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Committee of Public Accounts

Filing of VAT and Company Tax returns

Sixty–fifth Report of Session 2006–07

Report, together with formal minutes, oral and written evidence

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The Committee of Public Accounts

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Committee staff

The current staff of the Committee is Mark Etherton (Clerk), Philip Jones (Committee Assistant), Emma Sawyer (Committee Assistant), Pam Morris (Secretary) and Alex Paterson (Media Officer).

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Summary

HM Revenue & Customs (the Department) collects £129 billion a year in VAT and Corporation Tax. Some 1.8 million businesses are registered for VAT and 1.8 million companies registered to file Company Tax returns, which include a self assessment of the amount of Corporation Tax payable. 600,000 businesses file both types of return. Businesses are normally required to file VAT returns quarterly and Company Tax returns annually.

The Department spends over £9 million a year on processing over nine million VAT and Company Tax returns and incurs further costs in chasing businesses for overdue returns and correcting errors.

85% of VAT returns and around 77%–79% of Company Tax returns are submitted on time. Getting accurate tax returns in on time is important for the Department in ensuring that it is collecting the right amount of tax at the right time. It tends to focus more on getting tax payments in and on the accuracy of returns, although only 60% of companies pay Corporation Tax on time and 50% of VAT receipts are received by the due date. At least £1.5 billion of tax revenue was estimated to be in doubt from late and missing returns in October 2006, although businesses may have actually paid over some of the tax relating to these returns. There are gaps in the Department's information on the potential tax outstanding from all missing returns, the businesses that fail to file both types of return and the link between late filing and other forms of non-compliance.

In the absence of a return the Department may levy a penalty and it can raise an assessment of the tax due. The penalties have had limited impact on encouraging companies to file already overdue returns or in deterring those companies intent on filing late.

Since the Department introduced online filing for VAT returns in 2001 and Company Tax returns in 2003, take-up by businesses has been low. The Department does not expect to meet its Public Service Agreement target to get 50% of VAT returns filed online by 2007–08. Its plans for introducing mandatory online filing have been put back to 2010 for VAT and 2011 for Company Tax returns.

The Department expects online filing to save most of the £9 million a year it currently costs to process paper returns. It estimates that a typical business will save £5 per VAT return and £20 per Company Tax return by filing online. Online filing also brings added benefits because the potential for error in the returns is reduced.

The Department has measured the administrative burdens the tax system places on businesses and has a target to reduce the burden by at least 10% by 2011. It has various plans to make it easier for businesses to comply with their filing and tax obligations but many of these are unlikely to take effect before 2011.

On the basis of a report by the Comptroller and Auditor General,[1] we examined HM Revenue & Customs on getting VAT and Company Tax returns in on time, encouraging businesses to file tax returns online and making it easier for businesses to comply with their filing obligations.

1 C&AG's Report, *HM Revenue & Customs: Filing of VAT and Company Tax returns*, HC (Session 2006–07) 102

Conclusions and recommendations

1. **One in five Company Tax returns and one in seven VAT returns are filed late or not at all each year, putting at risk over £1.5 billion in tax revenues.** The Department takes a firmer approach on filing Income Tax Self Assessment returns where it achieves around 90% on time filing and has a target of 93%. If the filing obligations on businesses can be reduced without risk to tax revenues, the Department should formalise and communicate the reduced requirements to businesses. But where the statutory obligation to file remains, the Department should aim to achieve levels of on time filing of over 90%.

2. **The Department lacks information on which businesses repeatedly file late or which fail to file both types of return, and on the link between late filing and other forms of non-compliance.** These gaps undermine its effectiveness in targeting its compliance work and its assistance to help businesses comply, and in identifying areas where it could make significant improvements. The Department needs to:

    — identify which businesses have more than one return outstanding and which are late in filing both VAT and Company Tax returns;

    — analyse the linkages between late filing and other non-compliant behaviour such as filing inaccurate returns and late payment; and

    — devise a programme for obtaining comparative information for each main tax and taxpayer group, covering timeliness and accuracy in filing returns, paying tax due and levying and collecting penalties

3. **The penalty regimes for non-compliance with VAT and Corporation Tax are very different, the fixed rate penalties for a late Company Tax return are low, and penalties are not routinely applied**. As part of its Powers, Deterrents and Safeguards Review, the Department should introduce a consistent approach to penalties for both taxes that relates the penalties to the size of business and targets those who persistently do not comply. It needs to enforce all penalties and assess the effect of changes in the penalty regime in securing higher levels of on time filing.

4. **The Department could make more use of non-financial incentives to encourage businesses to file returns on time.** The Department should evaluate the benefits of introducing tax clearance certificates which have been used with some success by the Irish Revenue. It should also compare its performance in getting returns in on time with the performance and practices of other tax administrations to identify other incentives it could use to encourage on time filing.

5. **Less than 10% of businesses filed their VAT or Company Tax returns online in 2006–07**. The Department plans to make online filing mandatory by 2012. We reiterate our previous recommendation that before resorting to compulsion, the

Department should be offering a good quality service which a high proportion of businesses are willing to use voluntarily.[2]

6. **The Department's online services for VAT and Company Tax returns do not fully meet the needs of businesses for robust and secure online systems, which offer the facility to communicate electronically and view their tax liability statements and records.** Overseas tax authorities provide specialist services for agents and public access to online facilities, as well as differential filing dates for paper and online returns, earlier repayments of tax for those who file online and pre-populating returns with information they hold. The Department should facilitate routine use of electronic communications and payments by businesses and their agents, and consult businesses and agents on the benefits of implementing the other measures.

7. **Filing obligations account for between 30% and 50% of businesses' compliance costs on VAT and Corporation Tax.** Substantial reductions in the administrative burdens associated with filing VAT and Company Tax returns are needed to achieve a meaningful reduction in the overall costs for businesses in dealing with their tax obligations. The Department's target is to reduce by 10% the overall administrative burden of the tax system on businesses. To make a real difference, the Department should set and publicise differential targets, which seek greater reductions in those obligations which businesses find particularly onerous.

8. **On current plans it is unlikely that businesses will see significant change in the costs and ease of compliance before 2011, six years after HM Revenue & Customs was set up.** To introduce more rapid improvements, the Department should:

— improve the content and navigation of its website so businesses have ready access to full, clear and up to date information on filing VAT and Company Tax returns;

— provide businesses with a single point of contact covering the range of taxes, and share internally information it holds on individual businesses for the different taxes, so that businesses have to provide the information the Department needs only once;

— align the dates for filing Company Tax returns, payment of Corporation Tax and the filing of accounts with Companies House.

2 Committee of Public Accounts, Twenty-fourth Report of Session 2003–04, *Transforming the performance of HM Customs and Excise through electronic service delivery*, HC 138. Committee of Public Accounts, Forty-ninth Report of Session 2005–06, *Corporation Tax: Companies managed by HM Revenue and Customs' Area Offices*, HC 967

1 Getting VAT and Company Tax returns in on time

The Department's performance in getting returns on time

1. Getting businesses to file accurate tax returns on time is an important step in HM Revenue & Customs collecting £129 billion a year in VAT and Corporation Tax. Late filing of returns leads to difficulties for the Department in confirming whether businesses have paid the right amount of tax, and additional costs in chasing late returns.[3]

2. Around 1.8 million businesses are registered for VAT and 1.8 million companies registered to file Company Tax returns,[4] which include their self assessment of the amount of Corporation Tax payable. 600,000 businesses file both types of return. Businesses are normally required to file a VAT return one month after the end of each quarter. Companies are required to file their Company Tax returns annually, usually within a year of their accounting year-end.[5]

3. In 2005–06, 85% of VAT returns and 79% of Company Tax returns were filed on time (**Figure 1**). Similar rates were achieved in the previous two years. The Department does not have any international comparators to assess how it performs in getting returns in on time.[6] On Income Tax self assessment around 90% of returns are filed on time and the Department has a target to increase the percentage to 93% by 2007–08.[7]

Figure 1: HM Revenue & Customs' targets and performance on filing returns for Income Tax self assessment, VAT and Company Tax returns

	TARGET	ACHIEVED
	%	**2005–06** %
Income Tax Self Assessment	90.6	90.6
VAT	No target	85
Company Tax returns	77.5	79

Source: C&AG's Report, HM Revenue and Customs Filing of VAT and Company Tax returns Appendix 4, and NAO and Committee of Public Accounts Reports on filing of Income tax self assessment returns

3 C&AG's Report, *HM Revenue & Customs 2006-07 Accounts*, HC (Session 2006–07) 626, paras 1, 5 and 7

4 A Company Tax Return covers self assessment of the amount of Corporation Tax in the accounting period, and other taxes which are assessable as if they were Corporation Tax. The Company Tax return is the return form, together with accounts and computations.

5 C&AG's Report, paras 1,5, 1.3, 1.4

6 Qq 51–53; C&AG's Report, para 1.9; Figure 2

7 Committee of Public Accounts, Twenty-third Report of Session 2005–06, *Filing of income tax self assessment returns*, HC 681

4. In the absence of a return the Department may levy a penalty (see paragraph 8) and it can also raise an assessment of the tax to pursue the estimated tax due.[8] While some businesses may subsequently file a return, the Department does not know how many returns in total remain outstanding. Almost 230,000 VAT returns expected from businesses in 2004–05 and 2005–06, had not been received by mid October 2006. At the end of March 2006, around 160,000 Company Tax returns, due in 2004–05, were still outstanding. The estimated value of these returns was at least £1.3 billion in VAT and £180 million in Corporation Tax.[9]

5. HM Revenue & Customs considered that late or missing returns did not lead to significant losses of tax for several reasons. Firstly, there are separate deadlines for paying the tax due and some businesses pay their tax without submitting a return. For example payments of Corporation Tax are due for most companies three months before the tax return and 80% of Corporation Tax payments are made in instalments before the return is due. The Department can also raise assessments for the estimated tax due, which businesses may pay without submitting a return. In some cases where returns are missing there might be no actual tax liability. The Department concluded from some further analysis that 87% of businesses which had not submitted a Company Tax return within 12 months had in fact ceased trading and there was no tax liability.[10]

6. The Department tended to concentrate its effort more on the payment of tax and on the accuracy of returns where it believed it could achieve greater returns for the resources involved. Nevertheless only around 60% of companies pay on time and 50% of VAT receipts are received by the due date. The Department wrote off £2.8 billion in VAT (3% of net receipts) and £214 million in Corporation Tax (0.5%) in 2006–07.[11]

7. The Department accepted that there were deficiencies in its management information. It did not know which businesses persistently failed to submit a return or how many businesses fail to submit both their VAT and Company Tax returns.[12] It also had no detailed understanding of whether there was a link between late filing and inaccurate returns.[13] It had carried out initial analysis to identify the business sectors which had a poorer record in meeting their VAT obligations, but it had less understanding of the problem areas for Company Tax returns.[14] It recognised that it needed more in depth analysis and was developing its assessment of risk against a number of criteria.[15] For example it considered that the size of the business may be a better indicator of whether a company is likely to file on time. It was developing a compliance strategy and centralised

8 Q 4

9 C&AG's Report, paras 5, 1.9

10 Qq 14, 54, 58, 86–87

11 Qq 56, 58; C&AG's Report, para 1.12; Committee of Public Accounts, Fifty-third Report of Session 2006-07, *Helping newly registered businesses meet their tax obligations*, HC 489, Ev 14

12 Qq 25, 59, 61, 65, 91

13 C&AG's Report, paras 1.8, 1.10

14 Q 3

15 Q 62

risk profiling to provide a better overview and focus on those businesses which fail to comply with their filing obligations on both taxes.[16]

Sanctions and incentives to encourage businesses to file returns

8. The Department has a range of penalties to encourage businesses to file on time. Its powers to levy penalties differ for VAT and Corporation Tax reflecting how the powers of the two former departments evolved over time. On VAT it can apply a default surcharge penalty on VAT unpaid at the due date. On Company Tax returns, it can impose fixed penalties for late returns; tax-related penalties if the return is further delayed; and it can impose interest on late payment of Corporation Tax.[17] It recognised that the fixed penalty of £100 was modest. The penalty regime was similar to the regime for Income Tax self assessment where the Department issues an automatic penalty of up to £100 to individuals who have not filed their tax returns by the deadline.[18]

9. The Department raised over 250,000 VAT default surcharge penalties and 450,000 penalties for late filing of Company Tax returns in 2005–06.[19] It considered that fluctuations in the numbers of penalties issued each year largely reflected the changing behaviour of the filing business population rather than changes in the way the Department applied penalties, although it acknowledged that penalties were not routinely applied.[20]

10. It imposed £270 million of penalties for late payment of VAT in 2005–06 but it did not know the total value of the tax related penalties it levied for late filing of Company Tax returns. It estimated that, based on a sample, 78% of Company Tax return penalties were paid in 2005–06. On VAT, penalty payments are not separately identified from payment of the VAT due. Half of all VAT receipts are received by the due date.[21]

11. The Department considered that the penalty regime had limited impact on encouraging businesses to file already overdue returns or in deterring those businesses intent on filing late. In the 2007 Budget the Government announced a new approach to penalties for incorrect tax returns with a single penalty structure for Corporation Tax, VAT, Income Tax, Pay As You Earn and National Insurance Contributions. As part of the '*Powers, Deterrents and Safeguards*' review the Department was considering the range and level of penalties used, particularly against those who persistently filed returns late or not at all.[22]

12. The Department considered that financial incentives to reward those businesses who do file on time would not be a good use of taxpayers' money. It was however seeking to make clearer the incentives for achieving a good compliance record. Businesses with a good record would attract a lower risk rating and less scrutiny, whereas those who

16 Qq 2, 59, 88

17 Committee of Public Accounts, Fifty-third Report of Session 2006-07, *Helping newly registered businesses meet their tax obligations*, HC 489, Ev 14

18 Qq 6, 23, 31; C&AG's Report, paras 1.11 to 1.13

19 C&AG's Report, Figures 3, 4

20 Qq 22, 24

21 Q25; C&AG's Report, para 5

22 C&AG's Report, para 1.13

persistently fail to comply would increase their compliance risk rating which could lead to an enquiry.[23] In the 2007 Budget the Government announced a change from 2008 in the timetable for enquiries to remove one of the disincentives to early filing. The window for an enquiry would begin when the return is filed rather than from the filing deadline.

13. The Department agreed to consider the experience of the Irish Revenue in using tax clearance certificates as an incentive for businesses to achieve a good compliance record. The Irish Revenue issues tax clearance certificates to confirm that a business has complied with its tax obligations, for example that all taxes, interest and penalties have been paid and all returns have been filed. The certificates are issued electronically and must be applied for each year. As certificates can be required for the award of public sector grants, licences and contracts, the Irish Revenue has found that the certificates help to achieve greater taxpayer compliance, particularly in the payment of taxes in full on time.[24]

23 Qq 10,12

24 Qq 49–50; C&AG's Report, para 3.14; Figure 12

2 Filing online

Take up of online filing

14. The Department processes 7.8 million VAT returns and 1.3 million Company Tax returns each year. Company Tax returns are dealt with at 64 Area Offices across the United Kingdom, and by 11 Large Business Service offices for the largest companies. VAT returns are processed at a single location.[25] The Department intends over time to centralise the processing of Company Tax returns in more specialised Area Offices.[26]

15. The Department introduced online filing for VAT returns in 2001 and for Company Tax returns in 2003. Take up by businesses has risen slowly to 9% of VAT returns and 7% of Company Tax returns (**Figure 2**).[27] The Department has a Public Service Agreement target to increase the number of VAT returns filed online to 50% by 2007–08, but it did not expect to increase online filing significantly for VAT or Company Tax returns over the next 12 months.[28]

Figure 2: The percentage of VAT and Company Tax returns filed online

Year	Percentage of VAT returns filed online	Percentage of Company Tax returns filed online
2003-04	0.2	0.1
2004-05	1.2	0.5
2005-06	4.9	1.9
2006-07[29]	8.6	6.9

Source: C&AG's Report, HM Revenue & Customs: Filing of VAT and Company Tax returns

16. We previously reported in 2004 on the slow progress in developing an online service on VAT, and the steps needed to achieve a service that businesses would use.[30] At that time the Department considered that a 50% take-up rate was needed to make it a viable service and it was seeking to achieve this level by March 2006.[31]

17. The Department's online services for VAT and Company Tax returns do not fully meet business' needs and expectations. Lord Carter of Coles' report in March 2006, *Review of HMRC online services*, recommended a number of changes and targets to increase the take-up of online filing, including mandatory online filing for VAT and Company Tax returns in phases from 2008 to 2012. It identified aspects of the service which could be improved to address the difficulties in using the system and problems with telephone helpdesks. In the

25 C&AG's Report, Figure 1, paras 1.3 and 1.5

26 Q 65

27 Q 7

28 Qq 6, 35; C&AG's Report, paras 2.1, 2.2

29 Q 7

30 Committee of Public Accounts, Twenty-Fourth Report of Session 2003–04, *Transforming the performance of HM Customs and Excise through electronic service delivery*, HC 138

31 Q 37

2007 Budget the Government announced that the introduction of mandatory online filing would be delayed—VAT from 2010 and Company Tax returns in 2011—although the target date of 2012 for universal online filing on the main business taxes remains unchanged.[32]

Potential savings from online filing

18. The Department plans to invest £340 million in its online services between 2006 and 2015. As levels of online filing increase, it expects to save from 2013–14 most of the £9 million a year it currently costs to process VAT and Company Tax returns. Its research on the administrative burdens for businesses estimated the cost of preparing and filing VAT returns at £170 per business, and on Company Tax returns, £70 per company for the return and £120 for the self assessment computation. The Department estimates that a typical business will save £5 per VAT return and £20 per Company Tax return by filing online. There are added benefits of on line filing. Businesses paying electronically have an extra seven days to pay and file their VAT returns. In addition those filing online get a receipt confirming that the return has been received and passed validation checks. As a result the potential for error is reduced, which also reduces costs for the Department and businesses in correcting errors on returns. In 2005–06 the Department spent £1.2 million correcting errors on VAT returns.[33]

Incentives to encourage online filing

19. Businesses may consider that the costs of switching to online filing outweigh the benefits of reduced error and small savings in processing costs. On PAYE the requirement for employers to file their PAYE end of year returns online started in 2005 (for 2004–05 returns). Small employers were offered tax-free incentive payments of up to £825 over five years to file their returns online before 2010. The Department had doubts over whether it obtained real value from this premium and did not plan to offer similar incentives on VAT or Company Tax returns. Lord Carter of Coles' report rejected the option of offering new financial incentives and recommended that resources would be better spent on improving services.[34]

20. To increase online filing, businesses saw the need for robust systems which ensured data security. Other measures which would encourage them to switch included wider use of electronic communications such as email, and provision of other functions such as the facility to view their tax liability statement. A business in the Netherlands can view an online statement of account across all the taxes and duties it pays.[35] Additional incentives used in other countries included quicker refunds for online returns, longer filing periods, pre-population of returns, specialist services for agents and public access to online facilities.[36]

32 Q 7; C&AG's Report, para 2.2

33 Q 38; C&AG's Report, paras 2.3, 3.8

34 Qq ,40, 44; Committee of Public Accounts, Fifty-third Report of Session 2006-07, *Helping newly registered businesses meet their tax obligations*, HC 489, Ev 14

35 C&AG's Report, paras 2.4–2.7

36 C&AG's Report, para 2.8

21. The Department accepted that before introducing mandatory online filing it needed to improve the quality of the online service so businesses would be willing to use the service voluntarily.[37] The Department was intending to consult its customers and their representative bodies and software developers to identify their support needs. It had adopted an international data tagging language ('XBRL') to allow it to accept Company Tax returns with supporting company accounts and computations from a business. It had worked to develop standard VAT accounting software to help businesses get their VAT returns right first time. It was working with tax agents and other organisations, to improve the online guidance and the education it provides particularly to new businesses.[38] It proposed to draw on its experience of increasing the take-up of online filing for income tax self assessment which reached 35% in 2007, and on the experience of other countries such as Australia and private sector financial services. A particular focus was to improve the help and assistance it provides to small businesses to file online.[39]

37 Q 7

38 Q 96; C&AG's Report, paras 2.5–2.6

39 Qq 18, 48, 94, 96

3 Making it easier for businesses to comply

22. The integration of HM Customs and Excise and the Inland Revenue in a new Department in 2005 was designed to achieve improvements in customer service and reduce their compliance costs, as well improve the Department's effectiveness and efficiency. In particular customers were to benefit from a unified tax service, with the Department structuring its work around customers and functions rather than taxes, and adopting a more joined-up approach in its use of information.[40]

The compliance costs for businesses

23. Preparing the information and computations to complete VAT and Company Tax returns can be a lengthy and costly process for businesses. The Department's research indicates the administrative burden of preparing and filing VAT returns costs the 1.8 million VAT registered businesses £310 million a year, or 30% of the total burden of dealing with VAT. On Corporation Tax, the burden of filing returns and self assessment computations is estimated to cost the 1.8 million companies required to file £330 million a year, accounting for half the total burden of dealing with Corporation Tax.[41]

24. In 2006, the Chancellor introduced a target to reduce by at least 10% over five years, the administrative burdens on businesses of dealing with Departmental forms and returns. If the Department achieved a 10% reduction in the burdens associated with filing returns, the savings for individual business would be small—around £17 per business on average for a VAT return and £19 for a Company Tax return and Corporation Tax computation. The target is an overall target that is not specific to particular taxes or stages of the tax process. The Department expected to exceed the 10% target in the burdens associated with filing VAT and Company Tax returns.[42]

Improving the service to businesses

25. The Department considered it could reduce the burden further by improving the help, advice and guidance it gives to businesses. It had, for example, introduced Client Relationship Managers for businesses within the Large Business Service to provide them with a personal and tailored customer service and manage the Department's relationship for both direct and indirect taxes. It had targeted education and support to highlight frequently made errors on the VAT return and advise on how to correct and avoid them. However, the information and advice services available online and through helplines did not always fully meet businesses' and stakeholders' needs or expectations. The Department was exploring options to improve its website in phases by 2008, for example by improving the search facility so that customers can quickly find the information they need.[43]

40 Q 101; *Financing Britain's Future-Review of the Revenue Departments*, HM Treasury, Cm 6163, paras 1.5, 1.17–1.18

41 C&AG's Report, paras 11, 3.8; Qq 62, 9

42 C&AG's Report, para 3.7; Qq 72, 73, 99

43 C&AG's Report, paras 11, 3.5, 3.8

26. Businesses have suggested that the Department could also reduce the compliance burden by simplifying the tax returns and systems. The Department had introduced a short Company Tax return for small businesses. It recognised it could make other improvements such as providing receipts for sole traders submitting tax returns, and aligning the various dates for payment of Corporation Tax, filing the tax return and filing accounts with Companies House. This improvement would enable smaller companies to submit accounts to government once and make tax payments at the same time as, rather than in advance of, filing the return. Following consultations with businesses, it had decided against removing the requirement to file a tax return for the smallest companies if they have no tax liability.[44]

27. The Department collects a lot of basic information about a business which is common to both taxes. Because it operates separate systems for each tax businesses often have to provide the same information more than once. The Department accepted it should aim to collect the basic information it requires from businesses once, to cover all taxes.[45]

28. The Department accepted that improving how it holds and shares information about businesses across the taxes would assist in developing a single financial account for each business, covering all its taxes, and that it should provide a single point of contact for business covering all taxes.[46] Joining up its information in this way would also help in targeting its compliance activities. It was moving towards more centralised risk assessment with improved risk tools so that it had more structured, consistent, intelligent information drawn from different tax systems.[47] This change would enable it to give a lighter touch to businesses with a good compliance record. It would also be able to intervene in different ways to help businesses comply rather than always undertake more costly enquiries.[48]

29. The Department acknowledged that it had a long way to go in making it easier for businesses to comply and that it could learn from the experience of other tax authorities and the private sector.[49] It considered it needed to improve its understanding of the way in which customers wanted to do business with the Department.[50] The process of organisational change was continuing and most of the planned improvements in customer experience were unlikely to come into force before 2011.[51]

44 C&AG's Report, para 3.5; Qq 8–9, 76–77

45 Q 84

46 Q 82

47 Q 59

48 C&AG's Report, paras 11, 3.8; Qq 62, 9, 78, 81

49 Qq 10,18

50 Q 4

51 Qq 69, 79

Formal minutes

Wednesday 10 October 2007

Members present:

In the absence of the Chairman, Mr Alan Williams was called to the Chair

Mr Richard Bacon
Angela Browning
Mr David Curry
Mr Philip Dunne
Mr Austin Mitchell
Mr Don Touhig

Draft Report

Draft Report (HM Revenue and Customs: Filing of VAT and Company Tax returns), proposed by the Chairman, brought up and read.

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

Paragraphs 1 to 29 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Sixty-fifth Report of the Committee to the House.

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

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned until Monday 15 October at 4.30 pm.

Witnesses

Wednesday 16 May 2007

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Oral evidence

Taken before the Committee of Public Accounts

on Wednesday 16 May 2007

Members present:

Mr Edward Leigh, in the Chair

Mr David Curry	Mr Don Touhig
Mr Philip Dunne	Mr Alan Williams
Mr Sadiq Khan	Mr Iain Wright
Mr Austin Mitchell	Derek Wyatt
Dr John Pugh	

Sir John Bourn KCB, Comptroller and Auditor General, and **Jane Wheeler**, Director, National Audit Office, were in attendance.

Mr Marius Gallaher, Alternate Treasury Officer of Accounts, HM Treasury, was in attendance and gave oral evidence

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

FILING VAT AND COMPANY TAX RETURNS (HC 102)

Examination of Witnesses

Witnesses: **Mr Paul Gray CB**, Chairman and **Mr Geoff Lloyd**, Director of Company Tax and VAT, HM Revenue and Customs, gave evidence.

Q1 Chairman: Good afternoon, welcome to the Committee of Public Accounts where today we are considering the Comptroller and Auditor General's Report, *Filing VAT and Company Tax returns.* We welcome back to our Committee Paul Gray who is Chairman of HM Revenue and Customs. Would you like to introduce your colleague?

Mr Gray: On my left is Geoff Lloyd who is the director in the department responsible for corporation tax and VAT.

Q2 Chairman: Could we please start by looking at the problem of businesses that fail to file accurately and on time? If you look at paragraph 1.8 which you can find on page 11, you will see there that it says: "The Department does not have a detailed understanding of the businesses that fail to comply with both taxes or whether there is any correlation between businesses that file late and those that file inaccurate returns". Why do you not know which businesses present the greatest problems in filing their tax returns? This is fairly fundamental, is it not?

Mr Gray: We are developing our risk profiling in relation to both of the taxes. We are pretty clear that in relation to both VAT and corporation tax looked at individually, we are not unduly concerned about the degree of tax at risk as a result of filing after the due date, but we are doing further work to refine and improve our risk profiling and, in particular, one thing we are currently looking at—and it flows from the discussions we have had with the National Audit Office—is whether, in looking at companies who file late in relation to both those taxes, there is further focus we should be bringing to bear on them.

Q3 Chairman: If you look further down that page, you will see, it follows on quite logically, "The tax consequences of late filing". It says there in that paragraph 1.9 on page 11 of the Comptroller's Report that: "At least £1.5 billion of tax revenue was in doubt from late and non-filed VAT". This, by any stretch of the imagination, is a massive amount of money so why do you not have a target to reduce this?

Mr Gray: That figure, which is predominantly in relation to VAT—as the Report brings out, over £1.3 billion of that is the VAT, the lesser remainder is corporation tax—is the estimated value of the automatic assessments that we make and issue to companies who are late in registering their VAT. It is not a measure of taxes we are in some sense missing, it is a measure of the amount of tax we estimate to be due from those who have not filed on time. Setting a target to reduce the amount of tax we are seeking to recover from them would not make much sense. The underlying issue that your question flags up is whether we ought to have a different or more aggressive target in relation to reducing the number of companies who do file late so that we reduce that degree of uncertainty. The view we have taken and the NAO Report brought this out, is that in relation to VAT in particular earlier efforts that we have made to push up the extent to which companies do file on time does not seem to us to have produced any very significant rewards and our conclusion is that we are better placed in focusing our compliance effort on other dimensions. Having said that, and as is brought out in the report, we are keen to deepen our analysis to make sure that there are not some issues that we are missing.

Q4 Chairman: Could it be a general problem with your organisation that you are not sufficiently conscious of your customers' needs and their businesses and that your consumer relations with your client base are perhaps not as strong as they should be?
Mr Gray: As a general point I am committed to doing a lot more to make sure we do understand the way in which customers wish to do business with us in order to encourage their natural compliance. In relation to this particular issue, the question is more about where we put our compliance intervention effort. Do we worry about lateness as such or do we put more of our effort into pursuing those returns that we do get on time where the amounts are incorrect and we need to follow it up? Our analysis, up to this point, has suggested we are better off and there are better returns to us by focusing on incorrectness rather than pursuing lateness as such. As I said in the previous answer, if a VAT return is late, we make an automatic assessment to ensure that we are in a position to recover tax. On corporation tax, we do something broadly similar where, if we believe there may be tax due, we issue a determination, rather than an assessment, to make sure that we are pursuing any overdue tax.

Q5 Chairman: So it seems to me from what you are saying that your priority is not to pursue lateness, but to try to improve accuracy. Is this why, if you look at figure 3 on page 12, it seems to suggest that only half the companies who file late routinely get a penalty? Is that right?
Mr Gray: I assume you are looking at the figure in the top right hand corner, the 56%.

Q6 Chairman: Yes.
Mr Gray: I agree that that figure does look surprisingly low and in preparing for this hearing, it is something I have had a detailed look at. The way in which we agreed with the NAO to present figures in the report was that we based that percentage on what you might describe as the upper bound, the upper limit of the number of returns that might potentially be due. In fact, in quite a proportion of areas we do not actually issue a return for various good reasons. If this percentage were calculated in relation to those cases where we have actually issued a return and asked for it to be sent in, that 56% figure goes up to something in the high 80%. I agree that is also an issue we need to look at. There are some cases where it is not appropriate to have an automatic penalty, for example if a company is in liquidation, but we are certainly working to improve the effectiveness of all this and as part of a review of our powers which you know we are going through, at various stages we will be reviewing the position and the provisions on late filing penalties and considering whether we do need to do anything further.

Q7 Chairman: We have on page 15 a description of: "The challenges to achieving full mandatory online filing by 2012". It is going to be a big issue I would have thought. How are you going to ensure you provide a good quality service to business?
Mr Gray: We are working on a number of fronts to improve the quality of our service. As you know from the Report, the current proportion of companies filing online for these taxes is relatively low. It is now starting to rise quite rapidly, but it is still only 9% for VAT and 7% for corporation tax,[1] so there is a long way to go. We are operating over the next couple of years on a number of fronts. One is trying to improve the quality of the service that people get when they come to us online. I am very pleased with what we have done in some of our other tax areas, for example on self assessment we had a huge increase last winter in the proportion of people filing online for self-assessment, indeed we have already hit the target we were set for 2008 on that. We are now applying the same types of investment into our facilities for the other taxes. As you know, it was also decided at the Budget time to put back by a year or so the deadline for mandatory online filing and part of the reason for that was to make sure that we were getting all our systems and processes in good shape so that as we get towards mandation, hopefully we will already be a long way down the track of people being happy to use our service voluntarily.

Q8 Chairman: How are you going to try to help small businesses? For instance, one example is dealt with in paragraph 3.5 which you can find on page 22. It was suggested: "that the Department could reduce the compliance burden further by removing the requirement to file returns from those businesses with no tax liability and more generally simplifying the tax systems and returns". What do you say to that?
Mr Gray: That is actually an issue that we have pursued and it came out of the discussions with the NAO. It was a particular proposition we actually put to our Corporation Tax Operational Consultative Committee and our customer base on that group did not want to go down this route for a number of reasons. They pointed out that under company law provisions they were already going to have to prepare accounts. Quite a number of companies would still be keen actually to file a return in order to establish either a nil liability or indeed a loss position to carry forward in future years. Having had a rather negative reaction from our customers to this proposition, we are not currently pursuing it.

Q9 Chairman: Very quickly then, how are you simplifying filing for the smallest businesses? Is this a priority for you? Are you interested in the subject?
Mr Gray: We certainly are and your Committee had a hearing with me three weeks ago on small businesses and I tried to point then to a number of

[1] *Note by witness*: Year ended 31 March 2007, percentage of VAT returns filed electronically was 8.62%; 6.86% for Corporation Tax.

the ways in which we are making it a lot easier for small businesses to do business with us, for example introducing the short tax returns, more simplified guidance and so on.

Q10 Derek Wyatt: This is a counter-intuitive thought. I have always felt that in the National Health Service, if you are well, you should get paid for it because you have saved us lots of money. Is there a possibility that if you were to give your tax returns in early or on time, you could get rewarded for that? Have you done any research and work on the fact that if you were to give, say, £150 for people to be early or £200 to be on time, people who are late would start to think there was some reason to get it in on time? Does any other country in the world offer the counter-intuitive approach that if you are early we will give you some benefits?
Mr Gray: We have done work on this and I have had discussions on this with my counterparts in other countries. We have not gone for an approach under which we have introduced a financial bonus, if I may put it that way, for filing early. We do, of course, have the opposite arrangement that if you file late, then there are penalties. We have introduced the financial differentiation of that sort. The area we are putting more work into now is trying to make sure that companies who behave in an appropriate way with us—file on time, act in a cooperative way, get the kind of non-financial benefit, but nonetheless very valuable benefit that in our risk assessment of whether we need to pursue enquiries with us—they will acquire a good and a positive risk rating by comparison with others who do not. Certainly the idea of differentiating behaviour is something we are both doing and implementing; we have not gone down the route of actually introducing a positive financial incentive to do things on time or early rather than applying the negative financial incentive the other side.

Q11 Derek Wyatt: But in customer relationships, if you give an advantage, people like it. They like getting things. Given that probably we do not like sending in our returns to you, particularly because it is our money, so we try to obstruct, if we can, because we want to keep our money, that is what we think about tax by and large in business. That is a crude analogy but we do tend not to want to do these things though of course we want to file on time because we get fined. I am just saying in a customer relationship why can you not pilot some schemes to see whether in fact 90% get in early because you have incentivised it?
Mr Gray: We are incentivising early behaviour as distinct from late behaviour.

Q12 Derek Wyatt: You are fining as opposed to rewarding.
Mr Gray: The issue, when we have a tax system which determines the amount of tax that is due to be paid, is that I might expect questions from this Committee and elsewhere if I were positively going out and saying I was now going to collect less than the due amount of tax simply because they have done the right thing.

Q13 Derek Wyatt: But actually when you are pursuing the cases of people who have not sent it in, it is hundreds of thousands of people. How much are not collecting? People are late, which means we are not getting it so we have to borrow.
Mr Gray: For late payments, and this is slightly different under the two taxes we are looking at here, we are actually applying either an interest charge or a penalty. We have the financial differentiation, we are covering, through those interests and penalties the cost to the Exchequer of the money coming in later.

Q14 Derek Wyatt: How much are you missing? How much is late, two years late? Lots of them are not filing on time.
Mr Gray: The Report brought out the numbers that are not filing on time. There is a difference between the proportion of numbers of people who are not filing on time and the proportion of tax due which is being filed on time. By and large, the record of the big payers is significantly better than the small payers and for corporation tax in particular, although there is a significant proportion of people not filing on time, the last exercise we did suggested that 87% of the companies who had not filed within 12 months in fact had ceased trading, so there was actually no liability.

Q15 Derek Wyatt: This is a question of ignorance really. Who is giving you the advice or running your website team? What company is responsible for that?
Mr Gray: It is a combination of our in-house services; it is predominantly run in-house. We have a range of support contracts organised through our overarching IT supply contract with Capgemini but they subcontract to other people.

Q16 Derek Wyatt: When I fill it in online—and I do not at the moment—when I think: “Help, I’m not absolutely certain what you want me to do in this particular piece” does a voice come out to say: “You may be feeling nervous here, here are three examples”? How helpful is the experience?
Mr Gray: We do not have voice guidance at the moment. We do have online written guidance. It is one of the areas in which we can do better than we are doing at the moment. The experience is reasonably okay at the moment but it is certainly an area where I want to put a lot of effort into improving that experience.

Q17 Derek Wyatt: So whose responsibility is that? Is that Capgemini or is that your internal design team?
Mr Gray: I regard all these things as my responsibility for delivering service to the right standard. If I choose to contract any of that work to other people, I do not regard that as contracting out the accountability for making sure that we do things to the right standard.

Q18 Derek Wyatt: Where would you say there is better practice in the world on online filling in of tax returns?
Mr Gray: A number of our fellow fiscal authorities around the world are slightly ahead of the game compared with us; Australia would be an example where they have gone further and faster than we have. In the earlier hearing I had with the Committee a few weeks ago in relation to small businesses, we brought out there that we are looking to learn lessons from them and others. I also regard other private sector financial businesses as being a very close comparator of the sort of customer experience we should be aspiring to give to people.

Q19 Mr Touhig: You issued fewer penalties to companies who were late sending in their returns in 2005–06 compared with previous years. Why was that?
Mr Gray: I am not sure I can give you a precise explanation of that. The numbers were somewhat down, as you found from the Report. There was no material change in the nature of the penalty regime. Each year, where the penalty is not absolutely automatic, which it is in some cases, our staff are obviously making a judgment about whether a penalty—

Q20 Mr Touhig: Were they more lax perhaps in later years do you think?
Mr Gray: Lax is a rather pejorative word. The net result was that we issued somewhat fewer penalties. I do not regard the change between those two years as absolutely dramatic. In any series of this sort, I would expect the numbers to tend to go a little bit up and down and you are rightly pointing to a year in which it went down a bit.

Q21 Mr Touhig: Do you monitor that closely and find the reasons why?
Mr Gray: We seek to do that, but I do not regard ensuring that we hit a particular percentage of penalties as something which should be one of the primary things that drive our business. Other considerations about the effort we are putting into making sure we are getting the right amount of tax are probably ahead of that criterion for me.

Q22 Mr Touhig: I am sure that is music to the ears of those who give you the proverbial two fingers and who get their tax returns in late and consistently get them in late.
Mr Gray: People who get them in consistently late will be penalised and, as I said in my last answer, it is not that we were changing our practice, this was the net result of the behaviour of the people filing and the response of our staff to their behaviour.

Q23 Mr Touhig: How does this compare in terms of numbers and percentages of penalties against companies compared with the individual who fails to get his tax return in? Do you pursue individual tax, people who fail to get their tax returns in, as much as you do the companies?
Mr Gray: In relation to the automatic timing penalties, we seek to operate on a comparable basis. The Report brought out in table 3 the particular penalties and there are two automatic time penalties which kick in automatically. The position for self-assessment, which is individuals and self-employed, is essentially a similar approach on those automatic time-based penalties as it is for companies. When we get into the kind of ramping up of penalties where it is not just a time issue but there is an assessment issue, then again we seek to be even-handed about this.

Q24 Mr Touhig: The Report also tells us that in 2005–06 the number of penalties for late payment of VAT rose, so you did move in the other direction there. Why was that?
Mr Gray: This was not a particular kind of target-driven behaviour; it was the net result of the filing behaviour and our predominantly automatic response to that according to how many people filed late and how many filed on time.

Q25 Mr Touhig: Why do you not know the overall value of the penalties imposed for filing company tax returns late?
Mr Gray: It is a part of our management information that, as the Report brought out, is deficient. It is something that I am seeking over time to put in place. As in any big organisation, there is always scope for improving management information and that is something I would, in due course, like to have. Again, I do not regard it as a completely fatal flaw in terms of our ability to operate a sensible penalty regime.

Q26 Mr Touhig: You were acting Chairman for a while and you have been appointed Chairman now. Is it one of your priorities to look at this?
Mr Gray: It is on my list. I would not say it was absolutely near the top; I am keen to do a large number of things in the organisation. This I would have somewhere down in the middle of my list because, although it is unfortunate that we cannot provide those figures, it does not fatally affect our ability to operate the tax system effectively.

Q27 Mr Touhig: Following on from some points Mr Wyatt made, do you have a range of non-financial penalties for failure to get the tax return in on time?
Mr Gray: We have the sort of obverse of what I was trying to say to Mr Wyatt in that if we associate lateness of filing in our risk profiling with other characteristics that suggest a relatively low compliance attitude on the part of the taxpayer, whether it is inaccuracy of returns or any other factor, then our main non-financial penalty is that we will take a rather closer interest in the way in which that company conducts its tax affairs. They are more likely to attract our attention and to attract compliance visits and that is a very real penalty for people who are inclined to be less compliant than others.

Q28 Mr Touhig: Does a compliance visit mean sending somebody out to the company?
Mr Gray: It might be that, or it might mean—

Q29 Mr Touhig: That is quite labour intensive and time consuming.
Mr Gray: It is and it is not the only way in which we pursue things. We can, within the penalty regime where we are moving beyond the purely time-based penalties, adopt a more rigorous attitude, particularly if we believe that there is inaccuracy in relation to the assessments that companies have provided us with.

Q30 Mr Touhig: Some countries do have sanctions other than financial penalties. Have you considered looking at that? Have you looked at it? Is there anything we can learn from it?
Mr Gray: I am always keen to learn from other countries. It would be fair to say though that in the discussions I have with my counterparts in other countries there is a general trend, of which we are part, towards concentrating non-financial activity around the degree of attention which we are giving to relatively non-compliant taxpayers and indeed we have quite a lot of approaches from other countries to us seeking to learn from some of the things we have been developing.

Q31 Mr Touhig: I challenged you earlier about being lax in terms of pursuing the fixed penalties, but the Report also tells us that fixed penalties imposed on companies who file late returns are not generally a deterrent. That is quite the other side of the argument. Why is that do you think?
Mr Gray: There is a range of reasons. The initial fixed penalties at £100 or so for some people may be regarded as a relatively modest price to pay. I am sure in lots of cases, businessmen and businesswomen are busy people, tax returns and tax obligations do not always sit on top of people's in-trays, it is even true for me with my own self-assessment form.

Q32 Mr Touhig: Do you get yours in on time?
Mr Gray: I am pleased to tell you I have not paid a penalty recently, but I would be liable if I were late. It is a range of behavioural things. I would describe the way in which the levels of penalties have been designed at that initial level as being a slap on the wrist rather than anything more penal. The more penal things are when we are into more serious non-compliance.

Q33 Mr Touhig: I follow on from what Derek Wyatt said earlier and I thought there was some merit in the arguments that he was putting about having some sort of financial incentive to get the return in. The Report tells us that financial penalties actually do not deter those who every year will get their return in late and pay the fixed penalty and they do not much care about it. The Report also tells us you are looking at systems of rewards for companies that have a good compliance record. Following on the points that Derek has made, would you be looking at some sort of incentive saying: "If you get your return in on time, this is what we can do"?
Mr Gray: As I said in response to his questions, we have been looking essentially at non-financial ones and although I quite recognise the argument both of you are making, there would be some significant concerns, in a tax system which is designed to say that this is the right amount of tax to pay, particularly in a transaction tax like VAT, about consciously saying okay, if you do the right thing you do not have to pay the full right amount; there would be issues and concerns about going in that direction. What I do fully accept is that there is scope for sharpening the differentiation behaviour however we construct the incentive penalty regime around that.

Q34 Mr Touhig: As the Chairman pointed out at the beginning, at least £1.5 billion tax revenues were in doubt from late and non-filed VAT and company tax returns in mid-October 2006. If I were the Chancellor getting up to make a Pre-Budget Report, I would be rather worried whether I would have the money at the end of the day.
Mr Gray: The fact that it is in doubt does not mean that it is not all going to be collected. The point I made to the Chairman was that on the VAT side we automatically generate an assessment in order to protect the position. That is not to say I would not prefer to be in a position in which nobody makes their filing late. The choices I and the organisation inevitably have to face, as in any organisation within a fixed pool of resource, are where I get the most bangs for the bucks in intervening. The point I was trying to make to the Chairman was not that we could not get some bangs by going harder on lateness, but our judgment is that we get more bangs by concentrating those resources on things like inaccuracy.

Q35 Mr Dunne: The Government set targets for online filing for individuals which were hopelessly ambitious and they have cut those targets substantially. The targets set for online filing for companies and VAT appear to be pretty ambitious too and your progress in meeting those targets obviously, as you have acknowledged, is improving but has been very low. If I hear you correctly, to achieve the target you have got to get your VAT proportion of returns filed online up from 9% to 35% and up for corporation tax from 7% to 50% in less than 12 months. How are you going to do that?
Mr Gray: The honest answer is we are going to struggle over the next 12 months, particularly in relation to the VAT target. If you allow me to say so, I did not quite accept the premise of your question that we have been hopelessly ambitious in relation to individuals. In fact, on the self-assessment target, which was 35% in 2008, we have actually hit 35.5%[2] in 2007. On that one we have made better than target progress.

[2] *Note by witness*: The percentage quoted in the Spring 2007 Departmental Report is 35.1%.

Q36 Mr Dunne: Could you just remind the Committee what the original target was for 2008?
Mr Gray: That is the target that I have been operating with, in the current spending review of 35%.

Q37 Mr Dunne: I think it was much higher than that and it was reduced to 35%. That was perhaps before your time. This goes back to President Clinton and Mr Blair who set targets for each country at a fairly early stage in the current Government's life which were then reduced. The Americans met their targets; the British did not, as I understand it.
Mr Gray: My recollection may be hazy as a lot of those targets were around the 100% availability of online facilities as much as the percentage of people who were making use of the facility. Nonetheless, in relation to your immediate question on the corporate taxes and particularly on VAT, our progress has been, up to this point, slower than I expected. I obviously hope we are able to put on a real gallop and hit some interim targets in a year's time but they are ones that it is possible we may miss.

Q38 Mr Dunne: Are there significant cost benefits to the department of processing online returns compared to paper returns and can you indicate some order of magnitude?
Mr Gray: Yes. There are significant benefits to us. The average cost for us of doing a corporation tax paper form, and Geoff Lloyd will correct me if I get this wrong, is of the order of about £20 a time[3]; for online the figure is really quite a small fraction of that. At the same time, we are also mindful of ensuring that we do not just transfer cost from us to the company in terms of their position, but the evidence is that actually there is a helpful saving from the company point of view of the order of 1% to 2% in that it is less costly for them. It is less costly for us and the thing I would probably put slightly more weight on, which has certainly been our experience with self-assessment, is that the potential for error in online transactions is, on average, rather less than it is on written transactions because there are so many fewer opportunities as things are being taken from paper and keyed into machines. The quality issues are at least as important as the cost issues.

Q39 Mr Dunne: Indeed and now with the almost universal availability of broadband across the country the availability of online filing is greatly improved and it is in your interest, the taxpayer's interest and the filing entity's interest, to use the online facility.
Mr Gray: It is.

Q40 Mr Dunne: Why is it then that so few businesses, particularly small businesses, are aware of the online bounty, which I understand is applicable, of £150 to file online and aware that that should be completed by Saturday this week. I refer you to the *You Gov* poll in the *Financial Times* of last week which indicated that 28% of the 1,386 companies they interrogated were not aware of the deadline.
Mr Gray: I cannot give you a precise explanation of that. There is less awareness than one would like there to be. I am sure with the benefit of hindsight we may have been able to do better in terms of our own information provision and guidance. It is also similar to the point I was making to Mr Touhig that busy business people have a lot on their minds and their awareness of these things is less than we might wish. Certainly going forward, I am extremely keen and committed to making sure we do ensure that our provision of information and marketing of the online opportunity gets better.

Q41 Mr Dunne: May I ask you about the bounty? When was it introduced?
Mr Gray: I am afraid I do not have that figure in my head.
Mr Lloyd: I think you are referring to the amount for employer returns which is not the corporation tax.

Q42 Mr Dunne: This is the PAYE then.
Mr Lloyd: Yes.

Q43 Mr Dunne: It does not apply to corporation tax returns; there is no bounty applying to that?
Mr Gray: Nor for VAT; that is right.

Q44 Mr Dunne: Do you think you ought to consider an incentive to encourage people to file on time and online?
Mr Gray: In terms of on time I have sought to respond to your colleagues that, although it is an interesting idea, there are cons as well as pros of us consciously reducing the amount of tax we are collecting below the due level. In terms of online, we have not at this stage gone down that route in relation to the corporate taxes. As Geoff Lloyd pointed out, we did do that in relation to employers' PAYE returns. We are still in the process of evaluating whether the online premium that we gave people has offered good value or not. There is always a danger in economist jargon, particularly when the underlying trend is going up very sharply, of significant dead-weight and whether it is a good use of public money to pay people—

Q45 Mr Dunne: Do you mean rewarding the good behaviour of those who would behave properly anyway is not something you want to encourage?
Mr Gray: Behaving properly is a description that I would apply to on time. Whether I would regard it as proper in terms of online—

[3] *Note by witness*: Table 1 of the NAO's Report indicates that the cost to HMRC in 2005–06 of processing CT returns was about £4 per return (1.3m returns processed at a cost of £5.1m). HMRC estimates that a typical business will save £20 of its costs in filing a company tax return electronically (see paragraph 2.3 of the NAO's Report).

Q46 Mr Dunne: You have already just conceded that it is cheaper for you, for the taxpayer and for the company to file online and therefore it is good behaviour.
Mr Gray: It would be good value if we were actually able to direct the money to the people who would not otherwise do it. Giving the money to people who are going to do it anyway is the problem.

Q47 Mr Dunne: And that is your objection to the proposals in table 11 on page 24 for financial incentives that the NAO recommend and I accept that argument. Have you considered providing incentives for those companies who file late either on the second occasion or the third occasion and rather than hit them penalties, have you considered giving them incentives for them getting those filings in on time, online?
Mr Gray: No, we have not, to be honest.

Q48 Mr Dunne: May I suggest you have a look at that? It is a good suggestion from the NAO and I accept your argument on the first point. Just in relation to the other recommendations in table 7, the experience in other countries, are there any specific issues that have been raised by the NAO for improving online participation that you have recognised as something you could introduce or should consider introducing here?
Mr Gray: I cannot point you to anything very specific, but certainly all the issues that were brought out in that table and particularly around mandatory online filing we are obviously pursuing following the Lord Carter's Report. The table does bring out that there is one country, Mexico, that has gone for the monetary rewards approach and we have talked about that. It is certainly very helpful to have the further input from the NAO study that causes us to look a little more intensively at some of the things other countries are doing.

Q49 Mr Dunne: May I suggest you also look at the Irish experience? The tax clearance certification seems to be an interesting route to improve performance. Final question on table 14, pages 32 and 33. The flow of the process shows that at the end of the process, if someone has provided a validated form for their corporation tax, HMRC acknowledges the self-assessment or gives notice of a correction for a corporation tax form submitted by a company. Does it do the same for a partnership or for a sole trader and if not, why not?
Mr Gray: I am afraid I do not have that answer in my head.

Q50 Mr Dunne: The reason I raise it is that I have had constituent issues raised with me from tax advisers who submit returns on behalf of small businesses and are no longer able to be given a receipt by the local tax office because the procedure has changed. They are no longer able to prove to the Revenue or their client that they have submitted their return on their behalf. This is something which is quite wrong and I would urge you to look into that.
Mr Gray: I entirely take the point and I will happily look into it.[4]

Q51 Mr Wright: In 2005–06 85% of VAT returns and 79% company tax returns were filed on time; 74% of businesses filed and paid VAT on time in 2005–06 and 60% of companies filed their company tax return and paid their corporation tax on time, a slight decline. They seem very low to me. Are they?
Mr Gray: They are not low in relation to our recent historic experience. Those are the trends.

Q52 Mr Wright: Are they lower internationally?
Mr Gray: I am not sure to be honest.

Q53 Mr Wright: You do not do comparisons as to how European companies file and then pay VAT.
Mr Gray: We certainly do look at that, but I am afraid I do not have that material in my head.

Q54 Mr Wright: Is there a sense that, as you said, the trend has been around these numbers for quite some time? You said, and it was an interesting couple of quotes, that this is not absolutely near the top of the list and you said in terms of the resources of the organisation you want bangs for your buck. Is it just a case that you have an implicit feeling that it is always going to be round about this figure and if you throw any more resources at it, as you have done in the past when nothing has happened, you are just happy to keep it as it is? Is that true?
Mr Gray: I would take a rather different view if our assessment was that lateness was leading to significant losses of tax. I made the point earlier that although we do have significant proportions for both taxes where the filing is late, I am reasonably satisfied about the arrangements we have in place, via assessments for VAT and determinations for corporation tax, that we are still in the position to collect that tax. As I said earlier, if there were no other constraints in the world, I would push harder in this area. What is more important, as I said earlier, is trying to make sure we improve the accuracy level.

Q55 Mr Wright: May I just ask about that? I am interested in your accounting systems. When do you actually recognise the revenue? What is the point at which HMRC recognise the revenue? Is it when you issue the assessment or is it when the cash comes in?
Mr Gray: We have increasingly moved over recent years to a resource or accruals accounting basis, so we are accruing now rather than being purely cash accounting.

[4] *Note by witness*: When self assessment tax returns are filed online, receipts are given automatically. Postal services offer various facilities, including receipts and the ability to "track and trace" the progress of posted items both online and by telephone. It is not HMRC policy to issue receipts when returns are handed in at their enquiry centres. However, in 2005, the Working Together Steering Group, a consultative forum which comprises representatives of HMRC and tax advisers professional bodies, agreed a satisfactory "audit trail" which will normally be accepted as "reasonable" evidence of delivery.

Q56 Mr Wright: So how much debt do you write off on a year-by-year basis with regards to VAT and with regards to corporation tax?
Mr Gray: I wonder whether Geoff can help me with figures on that. We do have figures for how much we write off.
Mr Lloyd: We have written off around 2% of the VAT in 2005–06.

Q57 Mr Wright: Is that just a general assumption that you expect to get in a certain figure, you will write off 2%, rather than individual accounts?
Mr Gray: That is the net result of a lot of individual accounts.

Q58 Mr Wright: And how much is that?
Mr Lloyd: It is £1.5 billion. May I just add to the previous point that you were making about amounts received? We actually receive quite a considerable amount of the corporation tax before the return is due, not simply after. 80% of our corporation tax comes in through quarterly instalment payments and all four of those quarterly instalments are actually made well before the return itself. We are not simply looking at the difference between the date of return and some tax that is due afterwards, it goes both ways.

Q59 Mr Wright: May I ask about information that you receive, paragraph 1.8, and the Chairman alluded to this?: "The Department's understanding of the small and medium sized businesses that fail to file Company Tax returns on time is at local level only—as developed by the Area Office inspectors responsible for those companies". Do you think that is reasonable or do you think the level of control should be much stronger?
Mr Gray: That is an historical arrangement that we are seeking radically to move away from and to move to a much more centralised risk assessment. One of the first things that I and my predecessor did following the merger of the former Revenue and former Customs was to move our organisational structure away from an essentially regional geographic base to an essentially functional base. Although we still obviously have staff around the country, we are seeking to manage and drive the business much more on a centralised basis and we are developing centralised risk tools. We still have some way to go on that, but going away from local nous to more structured, consistent, intelligent, drawing information from different taxes so we are building a much better overview of the business or indeed the individual that we are dealing with.

Q60 Mr Wright: And you think that is compatible with efficiency savings and the tens of thousands of job losses that HMRC have carried out and will be carrying out in future years to meet the 5% real savings year on year?
Mr Gray: It is not only consistent it is actually a rather important enabler.

Q61 Mr Wright: But that loss of collective memory on a regional basis is surely an important factor?
Mr Gray: The direction in which we are going is seeking to make sure that our memory and intelligence from whatever source is captured and codified in our systems. That is going to be a lot more effective than it just resting in individuals' heads. We are obviously seeking to make sure, as numbers in the organisation do decline, that we do all we possibly can to capture and retain that memory and then systematise it better.

Q62 Mr Wright: May I draw your attention to page 7 (i) "Getting tax returns in on time"? The NAO seems to have made a perfectly reasonable recommendation about identifying the risk factors by sector. In the Report it seems to happen with regards to VAT; paragraph 1.7 seems to say there are certain traits of relatively poor filing performance, but that is not the case with company tax. Have you hazarded a guess as to which sectors are poor in terms of corporation tax?
Mr Gray: What the Report was saying in relation to both taxes is that we ought to be developing and improving our risk assessment not just by sector but by a range of other characteristics. What emerges from the work we have done so far, but we are putting more effort into that, is that particular sectors often are not a primary driver of relative risk. We are obviously always on the look-out to see whether there are particular sectors, and what we are looking at in particular now is whether there is a correlation between lateness and particular sectors and a correlation in which lateness in one sector seems to be a major cause of non-compliance. The results so far suggest that is not the case in most sectors.

Q63 Mr Wright: Is there any correlation between regions, say the North West might be slow at paying compared with the South East? Do any enhancements take place with regard to that?
Mr Gray: I am not sure we do give a lot of weight to that.

Q64 Mr Wright: Does any analysis take place with regards to that?
Mr Lloyd: The key correlation we are finding is between the size of the business and, as the Report says in paragraph 1.10, the sectoral cut and looking at large business we are seeing very much a reduced level of risk.

Q65 Mr Wright: But would you know whether it was a regional basis or not? On page 7 it says: "The Department did not, in 2005–06, monitor whether individual Area Officers met targets for processing returns promptly and accurately". I would have thought that would have been a key performance indicator, but that does not seem to be the case.
Mr Gray: I would accept that that is a past deficiency that we ought to be putting right; we talked earlier about deficiencies in management information. What we are now looking to do though is potentially streamline significantly the way in which we do the processing. As the Report brings out, there is a very sharp difference at the moment between the way in

which filing is done for VAT, where it is all done in a single centre in Southend in the former Customs site and corporation tax, where it was traditionally done in a large number of network offices around the country and was not done as a specialist task. It was often done alongside compliance work and other things and we are now definitely looking to put in place the more rigorous information you are talking about and there is a presumption over time that we will probably move to more specialised, more centralised areas in order to improve that very control point.

Q66 Mr Wright: Page 10, figure 2. There has been a virtual doubling of assessments in terms of VAT returns outstanding at mid-October 2006 not replaced by a late return. I may have misunderstood that but that is quite disturbing. Is there a significant loss to the Revenue because of that? Table 2, between 2004–05 83,000 assessments and 2005–06 150,000 assessments which were not replaced by a late return. Is that a disturbing trend or have I just misunderstood that?
Mr Lloyd: The simple answer to that is because we are talking about an earlier period where they have had longer to be replaced by a return. Less time has elapsed since the figure of 150,000 for 2005–06 for a return to be issued and for it to be replaced.

Q67 Mr Khan: You mentioned earlier on your issues of priority and in answer to a question you explained that a certain issue was not an issue of priority. How much of a priority is customer service to you?
Mr Gray: A very high priority.

Q68 Mr Khan: The biggest demand businesses have is a single point of contact. How are you meeting that request?
Mr Gray: Over the course of the next two to three years that is a very big priority for us as an organisation. Again, it was something that was discussed in the hearing a few weeks ago.

Q69 Mr Khan: How soon before a business has a single point of contact? It is 2007 now.
Mr Gray: It is likely to be 2010 or 2011.

Q70 Mr Khan: So another four years before their desire to have a single point of contact has meant that customer service is your highest priority. How high a priority is reducing cost for businesses?
Mr Gray: Again, that is a very significant priority.

Q71 Mr Khan: As high as customer service or below customer service?
Mr Gray: Broadly balanced between the two. I have explicit targets for both and I am seeking to meet both in parallel.

Q72 Mr Khan: 30% of the total burden of dealing with VAT is the administrative burden of preparing and filing VAT returns. The Chancellor of the Exchequer has imposed a target upon you of reducing that by 10% over five years from 2006. You are going to meet that target presumably.
Mr Gray: I very much hope I am going to exceed it.

Q73 Mr Khan: 50% of the total burden of dealing with corporation tax is the administrative burden of filing and preparing corporation tax returns. How much are you going to reduce that by?
Mr Gray: That is covered by the same target of 10% because that 10% target was not specific to a particular tax regime.

Q74 Mr Khan: We know the Chancellor of the Exchequer has assisted you in that goal by imposing this target upon you. The NAO have also tried to help you and have given you some ideas on how you can reduce the cost to business. Idea number one is to remove the requirement to file returns from those businesses with no tax liability. The Chairman referred to this in his opening questions and your answer was no.
Mr Gray: My answer was that that was a proposition that we put forward that we are perfectly happy, indeed keen, to pursue and in response to reaction from our customers we concluded that if they do not want it, we will not force it on them.

Q75 Mr Khan: Mr Gray, you have used 42 words to say no. You are not going to go ahead with that recommendation are you?
Mr Gray: At this stage, no.

Q76 Mr Khan: Right. The second thing the NAO recommended is to simplify the tax systems and returns; paragraph 3.5 of their Report alludes to this. What is your response to that recommendation to try to reduce the cost to businesses?
Mr Gray: We are very keen to respond to that and are looking to see how we can best meet that.

Q77 Mr Khan: The third recommendation they make in broad terms is that you could align the dates for payment of corporation tax, the filing of accounts to Companies House and the filing of the company tax return, which would reduce the cost to business. What is your response to that recommendation?
Mr Lloyd: We are looking to allow joint filing for Companies House and for HMRC in parallel with the mandation of CT online in 2011.

Q78 Mr Khan: Also 2011. The other recommendation they make is to introduce better interventions rather than costly inspection inquiries to help businesses comply. What is your response to that one?
Mr Gray: Yes.

Q79 Mr Khan: Yes; you agree with that. Also 2011?
Mr Gray: I hope we can do that more quickly than that and progressively roll that out over time.

Q80 Mr Khan: Roughly when?
Mr Gray: We are already on that road.

Q81 Mr Khan: Okay. The other recommendation is to provide a single financial account to give a view of the business's financial position across the range of taxes.
Mr Gray: Which is essentially the first point we were talking about.

Q82 Mr Khan: I suspect the biggest complaint that businesses have that file both a VAT return and a corporation tax return is that they have to do two. Is that just the nature of the beast that they will have to do the two because it is inconceivable to have one form because it would be too complicated?
Mr Gray: No, it is not the nature of the beast. It reflects the way in which both the former revenue departments had structured their business on essentially a tax-specific basis and the business processes and the supporting IT systems are on that basis. What we are looking to do, and I am afraid this is the reason that all these single view things are going to take a number of years, is turn round the whole structure of the business so that we are able to take a single view across a company. Does that mean companies will be able to fill in just one simple form to collect all their taxes? Probably not. What we will be able to avoid is a duplication of basic information where at the moment, because they are separate processes, companies are having to give us some of the same basic information.

Q83 Mr Khan: How easy would it be for a company to provide one set of figures on a form for VAT liability with corporation tax liability still to be worked out, rather than providing figures on two separate forms for those two liabilities?
Mr Gray: VAT and corporation tax are very different types of tax. One is a contemporaneous consumption tax—

Q84 Mr Khan: That was my "nature of the beast" point.
Mr Gray:—and corporation tax is profits after the event. My point about the benefits to business is that there is a lot of rather basic information about a company that is common to both those taxes. At the moment, because our systems are separate, companies have to duplicate that. The deeper you get into the specific characteristics of the tax in question inevitably the information we need is going to be rather different. When we get into a position in which we are looking at those things in parallel rather than separately, it will provide very significant benefits for business and us, because taking a single view of what is going on in a company is going to be more effective and efficient for us too.

Q85 Mr Khan: You have dealt with issues about customer service and reducing the cost of business and I have taken on board your points. If we look at the actual figures, 85% of VAT tax returns are submitted on time. Should we not just accept that?
Mr Gray: Should we?

Q86 Mr Khan: Yes. Is it not just inevitable that there will always be some businesses who fail to return their VAT forms in time? How much of a priority of yours is it to try to increase that figure or have you come to accept it?
Mr Gray: As I have said to some of your colleagues earlier, relatively low on the basis of our assessment that timeliness as such is not the most important issue in ensuring we collect the right amount of tax. If our analysis—and we are doing more analysis following the NAO's recommendations—were ever to point to the fact that the 15% of VAT coming in late was having a serious impact on our ability to collect the right tax, then we focus on it, but that is not the view we are currently taking.

Q87 Mr Khan: What about corporation tax? If 77% to 79% are on time, is that acceptable?
Mr Gray: At the moment it is because it is actually slightly above the target we have been set. There is a target for corporation tax but not for VAT. We are slightly above the target and our view, and it is supported by the figures the NAO brought out, is that there is relatively little tax in doubt or at risk from those who do not file on time, predominantly because a very large proportion of those non-filers quite quickly are not in business.

Q88 Mr Khan: Do you have any analysis of the size of the businesses that are filing VAT or corporation tax late? Are they small businesses?
Mr Gray: They are predominantly small. If we looked at it in terms of the proportion of tax take rather than just weighting every business, a very much higher proportion is being filed and paid on time.

Q89 Mr Khan: If you are going to be crude and do a cost benefit analysis of the money, time, effort, energy, resources it takes to chase these companies and the tax you could recuperate, assuming they did not go under and all the rest of it, presumably the calculation has been made that it is not worth it.
Mr Gray: Yes. That has been a key bit of the calculations why—the answer I gave to some of your colleagues earlier—this is not the top of our priority list.

Q90 Mr Khan: Can you go to figure 3 and paragraph 1.2, the corresponding paragraph? It says that you raised 450,000 penalties for late filing of company tax in 2005–06 but you are not sure of the overall value of the penalties you have imposed. Have I misunderstood that?
Mr Gray: No, you have not. You have correctly understood what I said in response to one of your colleagues earlier.

Q91 Mr Khan: You impose 10 fines, for argument's sake, and you have no idea that each fine, if you add them together, comes to £200. I am making up the figures obviously.

Mr Gray: As I have acknowledged already, it is a deficiency in our management information at the moment. What we are talking about for the nature of the penalties is that some are flat rate and therefore it is very easy to do the sums but others are percentage ones and that is what underlies the deficiency in our management information at the moment and why we cannot—

Q92 Mr Khan: That will be sorted out by . . . ?
Mr Gray: I do not have a precise target date for that and although this is a deficiency, it does not feel to me like the most important thing I need to fix in the organisation.

Q93 Mr Khan: You have made a conscious decision that that is not one of your priorities.
Mr Gray: Yes.

Q94 Mr Khan: My final question is on the issue of online filing. Mr Dunne spent quite a bit of time on this. The mandatory online filing for VAT has been deferred to 2010 with company tax returns 2011 and we rehearsed the reasons why there are advantages on both sides for it to be done online. What work are you doing before then to ensure that companies who I suspect, if we were to stereotype and generalise, may not be the ones who want to do that or have the skills to do that, are ready to do that in 2010-11?
Mr Gray: One of the key things in our education and guidance activity, particularly around relatively new businesses, is to try to help them generally to comply with their obligations. Over the next couple of years there is scope for us to get a lot better and a lot smarter at pointing to them the particular advantages and what they need to do.

Q95 Mr Khan: How do you do that? Do you do workshops during the day when they are working? When do you do that?
Mr Gray: No. We have done some workshops during the day and the evenings; increasingly we are looking to provide guidance in more modern and smarter ways.

Q96 Mr Khan: A lot of these smaller businesses may be husband and wife and sons working in the business who cannot afford for a third of the workforce to go to a workshop.
Mr Gray: No, so we are increasingly using online guidance, we are working with tax agents, other intermediaries, organisations who support new businesses and trying to use our education through those channels. I am sure there is scope for us to do a lot better on that over the next few years.

Q97 Mr Khan: What we do not want to happen is to come back here in 2011 or 2012 and discover that the mandatory online VAT/corporation tax system has only got a take-up rate of a percentage lower than you would expect, if you see what I mean.
Mr Gray: I certainly do not want to come back in that position.

Q98 Mr Williams: Just a piece of arithmetical clarity. We talk about a target of cutting by at least a third the business costs incurred with VAT and corporation tax. In paragraph 3.8 we are told that the VAT cost is £170 a year, the corporation tax cost is £70 a year and then there is this additional tax, the self-assessment one to be included. Just 10% of those figures is peanuts, absolute peanuts, is it not? What difference is it going to make?
Mr Gray: It is 10% of those numbers. I have been set a target that says reduce them by 10%. I very much hope I can exceed those targets. I am certainly not, once I have hit 10%, going to say I am not going to try any harder.

Q99 Mr Williams: In terms of reducing a burden, £19 a year does not exactly strike one as the most massive of burdens, does it, so the relief is not all that great?
Mr Gray: No, and that is why I am keen not to be limited by the targets that I have set. If I can get the 20%, 30%, 40%, that would be great.

Q100 Mr Williams: Well if you achieve those targets, I am sure the CBI will strike you a medal and there will be rejoicing.
Mr Gray: I was at their annual dinner last night and I heard their appeals in that direction.
Mr Khan: More importantly the then Prime Minister in 2011 will be giving you a medal.

Q101 Chairman: We have had this amalgamation of the Revenue and the Customs and this was presented to us as a sea change, a dramatic difference, customers were going to be helped much more, the revenues were going to rise, costs would be cut, but frankly the way you have described it this afternoon it strikes me that your organisation, in terms of helping business, is just moving forward at a snail's pace. Is this not a betrayal of all the hopes that were raised at the time of the amalgamation? What is your personal commitment to try to change the whole culture of the two organisations you now head?
Mr Gray: My personal commitment is very strong. I do not with respect accept the "snail's pace". In the first two years we have managed a very complex merger without—

Q102 Chairman: I do not deny that there have been huge discussions and changes of deckchairs and bureaucratic committees. I am not interested in what is going on inside your two organisations; I am interested in the burden placed on business, very heavy burdens in dealing with corporation tax, VAT. I want you to tell me how the amalgamation of these two great departments of state has actually improved things on the ground for your customers.
Mr Gray: We have made significant strides in the first two years; we have reduced cost to ourselves and the taxpayers.

Q103 Chairman: You have reduced costs to yourselves. That is precisely not answering my question.

Mr Gray: And costs to our customers. We now have these targets which I am very keen to exceed.

Q104 Chairman: Well the targets, as we have heard, are virtually derisory.
Mr Gray: That is why I am saying I wish to exceed them.

Q105 Chairman: By how much are you going to exceed them? As they are meaningless targets in any event, tell us now what you are going to do.
Mr Gray: Setting my own targets for the organisation is not the way things operate.

Q106 Chairman: Who is setting the targets? Let us ask the Treasury what they are going to do to try to have some meaningful targets.
Mr Gallaher: We will work with the HMRC to ensure that they meet their objectives and setting targets is a matter for discussion between HMRC and the Treasury.

Q107 Chairman: That is a complete non-answer. Carry on Mr Gray.
Mr Gray: My summary is that I think we have made a really good start on all those dimensions. My commitment is to turn this into a much more effective organisation, one that is easier to deal with. I am afraid I do not accept your snail's pace description. When I finish this job, whenever it is, I want to see all of those dimensions very significantly transformed and that is my commitment.
Chairman: Good. Well I do not think we are going to get any more out of you. Thank you very much Mr Gray.

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