

TAXREP 28/05

HM REVENUE & CUSTOMS AND THE TAXPAYER: MODERNISING POWERS, DETERRENTS AND SAFEGUARDS

*Response from the Tax Faculty of the Institute of Chartered Accountants in
England & Wales to HM Revenue & Customs, to the consultation document
issued on 24 March 2005.*

CONTENTS

	Paragraph
INTRODUCTION	1–5
KEY POINTS	6–17
GENERAL COMMENTS	18–22
THE CONSULTATION PROCESS	23–33
OBJECTIVES OF THE REVIEW	34–46
PRINCIPLES SUPPORTING TAXPAYERS’ RELATIONSHIP WITH HMRC	47–69
WHO WE ARE	Appendix 1
TEN TENETS FOR A BETTER TAX SYSTEM	Appendix 2

Tax Representation

HM REVENUE & CUSTOMS AND THE TAXPAYER: MODERNISING POWERS, DETERRENTS AND SAFEGUARDS

INTRODUCTION

1. This document sets out the ICAEW's response to the consultation document *HM Revenue & Customs and the Taxpayer: Modernising Powers, Deterrents and Safeguards* (the Document) published on 24 March 2005.
2. In Appendix 1 we provide information about the Institute of Chartered Accountants in England & Wales (ICAEW) and the Tax Faculty.
3. We welcome this wide-ranging review and the opportunity to participate. We look forward to being involved in the further consultation envisaged in the Document.
4. By way of background, we would mention that we are also participating in the work of the Consultative Committee on powers and appeal rights, chaired by Dave Hartnett. The Tax Faculty Chairman, Francesca Lagerberg, is a member of the Committee. We look forward to participating fully in that Committee and this current response is just the beginning of a much more detailed programme.
5. We will also be responding to the document *Working towards a new relationship: A consultation on priorities for reducing the administrative burdens of the tax system on small business*, and in related consultations, and are pleased to note that the findings of these two consultations will be shared.

KEY POINTS

6. We accept that there is a need for a review of the powers which HMRC should have. This is an important opportunity to produce an improved system which suits the needs of everyone who uses it.
7. We welcome the opportunity to participate in the debate and assist in ensuring that it successfully achieves its aims.
8. Based on the information about the consultation timetable set out in the Document, we are concerned that there may not be adequate time for formal consultation on the detailed proposals which will be published later this year, or for proper parliamentary scrutiny of the draft legislation which is planned for the 2006 Finance Bill.
9. We broadly support the Objectives of the review, and the Principles set out in the document for the relationship between taxpayers and HMRC. However, we have a number of comments on these, and points of concern.

Tax Representation

10. The review should consider how the principles set out in the Document can be formalised and published. The OECD has recommended that all its member states should have a Charter or Bill of Rights to safeguard the taxpayer. It is difficult to see how the UK could do other than act on the OECD's recommendation.
11. It is crucial that HMRC's computer systems should be properly designed and tested and have the capacity to cope with changes to HMRC's procedures for gathering and processing information. Recent problems with government computer systems raise concerns about what is achievable.
12. The trend is towards insisting that taxpayers communicate with HMRC and provide information electronically. We are concerned that those taxpayers who cannot use modern IT, or who do not choose to, should not be placed at a disadvantage because HMRC has decided to operate its systems in a particular way.
13. Penalties have a role to play as deterrents, but consideration should be given to other ways of encouraging compliance, including the use of incentives, which are not mentioned in the Document. Taxpayers and tax credit claimants can also be assisted in dealing with their tax and tax credits affairs if they have access to clear and accurate information and help, and HMRC has a responsibility to provide this.
14. The Document says far more about powers than it does about taxpayers' rights and safeguards. We believe it is important to strike a sensible balance and give proper consideration to both powers and safeguards in the course of the review.
15. In our view a taxpayer should be told why an enquiry or investigation is being instigated into their tax or tax credits affairs.
16. We should like to see a right of appeal against any decision of HMRC, and for appeals and other redress routes to be scrutinised by an independent body wherever possible.
17. We endorse the comment in the Document that the route for challenging a decision needs to be clear. It also needs to be accessible, and to this end we would like to see the second tier of the new tribunal structure given a statutory review power.

GENERAL COMMENTS

18. The Document is drafted in broad terms and addresses aims and principles. Therefore, we have taken the same approach in our response. We have considered the consultation process itself, its objectives and the areas on which it will be focusing. We have not attempted to provide here a comprehensive review and comparison of powers and rights, or detailed recommendations. We understand that this will be dealt with by the detailed work of the Consultative Committee.

Tax Representation

19. We have not structured our response around the list of possible issues in the Invitation for Comments section at the end of the Document. We have instead addressed all these issues by commenting on points made in the text of the Document itself.
20. Our comments in the document are organised under the same section headings as those in the Document.
21. First we would like to establish some basic principles, which we believe should underpin the review of powers and rights:
 - It is generally accepted that the powers of the state in a civilised society must be no more than are necessary to ensure that taxpayers pay the correct amount of tax legally exigible, and no later than the due date stipulated in the law.
 - Where the state's role is to distribute funds to citizens, it must ensure that they receive their correct entitlement at the time stipulated in law, and the state will require powers sufficient to ensure that recipients are not given more than their legal entitlement.
 - The way those necessary powers are exercised must respect the taxpayer's right to privacy and confidentiality, and more generally respect his or her human rights. In order to ensure that these safeguards are provided they should be enshrined in the legislation and where necessary in sub-ordinate legislation and in the practices to be adopted by the tax authorities.
 - In exercising the powers delegated to it, HMRC is acting as steward in collecting and administering taxes and tax credits on behalf of all members of society.
22. We would also like to emphasise at the outset that we accept there is a need to review the powers which the new-look HMRC should have. We welcome that move and we would like to see a wide-ranging discussion on all revenue department powers.

THE CONSULTATION PROCESS

Timetable

23. We are pleased to note from the Document that 'the Government believes it is important to take sufficient time to achieve the right balance within an overall package of measures'. However, we are concerned at the comparatively short time frame for producing the first set of new measures. A comprehensive review of powers and rights under the tax system is hardly a regular occurrence, and this is an important opportunity to carry out a thorough and well-researched review and produce an improved system which suits the needs of everyone who uses it. We note the length of time that led to the agenda-setting Keith Committee Report.

Tax Representation

This shows that to reach useful conclusions requires thought, consideration and time.

24. We are told that once Ministers have considered the Consultative Committee's recommendation (and presumably also the responses to the Document), 'HMRC will publish proposals for any legislative and non-legislative changes, supported by explanations.....The intention will be to do this in time to allow reflection before legislation is considered in detail by Parliament...'. A number of points concern us:
25. Will draft legislation be published at the same time as the proposals are published, or will this not be available until the Finance Bill 2006 is published? We would welcome clarification.
26. We are not sure what is meant here by a 'period of reflection', but it is essential that the detailed proposals which HMRC produces should be the subject of full formal consultation according to Cabinet Office guidelines.
27. We are concerned about whether there will be adequate time for proper parliamentary scrutiny of what is likely to be a substantial quantity of important new legislation on powers and rights. We already have concerns about the time available to scrutinise the annual Finance Bill. We have expressed our concerns about the scrutiny of the Finance (No 2) Bill this year in our comments on the Finance Act 2005, published as TAXREP 23/05.
 - This is why we would urge HMRC to publish draft legislation for comment at the earliest possible opportunity and certainly in advance of the Finance Bill 2006.
 - We also ask for assurances that MPs and Lords will be able to subject the new legislation to detailed scrutiny and will take evidence from outside HMRC at Committee Stage.
28. We note that the Document also refers to 'non-legislative changes'. We would like further details of what is envisaged – does it mean HMRC's internal guidance? And/or changes to non-statutory redress procedures? We think it is important that there is consultation on these aspects of the proposals, as well as on legislative changes.

Focus of consultation

29. We note that the consultation will initially focus on powers and rights affecting businesses, and that this will include income tax self assessment. We agree that this is a sensible approach since businesses are the taxpayers most likely to be dealing with HMRC across a wide range of 'old Inland Revenue' and 'old Customs & Excise' matters. We would however welcome a rather more precise description of which taxes will be covered in this first stage of the review.

Tax Representation

30. However, it is important that the review of these areas (business taxes and self assessment) should keep in mind the possible impact on other areas dealt with by HMRC. In particular, many of those within income tax self assessment, or who are taxed under PAYE, are likely to be tax credits claimants. There are many inconsistencies between the powers and safeguards for tax credits and for self assessment, and they could usefully be compared and aligned. In our view this would mean importing some of the features of the self assessment regime into the tax credits one, rather than vice versa. For example, there are no error or mistake provisions in tax credit law equivalent to those in s 33, Taxes Management Act 1970. A tax credit claimant has the right to apply for a direction to close an enquiry, but no such right in the case of an 'examination' into his or her tax credits claim.

Ongoing consultation

31. We would welcome public clarification of the next stages of the consultation timetable – both the publication of proposals and draft legislation for 2006, and details of how the consultation will proceed in 2006 and beyond.
32. It is important that the new provisions and procedures, once introduced, are kept under review. The aim must be to make sure the new regime is got right first time, but nevertheless one must accept that sometimes difficulties only emerge once a new system has been in operation. It may also be necessary to develop the system of powers and rights to deal with new taxes and new situations. Therefore, HMRC and the government should recognise that the new system may need to evolve and adapt.
33. Following on from this point, we recommend that there should be some form of independent monitoring of the new powers/rights regime, at least for the first few years of its existence. This might be by a parliamentary committee, or a new independent committee with members drawn from a variety of backgrounds.

OBJECTIVES OF THE REVIEW

34. We support the review's aims to improve the effectiveness and efficiency of the tax system. We also welcome the aim to introduce better customer focus – provided this also results in better customer service.

Alignment of powers

35. The objectives place emphasis on aligning powers and practices across different taxes. We welcome any measures which make the tax system simpler and more consistent. We can see that having core provisions which apply to all taxes and credits could have benefits in terms of clarity, consistency and resulting savings in administrative costs.

Tax Representation

36. However, we would raise a note of caution. Consistency should not be an end in itself. There may be good reasons why different powers have been developed for different taxes, and powers should not be aligned without a clear understanding of the reasons for the existing regime and a full consideration of the pros and cons of alignment.

Obtaining information

37. We are pleased to note that HMRC intends to make it easier and less onerous for taxpayers to provide information.
38. The current situation is unsatisfactory in that taxpayers and other ‘customers’ of HMRC are expected to contact different parts of HMRC separately for different purposes. For example, an individual going abroad who notifies his tax office for income tax purposes, is also expected to notify the tax credits office of the same information. In our view a taxpayer should only be expected to notify HMRC once of a particular item of information, and should be able to expect the department to disseminate the information internally as appropriate. The current review should consider these requirements and clarification should be incorporated in legislation and in HMRC guidance.
39. We do have a concern about HMRC’s ability to disseminate information internally, given the current situation where information is held on a number of different IT systems which cannot easily share information with one another. We appreciate that one of the recommendations of the O’Donnell Report, which the department is working towards, is to create better and more joined-up IT systems. However, this will take time and money, and it has to be said that recent experiences with government IT systems (eg NIRS2, the tax credits computer, the CSA system) have not been unqualified successes. Hopefully the lessons of the past can be learned to help ensure that HMRC’s computer systems will be properly designed and tested and will have the capacity to cope with proposed changes to information-gathering powers and procedures.
40. We also note that information-gathering is clearly going to be central to HMRC’s plans for developing customer service and operating a risk-based compliance regime. We would sound a note of caution here too. There is a trade-off between obtaining information to enable the efficient operation of the tax system, and placing a burden on taxpayers and others of providing the information. We would not wish to see businesses asked to provide a mass of information which HMRC consider might be useful, without a clear understanding of why it is necessary.

Use of technology

41. We accept that the review of powers and rights should take account of technological developments, and that this has the potential to deliver cost savings and other benefits for HMRC. It may also deliver benefits for some of HMRC’s customers.

Tax Representation

42. However, we are concerned at the trend towards insisting that taxpayers communicate with HMRC and provide information electronically. Those taxpayers who cannot use modern IT, or who do not choose to (for whatever reason), should not be penalised or placed at a disadvantage because HMRC has decided to operate its systems in a particular way. We are pleased to note that HMRC will look to ‘designing information requirements to fit in with the form in which it is held in a business’s existing systems or in other ways convenient to the taxpayer....’, but this is only mentioned in the context of electronic transfers. It does not address the situation where the taxpayer decided that the most convenient way for him to keep records is in paper form.
43. Our point in paragraph 29 about HMRC’s computer systems is also relevant here. A recent example is the new system for e-filing of employer’s year-end returns. This is now compulsory for large employers and will in due course be compulsory for all. Small employers who efile voluntarily are entitled to an incentive. But, the delivery of this new system was hindered because the new HMRC computer system was not ready at 6 April 2005 as planned, together with problems with the gateway for employer filing which resulted in employers and their agents being asked to file outside the hours of 10.00 am to 4.00 pm or at weekends – completely unrealistic for businesses. This sort of situation has an adverse effect on businesses’ confidence in HMRC and weakens the effectiveness of offering incentives.
44. Towards the end of the section in the Document dealing with modern technology, there is reference to ‘the redesign of processes so that liabilities can be settled sooner’. We are not clear whether this means a review of due dates for payment of tax, to bring them forward, or whether it means improving the efficiency of tax debt recovery. If the intention is to review payment dates, this seems to go beyond a review of powers, and should be opened to wider consultation. If the comment is referring to improving collection of tax, we trust HMRC will take account of the recommendations of the National Audit Office report *The Recovery of Debt by the Inland Revenue* published in March 2004.

Approach to compliance

45. In the section of the Document headed ‘A fair and risk-based approach to compliance’, we are concerned by the bracketing together of ‘criminality, fraud and avoidance’. Avoidance is legal and it is a matter for parliament to decide what is permissible under the law. If the transaction undertaken is within the law and properly reported, HMRC does not need powers to target this.
46. We have commented on some other aspects of compliance in paragraphs 53 to 59.

Tax Representation

PRINCIPLES SUPPORTING TAXPAYERS' RELATIONSHIP WITH HMRC

General comments on the principles

47. We broadly support all the proposed principles which should support taxpayers' relationship with HMRC, but we have some specific comments on aspects of these, see below.
48. The word 'taxpayer' in this section heading in the Document is something of a misnomer. The principles are relevant not just to 'taxpayers' but to anyone who has dealings with HMRC. This would include tax credits claimants, people in receipt of student loans, those affected by the National Minimum Wage rules, and so on.
49. The Document does not make specific mentions of powers or rights as they relate to third parties. HMRC has powers to obtain information or otherwise to involve third parties, with regard to a taxpayer's affairs. Third parties require rights and protections in the legislation when they are subject to HMRC powers. Accountants and advisers acting on behalf clients are one category of third party, and we are concerned to ensure that our members are adequately safeguarded when acting in that capacity. There need to be established principles for dealings with third parties, and this should be considered in the course of the review.
50. We would be interested to know if the intention is to give these principles some sort of formal status and publish them. They might be incorporated into something similar to the old Taxpayer's Charter. Or to take it a step further, a number of commentators have suggested a Taxpayer's Bill of Rights. We should like to see this given serious consideration.
51. In this context we would mention that the OECD has recommended that all its member states should have a Charter or Bill of Rights to safeguard the taxpayer. The UK is a strong supporter of the OECD and it is difficult to see how it could do other than act on the OECD's recommendation, particularly in the context of the current review.
52. In order to ensure that the principles for taxpayers' relationship with HMRC are followed, it is not enough that the powers and rights are incorporated in legislation, although that is obviously crucial. There also needs to be guidance for HMRC officers which makes clear how the powers and rights are to be applied, and a system of internal management which ensures that this guidance is followed. Equally, taxpayers and others who have dealings with HMRC need to know about and understand the powers and rights which affect them.

Compliance issues

53. The third bullet point in the list of principles says that 'where appropriate and possible there should be an opportunity to comply voluntarily'. We are not clear

Tax Representation

what is intended here. It is difficult to imagine a situation where it might not be appropriate or possible to encourage voluntary compliance before taking enforcement action.

54. We are pleased to note that ‘audits and inspections should have a reason’ but it is not clear whether this principle means that the taxpayer should be told what the reason is, or just that HMRC is required to establish the reason before going ahead. We would strongly encourage HMRC to be more open, at an early stage, about the concerns which have prompted them to open an enquiry or carry out an audit. In our view the taxpayer should always be told why an audit or enquiry has been instigated unless there is a good reason why this should not be done (and it would be for the revenue authorities to justify this). There is an argument that this is contrary to Article 6 of the European Convention on Human Rights.

Penalties, deterrents and incentives

55. We agree with the principle that there should be appropriate and effective deterrents to non-compliance and that these should be visible and intelligible.
56. It seems to be taken as read in the Document that penalties will act as a deterrent. While not disagreeing with this, we recommend that in order to develop the use of deterrents, data is needed on how and when penalties are effective in this way, and when they are not. There may be situations where a penalty is ineffective and some other approach would have better results. No amount of penalties will make a taxpayer or claimant compliant when they are simply struggling with the system. We are sure that HMRC have research data on this topic; it would be useful to share it with the Consultation Committee in order to inform any discussion on penalties.
57. We also note that although the Document refers to penalties, there is no mention of incentives. Incentives are an alternative approach to encouraging compliance, and may in some situations be more effective than penalties, as they enable the taxpayer to have control.
58. The sixth bullet point in the list of principles says that ‘deterrent measures should adequately reflect the seriousness of the contravention, the risk to the Exchequer and the circumstances of those they penalise’. We agree with this, but would point out that in order for these principles to be applied, they need to be incorporated clearly in HMRC’s own guidance. And, there need to be mechanisms to ensure that the guidance is followed properly.
59. The eighth bullet point says that ‘the most intrusive and extensive powers should only be used in cases where the circumstances make them appropriate...’. We should like to know which powers HMRC identify as falling within this category.

Tax Representation

Taxpayer safeguards and rights

60. The Document says far more about powers than it does about taxpayers' rights and safeguards. We believe that it is important to strike a sensible balance and to offer clarity and information on taxpayers' rights as part of this process. This will also help deflect criticism that is likely to be raised suggesting that any change to HMRC powers will work solely in the favour of the revenue departments.
61. The first bullet point in the list of principles mentions the need to comply with confidentiality guidelines, the Human Rights Act 1998 and the Data Protection Act 1998. Omitted from this list are the Freedom of Information Act 2000 and the Disability Discrimination Act 2005, with which HMRC must also comply.
62. Powers under the UK law also need to comply with EU treaty requirements. Increasingly we have seen legislation and interpretation in the UK which runs counter to embedded rights derived from the EU.
63. The ninth bullet point says that the design of powers and requirements should include appropriate safeguards for the individual 'except in the exercise of routine functions'. We disagree, and are concerned by this. What are these routine matters? And why is there no need for safeguards in their operation? There should always be some sort of safeguard and means of redress in respect of any power which is available to HMRC.
64. We endorse the comment that safeguards can include rights of appeal to an independent tribunal or scrutiny by an independent body. We would go further and say that an independent body should be involved wherever possible. We are unhappy with situations where the only recourse is to ask HMRC to review its own decisions. An example would be in the case of tax credit overpayments, where a claimant who objects to the way in which HMRC has decided to recover a tax credit overpayment has no right of appeal but can ask HMRC to look at it again.
65. Following on from the above point, in situations where there is no right of appeal and the taxpayer or tax credit claimant is unhappy about the way HMRC is applying its own powers, the only route for redress in the courts is by way of judicial review. This is not a feasible option for most of HMRC's customers. We should therefore like to see a right of appeal against any decision by HMRC so that the taxpayer would be able to take an appeal before the tax tribunals. We would also like to see the second tier of the new tribunals structure given a statutory review power, and we made this point in our comments on the White Paper *Transforming Public Services: Complaints, Redress and Tribunals* published by the DCA in July last year (our response is published as TAXREP 47/04).

Tax Representation

66. We endorse the comment that the route for challenging a decision should be clear. Any route of appeal or redress also needs to be accessible for those who want to use it – that is, affordable and readily understandable for a person with no specialist technical knowledge and who may be unrepresented.
67. The existing legislation contains safeguards and rights for taxpayers such as: anti-avoidance provisions not applying where there is a ‘bona fide’ purpose to a transaction; reasonable excuse in a variety of situation which would otherwise constitute default; the ability of HMRC to extend deadlines in certain situations but not others; the ability of HMRC to accept error or mistake claims at their discretion. A review of powers and rights could usefully look at where such facilities exist in the legislation, if they are available in a consistent way and in comparable situations; and whether there are situations where they ought to be available but are not. It should also consider whether HMRC procedures for applying discretions are consistent across the taxes.
68. We entirely agree that ‘everyone should be in a position to understand his or her rights and responsibilities’. But the complexity of the tax legislation we now have is an obstacle to that. It is often extremely difficult for the ordinary person, unrepresented and without specialist knowledge, to do this. Simpler and better legislation would address the problem. To this end the Tax Faculty has developed Ten Tenets for a Better Tax System, which we attach as Appendix 2.
69. HMRC has a responsibility to assist its ‘customers’ by providing clear and accurate information and help, which will enable them to deal with their tax and tax credits affairs. This information also needs to be readily accessible, and to cater for the different needs of the wide variety of individuals and organisations that have dealings with HMRC.

JMM
17 June 2005

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APPENDIX 1

WHO WE ARE

1. 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.
2. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy (which includes taxation).
3. 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 who pay an additional subscription.

Tax Representation

APPENDIX 2

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