

TAXREP 73/08

INTEREST – WORKING TOWARDS A HARMONISED REGIME

Comments submitted on 11 September 2008 by the Tax Faculty of the Institute of Chartered Accountants in England & Wales in response to the consultation document 'Interest – Working Towards a Harmonised Regime' published by HM Revenue & Customs on 19 June 2008.

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| ICAEW Tax Faculty, Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ www.icaew.com/taxfac | T +44 (0)20 7920 8646 F +44 (0)20 7920 8780 E tdtf@icaew.com |
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INTEREST – WORKING TOWARDS A HARMONISED REGIME

INTRODUCTION

- 1 In this document we present the comments of the Tax Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW) on the consultation document 'Interest – Working Towards a Harmonised Regime' (the Condoc) published by HM Revenue & Customs (HMRC) on 19 June 2008.
- 2 We are pleased to have the opportunity to respond to this consultation and we also welcome the opportunity to discuss the proposals with HMRC staff. We look forward to participating in the forthcoming workshop on this topic. In the meantime, we would be happy to discuss any aspect of our comments and to take part in all further consultations on this subject.
- 3 Information about the Tax Faculty and the ICAEW is given in Annex A. We have also set out, in Annex B, the Tax Faculty's ten tenets for a better tax system, by which we benchmark proposals to change the tax system.

KEY POINT SUMMARY

- 4 Our key points are:
 - We are not convinced that the Condoc makes a compelling case for major changes to the existing rules.
 - We are concerned particularly that HMRC has already decided to increase the rate of interest charged on overdue tax and that this Condoc is designed to support that decision. We trust that this is not the intention that think that HMRC should reflect on the responses received and ensure that they are factored in to any decisions that are made.
 - Harmonised interest rates may appear superficially attractive but we think that there needs to be a number of rates so as to ensure that the tax system is fair and reasonable.
 - We are not convinced at the case for charging differential rates and think that if they are to remain the differential should be small, ideally no more than 1%.
 - The charging of Interest should be based on the principles of restitution and be even handed. Any interest charges should be reasonable and not penal.
 - Any changes to the rules should be designed to improve compliance rather than raise revenue. If they are designed to raise revenue then we are opposed to any changes.
 - The Condoc does nothing to encourage early payment: many taxpayers might wish to pay tax liabilities earlier to help them with budgeting but are discouraged by low interest rates.

- Certificates of tax deposit have a useful role to play in encouraging timely payment of tax but have been allowed to wither on the vine. We think that consideration needs to be given to how they can be made more attractive.
- We are concerned that adopting a 'one size fits all' approach may not be appropriate for all taxes and that applying interest rules for direct taxes to indirect taxes could lead to considerable burdens.

GENERAL COMMENTS

5 We agree that the existing rules for interest on overdue tax and on repayments of overpaid tax across the different taxes are frequently confusing. They would benefit from simplification and a more coherent and consistent approach in accordance with our ten tenets for a better tax system (see Annex B). However, we are not convinced that the Condoc makes a compelling case for major changes to the existing rules.

6 More generally, we are concerned that the Condoc looks at the issue largely from the perspective of HMRC. Many of our members have expressed concern that HMRC have already decided that they want to increase interest rates for tax paid late and the whole thrust of the document is predicated on that outcome: in other words that this consultation is little more than a box ticking exercise to justify a decision that HMRC has already made. Given that the case for change has not been made, we trust that HMRC will now take stock of the responses it has received and ensure that they are fully factored in before any decisions are taken about what to do next.

Harmonised interest rates

7 Whilst in theory a harmonised interest rate may look attractive, a number of rates are probably needed so as to ensure that the tax system is fair and reasonable (see our further comments on this aspect below). For example, it would be reasonable to charge a lower rate of interest on underpaid tax where the tax paid is based on estimates rather than known liabilities.

Differential rates of interest

8 Views of our members were somewhat divided as to whether any interest rates should be 'mirror' rates or whether there should be different interest rates for underpaid and overpaid tax. There was widespread support for mirror rates in cases where any tax payments are based on estimates. Members were agreed that if there has to be differential interest rates, then the interest rate spread should be relatively modest and lower than the current spread, say one to one and a half per cent.

Fair and reasonable

9 Our ninth tenet is that the tax system should be fair and reasonable. The principles set out in the box in 3.1 of the Condoc look reasonable. However, there is widespread concern amongst our members that the result of this consultation exercise will be that rates of interest on unpaid tax will be raised to penal levels, thus handing a further advantage to HMRC. Interest charged or paid should be based solely on the principles of restitution and, as acknowledged in paragraph 3.4, it needs to work both ways and be even handed as far as possible.

10 This principle is important because HMRC are not operating in the same commercial environment as, say, High Street banks. HMRC's role is to collect tax as efficiently as possible whereas High Street banks are seeking to make money from the difference

between their deposit and loan rates. Further, HMRC has a number of special powers that are not generally available in the commercial world to help ensure that taxpayer pay their taxes in full and on time, for example it can levy surcharges and penalties in addition to interest.

- 11 We appreciate, of course, that commercial businesses such as Banks can and do levy penalties and other charges. However, the continuing controversy over excessive bank charges and the reputational issues it creates is a warning to HMRC that they should not seek to impose unreasonable charges on taxpayers.
- 12 In view of HMRC's already extensive powers, we think that the key principle should be that any interest regime is, and is seen to be, fair and reasonable to taxpayers. It should mirror, as closely as possible, the principles of commercial restitution and should not advantage unduly HMRC. If it does provide an undue advantage, it will merely entrench the perception that the tax system is too heavily biased in favour of the state.
- 13 The purpose of this review should be to work towards a system that encourages taxpayers to tax pay on time rather than penalise them if they do not. This Condoc makes proposals for changes but takes us no further forward in understanding taxpayer compliance trends and how, for example UK taxpayer compliance measures against other jurisdictions.
- 14 We are concerned that the end result of this consultation is that interest charges will be increased and taxpayers will be disadvantaged even more than they are under the existing rules. In Chapter Six, for example, HMRC appears to be looking to increase further the differential between the rate of interest on overdue tax and that paid on repayments, fuelling the concern expressed by many of our members that this decision has already been taken and that these proposals are a revenue raising exercise rather than a genuine attempt to understand and improve tax compliance.
- 15 The aim of this exercise should be revenue neutral. We would welcome confirmation that this is the intention. If it is not, then we are opposed to any proposals that merely increase further the burdens on taxpayers.
- Encouraging payment of tax*
- 16 We believe that a good tax system should help taxpayers by providing flexible ways of paying tax, and any interest system should support this approach. However, the current rules do little to encourage more flexible payment arrangements and neither do the proposals in this document.
- 17 In particular, most people work on a monthly budget whereas many tax payment dates (such as those under income tax self assessment) do not. We think that there is a demand from taxpayers for the ability to pay tax before the due date in order to help their budgeting.
- 18 However, the current rules do not encourage taxpayers to pay tax early and the proposals in this Condoc will not do so. Paragraph 3.6 states that:

Where tax is paid before it is due this is generally the decision of the taxpayer. The amount does not need to be paid until the date established in the legislation.

- 19 That may be true but where taxpayers have paid tax before the due date, HMRC will have had use of the money and no interest will be paid. The tax system should not actively discourage early tax payments as some taxpayers would like to do so for budgeting purposes, but do not do so because any interest paid is uncompetitive.
- 20 HMRC needs to adopt a more even handed approach and consider more innovative approaches to early tax payments based on the principle of restitution. The rate need not necessarily be at the same rate as would be obtained from a bank, but it needs to be sufficiently attractive for taxpayers to be willing to pay the money to HMRC. It would also be reasonable to pay interest from the date that the payment was made rather than the date that the tax was due.
- Certificates of Tax Deposit*
- 21 The Condoc does not mention the use of Certificates of Tax Deposit (CTDs). These were once widely used for the payment of tax liabilities and were particularly useful to stop taxpayers falling into problems where a liability was under dispute. However, their use has been allowed to wither on the vine: they can no longer be used to meet corporation tax liabilities and the rates of interest are uncompetitive on deposits of £100,000 and under,
- 22 We think that CTDs could be used more extensively to encourage timely tax payments but the rate of interest on deposits of up to £100,000 needs to be more competitive.
- One size fits all approach*
- 23 We are concerned that applying a 'one size fits all approach' to interest payments may not work particularly well given the different nature of taxes. Whilst in theory a single system that applies to all taxes looks not unreasonable, it is important to remember that, for example, direct taxes are usually levied on profits determined after the accounting period whereas taxes such as VAT are levied more regularly by reference to transactions. Applying an interest charge to late payments of VAT automatically may look reasonable on paper but could lead to considerable problems in administration and quickly become bogged down in complexity.
- 24 We would therefore caution against adopting rules developed for direct taxes to indirect taxes without detailed consideration of the likely administrative difficulties and costs that might result. If it was considered desirable to move to automatic interest charges, a more reasonable approach for indirect taxes paid regularly might be to give taxpayers a period of warning and provide them with an opportunity to bring their affairs up to date before they entered such a regime.

RESPONSES TO THE QUESTIONS POSED IN THE CONSULTATION DOCUMENT

Chapter five

Question one – Which of the options for a starting point for the interest rate formula best fits with the design principles of recompense, fairness and simplicity for the majority of taxpayers?

- 25 In the interests of simplicity, we think that interest rates should be harmonised across the taxes where it is reasonable to do so. However, the system needs to reflect a wide variety of circumstances and a single rate is not appropriate in all circumstances. The method of calculating interest should be kept as simple as possible, using a rate that is well-known. Once decided, it should be applied consistently.
- 26 Applying the principle of fair and reasonable we are not convinced that the arguments for differential rates between underpayments and overpayments as set out in the Condoc are valid. Due to the fact that the corporation tax quarterly payments system requires estimates to be made of the ultimate corporation tax liability and this is bound to lead to over and underpayments, we believe that there is a good case for mirror rates.
- 27 If a return to mirror rates as still found in the IHT regime is not accepted, then we think that the difference between the two rates should be small. It should not be more than the current spread of 1.25% and we think it should be less, say 1% maximum.
- 28 We think that the general principles of an interest regime should be as follows:
- the rate should follow the Bank of England base rate (base rate);
 - the number of changes should be kept to a minimum. Ideally, the rate should be set for the whole year, but to preserve some flexibility we suggest that rates could be changed twice a year.
 - whilst we understand the arguments for and against compound interest, in the interests of simplicity we agree that interest should remain as simple interest (as set out in the sixth bullet point in paragraph 5.39). Compound interest should only be adopted for payments/repayments have been outstanding for a long time, say at least a year.

Question two – How far should the difference between the rate of interest charged by HMRC and paid by HMRC reflect the difference between the borrowing and lending interest rates used commercially?

- 29 For the reasons given above about HMRC's role and powers we are concerned that commercial comparisons are not wholly appropriate. In addition, 'commercial' needs to be considered in the light of the type of taxpayer and the amounts involved. Commercial interest rates available to, say, a major UK plc will be different to the rates applicable to an individual taxpayer of modest means.

30 The need to adopt a simple system will mean that compromises have to be made which may not be commercial for all types of taxpayer. This might suggest that there should be, for example, different rates of interest for business and non-business taxpayers. A simple approach would be to have different rates for income tax and corporation tax, but in practice the distinction between these two types of taxpayers is often blurred and in any event the differences between small and large businesses will often be considerable.

31 In summary, whilst we see the advantages of one rate for all taxpayers, in practice and for the reasons we have already given above we think that adopting one rate is probably unrealistic. In particular, the corporation tax quarterly payment regime is a special case and given that it will apply to only the largest companies, rates for it should reflect the commercial rates available to such companies. This would suggest a rate based on LIBOR rather than base rate.

Question three – What do you consider is the best way to strike a balance between delivering simplicity through stability and achieving recompense in setting the rates of interest charged and paid by HMRC?

32 The method of setting the rates should be transparent and based upon published rates as discussed above.

33 For stability, we think that rate changes should be minimised. If possible, rates should be set for a year, although we appreciate that this could favour HMRC or taxpayers depending upon the movement in rates through the year. As a compromise, we suggest that rates should only be adjusted twice a year.

34 A simple system would also suggest that there should be consistency across taxes as to whether interest paid is tax deductible and interest received is taxable. The advantage of the approach adopted for corporation tax is that it minimises adjustments that need to be made to the corporation tax computation.

Question four – Which of these approaches for charging interest on late payments of in-year PAYE do you feel best deliver the design principles of recompense, fairness, and simplicity?

35 We understand the difficulty of in-year PAYE payments and appreciate that the current situation is not satisfactory. It seems to us that any system that is adopted will of necessity add to the burdens that are imposed on businesses, and this factor needs to be weighed up against the costs of employers not paying PAYE on time.

36 Most employers will provide employees with a monthly payslip showing what tax and NIC has (or ostensibly has been) deducted, so for many employers it would not be too unreasonable a burden for them to provide the information due in paragraph 5.4.

37 Of the other options, the approach in paragraph 3.7 might be possible but it looks cumbersome to operate.

Question five – Are there other approaches that could be taken for charging interest on late payments of in-year PAYE that would fit with the design principles of recompense, fairness, and simplicity?

- 38 Another possible approach might be that the monthly payment of PAYE includes a declaration that the payment includes all amounts of income tax/NIC that were shown as deducted on the employees' payslips. Failure to make a correct declaration might then result in a fine or HMRC being able to raise determinations of PAYE due in future months which could carry interest.

Question six – This chapter has considered the possible features of a new interest regime. Your views are invited on how the options discussed meet the principles of recompense, fairness, and simplicity (as described in chapter three).

- 39 We are concerned about the comments and comparisons made in Chapter 6. The table of rates in Chart 1 and the comparisons with other jurisdictions suggest that HMRC is seeking to increase the rate of interest on overdue tax even further than the current differential of 2 to 2.5%, a spread which we think is already too high.
- 40 The key principles underlying any changes should be even handedness and restitution. Any further increase in the existing differential begins to look like a penal rate of interest. Given that HMRC has powers to enforce payment and to levy surcharges on late paid tax, we think it is essential that the rates are reasonable.
- 41 We are also concerned that comparisons with other jurisdictions can be taken too far and may be potentially misleading. Rates of interest are only one factor in a tax system and in order to make a fair comparison it is necessary to consider other tax systems 'in the round'. Merely picking out headline rates can be misleading and is not a sound basis upon which to make policy decisions.
- 42 For example, we do not know whether the high differential in rates in Australia is successful in encouraging taxpayers to pay on time, whether it is actually collected and what other problems it may cause. There is no attempt to examine the relationship between interest rates and taxpayer compliance in the different jurisdictions.
- 43 The Condoc does not contain any analysis of why taxpayers do not pay tax on time, nor whether interest rates are a factor that can encourage improved compliance. This is disappointing. The Condoc does not in our view provide compelling evidence that any changes made will lead to improved compliance.

Question seven – This chapter has considered how a new interest regime could be harmonised across all taxes - are there any conditions that are specific to any of the taxes that create a case for different treatment?

- 44 See comments made earlier in relation to direct v indirect taxes and also in respect of quarterly payments for corporation tax.

Chapter eight

Question eight – What other factors should be taken into account in setting the formula to determine the interest rates HMRC charge and pay?

- 45 We think that the relevant factors have been identified in our response above.

FJH
11.09.08

THE 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. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department for Business, Enterprise and Regulatory Reform through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.
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.
4. To find out more about the Tax Faculty and ICAEW including how to become a member, please call us on +44 (0)20 7920 8646 or email us at taxfac@icaew.com or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.

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.com/index.cfm?route=128518>).