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INLAND REVENUE'S SELF-ASSESSMENT SYSTEMS FOR INDIVIDUALS AND COMPANIES

Response of the Tax Faculty of the Institute of Chartered Accountants in England and Wales to the Treasury Sub-committee inquiry

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About the Tax Faculty

1. The Tax Faculty is the focus within the Institute of Chartered Accountants in England and Wales for those Chartered Accountants working in the area of tax. It is a centre of excellence and the authoritative voice for the 116,000 members of the Institute on taxation matters. The Tax Faculty makes representations to Government and other authorities, and public pronouncements on major tax issues.

Summary

Self-assessment for individuals

2. The Tax Faculty has considered in detail the objectives set out when self-assessment was first announced in 1991. Whilst we feel that it made a good start, with adequate consultation at the formative stage, it is unfortunate that the operational stage has been less thoroughly monitored, resulting in many practical problems and additional costs for taxpayers and their agents.
3. Three years ago The Tax Faculty published 'Towards a better tax system' containing the ten principles that we thought should underlie all tax legislation. Simplification of our tax system is needed urgently.

Self-assessment for companies

4. Building on the success of 'Pay and file', Corporation tax self assessment has maintained successfully the requirement for a company to file its tax return on time.
5. Difficulties remain however with the system of process now, check later, arising inevitably from the plethora and complexity of UK tax law and accounting practice. In many cases, subjective opinion can leave a company open to high interest charges some time after the deadline for paying its tax has passed.

Self-assessment for individuals

Objectives of self-assessment

6. The objectives of self-assessment for individuals were first set out in a consultative document published in 1991 and centred on the need to devise 'A simpler system for taxing the self-employed'. These were intended to:
 - make the system easier for taxpayers to understand;
 - make the system simpler and more efficient for both taxpayers and the Revenue to administer;
 - make it possible for the Revenue normally to accept the return without further correspondence;
 - make it possible for taxpayers normally to pay the right amount of tax at the right time without Revenue intervention; and
 - open up the way for further reforms to simplify, unify and improve the system of personal taxation.
7. In order to achieve these objectives, the document recognised that the system for taxing the self-employed needed to be aligned more closely with the system for collecting tax from employees. The new system was originally referred to as 'simplified assessing' but this ideal was later dropped in favour of the misleading nomenclature of 'self-assessment'.
8. The extent to which the original objectives have been met varies considerably and each is considered in detail below:

Has self-assessment made the system easier for taxpayers to understand?

9. In a word – 'No'. The tax system is as complex as ever although certain administrative issues are now easier to follow. It would be unfortunate if the administrative improvements were to be misunderstood as indicating that the tax system is in anyway more straightforward than it was before the changes introduced in 1997.
10. The Government chose 1996-97 as the year to introduce simultaneously the two greatest changes to the UK tax system affecting the taxation of individuals for many years. The first of these was the current year basis for taxing the profits of self-employed individuals and partnerships; the second was the process of self-assessment. As these two changes both appeared under the self-assessment banner, there was considerable confusion between them for many taxpayers.
11. The current year basis is undoubtedly much easier than the preceding year basis for taxpayers to understand. This change did represent a simplification of the tax system and it was a pre-requirement of a self-assessment tax system. It is however quite separate from the introduction of the new obligations imposed on taxpayers.

12. The term 'self-assessment' itself is a misnomer. Taxpayers are not obliged to 'self-assess' their liability to tax, but only the extent to which their income is taxable.
13. The process of self-assessment is easier to understand than the old system of estimated assessments, appeals and postponement applications that it replaced.
14. Although self-assessment has made certain aspects of the system easier to understand, it has not simplified in any way the tax rules which the process implements. It is the complexity of these rules that continues to cause operational difficulties. Having a tax system, which is understandable to the intelligent layman, should have been a pre-requisite for introducing self-assessment. Taxpayers are more likely to file their tax returns and make tax payments on time if they can easily complete the forms and understand the tax that they have to pay.

Has self-assessment made the system simpler and more efficient for both taxpayers and the Revenue to administer?

15. Once again we have to say 'no'. The general taxpaying public does not understand the concept of a 'process now – check later' regime. An individual receives tax calculations and refunds by reference to the figures on his or her tax returns when it is processed. At a subsequent date, often many months later, he may receive an enquiry notice and may have his tax liability recomputed after his return has been checked.
16. Few taxpayers appreciate that their tax return is no longer 'checked' by the Inland Revenue. We believe that there is a common misconception that the Inland Revenue have 'agreed' a taxpayer's return until such time that an enquiry notice is received. Where, as is so often the case, no such notice is received taxpayers assume that their tax affairs are in order. In fact they are often susceptible to a 'discovery' assessment in future years even after the deadline for an enquiry notice for the year in question has passed.
17. Those taxpayers who do understand the concept of 'process now – check later' do not like the absence of 'certainty' that exists under the self-assessment system. Except in those rare cases where the Inland Revenue issues an enquiry notice, a taxpayer has to wait until the anniversary of the filing deadline before he can be confident that the Inland Revenue has accepted his tax return.
18. To the extent that a single tax district now deals with a taxpayer's affairs, the administration of the self-assessment system is both simpler and more efficient. Unfortunately this has been at the expense of continuing contact with a named individual at the Inland Revenue dealing with a particular taxpayer's affairs. This leads to operational difficulties and inefficiencies.

Has self-assessment made it possible for the Revenue normally to accept the return without further correspondence?

19. The vast majority of Tax Returns are processed on receipt to be checked later without any need for further correspondence. This is as a direct result of self-assessment. The number of returns submitted in this way on a timely basis, enables the Inland Revenue to use statistics to decide which returns are most at risk of error and to target its resources accordingly.
20. The question should also be asked whether it is a laudable aim for the Revenue to normally accept tax returns without asking any questions about the entries that it contains? The number of enquiries into tax returns has fallen substantially over the last few years. Enquiry notices are currently issued in respect of less than 1% of self employed taxpayers' returns. This is less than one-third of the pre self-assessment number. In order to operate effectively, the threat of a likely enquiry must seem real. Fewer enquiries are likely to lead to more avoidance and non-disclosure as there are fewer individuals with experiences to share with friends and acquaintances.

Has self-assessment made it possible for taxpayers normally to pay the right amount of tax at the right time without Revenue intervention?

21. The Revenue's computer always computes a taxpayer's liability even if he has done it himself and inserted his figures on his return. This calculation is issued to every taxpayer although at last the computer has stopped highlighting minor computational differences over a few pence.
22. The self-assessment process allows a taxpayer to choose between calculating his own tax liability (to be checked by the Revenue) or asking the Inland Revenue to perform the calculation. Although self-assessment has made it possible for a taxpayer to pay the right amount of tax on time in theory, the process becomes more complex with the passing of each Finance Act. Currently every taxpayer must work through a 27-page booklet in order to calculate tax payable. It is difficult to imagine that this was the result envisaged by the original objective.
23. The facility to file tax returns via the Internet has not yet attracted widespread support. However this facility does at least enable taxpayers to identify the right amount of tax to pay without the need for any Revenue intervention.

Has self-assessment opened up the way for further reforms to simplify, unify and improve the system of personal taxation?

24. 'Yes' it has and the move to a current year basis of assessment was an invaluable step in the right direction. Three years ago The Tax Faculty published our 'ten tenets' against which all tax changes and new legislation should be judged. We were the first tax body to call publicly for simplification of the tax system. This means more than merely rewriting the existing legislation in language which is easier to understand.
25. The evolution of the self-assessment system of personal taxation has reached a critical point. In administrative terms, the Inland Revenue is clearly of the

opinion that the next step requires a substantial increase in the use of technology. Unfortunately the UK tax system does not adapt easily to interpretation by computers. The rules have developed piecemeal and new rules usually work alongside, as opposed to instead of, old rules. The taxation of share options and relief for pension contributions offer clear illustrations. Self-assessment has done little to reform the system of personal tax beyond the original abolition of the preceding year basis. Further reform of the tax system as a whole can only work as part of a significant programme of simplification of the rules for identifying and computing taxable income, reliefs and allowances.

Operation of self-assessment

26. Self-assessment is a system overlaid on to the existing tax rules for determining taxable income and expenditure. This makes it difficult to look at self-assessment in isolation, and to differentiate those changes which are as a direct result of self-assessment from those which have been brought about by the Inland Revenue's implementation of self-assessment.
27. The Tax Faculty considers that self-assessment is a better and more efficient system for collecting tax, than the system of assessments, appeals and postponement applications which it replaced. There are however a number of operational issues which are of concern.

Relationship issues

28. Self-assessment has been responsible for a significant deterioration in the relationships between the Inland Revenue, taxpayers and their advisers. Much of this can be attributed to the widespread use of time limits together with the accompanying penalty regime.
29. There is no longer a specified individual within the Inland Revenue with responsibility for a particular case. As a result there is a lack of knowledge about who to approach and considerable amounts of time are wasted re-explaining details of particular cases. The growth in the use of telephony, or call, centres has contributed to this problem. Staff don't have access to files and can't deal with queries. Too often, the only way to contact a Tax Office is through such a centre. Time wasted in making such calls is time lost to a business. In addition, the need to dial 0345 numbers rather than a local rate number adds considerably to the cost of an agent's telephone bill without having any benefit for the agent.
30. 'Working Together' has been established as a means of aiding communicating between agents and local Inland Revenue staff. Whilst the Tax Faculty supports this development, a large part of its work would be unnecessary if efficient channels of communication existed within the Inland Revenue itself. Problems arise often because the Inland Revenue management does not realise the practical impact that changes will have on the day to day contact between their staff, agents and taxpayers. Too often Head Office instructions are not followed correctly, resulting in more time wasted by taxpayers and agents. The operation of the enquiry process illustrates this problem.

Forms design

31. It is our understanding that the Inland Revenue's self-assessment computer system was programmed before the supporting forms were designed. As a result, the forms continue to cause widespread confusion and waste huge amounts of time for taxpayers, agents and Inland Revenue staff. Insufficient funds have subsequently been made available for adequate improvement. Greater emphasis is placed on devising new processes for electronic submission of forms and in marketing than in getting right what we already have.
32. It is a fact of human nature that individuals put off doing tasks that are difficult or unpalatable. Collecting together the necessary information and then completing a tax return falls into this category. The Inland Revenue is supplied with a considerable amount of data about an individual's taxable income before it needs to be issued. Issuing a tax return which already has this data filled in would help the taxpayer by reducing his need to provide information. Furthermore, the Inland Revenue would not need to re-key the data, reducing the potential for error.

Statements of account

33. It is absurd that every high street bank, energy supply and credit card statement is set out in a more comprehensible form than the taxpayer's statement of account. It has always been the case that taxpayers will pay bills that they understand more readily than those which they don't understand. The statement of account should be changed, and not merely reviewed, as a matter of urgency.
34. One of the reasons for the complicated statements is the complex rules for allocating sums paid by taxpayers against outstanding tax, interest and surcharges. In an effort to be helpful and to reduce the quantum of interest charges the Revenue's procedures governing this topic actually cause widespread confusion and concern. For example, lump sums paid to settle known tax liabilities are routinely offset against minor interest charges thus leaving part of the known tax liability as apparently outstanding even though it has been paid in full and it is the interest liability that really remains outstanding.

Enquiries

35. The Inland Revenue would like to dictate to advisers what they do and how they operate in relation to the enquiry process. The reluctance of some Inland Revenue staff to follow agreed procedures has created an unacceptable burden of proving their innocence for many taxpayers.
36. 'Faster Working' was originally an Inland Revenue idea, the detail of which was agreed with the Professional Bodies. The process had two objectives: to ensure continued co-operation between professional advisers and Inland Revenue staff and to speed up handling of enquiry cases. It was supposed to be offered in all enquiry cases.

37. In practice, 'Faster Working' was offered in very few cases. The process as it was originally defined has now been withdrawn, although many of the co-operative elements have been retained. It is regrettable that it can now be unilaterally imposed, where Local Offices were unwilling to use it while it was optional.
38. There remains widespread confusion as to the difference between 'random' and 'aspect' enquiries. We are not convinced as to the rationale for 'random' enquiries (pre-selected by the computer before the tax returns are filed). Such enquiries can cause perfectly innocent taxpayers enormous worry and concern. If this was matched by a realistic number of aspect enquiries, selected after tax returns had been filed the concept might act as a better deterrent against fraud than does the present system.
39. The procedures set out in the published Inland Revenue Enquiry manual are not always followed. For example, the manual specifically states that opening enquiry letters should not ask for an individual's private records and bank statements, yet this still happens on a widespread basis. This causes further damage to the taxpayer/ agent/ Inland Revenue relationship, and raises the question of why the manuals are published if the Inland Revenue themselves are not obliged to operate in accordance with published procedures.

Positive Achievements

Self-assessment has had many successes:

40. Speeding up the submission of Tax Returns;
41. Quicker finalisation of the tax payable for a tax year, although only if an enquiry is opened and closed;
42. All of an individual's tax affairs are dealt with by one tax office;
43. Faster collection of tax.
44. Faster processing of repayments which are correctly due. This is largely attributable to the Inland Revenue's system of 'repay now, check later', a system which has resulted in problems where significant and inappropriate repayments have been made to taxpayers who were not entitled to them.
45. Highlighted to the general public the extent of the complexity of the UK tax system;
46. A reduction in the number of Inland Revenue staff needed to operate the tax system. This has however been at the expense of placing the additional burden on taxpayers, much of which has caused resentment and damaged further the relationships described earlier.

Negative achievements

47. We note that the terms of reference for this inquiry sought written evidence on the achievements of self-assessment and assume that the Sub-committee would also like to be informed as to the failings (or 'negative achievements').
48. Faster processing of excessive repayments. The same 'repay now, check later' system referred to in paragraph 40 above, has resulted in problems where significant and inappropriate repayments have been made to taxpayers who were not entitled to them. We had understood that this was supposed to be impossible, but it has happened, usually due to data input errors.
49. Self-assessment has provided the Inland Revenue with the opportunity to spend large sums of money on first finding and later marketing its brand. Although 30 September and 31 January have been established as key dates in the tax calendar, there remains widespread confusion about the importance of the former in the mind of the taxpaying public.
50. Five years after the introduction of self assessment, nearly 10% of taxpayers fail to meet the deadline for filing their tax returns.

Self-assessment for companies

51. Pay and File was introduced in 1993. This formed the basis for the current system of self assessment for corporation tax.

Objectives

52. To a greater extent than for individuals, the system of self assessment for companies has enabled them to pay their tax on time. However this becomes more difficult where a company is required to pay its tax by quarterly instalments. It is impossible to judge what this should be with certainty, and interest will always be in point.
53. Corporation tax self assessment has maintained successfully the requirement for a company to file its tax return on time.
54. Corporation tax self assessment, together with pay and file, have succeeded in speeding up collection of tax, replacing the previous system of assessments, appeals and postponements.
55. File now, check later, has enabled greater emphasis to be placed on risk assessment, allowing the Inland Revenue to better concentrate its resources.

Operation

56. The operation of corporation tax self assessment will always be hindered by the complexity of the underlying tax rules.
57. The growing use of accounting principles to determine taxable profits will also add to the burden. In many cases, where different accounting policies are possible, differences of opinion between companies and the Inland Revenue will inevitably create more problems. The system of 'file now, check later' does not allow for such differences to be dealt with at an early stage.
58. A comprehensive pre transaction ruling system would give proper assurance to a company seeking to submit a correct and agreed corporation tax self assessment return at the outset.
59. Although advance corporation tax has not been payable since 6 April 1999, companies with surplus ACT brought forward must continue to grapple with an even more complex set of rules before they can claim relief by set off. This problem is even greater where a company is paying its tax by quarterly instalments.
60. Large companies are required to pay their corporation tax in quarterly instalments. As the first of these is almost always due before the company's accounting period has ended, this must be based on estimates, and interest will always be in point.

This is an unnecessary complication which could be avoided if instalments were based on, for example, the previous year's figures.

Achievements

61. More companies are now filing their returns and paying their tax on time. This was already happening following pay and file. The introduction of the penalty regime contributed to this achievement.
62. Most corporate entities are already fully conversant with the use of technology. Corporation tax self assessment will be seen as a stepping stone towards further electronic exchange of information with the Inland Revenue. It would be unfortunate however, if progress is forced in advance of a programme of tax simplification.

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