

TAXREP 43/04

THE NEW TREASURY DEPARTMENTS

Memorandum submitted in August 2004 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to an invitation to comment issued in July 2004 by the Small Business Service

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INTRODUCTION

1. On 2 July 2003 the Chancellor announced a major review of the organisations dealing with tax policy and administration. The review was conducted by Gus O'Donnell and led to the report "Financing Britain's future: a review of the Revenue departments" published in March 2004. The outcome of the review will be a single integrated tax department, which among other things, will offer a more specialised service to small businesses.
2. The Small Business Service (SBS) is an agency of the Department of Trade and Industry. This consultation by the SBS is to help it to establish what the issues are for small businesses and how the changes will affect them.
3. The consultation document can be found on the SBS website at <http://www.sbs.gov.uk/content/consultations/new-treasury-review.pdf>

WHO WE ARE

4. The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.
5. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.
6. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.

COMMENTS ON THIS REVIEW

7. We are pleased to contribute to this review, but we are concerned about the short time which has been allowed for it. The SBS announced its review on 30 July and asked for responses by 31 August. This allows only four weeks and coincides with the summer holiday period. This seems unnecessarily short, and is insufficient for representative bodies such as ourselves to seek members' views or prepare an in-depth response. We see no reason why the consultation period should not be in accordance with the Government's Code of Practice on consultation which specifies a minimum period of three months. We hope the SBS will take this into account when influencing the formulation of policy based on responses to its questionnaire.
7. In October 2003 we submitted a paper to the Treasury, containing detailed comments and suggestions for the Review of Inland Revenue and HM Customs & Excise. We attach a copy of this paper – **TAXREP 39/03 HM Treasury Review of Inland Revenue and Customs & Excise**. The majority of the comments in it are still relevant in the context of the proposals in HM Treasury's March 2004 report *Financing Britain's Future: Review of the Revenue Departments*, 'the O'Donnell Report'.
8. We updated our October 2003 representations in May 2004 drawing out some key points of relevance to the proposals to merge and reorganise the revenue departments. We also attach a copy of this paper – **TAXREP 18/04 Merger of Customs & Excise and the Inland Revenue**.
9. The Tax Faculty has had a number of meetings with the SBS and would be pleased to take part in any future consultations on this issue.

SPECIFIC COMMENTS

10. We have based our answers to the questions posed by the SBS on the Tax Faculty's Ten Tenets for a Better Tax System. We believe that all changes, whether policy or operational, should be measured against these guidelines. They provide some fundamental principles, which should underpin any good tax system. Those which are particularly relevant in this context are that tax should be simple, easy to collect and calculate and properly targeted.
11. Our responses to the specific questions (in *italic*) raised by the SBS in the current consultation follow:

The revenue departments today

Does the distinction between direct taxes e.g income and corporation tax and indirect taxes e.g. VAT matter to small businesses?

12. The distinction between direct and indirect taxes is particularly relevant to small businesses because of the practical consequences. Tax rules should be simple and the associated tax easy to collect and calculate. The rules for direct and indirect taxes are very different and are complex for a small business to understand and operate. This is a particular problem in relation to VAT. Many small businesses are run without either bookkeepers or access to day to day advice. Although they

may have their accounts prepared by a qualified accountant, they may complete and submit their own VAT returns to save money. Errors may not be discovered until months or even years later, by which time the effect may be significant.

13. The VAT registration limit is extremely important to smaller businesses. The cliff edge effect beyond which a business must register can drive people into the informal economy and has a big effect on competitiveness.

What should the more specialised service to small businesses offer?

14. A small business currently has to deal with two very different sets of people from the Inland Revenue and Customs & Excise. A one-stop shop where a small business has a single named contact within the merged department would be preferable. This would need to accommodate the need for specialist information for different problem areas. For example small retailers have very different needs to builders and it would be helpful to be able to build units with experience and knowledge of these different types of businesses.

How can the use of new technology in relation to information and knowledge be improved?

15. Many small businesses do not use technology for their work. They may have internet access but will not necessarily use this for their work whether because of security fears or other concerns. Many small businessmen are too busy running their business to keep logging on. For example a long distance lorry driver would not put accessing the Revenue's website high on his list of priorities, even if using an internet café to contact business colleagues or friends.
16. The Inland Revenue's website was re-launched in a new format last year without any prior consultation on usability. Although better in some respects we are not convinced that the navigation on the new site is better than the old site – indeed, a common reaction from users is that it is often harder to find things on the new site compared with the old. The important point we have made previously about the accessibility and updating of manuals and reference material on the website is also still valid. It is too early to comment on the new Customs & Excise website launched earlier this month, although we note that it proved unstable during its early weeks.
17. One possibility would be to use email alerts to communicate important messages. CD-ROM could be used to communicate with those businesses not using the internet.

How can the use of new technology in relation to customer service and contact be improved?

18. It is important to have a robust and reliable system. Well written, simple forms and leaflets which can be downloaded and printed out reliably.
19. The Revenue Manuals have been written and compiled for access by computer only. Most users have reported to us that they need to print out sections

periodically in order to follow the detail of a topic. It is not easy to print out the Manuals and although we understand why they are 'built' in this way, we do not agree that this is appropriate for a 'rules based' tax system.

20. Email access to a named adviser within the department would allow real time access to help for small businesses struggling to complete forms.

Improving tax administration:

How do you want the service for small businesses to improve?

21. In addition to the points made above, we have commented in our earlier responses that better liaison between policy formulation and implementation will lead to better service for small businesses.
22. Long term consideration must be given to establishing a system which reduces the amount of time it takes a business to comply.

How can the compliance costs for small businesses be reduced?

23. Whenever a business needs to make contact with a Revenue department, compliance costs are incurred. It therefore follows that the fewer contact points in a year, the more costs are reduced. This includes being able to get it right first time, both on the part of the business and the Revenue. The more complex the system, the more likely it is that mistakes will be made.
24. One of major areas of compliance problems payroll. Operating a payroll system for the benefit of Government places a disproportionate cost on small businesses. It is also important to distinguish micro businesses (less than 5 employees) in this respect, since the costs are disproportionately high for such businesses.
25. The lack of up-to-date research on the costs of operating the tax system makes it impossible to assess compliance costs in the post self assessment era with any degree of accuracy. We understand that the reluctance of the Revenue to supply raw data necessary for statistical validity has discouraged relevant research into compliance costs in the self assessment era respect.
26. The Government should adopt a coherent system for the taxation of small businesses, which also takes into account the different compliance costs involved with the different structures. The new merged department will need to address this issue.
27. We are aware that the Regulatory Impact Unit of the Inland Revenue is aiming to do more monitoring and follow-up of policies post-implementation, and to form links with their colleagues on the operations side such as the Working Together team. We applaud this and hope that adequate resources will be allocated to it, both now and in the merged department, and that this will also include links to the SBS.

Do you think the changes will result in a more hard-line compliance regime for small businesses? If so why.

28. Merging of Customs & Excise with the Inland Revenue is likely to result in a more hard-line compliance regime for small businesses which are not compliant. It should however result in a smoother transition for such businesses to become compliant.

How important is it to retain a local area office network for small businesses?

29. Good access to the merged department does not necessarily mean physical presence. Where a business has identified a problem, it needs to know where to call for help and to be sure that the person answering the call will give a prompt, reliable answer. Follow up should also be available. Such calls should be charged at local telephone call rates.

30. Email to a helpdesk would also be helpful.

How helpful would it be to reduce the number of tax returns that small businesses have to complete?

31. Reducing the number of tax returns required by a small business would be helpful. Perhaps annual accounting for VAT could be linked to completion of the Tax Return. In many cases the owner of a small business will also be claiming tax credits and will also have to complete paperwork for these. The link between these forms should be explored to see how they could be streamlined, perhaps by some pre-population of data.

32. Merely reducing the number of forms will not help small businesses if this is simply squeezing a number of separate forms together. A reduction must be accompanied by a genuine attempt to cut red tape and form filling.

How helpful would it be to provide a single account for payments and repayments for small businesses?

33. The current statements of account provided for income tax are confusing. This is partly caused by the complex rules on calculating interest on over/under payments of tax.
34. One possibility for a single account would be to have a single record for each taxpayer, accessible by a pin code.
35. More flexibility is needed in the payments system. For example, some people would prefer to pay their tax regularly, perhaps monthly, but there is no incentive to do this under the current system.

Better information use:

How can the better information resources be used to improve the service for small businesses?

- 36. Information could be made more widely available through local libraries, Citizens Advice Bureaux etc. We have already mentioned better use of the internet and email.
- 37. More timely production of updated leaflets, such as when NIC rates are increased, should be prioritised.

How can the better information resources be used to reduce the compliance costs for small businesses?

- 38. All information should be well written and properly targeted to the business affected. Reliance on availability on the internet alone is not acceptable to many small businesses as previously discussed.

How can the better information resources be used to improve policymaking and implementation in relation to small businesses?

- 39. Policymaking is the preserve of Government, however, Government needs to speak to and listen to customers and advisers. This must be on a timely basis with more open consultation with a range of options.
- 40. Too often, policy makers don't get feedback on the practical results of implementing their policies.
- 41. A few years ago the Revenue issued a peer review called architectural engineers. This highlighted that many people in the Revenue did not understand commerciality or practicality. Two key issues for small businesses.

How can the better information resources be used to identify and tackle noncompliant businesses without increasing the burdens on all small businesses?

- 42. Non compliance takes different forms. Some businesses know that they are not compliant, whereas others do not. These need different solutions.
- 43. A system which is easier to understand leads to fewer accidental incidents of non-compliance.
- 44. Meanwhile, the Inland Revenue should look earnestly at its risk assessment procedures and the methods which it applies to assist compliant businesses. The focus should be on the non-compliant business. In the past few months 'enabling letters' have been written to thousands of businesses inappropriately giving the impression that these businesses have been getting their past tax returns wrong.

How important is a single point of contact to small businesses?

- 45. Very important as previously stated.

Co-ordinating tax policymaking:

How can the contact between tax policy officials and small businesses be made more effective?

46. Small business specialists should be deployed, perhaps with two-way secondment to business and with regular surgeries, open days etc where help is available. Communication is crucial to the success of the new merged department as far as small businesses are concerned. Incentives may be required to help them to attend since most small businesses are often too busy to attend.

How can the contact between tax policy officials and small business representative bodies be made more effective?

47. Regular contact on a timely basis.

How can the contact between tax policy officials and professional representative bodies be made more effective?

48. Agents offer a filter and hence a more sanguine view. They deal with a variety of clients and offer a balanced perspective without a personal axe to grind. Our members act for many thousands of small businesses and this offers an effective route for the new department to make contact with business. Regular consultation is essential for this to be productive.

49. Contact would be improved with meaningful consultation. This should allow for time to reflect and of course time to consider implementation.

Are regular reviews to improve the tax system for small businesses preferable to a stable but static tax system?

50. Regular review of the tax system is essential to ensure that it is meeting its objectives. However, we believe that the core principles should not change from year to year. The review must make sense. We believe that this is different from an endless stream of policy initiatives.

Are tax incentives and reliefs for small businesses (which inevitably complicate the system) preferable to a simpler system without the “frills”?

51. Most recent 'incentives' don't help micro-businesses who can't use the Enterprise Investment Scheme, Enterprise Management Investments nor are they involved in research and development. They see only sticks e.g. the non corporate distribution regime, IR35 and settlements legislation.

52. Tax should be simple to collect and easy to calculate. We believe that the tax system should be used to raise revenue and not to change behaviour. Tax should be neutral and a business should be allowed to make decisions primarily for commercial reasons (although we accept that the tax benefit will have some influence on the final decision).

53. Too often incentives end up encouraging a particular type of business behaviour, which can then come to be regarded as avoidance. This results in the incentives having to be changed or even reversed. A recent example of this is the nil rate starting band for corporation tax which encouraged small businesses to incorporate to benefit from annual tax savings of as much as £3,000 per year. This has now resulted in the introduction of the non corporate distribution regime with a 19% minimum tax charge on distributed profits and a tax system which has further complication added to it.

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THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99; see http://www.icaew.co.uk/taxfac/index.cfm?AUB=TB2I_43160,MNXI_43160