising in UK cases, are incompatible with existing UK tax law it is altering UK legislation to bring it into line. This piecemeal process creates uncertainty which is bad for investment. It also generates the new compliance costs of the changes, as well as destroying elements of UK tax law which form part of its coherence and its international competitiveness.

35. It is already known that there are increasing numbers of tax cases in the ECJ pipeline which, if decided against the member states involved will, on current precedent, cause HMG to change further parts of the UK tax regime.

36. When faced with ECJ decisions of this sort the UK has a choice of responses. It could amend domestic law so that it gives the same treatment to other EU residents as it gives to UK residents, a process commonly known as levelling up. Alternatively it could level down by removing from UK residents relevant competitively favourable treatments which it is not prepared to extend to other EU residents. For example, for protection of the Exchequer, HMG has chosen to impose transfer pricing onto transactions conducted wholly within the UK rather than remove transfer pricing from transactions involving UK and other EU taxpayers.

37. The fear is that this process is likely to be repeated for other competitively favourable aspects of the UK tax regime in response to future ECJ decisions thereby further destroying UK competitiveness and imposing more change compliance costs onto UK taxpayers.

ALTERNATIVE APPROACHES TO THE ECJ PROBLEM

38. We have suggested to the Government that there are alternative approaches to the ECJ's erosion of UK tax sovereignty and the ensuing compliance costs of making changes on a piecemeal basis.

39. First, at the European political level, HMG could make use of the EU constitutional treaty debate to try to persuade other member states that they each have a stake in maintaining the coherence of their own tax regimes and thus should agree to review the remit of the ECJ in direct tax matters.

40. Second, at the purely domestic level, the CBI believes that a holistic approach to EU law is needed. By this we mean that the Government should consider with business all the areas of the current UK tax regime which are at risk of incompatibility with EU law and seek to find coherent solutions to them as a whole.

41. The holistic approach has a number of advantages compared with the current piecemeal approach. Not only would it minimise the number and hence compliance costs of individual changes but also it would facilitate the devising of solutions which would help optimise UK tax competitiveness going forward. Further, it would help address the cost of uncertainty—the adverse impact on investment decision making of not knowing where, when and how the next changes to UK tax law will be forced upon us.

²⁶ Not printed.

²⁷ Not printed.

CORPORATION TAX SELF-ASSESSMENT COMPLIANCE ISSUES

42. A broader issue cutting across detailed compliance law and practice in many areas is the introduction of corporation tax self-assessment. Self-assessment itself constitutes an enormous movement of function from the Inland Revenue to taxpayers. Self-assessment also gives the Inland Revenue a significant degree of assurance of taxpayer compliance, which has not, to date, been fully reflected in regulation. Serious self-assessment compliance burdens arise from the transfer pricing of UK/UK transactions as explained above and from the situation that has developed in relation to the UK's system for giving international double taxation relief.

THE DOUBLE TAX RELIEF COMPLIANCE BURDENS

43. The changes to the UK's double tax relief regime introduced in FA 2000 and amended piecemeal in 2001 have resulted in a complex new regime. Compliance with this regime involves having to follow rules in a mechanical way rather than dealing with a regime the principles and rationale of which are apparent from the provisions themselves. The regime also creates ongoing compliance problems such that UK companies which acquire foreign companies, which happen to have their own existing foreign subsidiaries, face the costs of restructuring these foreign groups to fit in with the UK DTR rules.

44. The CBI suggested at the time of reform that what was needed were provisions suitably rewritten as a coherent, understandable, whole.

HIDDEN TAX COMPLIANCE COSTS

45. Compliance costs are not just the costs of recording transactions, introducing systems to capture tax events, making self-assessments or reporting matters to the Revenue authorities. They also include the hidden costs of not being able to carry out transactions in a commercially optimal way.

46. One corporation tax situation which the CBI has long requested be addressed, concerns Section 765 ICTA. This section criminalises for tax purposes certain corporate financing activities, otherwise perfectly normal and legal, if prior Treasury consent to them is not obtained. This is the only section in direct taxes which criminalises non fraudulent behaviour. Furthermore there is no clear compliance guidance for taxpayers as to which transactions will be given clearance and which will be rejected. This anachronistic section imposes overt and hidden, unnecessary and anti-competitive compliance costs and delays. The overt compliance costs are those of obtaining such consents but the hidden costs are those of having to find alternative, sub-optimal, ways of conducting transactions because commercial timeframes and pressure from competitors and contracting parties not facing these traps do not permit use of the Treasury consent application procedure or the dispute of its decisions. The policy reasons for the section relate to the days of UK exchange control, long since abandoned, and the section can no longer be applied to EU transactions because of EU law. The CBI has pointed out that reporting under corporation tax self-assessment provides the Inland Revenue with sufficient alternative information gathering powers so that the section ought now to be repealed for those remaining transactions which it catches.

OTHER CORPORATION TAX ANACHRONISMS CREATING COMPLIANCE COSTS

47. In our submissions on the reform of corporation tax over many years we have drawn attention to the compliance costs of other archaic tax rules which bear no relation to modern business practice. These include the so-called schedular system—the calculation of taxable profits in separate compartments rather than looking at profits as a whole and the perpetuation of tax nothings—items of normal commercial expenditure which are not recognised for tax purposes for historical reasons even where there is no real policy reason for such disallowance. The continued existence of these rules means that relevant transactions have to be identified and processed for tax purposes even though that would not be needed for commercial purposes, thereby pushing up compliance costs.

48. The situation is exacerbated by the continuing creation of new items falling into the nothings category. A simple example is the cost to business of providing disabled access to buildings which is required by recent non-tax legislation but which is not tax deductible.

49. The CBI has suggested as a first step towards elimination of nothings that where such expenditures are imposed on business by government they should automatically be recognised for tax purposes. This would fit in with our suggestion of a more joined-up approach to regulation. Examples of other compliance cost creating nothings are shown in the Annex.

COMPLIANCE COSTS OF OBTAINING TAX INCENTIVES

50. Even where government policy is to provide incentives to businesses via the tax system, for instance Research and Development Tax Credits, the compliance practicalities of obtaining the incentives can erode their value significantly.

51. For example, we have recently been informed that in one case:

“... Under UK GAAP rules our R&D claim would have been approximately £207,000. After review by the Revenue and application of their narrower rules we got around £180,000. This then cost us around £12,500 in tax advice fees to get. So the net benefit to us was only £167,500 ie, we got 80% useful cash compared with initial view, and the direct cost of getting the cash was around 7.5% of final award.

These numbers take no account of the internal man-hour cost, and management time opportunity cost, or the cost to the country of the revenue man at the other end of this chain.

The above numbers are approximate . . .”

52. Coincidentally, recent newspaper reports have made the same point.²⁸

PART IV—ILLUSTRATIVE EMPLOYMENT TAX BURDENS

53. Over recent years there has been a step-change in tax related employer compliance burdens. Many of these relate to payroll administration and arise from the move to deliver the Government’s social welfare measures via employers rather than via the public service. Others stem from using one set of taxpayers to police other taxpayers.

54. In complying with PAYE rules employers are already acting as unpaid tax collectors both as regards income tax and National Insurance Contributions. What is new is that they are now being required to act as welfare agents in terms of items such as Working and Child Tax Credits, Student Loans Repayments and Scottish Variable Rate.

THE EVER CHANGING BURDENS ON EMPLOYERS

55. Employers’ tax obligations are constantly changing so that it is a never ending task to keep up to date. Whether the cost of meeting all these requirements is by way of in-house specialist staff or by way of extensive professional advice or both, two things are clear—the obligations have increased dramatically and they are subject to recurring change. All this erodes the time and energy that entrepreneurs and managers have available to focus on creating wealth and new employment.

56. The problem is exacerbated by differences between income tax and NICs and by the modern trend towards multiple concurrent employments or part-employment and part-self-employment. All this needs to be addressed starting, perhaps, by examining the total regulatory burden faced by new employers.

PAYE/NIC COMPLIANCE COSTS

57. As long ago as 1998 The University of Bath pointed out the considerable costs to employers of having to apply different PAYE and NIC rules.²⁹ It would be instructive to have up-to-date figures.

58. Some concerns about PAYE/NIC differences which have been raised by business with the Inland Revenue but not yet fully resolved are:

- The different bases for tax and NIC. NIC has an earnings period basis but not tax.
- Tax and NIC use different definitions of pay.
- The implications arising from the normal employment practice of handling payroll and expenses separately.
- Differing tax and NIC documentation requirements.
- Liability to NIC continuing to apply even where no liability to income tax exists.
- The increasing number of cross-border employment events with differences for tax and NIC whether relevant personnel movements are within or outside the EU.
- Differing treatment of items as Class 1 or Class 1A NICs according to the method of payment. Typical examples are work-related phone bills, company card payments, home leave expenses.

²⁸ *Financial Times*, 13 February 2004—“Companies failing to claim ‘too complicated’ tax break”, David Firn and Jonathan Moules.

²⁹ *The Tax Compliance Costs for Employers of PAYE and National Insurance in 1995–96*—A Report by the Centre for Fiscal Studies, University of Bath: Inland Revenue, October 1998.

PAYE/NIC PROBLEMS FOR SHARE SCHEMES

59. Differences in PAYE/NIC treatment of share options create their own particular difficulties. These are illustrated on pages 4 and 5 of Annex F³⁰ to this paper.

CONSTRUCTION INDUSTRY SCHEME

60. The Inland Revenue are currently consulting on reform of the Construction Industry Scheme relating to the policing of the taxation of workers in a wide range of activities treated as “construction” for tax purposes. One of the declared objectives of the reform is:

“... to reduce the regulatory burden of the scheme on construction businesses . . .”

61. The CBI believes that the opportunity should be taken to reduce regulation by completely removing from the scheme those firms not themselves in the construction sector, because that is not their main trade, but which are nonetheless treated as “deemed contractors” merely because they have an average annual expenditure on construction operations exceeding £1 million even though, in commercial terms, they are only the clients of construction firms.

62. If this is not done a cost/benefit analysis should be produced to justify the considerable compliance costs of including these companies in the scheme compared with the tax saved as a result of their inclusion.

OTHER EMPLOYMENT COMPLIANCE ISSUES

64. Annex F³¹ contains some further illustrations of employment tax compliance issues which we have put to the Inland Revenue.

PART V—ILLUSTRATIVE INDIRECT TAX BURDENS

APPLICATIONS FOR VAT REGISTRATION

65. In the last year, businesses of all sizes have been experiencing long delays in obtaining VAT registration numbers, whether these involve single or group registration applications. This causes significant difficulty for businesses through the consequent delays in printing stationery, issuing invoices, and obtaining repayments. One of the CBI’s members reports that registration applications are typically taking about six weeks to be processed. Where a new business receives a large invoice on which VAT is charged, a six-week delay in registration on top of the time required to submit a return and obtain a repayment can cause severe cash-flow problems.

66. Customs have indicated that more resources will be allocated to registration applications in the next financial year, and that administrative measures have recently been taken to relax certain procedures in order to help clear the backlog. However, we are concerned that effective measures to deal with the situation were not taken more quickly once the need became apparent, and that additional resources have not been made available earlier. While we recognise the need to minimise the impact of fraudulent registration applications, it is unacceptable that legitimate businesses should be faced with these delays. There is clearly a need to put more resources into this area as a matter of urgency.

LIMIT FOR VOLUNTARY DISCLOSURES OF VAT ERRORS

67. The £2,000 limit for making adjustments in VAT returns to correct errors made in previous returns under the voluntary disclosure procedure is unrealistically low. The limit could reasonably be increased to £20,000 to reduce administrative burdens, both for taxpayers, who otherwise have to make separate disclosure of errors, and for Customs, who then have to issue formal notices of voluntary disclosure and statements of account. In future, there should be provision for periodic review of the limit.

68. For a VAT group, the limit should apply separately to each group member. In most cases it is totally impractical to operate a single limit for the group as a whole, particularly where business activities are spread over a number of different locations and involve a number of accounting centres.

ALCOHOL TAX STAMPS

69. We had believed that representations made last year both by ourselves and the alcohol sector had made clear that there was a good case for not proceeding with the idea of imposing the fixing of excise strips on bottles of spirits. It is therefore disappointing that the proposal has resurfaced in the 2003 PBR proposals. We hope that the Sub-committee will take the opportunity of its present review to look into the merits of the proposals from a practical compliance and competitive angle.

³⁰ Not printed.

³¹ Not printed.

PART VI—ORAL EVIDENCE

70. In this paper we have been able to touch on some only of the myriad UK tax compliance issues.

71. In conclusion, we would welcome the opportunity to give further, oral, evidence to the Committee.

February 2004

Annex

EXAMPLES OF TAX NOTHINGS

COSTS ASSOCIATED WITH PROPERTY LEASES

Businesses looking to expand, relocate or restructure need to be able to dispose of premises which are no longer suitable and acquire new ones with the minimum of additional costs. The Government could assist this process by removing the following disallowances:

— *Costs of lease termination*

The disallowance of the costs of terminating a lease of surplus business accommodation distorts behaviour by encouraging retention of the vacant property, instead of re-letting it. The present rules give relief for the rent paid on the surplus accommodation, but not for a lump sum and related costs paid for early termination. This is both economically inefficient and environmentally damaging. Section 87, ICTA 1988 should be extended to rectify the problem.

— *Costs incurred on grant of a new lease*

Following the changes in the Schedule A rules, the Revenue have been contending that no deduction is due for costs incurred in connection with the grant of a lease for a term of more than one year, on the ground that this is capital expenditure. Under the old Schedule A rules, it was accepted that such costs were deductible provided the lease did not exceed 21 years. This policy should be reinstated. It is significant that FRS15 does not allow the capitalisation of such costs in the landlord's accounts.

ABORTIVE CAPITAL EXPENDITURE

Abortive capital expenditure incurred for genuine business purposes should attract tax relief in the same way as other business expenses. The denial of tax relief amounts to a penalty on businesses seeking to diversify or expand their activities, and is incompatible with the objective of making the UK an attractive location for business. The following specific examples merit early action:

- Capital allowances should be given for expenditure incurred on buildings intended to be used for a qualifying purpose but never actually completed and brought into such use.
- Allowances should also be given for abortive expenditure on planning applications and design fees generally, the relief being given for the period in which the expenditure becomes abortive.
- Expenditure incurred in connection with abortive take-over bids or other strategic acquisitions of businesses or shares, whether by trading or investment companies, should be deductible in the period in which the expenditure becomes abortive.

EXPENDITURE REQUIRED BY LAW

As a matter of principle, expenditure which a business is obliged by law to incur for reasons of Government policy should be deductible for tax purposes. Capital expenditure under this heading should qualify for capital allowances.

The following examples are proposed for early action:

— *Special lighting for display screen equipment*

The Health and Safety (Display Screen Equipment) Regulations 1992 require companies to install special lighting where computers and visual display units are in regular use. Some businesses have encountered Revenue resistance to capital allowances claims for such expenditure. It is suggested that this inconsistency of treatment should be addressed by way of a Statement of Practice or Revenue Bulletin making clear that relief is available.

— *Fire safety expenditure*

The conditions for obtaining capital allowances on fire safety expenditure which would not otherwise qualify as plant and machinery are unnecessarily restrictive. Not only do they largely negate the intended incentive to improve fire safety, but they are also out of step with normal building and fire safety practice. Such expenditure should qualify for allowances automatically, without the need for any prior notice or other requirement of the fire authority.

— *Expenditure on providing disabled access*

It is Government policy that businesses should adapt their premises to make them accessible to disabled people by October 2004. If this is to be achieved, the necessary work needs to be undertaken now. However, under present tax rules much of the expenditure necessary to achieve this objective will not be deductible because it is capital in nature. A new relief is therefore required in Finance Bill 2003 for expenditure on a building necessary to give the disabled unrestricted access. The greatest incentive would be provided by a straightforward revenue deduction for such expenditure but, if the cost of this is too high, capital allowances should be given at the rates applicable to plant and machinery.

DEFINITIONS FOR CAPITAL ALLOWANCES

An attempt was made in the Finance Act 1994 to clarify the boundaries between buildings and plant and to limit the extent to which expenditure can be regarded as attributable to plant rather than buildings.

Unfortunately, the definitions of plant, machinery etc for capital allowances purposes are too narrow.

Examples which have arisen since the 1994 definitions were adopted include plant which stands in the open air with a structure around it protecting it from the elements, and a car-wash hall in which car-wash machinery is housed. In both these cases (and there are others), the structure was not regarded as plant on the basis that it constituted premises rather than an integral and essential part of the plant. The relevant costs therefore fell into the category of “tax nothings” attracting no allowances.

An interpretation more in line with business practice should be given to the term “plant”.

Incidental costs of raising finance

The tax bias against raising new equity finance should be removed so that the costs of raising all types of finance are tax deductible. This is of particular concern to smaller firms.

Assets leased for use outside the UK

The anti-avoidance provisions in Sections 109, 110 and 222, *Capital Allowances Act 2001* should be more finely tuned to allow genuine UK business leasing arrangements to be conducted on terms competitive with local (foreign) competitors. As these provisions effectively prohibit UK companies from competing within Europe, we believe that they are in breach of the *Treaty of Rome* and accordingly—at a minimum—these provisions should not be applied to transactions within the EU. At present, if these sections apply to deny capital allowances, a lessor gets no relief for capital expenditure but remains fully taxable on rental income received. Such leases are prohibitively expensive and therefore do not normally arise in practice, unless entered into in cases not expected to trigger the anti-avoidance rules but where a condition is accidentally breached.

Licences or rights to use or exploit assets

Expenditure incurred to acquire licences or rights to use or exploit assets for business purposes should be tax deductible. Many such assets or rights are being unbundled from former public utilities and licensed out to separate businesses. Examples of the types of asset or right involved are gas and water meters, and the right to run electric cables through gas pipelines.

Letter from the Chairman of Webster & Horsfall Limited to the Chairman of the Sub-committee

PAYROLL ADMINISTRATION

I showed the article in today’s *Telegraph* to my payroll manager, who has been struggling to keep up with the ever increasing demands put upon us by the ever increasing number of civil servants put over us.

We have a weekly payroll of over 100 run by one person, the payroll manager. She tells me that the wages are easy. The hard part is satisfying all the civil servants who think they have priority call on her time. The CSA are apparently the worst offenders. They telephone in and expect instant replies and when they don’t get it, they go on ringing until they do.

Running a payroll requires an ordered and efficient person who has to meet deadlines. The worst-case being that wages are not paid on time. A situation which has not occurred here, but it could.

Last week I was in the middle of an important meeting with a customer who was placing a large contract with us. We were interrupted by a call from the Inland Revenue who would only speak to the person who signs the PAYE cheque. I broke off the meeting to be met by a very cold officious voice that demanded to know where our payment was for the previous month. Although I knew the cheque had been sent, I spent some time double checking our system and eventually ringing the Revenue office and giving them details of the payment. They denied having received it and demanded we stop the cheque and send another immediately. I told them I would review the matter the next day if the cheque had not been found. The payment was cleared through our account the next day. It had been in their system all along.

The vast majority of small firms in this country are our size or smaller. It is quite impossible to keep track on the deluge of changes and new regulations that are being heaped upon us on a daily basis. We cannot afford HE departments or compliance officers. Everyone here works very hard to do what has to be done which in most cases means wearing several hats. Government must recognise this and take steps to support us. Not help to drag us down.

9 February 2004

Supplementary memorandum submitted by HM Customs and Excise

THE ADMINISTRATIVE COSTS OF TAX COMPLIANCE

At the Select Committee's hearing on 21 January I agreed to provide a detailed note on how Customs arrived at the £600 million figure for UK spirits fraud.

Since 2001, HM Customs has published annually estimates of the scale of fraud against a range of our taxes. These are brought together for publication alongside the *Pre-Budget Report* each Autumn/Winter. In December 2003, the estimates were presented in the Customs paper *Measuring and Tackling Indirect Tax Losses*.

That paper noted that estimating the scale of illicit activity is inherently difficult, and that the results are therefore subject to margins of error. It also re-affirmed our commitment to producing the most accurate, up-to-date estimates presently available of revenue losses from fraud and avoidance.

As part of that commitment, we amend our estimates if the underlying data is revised or if we introduce improvements to our methodology. When this occurs, Customs publishes a detailed explanation to accompany any revised estimates.

General Approach

Customs has published a significant amount of detail on the methodological approach to estimating the scale of revenue lost. In general, two complementary approaches are employed by Customs to assess the scale of tax lost from the indirect tax system:

top-down—compares levels of total consumption or theoretical tax liability with actual UK tax paid purchases and assumes that the difference represents the total tax loss, commonly referred to as a “gap analysis”; and

bottom-up—obtaining direct measures of levels of losses by various methods, such as targeted surveys or through the use of Customs' administrative and operational data.

Spirits Methodology

The scale of spirits fraud is estimated using a top-down gap analysis. Total UK consumption is estimated using data from ONS's *Expenditure and Food Survey* (EFS). The EFS brings together data from two complementary household surveys—the *Family Expenditure Survey* (FES) and the *National Food Survey* (NFS)—which, in addition to numerous other questions, ask respondents about their consumption of spirits. The data is then used to generate an estimate of total spirits consumption in the UK. Legitimate cross-border shopping is estimated using data from the ONS's *International Passenger Survey* (IPS), which collects information on the shopping habits of travellers coming into the UK. Customs' own figures provide information on the quantity of UK duty-paid spirits consumed in the UK.

The illicit share of the spirits market is then estimated by subtracting from total consumption the level of cross border shopping and legitimate UK-duty paid consumption. The illicit market share is then presented as both a percentage of total consumption and as the monetary value of the revenue evaded or avoided.

Spirits Results

Our latest estimates of spirits fraud were published in December 2003 in *Measuring and Tackling Indirect Tax Losses*. The estimates are reproduced in the tables below. As data from the EFS is published over a year after the end of the financial year in question, estimates for 2002–03 are not yet available.

Spirits Revenue Evaded and Avoided (£million)³²

| | 1999–2000 | 2000–01 | 2001–02 |
|--------------------------------------|-----------|---------|---------|
| Cross-border shopping ³³ | 100 | 150 | 150 |
| Illicit (Fraud and Smuggling) | 350 | 450 | 600 |
| Total non UK duty paid ³⁴ | 450 | 600 | 700 |

Spirits: Market Shares (%)

| | 1999–2000 | 2000–01 | 2001–02 |
|-------------------------------------|-----------|---------|---------|
| Illicit Market Share | 11 | 14 | 16 |
| Cross-border Shopping ³⁵ | 4 | 4 | 4 |

A number of improvements were made both to the data and the methodology used which resulted in revisions to previously published figures. *Measuring and Tackling Indirect Tax Losses* provides fuller details but the following changes in particular were noted:

Population projections. A downward revision to the time series of the official UK population estimates, stemming from the results of the 2001 Census.

Estimates of population are a vital component of the method used for estimating spirits fraud because they are used to gross up the results of the *Expenditure and Food Survey* (EFS) to provide estimates of consumption at a national level. ONS published revised population estimates during 2003. The revisions have the effect of reducing the estimate of the spirits illicit market share by about 1% point from 1998 onwards and by about 0.5% for earlier years. If ONS make further revisions to the population estimates during 2004 revisions to the estimates may again be necessary.

Off-Licence Consumption. The introduction of the EFS, which brought together the NFS and FES, caused DEFRA to revise the back series of off-licence alcohol consumption in the NFS.

These revisions increased the weight that the NFS data has in the final consumption estimate and consequently reduce the estimate of total consumption. This results in a downward revision to previously published estimates of the illicit market share.

Intra-EU Duty Free Sales. Inclusion of intra-EU duty free sales.

Customs allow for under-reporting of spirits consumption in the survey data by indexing the trend in consumption from 1992, a time when other operational evidence suggests that the level of spirits fraud was negligible. Omitting consumption of duty free spirits from that point would affect the whole consumption series and lead to an underestimate of the current scale of the illicit market. Customs constructed a new estimate of the scale of intra-EU duty free shopping before its abolition in 1999. Its inclusion raises the illicit market share.

The revised estimate of losses for 2000–01 was broadly comparable with the previously published figure while the scale of spirits in 1999–2000 has been revised downwards. For comparison, the figures published alongside the *2002 Pre-Budget Report* in *Measuring Indirect Tax Losses* are also shown below:

Spirits Total Revenue Evaded And Avoided (£million) (As Published in 2002)

| | 1999–2000 | 2000–01 |
|--|-----------|---------|
| Cross-border shopping ³⁶ | 100 | 100 |
| Cross-Channel Passenger smuggling | < 50 | < 50 |
| Fraud, freight smuggling and other smuggling ³⁷ | 500 | 500 |
| Total non UK duty paid ³⁸ | 600 | 650 |

³² Includes duty and VAT although this will overstate losses to the extent that VAT is collected on sales of illicit alcohol through normal retail outlets.

³³ Includes intra-EU duty free as well as EU duty paid.

³⁴ Figures are independently rounded to the nearest £50 million. As a result components may not appear to sum.

³⁵ Includes intra-EU duty free as well as EU duty paid.

³⁶ Includes duty free as well as EU duty paid.

³⁷ "Other" includes smuggling by air passengers, Internet and parcel.

³⁸ Figures are independently rounded to then nearest £50 million. As a result components may not appear to sum.

Spirits: Market Shares (%) (As Published in 2002)

| | 1999–2000 | 2000–01 |
|-----------------------|-----------|---------|
| Illicit Market Share | 15 | 15 |
| Cross Border Shopping | 3 | 3 |

I hope that the above information is helpful to the Committee's enquiry.

11 February 2004

**Supplementary memorandum submitted by the Tax Faculty of the Institute of
Chartered Accountants in England and Wales**

GENERAL COMMENTS

1. We set out below NIC and VAT points which we would like to add to our earlier submission dated 6 January 2004 (published as TAXREP 1/04).

NATIONAL INSURANCE CONTRIBUTIONS ("NIC")

Income determination

2. Paragraphs 22-23 of our previous memorandum referred to inconsistencies between income tax and NIC definitions and even between different Classes of NIC. There are also differences between who pays the earnings and who is liable to account for the two taxes.

3. Differences between the income tax and NIC treatment of different types of earnings has long been creating extra work for employers. Whilst much has been done in recent years to reduce differences, the harmonisation of the treatment of earnings needs to go further than just having something that is chargeable to income tax being liable to NIC and *vice versa*. Indeed we believe that the legislation has taken the wrong approach in seeking to harmonise NIC with income tax whereas the need of business was to harmonise it with PAYE.

4. We consider that where something is chargeable to income tax under PAYE, then it should be subject to Class 1 NIC and *vice versa*, and where something has to be entered on form P11D, then it should be liable to Class 1A NIC and *vice versa*. The only exception to this would be where occasionally an item was omitted from the P11D under the terms of a dispensation, but was nevertheless chargeable to NIC. This would not only reduce the time spent by employers on ensuring that they account for the correct amounts during the year but also save time when completing end of year returns.

5. Where a payment is made by a third party to an employee, any Class 1 NIC often has to be accounted for by the employer. This can apply even where the employer does not know how much has been paid; for example, the recently-issued Revenue leaflet E24 on tips states that a troncmaster is obliged to account for PAYE income tax but that no NIC is normally payable, but that where an employee has a contractual right to tips, the employer is liable to account for Class 1 NIC but still not for the PAYE. In most cases, the employer may not even know that a payment has been made, let alone by whom, in what earnings period and how much; for example gifts or incentive payments received direct by salesmen from suppliers. The "contractual right" test creates huge practical problems.

VALUE ADDED TAX ("VAT")

The National Advice Service ("NAS")

8. Generally, the replies given by NAS are helpful where questions are simple and can be answered by telling the caller what form number to use or by referring the caller to a section in a public notice. However, this expedient is used too often on more complicated questions. Small traders can encounter the same VAT problems as international quoted companies. Other than the size of the figures, the main difference is that large concerns have the resources to obtain good advice whereas the small trader does not. In some cases even his adviser, whilst being aware that the VAT issues are complex, is unlikely to know what questions to ask.

9. VAT law is so complicated that an answer to a non-straightforward question given by someone in a call centre off the top of the head without considered research has only a small chance of being correct. NAS call centre operatives obviously have only fairly basic VAT knowledge, do not have access to any particulars about the case in hand and seem to have little general business knowledge. They should at least ask questions of the caller to elicit the facts before they provide an answer and in more complex cases should advise the caller to write in for an answer.

10. What most traders want to do is get on with running their businesses and be sure that they pay the right amount of tax. As VAT is a self-assessed tax, government departments have a responsibility to help citizens comply. Whilst large PLCs and their advisers have access to dedicated VAT officers within Customs with whom difficult issues can be discussed and resolved, often face to face, smaller traders do not have this facility. We suggest that there is a serious need for Customs to provide a higher-level inquiry service to which more difficult queries could be referred, manned by experienced officers who have knowledge of the trader's business and can respond promptly to queries. We do not believe that NAS currently meets this need.

Registration

11. It is essential that new applications for VAT registration are dealt with promptly. There have been unacceptably long delays recently. We accept that this coincided with a change in the rules for corporation tax (0% rate of tax introduced) following which there was a large number of incorporations and as a result a far higher than usual number of new VAT registration applications. Joined up government ought surely to ensure that where changes by government will create pressures elsewhere that will result in a significant deterioration in the service to taxpayer's, additional resources are deployed in advance to ensure that the service is maintained. Registration delays not only result in lost time by traders and their advisers in chasing up Customs to ascertain whether they have received the application and are dealing with it, but also may mean that VAT chargeable during the waiting period becomes irrecoverable without a great deal of extra work by the trader. We suggest that Customs should at least acknowledge all applications and use that opportunity to inform applicants of current turnaround times.

12. Registering for VAT involves completing form VAT 1 which is seven pages. Customs have said that about 60% of the forms submitted are incorrect. Such a high percentage begs questions about the form and the definition of "incorrect". As the form has a space for a contact telephone number we do not understand why Customs do not telephone the applicant for missing information while processing the form, rather than simply rejecting it.

13. Traders have to charge VAT and pay it over to Customs from the date that they are liable to be registered. Traders can charge VAT before they are registered but until they have a registration number they cannot show VAT as a separate item on any invoice that they issue. This means that additional VAT invoices have to be issued by traders once they have received their registration number. This has to be done within 30 days. The longer the delay between the date a trader is liable to be registered, the more invoices that the trader who follows this procedure will have to issue, which will involve not only the trader but also his customers in double the processing costs and can sometimes result in the VAT being irrecoverable.

14 February 2004

Supplementary memorandum submitted by the Institute of Payroll and Pensions Management

The Institute of Payroll and Pensions Management is grateful for this opportunity to further develop the point that arose from a question from John McFall, MP in oral questioning at the Treasury Sub-committee of the House of Commons on Thursday 4 February 2004.

In our submission, we stated that payroll had not gained as much from the benefits of embracing Information Technology as other areas of business administration. In questioning, we stated that the IT gain was limited because the IT progress that the Inland Revenue has made in the basic PAYE system is simply to computerise the manual system that is little changed (but greatly enlarged) from the system originally devised for the introduction of PAYE in 1944. The PAYE system has not been re-engineered to allow more benefits of the computer age to flow to employers and the Inland Revenue. We recognise that this would be a significant IT project for both Government and employers and for that reason we had not included it in our original submission. The issue arose in response from the question from the Sub-committee.

Apart from the requirement to file end of year returns electronically (large employers in 2004–05 and all employers by 2009–10), the Inland Revenue does not require any employer to have any computing facility to meet his obligations under PAYE. The Revenue provides forms and tables as well as guidance in printed form to allow employers to undertake the necessary calculations manually. All that is required in mathematical terms is the ability of the employer to be able to add and subtract a pair of numbers. It was only in 1998–99 that the manual tax tables issued by the Inland Revenue recognised that the employer may have a calculator (capable of multiplication).

Because of the preservation of the manual option, there are two methods of calculating National Insurance contributions: manually using the tables provided and "the exact percentage method". These give small differences in contributions and the earnings figures that are to be recorded. Employers cannot change from one method to the other more than once in a tax year (for any one employee) without the agreement of the Board of the Inland Revenue.

Some easements have been put into the PAYE system to reduce the burden of the manual processes. For example, for an employee paid below the threshold for income tax and National Insurance liability, the employer does not need to set up the "deductions working sheet" (P11) and at year end no P14/P60 has to

be produced but another form, P38A, has to be sent to the Inland Revenue. For an employer with a computerised payroll system, he will have all employees on the payroll system, as the business need is to pay employees for work done. At year end, the computerised payroll system needs additional processing logic to suppress P14/P60 for employees below the thresholds and instead, produce the P38A. All the information that is required on a P38A can be included in a P14 but the Quality Standard for electronic filing does not allow for this. So an easement for manual operation is an overhead for computerised systems.

There are similar issues with the P38(S) procedures for students working during their vacations and earning below the single person's tax allowance. Again, production of the P14/P60 has to be suppressed and employers must submit the P38(S) forms manually. Under the requirements for electronic filing, employers are to retain P38(S) for possible inspection by the Inland Revenue. Thus no record of the payments will flow to the Revenue who thereby wastes this opportunity to gather the data on students' earnings.

The vast majority of tax codes issued by the Inland Revenue are derived by dividing the individual's personal allowances by 10. Presumably this is to minimise the manual effort in calculating how much of the allowance to give in any tax period (using the Pay Adjustment tables—tables A—supplied by the Revenue). The loss of accuracy is rounded in the employee's favour and in theory corrected in the final assessment. However, in practice, those outside self-assessment are not required to make good the difference. Albeit small for the individual, this is a significant loss to the Exchequer and with the moves this year to take more taxpayers out of SA this leakage will increase.

The computer specification for tax tables issued by the Inland Revenue has the same authority as the tax tables (section 203 of the *Income and Corporation Taxes Act 1988*/section 685 of the *Income Tax (Earnings and Pensions) Act 2003*). Yet the computer specifications issued for National Insurance contributions and statutory maternity, paternity and adoption pay clearly state that they are only guidance. If an employer wants certainty, he must use the tables provided and calculate manually.

These are small points within the vast and complex PAYE system but are examples of where the desire to maintain the manual system limits the benefits of information technology that could be gained by both the Inland Revenue and employers.

It is also important to view these observations in the context that whilst the Government is likely to legislate to compel small employers to file year end returns online for 2009–10 there are no proposals to make the use of a computerised payroll system mandatory. Although we represent mainly large employers, who between them pay the vast majority of UK employees, we are mindful of the needs of the very small employer. For this group, who represent 97% of the UK's PAYE schemes, the availability of manual processes is very necessary. Our comments here simply serve to highlight that there is not currently “a one size fits all solution” and we acknowledge that the needs of small employers must figure largely in the debate as to how the costs of PAYE compliance can be ameliorated. Any future solution must be beneficial for all sizes of employers and the Exchequer.

23 February 2004

COMPLIANCE COSTS IDENTIFIED IN RIAs SINCE APRIL 2001

INTRODUCTORY NOTE

The figures in the table below are not completely self-explanatory, and should be read with these introductory notes:

- The table summarises the cost and savings figures set out in recent Inland Revenue Regulatory Impact Assessments.
- The two columns on the left show the figures for all businesses, those on the right for small businesses only.
- Savings are shown in brackets, costs without brackets.
- The column “implementation costs” shows the one-off costs of implementing the change concerned: the column “on going costs” shows the costs (or savings) each year.
- Thus, looking at the end of the table, all of the measures added up show for small businesses a one-off implementation cost of £5.75 million to set against an annual saving of £12.65 million.
- A number of boxes in the table show the figure zero. This may mean that the costs or savings are small or negligible (as opposed to nil).

| <i>Date</i> | <i>Measure</i> | <i>All business</i> | | <i>Small business</i> | | <i>Objectives</i> |
|-------------|---|-----------------------|-----------------------------|-----------------------|-----------------------------|---|
| | | <i>On-going costs</i> | <i>Implementation costs</i> | <i>On-going costs</i> | <i>Implementation costs</i> | |
| | | <i>£ million</i> | | <i>£ million</i> | | |
| April 2001 | Internet filing of tax information. | 0 | 0.75 | 0 | 0.75 | Increased productivity. To achieve compliance cost reductions in time and handling—fewer errors—improved customer service—cash discounts offered to incentivise. |
| April 2001 | The Construction Industry scheme: extension of CIS 5 cards to partners in a firm. | (1) | (1.84) | 0 | 0 | To allow partnerships to qualify on same basis as companies and enable electronic submission of vouchers. |
| April 2001 | Authorised mileage rates. | 2 | 0 | 0 | 0 | To encourage smaller, more fuel efficient cars and closer alignment of tax and NICs treatment. Easier administration for employers and IR. |
| July 2001 | Double Taxation Relief. | (1) | 0 | (0.3) | 0 | To reduce distortions in the international allocation of savings/investment and ensure that the UK receives a fair share of international tax revenues. Ensures fairness to all taxpayers, and minimises compliance and administrative costs. |

COMPLIANCE COSTS IDENTIFIED IN RIAs SINCE APRIL 2001—*continued*

| <i>Date</i> | <i>Measure</i> | <i>All business</i> | | <i>Small business</i> | | <i>Objectives</i> |
|---------------|--|-----------------------|-----------------------------|-----------------------|-----------------------------|---|
| | | <i>On-going costs</i> | <i>Implementation costs</i> | <i>On-going costs</i> | <i>Implementation costs</i> | |
| | | <i>£ million</i> | | <i>£ million</i> | | |
| August 2001 | Life Insurance Policies etc, Information duties of insurers. | 2.06 | 12.85 | 0 | 0 | To ensure life insurers always advise policy holder when gain has arisen so they can include on tax return. Removes obligation on insurers to notify IR of every gain and allows them to deliver information in the most convenient way for them (paper, floppy disk, magnetic tape or Internet). |
| November 2001 | New Tax Credits.* | (11) | 0 | (3) | 0 | Targets support at those who need it most by assessing entitlement to new tax credits on a household basis. Streamlines the systems for claiming support, improve customer service and increase efficiency by bringing the administration of tax and benefits closer together. |
| April 2002 | Fuel Scale Charges. | 0 | 5 | 0 | 1 | To tax the benefit of provided free fuel for private journeys in company cars to help the environment. Administration simplified by calculating the taxable benefit using the same percentage figure used to assess benefit of company car. |
| April 2002 | Reform of the taxation of intangible assets. | (6) | 25 | (0.75) | 3 | To produce a comprehensive tax regime for intangible assets that gives relief on a consistent basis and reflects the key role of intangible assets in the knowledge-based economy. |

* *Footnote* Employers started to pay Tax Credits through the payroll in April 2000. The New Tax Credits, which took effect from April 2003, introduced a number of simplifications for employers, resulting in the savings figures shown here.

COMPLIANCE COSTS IDENTIFIED IN RIAs SINCE APRIL 2001—*continued*

| <i>Date</i> | <i>Measure</i> | <i>All business</i> | | <i>Small business</i> | | <i>Objectives</i> |
|-------------|--|-----------------------|-----------------------------|-----------------------|-----------------------------|---|
| | | <i>On-going costs</i> | <i>Implementation costs</i> | <i>On-going costs</i> | <i>Implementation costs</i> | |
| | | <i>£ million</i> | | <i>£ million</i> | | |
| April 2002 | Construction Industry Scheme. | 0 | 0 | 0 | 0 | To allow companies to set off CIS deductions against the PAYE, NICs, Student Loan repayments and CIS payments they are due to account for in respect of their own employees and subcontractors thus easing their cash flow. Increases the competitiveness between the companies that receive net payment and companies that receive their payments gross. |
| April 2002 | R & D tax credit for large companies/ vacancies research relief. | 1.33 | 0 | 0 | 0 | Research and development is an important driver of productivity growth acting to open up new markets and new opportunities for companies. Vaccines research relief is an associated measure targeted specifically at R&D into vaccines for the prevention and treatment of “killer diseases” in the developing world such as TB, malaria, HIV, etc. |
| April 2002 | Exemptions for gains and losses on substantial shareholdings. | 0 | 0 | 0 | 0 | Benefits UK trading groups no longer faced with a charge on gains on substantial shareholdings. Puts the UK into a similar position to other countries that have exemption regimes thus increasing competitiveness. |
| April 2002 | Reform of the corporate debt, financial instruments and foreign exchange gains and losses regimes. | 0 | 0 | 0 | 0 | Introduced a modernised and simplified regime for the taxation of loan relationships, derivative contracts and foreign exchange gains and losses. Eliminated 200 pages of financial instrument legislation. Allowed market freedom to develop innovative financial products. |

COMPLIANCE COSTS IDENTIFIED IN RIAs SINCE APRIL 2001—*continued*

| <i>Date</i> | <i>Measure</i> | <i>All business</i> | | <i>Small business</i> | | <i>Objectives</i> |
|---------------|--|-----------------------|-----------------------------|-----------------------|-----------------------------|---|
| | | <i>On-going costs</i> | <i>Implementation costs</i> | <i>On-going costs</i> | <i>Implementation costs</i> | |
| | | <i>£ million</i> | | <i>£ million</i> | | |
| April 2002 | Community Amateur Sports Clubs. | (5) | 0 | (5) | 0 | To offer the benefits of charitable status but with a simpler registration system to 110,000 community sports clubs. |
| April 2002 | National Insurance Contributions Bill. | 1.5 | 0 | 0.4 | 0 | A package of reforms to the structure of NICs and the Income Tax system for 2003–04. Aimed at providing extra funds for the Government’s spending plans with the maximum efficiency and the minimum disruption to business, individuals and IR. |
| November 2002 | Tax law Rewrite—Income Tax (Earnings & Pensions). | 0 | 0 | 0 | 0 | Rewriting UK primary direct tax legislation so that it is clearer and easier to use. |
| December 2002 | ISAs—Simplified voiding for investor error. | 0 | 0 | 0 | 0 | To allow ISA savers who have made common errors in subscribing to or transferring their ISAs to retain their ISAs with tax relief. |
| April 2003 | Corporation Tax Relief and Employee Share Schemes. | 0 | 0 | 0 | 0 | To encourage companies to set up or expand employee shares schemes by removing need for complex arrangements solely to obtain CT deduction. Provides for: <ul style="list-style-type: none"> — Greater clarity. — Fairness between companies. — Reduced bureaucracy. |
| April 2003 | Stamp Duty in disadvantaged areas— Extension of the relief to all non residential property. | 0 | 0 | 0 | 0 | Extension of Stamp Duty relief to all non-residential property in disadvantaged areas. |

COMPLIANCE COSTS IDENTIFIED IN RIAs SINCE APRIL 2001—*continued*

| <i>Date</i> | <i>Measure</i> | <i>All business</i> | | <i>Small business</i> | | <i>Objectives</i> |
|--|--|-----------------------|-----------------------------|-----------------------|-----------------------------|---|
| | | <i>On-going costs</i> | <i>Implementation costs</i> | <i>On-going costs</i> | <i>Implementation costs</i> | |
| | | <i>£ million</i> | | <i>£ million</i> | | |
| April 2003 | Simplification of Employee share Schemes. | (9) | 2 | (3) | 1 | To encourage growth in productivity. Changes to simplify and deregulate and — removes burdens on employers; — reduces uncertainty of tax consequences; — increases flexibility for employees. |
| April 2003 | Payments by Employers towards the cost of homeworking. | (3) | 0 | (1) | 0 | Supports the Government's policy of helping employers to promote the benefits of flexible working and align the treatment of employer paid homeworking expenses for tax and National Insurance Contributions (NICs) purposes. |
| April 2003 | Taxation of UK branches of foreign companies. | 0.5 | 3.5 | 0 | 0 | Modernises taxation of foreign companies operating in UK through branches and provides equity with UK companies. |
| September 2003 | National insurance contributions—offshore manning. | 0 | 0 | 0 | 0 | Defines the circumstances in which shipping operators with a place of business in the UK who engage UK resident mariners through offshore manning companies have to pay employers' National Insurance Contributions (NICs). Provides equity with companies who do not use offshore manning companies. |
| September 2003 | Mandatory electronic payment for large employers. | 0 | 0 | 0 | 0 | Compulsory electronic payment by employers with 250 or more employees to ensure prompt and secure payment and introduction of a later due date for electronic payments made by all employers to encourage smaller employers to adopt electronic payment voluntarily. |
| April 2001—September 2003 Total | | (28.61) | 47.26 | (12.65) | 5.75 | |

Notes: 1. Costs are shown without brackets, savings in brackets.
2. The figure zero may denote a small/negligible cost or saving.

COMPLIANCE COSTS OF PAYE & NICS BATH UNIVERSITY 1998

RECOMMENDATIONS AND ACTION TAKEN

| <i>Recommendation</i> | <i>Actions taken</i> |
|---|---|
| <ul style="list-style-type: none"> ● Closer collaboration between the Inland Revenue(IR) and the Contributions Agency(CA). ● As far as possible achieve consistency and uniformity across Pay As You Earn(PAYE) and National Insurance Contributions (NICs) operations, so as to minimise compliance costs to employers. | <ul style="list-style-type: none"> ● IR and CA merged April 1999. PAYE and NICs assurance now covered in a single visit to the employer, rather than two separate visits, saving employer costs. ● Long-term administrative benefit to employers from abolition of previous multiple rates of secondary Class 1 NICs and from alignment of income tax personal allowance and NICs thresholds. ● Legislation aligning the treatment of benefits in kind for NICs with that for tax has been introduced. |
| <ul style="list-style-type: none"> ● Continuation of the existing programme of rewriting and simplifying the PAYE, NICs, Statutory Sick Pay(SSP) and Statutory Maternity Pay (SMP) literature. ● Monitoring of the new system of despatch of literature and forms to employers. ● A shorter and simplified Employers' Guide for a manual PAYE, NICs and SSP/SMP system which should be piloted with small employers. ● A well written booklet explaining the system for employees on their first employment should be available for distribution by employers. ● Attractive, simple leaflets should be produced about specific aspects of the tax system and offered to employers for distribution to employees. | <ul style="list-style-type: none"> ● Inland Revenue Employer Programme has prepared simplified booklets such as "<i>Paying Someone for the first time</i>" and "<i>Day to Day Payroll</i>". "<i>Pay and Time off work for parents</i>" written in collaboration with Dept for Work and Pensions, Dept Trade and Industry and employer and employee representatives. ● All forms and guidance now routinely tested for usability with employers. ● New Employer's Starter Pack to be re-launched in 2005 focusing readers' attention on the essential early tasks. ● Employer's CD-ROM has been widely welcomed and includes a "<i>Teach Yourself Payroll</i>" package. ● Leaflets on all aspects of the tax system are available on IR website and from Inland Revenue Enquiry Centres. These include simple leaflets for employees. |
| <ul style="list-style-type: none"> ● The new system despatch of literature and forms to employers should be monitored. | <ul style="list-style-type: none"> ● IR has identified agents in receipt of multiple packs and now sends them only five copies. We also have substantially and progressively reduced the number of paper annual packs sent by identifying employers who only require a CD-ROM and order form. |
| <ul style="list-style-type: none"> ● There should not be unreasonable delays in responding to calls and helplines should be open during the hours in which employers have to contact them. ● Helpline staff should be trained to pass specialised enquiries to competent experts speedily and to ring back if necessary. ● "Named" contact staff assigned to particular payrolls should be trained up to the appropriate level of expertise. | <ul style="list-style-type: none"> ● Employers' helpline now open 8.00 am to 8.00 pm Monday to Friday and 8.00 am to 5.00 pm Sat and Sun. Helplines identified for specialist topics eg Electronic Business Unit. ● The Better Guidance programme now underway will deliver guidance to customers and advisers consistently in a form which is accurate, up to date and accessible. |
| <ul style="list-style-type: none"> ● New employers be given a named IR contact at the outset and offered an "educational" visit so as to get them "up and running". | <ul style="list-style-type: none"> ● Business Support Teams (BSTs) set up 1999. 70 teams across the UK offer one to one visits to help any new or small employer. |

| <i>Recommendation</i> | <i>Actions taken</i> |
|--|--|
| <ul style="list-style-type: none"> ● More informal one-to-one visits, having a preparatory or educational function, should be offered to employers. In view of their expense these would have to be carefully geared to needs. | <ul style="list-style-type: none"> ● BSTs also offer nine different half day workshops at locations across the UK that are designed specifically for the new and small employer. |
| <ul style="list-style-type: none"> ● The availability of dispensations for expenses should be more widely publicised. ● The coverage of particular dispensations (eg, locations covered by car dispensations) should be interpreted more liberally. ● Consideration should be given to widening the benefits covered by dispensations. ● The treatment of benefits-in-kind should be common across PAYE and NI class 1A contributions. ● The valuation of company cars for tax purposes should be reviewed. | <ul style="list-style-type: none"> ● IR has reviewed guidance on dispensations to stress that staff should be proactive to alert employers to the possibility of applying for one, where the circumstances allow. We have also clarified the situation in which one-man companies can seek a dispensation. ● Review Associated Work Teams (RAWTs) handle all Dispensation/PSA work. This includes carrying out a review programme to update existing dispensations. Channelling this work through specialist teams improves both the quality and consistency of decisions. ● RAWTs have been holding road shows and carrying out mailshots to increase the number of Dispensations/PSA in place. We have supported this through articles in the <i>Employer's Bulletin</i> to raise awareness of the benefits of dispensations. ● As well as specific action on dispensations, there have been a number of legislative changes: <ul style="list-style-type: none"> — exemptions for mobile phones; — exemptions for employer loaned computers; and — exemption for reimbursed homeworking expenses. ● IR website has an interactive ready reckoner to help employers calculate the taxable benefit arising on company cars. |
| <ul style="list-style-type: none"> ● A well-written booklet explaining the system for employees on their first employment should be available for distribution by employers (and educational institutions), with a view to improving employee education on tax and related matters. | <ul style="list-style-type: none"> ● This has been addressed in “<i>Pay and Time off Work for Parents</i>” and better guidance will follow for other topics as resources permit. |
| <ul style="list-style-type: none"> ● Requests for duplicate information from employers should be reduced to a absolute minimum. | <ul style="list-style-type: none"> ● Modernising PAYE Processes for Customers (MPPC) programme will restructure business processes and the computer support on which they depend to make the PAYE system easier, faster and cheaper for taxpayers, employers and the Inland Revenue to operate. |
| <ul style="list-style-type: none"> ● IR should evaluate and “kitemark” commercially produced software. More “hands-on” guidance should be given in choosing and running software. ● Information for employers should be made available electronically so as to reduce the amount of paperwork. ● It should be made as easy as possible for employers to submit electronically if they wish to do so. | <ul style="list-style-type: none"> ● A Payroll Standard was introduced and is carried out on commercially produced software products. Companies approach IR to test their products. ● The CD-ROM and Internet site contain help for employers. ● PAYE Online is also available for employers who wish to submit forms electronically to IR. |
| <ul style="list-style-type: none"> ● The system of qualifying days, linking periods and so on for SSP should be revised, simplified and made more comprehensible. ● The treatment of waiting days etc for part-time employees should be reconsidered. | <ul style="list-style-type: none"> ● Implemented (Department of Work and Pensions (DWP)). ● Implemented (DWP). |

| <i>Recommendation</i> | <i>Actions taken</i> |
|---|--|
| <ul style="list-style-type: none"> ● The Percentage Threshold Scheme should be reconsidered and possibly revert to a pre-PTS type of scheme for small employers only. | <ul style="list-style-type: none"> ● Not implemented (DWP). |
| <ul style="list-style-type: none"> ● The periods for maternity pay and maternity leave should be the same. ● The DSS should explore ways of allowing employers more flexibility within the SMP scheme to deal with issues such as premature or still births and predicting confinement dates. | <ul style="list-style-type: none"> ● Implemented (DWP). ● Implemented (DWP). |
| <ul style="list-style-type: none"> ● IR should go as far as it possibly can in achieving consistency and uniformity across PAYE and NICs operations, so as to minimise compliance costs to employers. | <ul style="list-style-type: none"> ● Long-term administrative benefit to employers from abolition of previous multiple rates of secondary Class 1 NICs and from alignment of income tax personal allowance and NICs thresholds. ● IR has recently published a new Internet guide about the tax and NICs treatment of expenses and benefits in kind. This is the first time this tax and NICs guidance has been brought together. |
| <ul style="list-style-type: none"> ● In view of the high compliance costs associated with establishing the right tax codes, serious consideration should be given to the costs, benefits and feasibility of a tax allowances “smart card”. | <ul style="list-style-type: none"> ● Consider for possible future study. |
| <ul style="list-style-type: none"> ● Policies should be effected with the minimum possible compliance costs for all parties, especially for small employers. ● Using the present estimates of compliance costs as a benchmark, a further study should be carried out as soon as the new changes have bedded down. | <ul style="list-style-type: none"> ● Businesses are consulted when new policies are being introduced and Regulatory Impact Assessments are carried out to assess the impact on compliance costs, particularly for small business. ● After new policies have bedded down some post implementation assessments have been carried out, and the Department intends to do more such exercises. |

Annex C

INLAND REVENUE ACTION TO HELP EMPLOYERS WITH PAYE

WORKING TAX CREDIT

The Government has announced in the 2004 Budget that it accepts the case for phasing out payment via employers for Working tax Credit, and will be consulting on the implementation.

BUSINESS SUPPORT TEAMS (BSTs)

Business Support Teams were set up in 1999. Seventy teams across the UK offer one to one visits to help any new or small employer. We are currently conducting four national pilots offering the BST service at evenings and weekends to fit the needs of small business.

ELECTRONIC FILING

Inland Revenue is taking forward the Carter Review recommendation that employers should file returns electronically, in order to encourage switching all payroll communications to electronic channels:

- employers with 250 or more employees will file electronically at the end of 2004–05;
- employers with 50–249 employees will file electronically at the end of 2005–06;
- employers with less than 50 employees will file electronically at the end of 2009–10.

Small employers can get up to £825 tax-free from IR over five years if they voluntarily file end of year returns online before 2009–10 starting with the 2004–05 return:

| | |
|---------------------------------------|-------------|
| File online for 2004–05 and get | £250 |
| File online for 2005–06 and get | £250 |
| File online for 2006–07 and get | £150 |
| File online for 2007–08 and get | £100 |
| File online for 2008–09 and get | £ 75 |
| Total | £825 |

A marketing and communications strategy will publicise and encourage online filing. The BSTs are doing presentations on how to register, enrol and file online and extra BST staff are being recruited for online filing education.

We are jointly arranging nation-wide seminars with Payroll World. These seminars have been designed to help all employers decide how best to prepare for this. Each event allows employers attending to discuss their plans informally with Inland Revenue and Payroll World experts.

EXPATRIATE EMPLOYEES

After consultation with employers IR are creating five specialist teams by 31 March 2004 to work on the tax affairs of inward expatriate employees (employees from abroad).

COMPANY VANS

Many employers have vans which a number of different employees use and the complex tax treatment of the benefits arising to employees who use vans is a regular source of complaint from employers. The Inland Revenue is currently consulting on revision of the rules on the tax treatment of company vans to see if there is scope for simplifying them.

EMPLOYERS CD ROM

In 1998, the IR introduced for employers a CD ROM to take the place of all the normal PAYE and NIC instructions. In 2003 we changed the style and navigation of the CD ROM to make it easier to use. It now includes:

- a K code tax calculator;
- a NICs calculator for contracted out employees; and
- a Director’s Annual Earnings period check.

INLAND REVENUE WEBSITE

This has been improved and the employers’ section includes:

- a dedicated area with easy access to information, forms, news and frequently asked questions;
- tailored pages for new employers and contractors; and
- easy access to employer online services.

ELECTONIC CALCULATORS

The Inland Revenue website includes an interactive “ready reckoner” to help employers calculate the taxable benefit arising on company cars and Statutory Maternity Pay calculator. The CD-ROM for employers also contains a number of calculators.

NI NUMBERS

We now offer a National Insurance Number tracing service for employers.

PAYE ONLINE

As a result of customer feedback we will be making further improvements to PAYE Online for Employers from April 2004:

- A single entry point means employers will only need one User ID and Password per scheme to access online services using the Internet.
- This will give easier access to the Inland Revenue’s PAYE online software (Online Return and Forms—PAYE) and secure mailbox.

- Employers will be able to send back Tax Credits Payments Via Employer (PVE) rejections online.
- Employers will be able to choose on screen whether or not they want to receive statutory notices, eg coding notices, over the Internet to their secure mailbox without having to contact the Online Services Helpdesk.
- Employers will be able to download PVE and statutory notices and transfer this information as a .csv (comma separated value) file directly into many of their own payroll software applications. Employers will no longer have to read and input each form manually.

EMPLOYER TALK EVENTS

Employer Talk events held at venues across the UK provide a chance to speak to IR experts face to face, and to listen to key speakers give IR's latest news and payroll developments. Around 10,000 people attend these events each year.

NEW GUIDANCE FOR EMPLOYERS

We have recently published a new booklet for employers called "*Tips, Gratuities, Service Charges and Troncs: A guide to Income Tax, National Insurance contributions, National Minimum Wage issues and VAT*".

We have recently published a new Internet guide about the tax and NICs treatment of expenses and benefits in kind. It's the first time this tax and NICs guidance has been brought together. It has:

- an A–Z list of common benefits and expenses, whether they are liable to tax and NICs and whether a dispensation can be given for them;
- a quick and easy guide on how to treat them;
- detailed guidance on the treatment of some of the more common types; and
- links to our internal guidance.

IMPROVED FORMS

The 2003–04 P35—employer's annual return has been revamped to take into account employers' comments. The form is bigger, less crowded and in a different format from last year's form.

We are trying out a new style coding notice (P2) on employees and pensioners who are dealt with by our offices in the South West of England. The new P2 will provide a better explanation of what makes up each tax code—the tax allowances and any benefits in kind etc, so there's no need for accompanying notes.

WORKING WITH SOFTWARE COMPANIES

We removed the £1,000 charge for successful accreditation of software by the Inland Revenue in July 2002 and IR have worked very closely with Software developers for online filing.

USABILITY TESTING

Usability testing of all employer forms, packs and guidance products with the users of those products is carried out as part of the ongoing work of the Employer Programme.

Letter to the Chairman of the Sub-committee from the Paymaster General, HM Treasury, providing further information in response to Question 367

STATUTORY SICK PAY, BURDEN OF COMPLIANCE ON EMPLOYERS

During the hearing on 21 April Nigel Beard asked me if there were any proposals to look at the question of statutory sick pay and its impact on small firms who find it difficult to operate. I promised to write to the Committee on this point.

The Government believe it is right for employers to have a statutory duty to provide for their employees during short-term spells of sickness. By making employers responsible for sickness payments they are encouraged to manage sickness absence in the work place and by reducing sickness absence levels they will reduce their costs and increase productivity.

The rules relating to SSP are intended to give employers and employees complete flexibility to reflect the fact that many people have unusual working arrangements. Research shows that the majority of employers operate SSP effectively.

Ninety per cent of employees are in fact covered by their employer's occupational sick pay schemes, which are at least equal to or more generous than SSP. In these cases, employers effectively do not operate the SSP scheme and are only required to keep the necessary records in case the employee needs to transfer to Incapacity Benefit.

The Government is aware that employers have concerns about the administration of the scheme and have already taken steps to provide support to employers and to revise the guidance with particular regard to explaining the basic rules more simply.

- Assistance is available for employers on the Revenue's internet site in a simple question and answer format and including a useful flowchart;
- The Revenue also send all employers a CD-ROM which contains guidance and other aids in easily navigable format; many employers have welcomed this initiative and find it a very helpful way of meeting their payroll obligations;
- The Revenue are planning to add to their CD-ROM a teach-yourself package on SSP to complement their existing packages on other payroll topics. This should be available for new employers later this year and for all employers from February 2005;
- The Revenue's Business Support teams provide a free workshop for employers on SSP at locations across the UK—these can be booked online through the website;
- The Revenue's Employer's Helpline offers telephone assistance at hours to suit the busy employer—the helpline is open from 8 am to 8 pm Monday to Friday and from 8 am to 5 pm on Saturdays.

Work is also ongoing to develop an internet based calculator, which will be helpful to those employers who don't use payroll software in relieving them of the burden of manual calculation and reducing the risk of error.

The Inland Revenue would also be happy to listen to suggestions for further changes to the administrative aspects of the scheme from employers and their representative bodies.

I am copying this letter to Andrew Smith.

11 May 2004