

TAXREP 1/04

ADMINISTRATIVE COSTS OF TAX COMPLIANCE

Memorandum submitted in January 2004 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to an invitation to submit evidence to a Treasury Sub-committee inquiry announced in November 2003

CONTENTS

	Paragraph
INTRODUCTION	1
WHO WE ARE	2-4
GENERAL COMMENTS	5-11
SPECIFIC COMMENTS	12-39

Tax Representation

ADMINISTRATIVE COSTS OF TAX COMPLIANCE

INTRODUCTION

1. We welcome the opportunity to comment to the Treasury sub-committee on the administrative costs of tax compliance further to the call for written evidence published on 14 November 2003 at http://www.parliament.uk/parliamentary_committees/treasury_committee/tc141103_51.cfm. We would also be happy to give oral evidence at a sub-committee meeting.

WHO WE ARE

2. The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 125,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.
3. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy (which includes taxation).
4. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.

GENERAL COMMENTS

5. We believe that it is extremely important to consider the cost of the obligations imposed on business when seeking to implement new tax policy. We do not believe that the existing system of Regulatory Impact Assessments ('RIA') properly reflects these costs. Frequently, RIAs are partial and appear to be merely a best guess of the costs involved. Furthermore, once a proposal is implemented, there is little evidence of any attempt to return to the original estimate and assess with the benefit of hindsight whether the change was cost effective when compared to the benefits achieved.
6. In 1999 the Tax Faculty published 'Towards a Better Tax System' in which we set out Ten Tenets by which all new legislation should be judged. A copy of this is attached for the committee's reference, or see http://www.icaew.co.uk/taxfac/index.cfm?AUB=TB2I_43160,MNXI_43160. Whilst this paper is now over four years old, and we have supplemented it in other publications, our conclusions are as valid now as they were then.

Tax Representation

7. The costs of compliance include the costs of
 - Employing individuals skilled in handling the relevant areas
 - Substantial time input for managers, owners and directors who must try to understand the welter of legislation imposed upon them
 - Professional fees either for advice or for outsourcing
 - Continuous additional anxiety that there may be unknown errors for which penalties will be imposed
 - Lack of certainty
 - Distraction from the prime purpose of business – namely making a profit.
8. As far as we are aware, there has been little detailed research into the costs of tax compliance. In 1996, the Centre for Fiscal Studies at the University of Bath was commissioned jointly by the Inland Revenue and Contributions Agency to research the costs to business of PAYE and National Insurance compliance. The project, which included many of the costs described above, took in excess of a year to complete and cost hundreds of thousands of pounds. To date, there has been little evidence that its findings were acted upon. It remains of great concern that the overall compliance cost per employee ranged from £5 for large employers to £288 for small employers.
9. These results will now be considerably out of date, and for example, pre-date the introduction of self assessment. The scope of this current sub-committee inquiry far exceeds this research project. We suggest that at the very least the previous research is repeated and the results compared. This would enable the sub-committee to determine more accurately how the administrative costs of tax compliance in this area have changed over time.
10. Further research should also be commissioned to produce quantitative and qualitative data in other areas. We would be happy to help the committee scope such projects in further detail.
11. We have identified several areas where steps have been taken to reduce the administrative cost of tax compliance, although this has not always been successful – see paragraphs 18, 19, 20, 22, 24, 31, 32 and 33.

SPECIFIC COMMENTS

Payroll procedures

Tax credits

12. Many employers see themselves as the unpaid collectors of taxes for the government. Many of the most complex areas of tax affect employees and are subject to constant change.
13. Since the introduction of new tax credits on 6 April 2002, employers must now also deal with paying social security benefits under the guise of tax credits. The complexity of the system alone creates an unacceptable burden on small employers in particular, who had to cope with a revised new tax credits system

Tax Representation

from 6 April 2003. The introduction programme was unsatisfactory and, coupled with an unreliable Inland Revenue computer system and Helpdesk, has resulted in thousands of incorrect start and stop notices being issued, and in many cases issued too late for employers to action. We anticipate further problems for employers when employees have to complete renewal applications starting in April 2004. The employer will usually be the first contact point for an employee struggling with this area.

Staff changes

14. The current system of form completion can take hours of payroll staff time to implement. This is particularly a problem for businesses which use a large number of casual staff. The system is so complicated to operate that it increases the temptation for small businesses to make cash payments. Anecdotal evidence suggests that many small businesses, in particular within the catering industry, find the system so cumbersome that they pay wages in cash, leaving the 'employee' to sort out any tax due. Clearly this amounts to evasion but the system does little to encourage compliance. Larger businesses will adopt other unorthodox practices. We have come across one large hospital which keeps a list of around 5,000 nurses which may work for the hospital. If a nurse has submitted a time sheet for the month, then hours worked are paid. If not, then the nurse has a nil wage packet. At the year end an unnecessarily large number of employees are shown on form P35, since many nurses will be shown as employees even though they have not worked during the year at all. Nevertheless this practice is followed as it is quicker than issuing endless P45/P46 forms as such staff leave and rejoin. Whilst this particular arrangement is a sensible practical solution, it also imposes a further administrative burden on the employer who must bear the cost of distributing 5,000 Forms P60 each May, many of which are blank and for which there is no forwarding address.

Notices of coding

15. Notices of coding have traditionally been used to ensure that employees pay the correct amount of tax on their employment income, so that as a result, many employees do not have to complete self assessment tax returns. The notice of coding is very successful in keeping large numbers of taxpayers out of self assessment but the price is that it creates complexity. These notices may have many constituent parts which employers will frequently have to explain to staff at the cost of their own time. Different rates of tax applied to different sources of income make the process even more opaque. Similar problems exist where different rates of tax relief are allowed.

Benefits and £8,500 limit

16. The £8,500 limit for determining which benefits are taxable has not been increased for many years. This results in an additional compliance burden where many more Forms P11D must be completed than were originally intended.

Overseas travel expenses

Tax Representation

17. It is now common for employees to make business trips overseas. As a result of representations from our members in business, we have previously suggested that the compliance costs would be reduced if a scale of daily allowances could be agreed for subsistence in different countries. The administrative burden is greatest in developing countries where obtaining receipts is not customary.

PAYE settlement agreements

18. Whilst PAYE settlement agreements were introduced to relieve some of the administrative burden from employers who would otherwise have to report small benefits, the cost is now prohibitive for many, following the imposition of Class 1B national insurance contributions.

Dispensations

19. Dispensations are an excellent means of relieving the burden of reporting expenses related to employment. We have had reports from employers who have had difficulty securing these, particularly for small companies. This area should be reviewed to consider how it could be extended and in particular made more accessible to owner directors.

Compulsory electronic filing

20. Compulsory electronic filing is being introduced for all employers over the next five years. Whilst for many businesses this may become the natural choice, there will be others for whom the change is more difficult and is not cost effective. In particular, micro employers (only one or two employees) may find it simpler to continue to use the existing simplified scheme. Computers do not always make a process quicker for the user. Furthermore, experience shows that the Revenue's ability to produce software to cater for those wishing to undertake tasks such as filing on-line has not been good.
21. We have said before and repeat now that coercing taxpayers to use government on-line systems on pain of fine is unacceptable. Whilst we welcome the financial incentives to encourage smaller corporate employers to file and pay by internet, government on-line systems should be sufficiently easy to use, comprehensive and permanent that taxpayers use them as a matter of choice, not so bad as to make it necessary for government to make their use obligatory.

National insurance

Income determination

22. National insurance and income tax are both calculated on income. Whilst steps have been taken in recent years to harmonise definitions, there remain many differences between the definitions of income on which national insurance contributions and income tax are calculated.

Tax Representation

23. The self-employed taxpayer may also calculate income differently for income tax and for Classes 2 and 4 national insurance purposes. For example, the accounting profit net of depreciation is used when applying the lower exemption limit for Class 2, whereas profits after capital allowances are used as the basis for income tax.

Periodic calculation used for NIC

24. The periodic calculation used for NIC (weekly/monthly) creates calculation difficulties. Since 6 April 2002 reimbursement by an employer for the use of an employee's own car for business has been charged to income tax only where the amount reimbursed exceeds 40p per mile for the first 10,000 miles and 25p per mile for any additional miles. It was originally intended that the same rules would apply when calculating Class 1 national insurance. However, the periodic calculation made this impossible and 40p is used for all miles. Whilst this works to the taxpayer's benefit, the different calculations create an additional burden.

More than one source of earned income

25. Where a taxpayer has more than one job, the application of the additional 1% NI charge in excess of the upper limit, introduced with effect from 6 April 2003, is extremely complex. Few employers will be skilled in this area resulting in the incorrect amount of NIC being paid by many employees and much time being wasted with the calculations.
26. A similar problem arises for the small entrepreneur who starts his own business at the same time as being in employment. All employments and self employments are considered together when determining how much income is chargeable at the additional rate.
27. The practical application of the additional charge has been ill thought through and there is little help available to small businesses and employers facing this problem.

Corporation tax

Size definitions

28. There are many instances throughout the Taxes Acts where the definition of a small, medium or large company is used. There are also many different ways of defining these limits. Sometimes the Companies Act definition is used, sometimes, the level of taxable profits and sometimes the EU definition for State Aid.
29. These differences create additional work for businesses, particularly in marginal cases.

Quarterly payments

Tax Representation

30. The abolition of Advance Corporation Tax resulted in a new system of quarterly payments being required by large companies. This requires a company to pay instalments based on its predicted profit for a year. Interest is charged or credited on under or overpayments. Whilst the interest rates purport to be commercial, this is not the case. As we said at the time the new regime was introduced, a system requiring such payments to be based on the previous year's profits would relieve the administrative burden on companies who currently have to make predictions or suffer a financial penalty.

Flat management companies

31. A published, formal de minimis exemption should be given where virtually dormant companies such as 'flat management companies' receive small amounts of bank interest. The administrative cost of declaring small amounts of income is considerable. We are pleased to note that this issue is under consideration as part of the recently-started consultation on the taxation of trusts.

Value added tax

Cash basis

32. Smaller businesses may adopt a cash approach to determining VAT payable in each period. A cash basis is easier for many non-accountants to understand. However, the cash basis cannot be used to determine taxable profits for either income tax or for corporation tax. A year end accrual is therefore often necessary, creating an additional compliance burden for small businesses who may not have the necessary accounting knowledge or appreciation of the problem.

Flat rate scheme

33. Businesses have been encouraged to adopt the new flat rate scheme for VAT. In order to determine whether it is beneficial, actual calculations are needed and a calculator is now available. The Government has stated that the scheme is revenue neutral, which implies that there must be both winners and losers. Few businesses will want to be in the latter category. Nevertheless, the intention of Customs is to simplify the compliance burden, which we think they have achieved.

VAT registration by Charities

34. This is an area fraught with difficulty for most charities. The complexity of the rules requiring registration causes administrative confusion and is of concern.

Capital gains

Taper relief

35. There are now two regimes for taxing capital gains; corporation tax applies to companies' gains and capital gains tax rules to individuals and trusts.

Tax Representation

36. Capital gains tax taper relief was introduced in 1998 with significantly different rates applying to business and to non business assets. These rules have changed several times since then, but the changes are not retrospective. This results in an additional compliance burden where business assets are disposed of today and complex time-apportionment calculations are needed.

Further issues

Statements of account

37. Income tax statements of account continue to cause frustration. Taxpayers were originally promised a simple statement similar to that used by credit card companies, but little progress has been made resulting in a considerable waste of time.

Student loans

38. Since the introduction of student loans, employers have had to handle their recovery. We understand that many employers have spent large amounts of administrative time on this area.

Statutory Sick Pay, Statutory Maternity Pay and Statutory Paternity Pay

39. SSP, SMP and SPP are all extremely complex. Many small employers will only have to deal with this part of the tax system once or twice in their working life. The administrative cost of tax compliance is inevitably substantial.

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