

TAXREP 30/05

‘WORKING TOWARDS A NEW RELATIONSHIP – A CONSULTATION ON PRIORITIES FOR REDUCING THE ADMINISTRATIVE BURDEN OF THE TAX SYSTEM ON SMALL BUSINESS’

*Memorandum submitted in June 2005 by the Tax Faculty of the Institute of
Chartered Accountants in England and Wales in response to
an invitation to comment issued in March 2005 by HM Revenue & Customs.*

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‘WORKING TOWARDS A NEW RELATIONSHIP – A CONSULTATION ON PRIORITIES FOR REDUCING THE ADMINISTRATIVE BURDEN OF THE TAX SYSTEM ON SMALL BUSINESS’

INTRODUCTION

1. This submission responds to the consultation published in March 2005 by HM Revenue. (see http://www.hm-treasury.gov.uk/media/A62/4A/bud05_working_towards_new_relationship_370.pdf). The consultation is intended to find out what small businesses and their advisers need from HM Revenue & Customs (HMRC) and what the new department’s priorities should be in responding to the needs of small businesses and their advisers to enable HMRC to deliver real benefits by reducing the administrative burden the tax system imposes and improving relationships.
2. The second part of our submission relates to the 18 questions specifically posed by the consultation document.
3. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Annex 1 to this document.
4. We would be happy to meet with relevant Treasury and HMRC officials to discuss any particular items in further detail.
5. We also attach the Tax Faculty’s Ten Tenets for a Better Tax System. These are the ten principles that we think should underpin a good tax system. We have set these out in Annex 2 and we would urge Government and government departments to bear them in mind when designing a tax system better suited to the needs of smaller businesses.

KEY POINT SUMMARY

6. The following key points are made in the paragraphs which follow:
 - The key to reducing the administrative burden of the tax system for small businesses is to simplify the tax system itself.
 - Tax forms and processes should be streamlined to reduce the need to repeat the same data on different forms.
 - Operating a payroll is one of the most burdensome tasks to face a small business.
 - Government computers systems must be able to communicate with each other before any truly effective administration savings can be achieved.
 - Change should not be introduced too quickly and should be tested rigorously first.
 - HMRC staff need better training.
 - More flexible tax payment arrangements are needed.
 - Small businesses respond better to encouragement rather than rigorous imposition of penalties

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GENERAL COMMENTS

7. We welcome the review of small businesses and are pleased that all areas are being reviewed. We will be participating actively in the continuing discussions via our involvement on the Small Business Panel.
8. We mention we'd like to see the technical issues looked at too but it is good that HMRC is looking at administrative issues. However, a business has to cope with many other admin matters outside of tax eg health & safety rules etc and overall costs of employment. We would like these issues to continue to be addressed as part of the overarching aim to help small businesses. To achieve a fairer, more certain system will require radical thinking and minor tinkering will only cause more problems rather than good longer term solutions.
9. In the meetings which we have attended during this consultation period we have understood that this consultation is an opportunity to make fundamental changes to the way that small businesses are taxed. Although this was not emphasised in the published consultation document, which focuses on the administrative part of the tax system, a number of our responses reflect this broader intention. We have sought to answer the questions posed but in addition our responses highlight that these are not the only important questions, and indeed sometimes are not even the relevant questions, for many small businesses.
10. Fundamental change cannot be achieved reliably in a short time scale. We hope that this consultation will produce ideas which can go on to form the framework of a simplified and unified tax system for small businesses in the future. This is likely to take some years to implement and will need the involvement and backing of all government departments, business and tax professionals.
11. Many of our volunteers have stressed the need to simplify the tax system so that self assessment can work more effectively.
12. It is essential that tax forms and processes are streamlined and that government computers are able to communicate with each other before any truly effective administration savings can be achieved.
13. A business has to cope with many administrative matters in addition to tax. For example health and safety rules. We would like these issues to continue to be addressed as part of the overarching aim to help small businesses. To achieve a fairer, more certain system will require radical thinking and minor tinkering will only cause more problems rather than good longer term solutions.

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SPECIFIC COMMENTS

Simplifying forms

Q1. Which forms give rise to the greatest burden for businesses, and why? How might they be improved?

14. The greatest burdens are caused by those that are:
 - Unexpected (especially new forms).
 - Incomprehensible because of lack of technical knowledge of what is being asked for (for example questions on Forms P35) or where the layout or design is poor.
 - Time consuming, especially where substantial staff time is required to obtain information after the event because introduction time was too short, lack of publicity and lack of clarity about purpose (for example Form 42).
15. The IR35 legislation causes problems for some businesses when they come to complete Form P35 because of the level of judgement required.
16. Too many forms (for example numerous and lengthy VAT forms).
17. Corporation Tax Returns where there is unnecessary duplication. In particular, the requirement for Form 42 to be completed by small companies following a straightforward share issue. Such companies do not consider that they are operating a share scheme, but simply reorganising the ownership of the business to make it work. The example put forward by many of our members is a flat management company. As such companies already complete a plethora of other forms into which the basic Form 42 information could be included, the return to Companies House or Form CT41G could be used in most cases.
18. Many small businesses do not provide benefits in kind to their employees but are still required to complete forms P11D to disclose reimbursed expenses. The guidance from HMRC is also confusing as to what constitutes reimbursed expenses. Dispensations can be difficult to arrange, particularly for very small companies. Most ask their accountant to deal with this work and therefore incur costs.

Q2. Do the existing on-line services offered by Revenue or Customs meet small businesses' needs? What are the main areas for improvement that would encourage more small businesses and their advisors to file returns electronically?

19. Most small and medium sized enterprises (SMEs) want to use electronic forms provided by their software providers which make use of existing databases. HMRC need to work with software providers to achieve this.
20. Businesses want to be able to populate forms easily and not reintroduce data.

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21. The on-line services available have improved greatly over the past few years, however much of the information remains hard to find. There are a number of tasks which have to be repeated such as the on-line entries for employees leaving as well as the hard copy of Form P45 needed for former employees.
22. We have had complaints from members about PAYE on-line filing being slow and the problems incurred by HMRC in April and May this year have been well documented.
23. The ability to look at a client's payment record is very useful. However, we have had comments that rather than use the online filing facility for Corporation Tax Returns it is often quicker, and therefore cheaper, to print out the computations and send them with a covering letter. If SME Corporation Tax Returns did not have to be accompanied by accounts and computations, so making the Return similar to an Income Tax Return with standard accounts information, more agents could be persuaded to use on-line filing.

Making payments easier

24. There is a lack of consistency with regard to collection of outstanding tax. We have heard of PAYE returns and amounts due being outstanding for several years on some employers when a harder attitude could initially have been more helpful. Conversely other businesses have suffered serious cash flow problems through an intransigent attitude to PAYE collection.
25. Most businesses go through cash flow problems. Some agreed statement or legislation detailing what help can be provided in these situations would be helpful.

Q3. Should the department be doing more to offer modern and flexible payment options for small businesses?

26. This question received a unanimous 'Yes'. There should be as much flexibility as possible, including payment by direct debit, credit card and by monthly instalments.
27. It could also help to separate the balancing income tax payment from one year from the first payment on account for the following year. Statements still need to be easier to understand, particularly where errors to past entries were made and corrected some months later. These adjustments are very difficult, and so time consuming and costly, to follow.

Q4. Is the current balance right between providing a level playing field for all, and providing payment flexibilities for businesses?

28. This question implies that there is a level playing field and that payment flexibility is the distorting factor. We believe that the problems are more fundamental than this and that the current system is inconsistent. It is these underlying issues which need to be addressed. The different treatments of employment and self employment, and also between unincorporated and incorporated small businesses, where the underlying activity is the same, creates unnecessary complexity.

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29. We consider that the automatic £100 penalty for late registration as a newly self-employed person is unreasonable. We note that this penalty, which was a recommendation of the Grabiner Report to encourage people to come out of the informal economy, attempts to level the playing field between unincorporated businesses and companies which need to register beginning to trade or face a similar penalty.
30. Many individuals set up in business by themselves and are only aware of the deadline for tax return submission because of HMRC advertising campaigns. They therefore often do not contact an accountant until several months after becoming self-employed. By this time they are at risk from the automatic penalty for not registering as self-employed. Conversely, in order to begin trading through a company, an individual is almost certain to have needed professional advice from the outset and so is less likely to miss the three month deadline for submitting Form CT41G..
31. Further to our comments relating to the newly self-employed, there is no intention to defraud the government and no loss of revenue. This is a very heavy-handed response to genuine ignorance on the part of many individuals.

Q5. What might enhance the existing range of VAT simplification schemes available to small businesses?

32. Turnover levels should be increased so that more businesses qualify for the schemes. More simplification is required, such as fewer flat rates. Turnover levels should be aligned such as the flat rate turnover and cash accounting limits. Whilst this may increase the risk of loss to the Exchequer, it would encourage greater take-up and so reduce administration costs.
33. VAT generally is too complex for most small businesses to operate without professional advice. This is most problematic for growing firms for example those which may be considering expansion abroad and which have to decide how to invoice new services to other Member States.
34. Although this is not relevant to any of the specific questions posed by the consultation, there are two problems with the VAT registration threshold. First, for a trader whose sales are just below the threshold there is a very real cost if he increases the size of his business, registers and so makes his services more expensive to non-registered customers.
35. Furthermore, people do not appreciate the rolling annual calculation of turnover for VAT. They tend to look at the sales in say the annual accounts and then consider whether they should be thinking of registration. That can then be too late. An example illustrates the point:

'A builder client was monitoring his sales. At the beginning of December he was below the limit but just before Christmas he issued a large sales invoice and received the money and that pushed him over the limit. He had to be registered by 1 February. He came to us in the middle of February by which time he had issued another substantial invoice and received the money. He was compulsorily registered from 1 February. His sales were to private individuals and so

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therefore he had to stand the VAT on the sales invoice in February. The VAT office refused to move on the date of registration.'

Q6. To what extent do different payment dates for different taxes give rise to problems for businesses?

36. We do not see this being a big problem, but it is annoying that some forms (such as Form P11D) are on a fiscal basis and are not necessarily in line with the accounting period

Tax inspections

Q7. Would businesses prefer to have one visit to inspect all business records for all taxes, or separate visits for different taxes?

37. Most businesses believe that this would save them time.
38. A number of members have said that they have received helpful and constructive advice from VAT visits in particular. Given that this is the case, it might be helpful for small businesses if they could actually opt for a PAYE, VAT and/or corporation tax inspection. Although it is possible to purchase such a service from the business' professional advisers, the compliance aspects of such a review could equally be given by an HMRC official early in the life of the business, often before they have an adviser, and it would tie in with previous guidelines previously operated by Customs & Excise to visit new firms within three years of registering for VAT.
39. This would give comfort that the tax affairs are in order and the business would not have to fear a possible future inspection.
40. It would be helpful to allow as much flexibility as to timing as possible.
41. There is an alternative view however. Currently, the different taxes have different information gathering powers. A single visit could lead to HMRC officers exceeding their powers on one or other of the areas they are looking at. Further to our recent response to the HMRC Powers consultation, published as [TAXREP 28/05](#), there would need to be safeguards and clear information for businesses to understand the purpose of the visit and their rights

Q8. What other steps might be taken to reduce the burdens on business that result from inspections and enquiries?

42. Greater understanding, technical knowledge and practical experience on the part of those undertaking the inspections. This would involve better risk assessment for selecting cases, fewer but more targeted inspections and more highly qualified individuals leading the inspection teams with relevant industry knowledge. More joined up understanding of business issues with other government bodies (FSA, DEFRA, etc).
43. Following an inspection there could be a de minimis limit rather than needing adjustments for every small error.

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Improving Communications

Q9. How high a priority is delivering Whole Customer View (WCV) to small businesses and their advisers?

44. Most of our members held this as a low priority although recognise that it could save time and reduce the need for queries to be transferred between departments.

Services for intermediaries such as accountants and tax advisers

Q10. How do small businesses and intermediaries prefer to obtain the information they need?

45. Information is needed in the most timely, clear and unambiguous manner.
46. Regular HMRC newsletters with worked examples on new topics showing both positive and negative implications. These should not be used as political tools, but should be informative.
47. Email communication is preferred to the telephone. Although notes of telephone calls can be kept, it is much easier to keep a record of discussions which take place by email.

Technical helplines

Q11. If the department needs to prioritise early action to improve channels of communication, should it focus on a better website, better designed leaflets, or improved phone contact services?

48. Our members' responses to this question varied and depended on the extent of use of new technology. Overall their order of preference was:
- telephone
 - website
 - leaflets

Q12. Is having a single view of clients' accounts with HMRC a priority service for intermediaries?

49. No

Q13. What can the government do to further reduce the costs of using intermediaries and to ensure that those savings are passed through to small businesses?

50. Stop changing forms, processes and systems. The pace of change in underlying tax law has of course forced many of the administrative changes, but the fact that they are introduced piecemeal means that much repetition becomes embedded in the system.
51. Simplify and streamline reporting requirements.

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52. Offer easier access to HMRC staff who actually deal with the case in hand and who are technically competent to deal with phone calls from practitioners. This would reduce the amount of wasted time spent by all concerned. We received many comments that too much time is wasted trying to fight one's way through call centre staff who are not able to deal with the question and who are not always willing or able to refer the matter to technically competent staff. This leads to the general perception that HMRC staff are not adequately trained. Call Centre staff in particular follow scripts mechanically. Lack of wider knowledge can lead them to misunderstand a concept and give the wrong answer. It also means that they deal just with the specific point raised and are unable to deal with other unrelated questions, for which the caller must go to a different helpline. HMRC staff with a broader knowledge of all tax areas likely to affect businesses could take a more holistic approach.
53. Accountant's costs would be reduced if HMRC did not make so many mistakes and dealt with communications more quickly. Too often HMRC demand a response within 30 days only to send a holding reply or else take months to deal with their own correspondence in turn. This is particularly so with tax credits correspondence for which there are no statistics publically available. Chasing up repayments and sorting out HMRC mistakes costs our clients money and the COP1 procedure itself adds to this.
54. It is not correct that accountants do not pass on cost savings to clients. Unfortunately it is more often the case that additional HMRC reporting requirements increase costs which cannot be passed on to the clients. Form 42 has already been cited as an illustration of this.
55. The government could offer further incentives (as currently for PAYE returns) for filing forms electronically.

Small businesses as employers

Q14. What drives the cost of administering the Government's payroll reporting requirements? What are the main implications for employers' resourcing that come with these requirements?

56. Staffing, training and software are the main cost drivers. The cost is often seen as disproportionate to the benefits. Many small business people detest all forms of administration and compliance which is why they set up their own businesses in the first place.
57. Reporting complexity of running a payroll leaves no option but to outsource for many small businesses.
58. Time constraints faced by small businesses may also lead to outsourcing.
59. The greatest costs facing businesses are created by the complexity of the tax system. The PAYE system worked well in its early years because the rules for income tax and national insurance were more straightforward. One of the greatest hurdles that a business will face will come when it decides to take on its first employee and the

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owner must grapple with unfamiliar forms and rules. The next hurdle comes when the payroll is computerised for the first time. Software and possibly also computer hardware must be purchased and more time set aside from running the business to learn how to operate this.

60. One possibility which has been suggested is that in say the first two years of the life of a small business, incorporated or unincorporated (perhaps using something along the lines of the EIS definition as the qualifying size) there could be a special tax break (along the lines of the Research and Development credit) for expenditure by the company on tax based compliance costs.

61. A major area of difficulty is still PAYE investigations. This is made worse where there are status issues to be resolved. It is time consuming and distracts from running the actual business itself. Unless handled carefully these can have a very detrimental effect and in extreme cases affect the owners' perception as to whether they wish to continue in business at all and certainly whether they wish to employ others.

Q15. What are the benefits of using intermediaries to deal with payroll? Do these benefits to business always outweigh the cost? Are there best practice examples available that might help small employers attain the optimum cost/benefit balance?

62. The benefits are that compliance is achieved and aggravation and disruption to the business are kept to a minimum. These are the same issues as for all outsourcing.

63. The quality of intermediaries undertaking this work varies considerably.

Q16. What more can be done to encourage small employers to make greater use of intermediaries to administer payroll or aspects of payroll?

64. Quality assurance and publicising the benefits of using a professionally qualified adviser.

65. Rebates or tax credits for the costs in the early years of running a payroll as discussed earlier.

66. Use incentives to encourage paying PAYE on time and returns being made online, rather than putting the emphasis on penalties for missing deadlines.

Q17. To what extent do businesses artificially constrain their growth as a result of the tasks associated with taking on their first employee? What could be done within the existing tax and benefits system to minimise this?

67. Make it easier to engage casuals and low paid staff without all the complexities of PAYE. We note that this has implications for contributory benefits.

68. The PAYE system does not cope well with issues such as multiple employments. This frequently leads to under or over payment of tax which needs to be sorted out after the year end. We have already suggested the basis of a payroll system which could be used as a solution for this in our response to the Treasury discussion paper

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‘Small companies, the self employed and the tax system’ published in December 2004. The relevant extract from our paper, TAXREP 22/05 is appended as Annex 3.

69. Small businesses are reluctant to employ staff mainly due to the high National Insurance costs and complex tax and employment law issues. The government should consider ways of incentivising small employers (see below re training courses).
70. Some businesses have such bad experiences of dealing with the authorities in relation to tax matters that they stop employing people at all.

Q18. How can we best encourage small employers to take greater advantage of the benefits of technology? Are there best practice examples available that might help small employers achieve the optimum cost/benefit balance?

71. This can be achieved through incentivising the use of intermediaries and software providers, possibly by introducing financial incentives over a transitional period.
72. Many small businesses are still very nervous of using technology. We think it would be helpful if basic training courses could be offered and an incentive should be offered to encourage people to attend.
73. The relentless drive to electronic records and filing is welcomed by many businesses. However, those who prefer not to use electronic means, for whatever reason, should not be made second class citizens because the government departments want to operate their own systems in a particular way.

ICAEW AND THE TAX FACULTY: 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. 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 and students, to provide services to its members and students, and to advance the theory and practice of accountancy, including 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 of the ICAEW who pay an additional subscription.

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ANNEX 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.

SIMPLIFIED PAYROLL SYSTEM

(Extract from TAXREP 22/05)

Angie, Betty and Cathy each work between 15 and 25 hours a week for the Red Lion pub. Cathy also works for an outside catering company, BBQ Ltd, which is unconnected with the pub. The landlord knows that he can afford to employ people as long as his total cost per hour per employee is £6.00. BBQ Ltd knows that it can afford to employ people as long as the total cost per hour per employee is £7.50.

Arthur is a pensioner who receives each year an old age pension, an NHS pension and an occupational pension.

Let us suppose that the Government sets up a state employment service (SES), which could be outsourced to a bureau if the Government does not want to actually run the service itself. The system could be state funded, or participating employers could pay a small fee.

Any employer or pension provider can register to use the scheme. Any employee can also register to use the scheme. Each participant is given a registration number, which could be the NI number for the individuals.

All the above are registered with the scheme.

Each pay period, weekly or monthly, the landlord of the Red Lion, BBQ Ltd, the Government pension, the NHS pension and the occupational pension are paid to the SES. They run the payroll and make a single net payment to each of the employees.

Benefits: The two small businesses are relieved of all tax calculations, including the consideration of employers' NIC. They each know exactly how much buying one extra hour of labour will cost them. BBQ Ltd does not have to keep completing forms P45/P46 as it uses casual staff. In cases where there was doubt over whether a worker was employed or self employed, normal rules would apply, although they could ask HMRC for assistance as they do now.

Employees with multiple employments and pension sources receive the correct net income without endless wrangling with HMRC over tax codes for different sources of income.

AM
1.7.05