

Making the new relationship a reality:

**HMRC's response to small
businesses' priorities for reducing the
administrative burden of the tax system**

November 2005

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FOREWORD

There are some 4 million small businesses in the UK today, more than 99 per cent of all UK businesses. Together they employ around 12 million people, over half the private sector workforce, and create wealth and employment opportunities, especially in deprived areas. It is therefore essential that HMRC continues to make progress against the vision I set out at Budget earlier this year, and delivers a real reduction in the burden of dealing with the administration of the tax system.

Gus O'Donnell identified small and medium businesses as the customer group with most to gain from the formation of HMRC. They would, in future, need to deal with only one organisation for all their tax affairs, leaving more time to concentrate on their business. To make this a reality I have created an organisation and strategy for HMRC that has the customer at its centre.

I am pleased that we have made considerable progress since Budget 2005, including:

- delivering the short tax return (down from 16 to 4 pages for the 500,000 smallest businesses, saving them an estimated £5m in compliance costs);
- beginning the withdrawal of payment via employer for tax credits (reducing employers' costs by an estimated £110m a year from 2006-7); and
- introducing a new online direct debit system for use with the electronic VAT return.

HMRC has also launched its programme for measuring the administrative burdens imposed on business by the tax system. This programme will allow a baseline to be published next year, with stretching targets (including clear milestones) set for administration cost reductions. Businesses will be able to hold the department to account for making real progress in delivering reductions in burdens through the publication of regular reports that will allow progress to be visible and monitored.

There is still a long way to go to deliver the long-term vision set out at Budget. This report outlines what businesses told us about their priorities and how we are taking them forward.



DAVID VARNEY

EXECUTIVE SUMMARY

Budget 2005 set out how Her Majesty's Revenue and Customs (HMRC) would deliver for small business the benefits of merging Inland Revenue and HM Customs and Excise into a single organisation dealing with all business's tax affairs. This paper explains what progress has been made in realising those benefits, and outlines the steps that will be taken to make the vision of a new small business relationship with HMRC a reality.

The Hampton Review¹, published alongside Budget 2005, set out the principles of risk-based inspection and enforcement that should underpin all activities by regulators across the public sector. HMRC was not within the remit of the Hampton review, in recognition of the different nature of the enforcement of the tax system from the inspection and enforcement of government regulations. Nevertheless the department committed to embedding those principles within its day-to-day activities, building on the many examples of good practice already developed by both Inland Revenue and HM Customs and Excise.

The consultation paper *Working towards a new relationship*² asked for views from business on a new vision in which businesses will:

- **provide information only once;**
- spend **less time dealing with inspections;**
- benefit from a range of **flexible payment options;**
- enjoy a **single point of contact** with HMRC; and
- benefit from clear and targeted **support, education and guidance** at the time they need it most.

The responses from businesses and their representatives confirmed that this vision is consistent with what small businesses want to see from a modern tax authority. Their views have allowed HMRC to start prioritising the work necessary to deliver on the vision, so that it can focus its resources first on the issues of greatest concern to small businesses themselves.

In the first seven months HMRC has taken a number of significant steps to improve its relationship with small businesses. The overall programme of reform is long-term, with significant IT systems and legislative changes needed to underpin some of the key elements. It will be at least 5 years before all of the benefits anticipated in the original proposals for the integration of the two departments³ have been realised. But in the near term, the department is keen to ensure that it is able to demonstrate early progress in the form of immediate 'wins' for businesses in the areas they have identified as the most pressing.

¹ http://www.hm-treasury.gov.uk/budget/budget_05/other_documents/bud_bud05_hampton.cfm

² http://www.hm-treasury.gov.uk/budget/budget_05/other_documents/bud_bud05_otherindex.cfm

³ http://www.hm-treasury.gov.uk/budget/budget_04/associated_documents/bud_bud04_odonnell_index.cfm

SAVINGS FOR BUSINESS

Measures announced today will significantly reduce costs for small and medium enterprises and employers when dealing with tax administration. The revised requirements for Form 42, simplified Form P46 and the improvements in the Employer's CD-ROM could result in cost savings to employers of up to £80 million per year. They will also benefit from the abolition of payment of tax credits via employers, reducing payroll costs from 2006 by a further £110 million per year. For companies, the alignment of information needed by Companies House and HMRC should result in savings of £100 million when fully implemented. This will, in time, lead to estimated total savings for those businesses affected in the order of £300 million per annum. These savings will contribute towards the target for reduction in administrative burdens on small businesses that will be set next year.

PROVIDE INFORMATION ONLY ONCE

Responses to the consultation confirmed that, where possible, businesses would like to provide the same information only once. The department has been able to make some early progress on tackling the forms that businesses have complained about most:

- HMRC has abolished with immediate effect the need for over 90 per cent of new companies to complete Form 42, saving an estimated 300,000 businesses up to £ 200 per form;
- Enhancements to the Employer's CD-ROM (the introduction of calculators for statutory payments and P11 working sheet) will be launched in February 2006, reducing costs to employers by over £10 million;
- A revised Form P46 will be released in April 2006, reducing coding errors by one million, and cutting out enquiries to employers about their employees' tax, reducing employers' costs by up to £10 million;
- A revised main self-assessment (SA) tax return will be piloted from April 2006 on 7,500 taxpayers running small businesses, with clearer help and guidance to make its completion easier. The SA Statement of Account has been redesigned for delivery during 2006-7 to make it easier for businesses to understand their tax liability;
- For those businesses that choose to deal with HMRC through an agent or other tax adviser, HMRC plans to provide during 2006-07 a facility to allow documents to be attached to SA returns filed online, thereby removing one of the remaining obstacles to online filing.

In addition, we are consulting with business on a package of measures to bring together the returns which companies make to Companies House and HMRC, which could produce savings of £100m per year to business from 2010.

LESS TIME SPENT DEALING WITH INSPECTIONS

The Review of Links with Medium-sized Businesses⁴, which was launched last year, will publish its findings shortly. The report will set out how HMRC will take work forward over the next two to three years to redesign the enquiry process better to reflect the needs and practices of modern business.

In the shorter term HMRC is

- extending trials of a secure electronic messaging system that will allow business advisers and agents to correspond with HMRC online. Trials have demonstrated that this can deliver substantial reductions in the time taken to settle an enquiry by allowing staff and agents to share analysis and update common records electronically; and
- launching a new tool to allow off-site audit of payroll, which will reduce the time payroll audit takes for employers with 20 or more staff.

MODERN FLEXIBLE PAYMENT OPTIONS

Cashflow is critical for small businesses. Late payment and non-payment by customers are significant contributors to business failure. Independent research for the Government has suggested that tax is not a significant factor in causing cashflow problems for business, although some firms find it hard to manage the 'lumpiness' of some payments. In response HMRC is continuing to develop a range of flexible payment options so that businesses can manage their cashflow by paying 'little and often' if it suits their business needs. Delivery of changes in this area will be dependent on the IT systems that underpin the payment operations of the new department.

⁴ <http://www.hmrc.gov.uk/pbr2004/nr1.pdf>

SINGLE POINT OF CONTACT

Underpinning many of the reforms that are needed to realise the benefits for small business from the creation of a single tax authority is the concept of a 'whole customer view' (WCV). This is particularly the case for developing a single point of contact, but it applies to other areas of the reform programme.

WCV would:

- allow taxpayers and department officials to have the same overall view of their tax affairs for the first time;
- enable the department's staff to provide better help and support; and
- help the department develop better risk assessment and improve compliance, for example by using more real-time data across different taxes.

HMRC has made good early progress and established that in principle there are technical solutions to allow joining up of data, to enable single registration and notification of change of circumstances for all taxes, and improved contact management. Against a background of significant changes to the IT systems of the new department, the next stage in this long-term programme will be to discuss with businesses what the benefits of this programme will be. This will allow HMRC to develop the business case to determine whether or not the programme will offer value for the taxpayer.

HMRC is continuing to explore the range of future benefits that WCV will be able to offer small businesses. These include:

- single customer account – showing all liabilities and payments as well as enabling monthly payments on account to be made;
- debt management – helping HMRC target more flexible payment terms on businesses with good payment histories who slip into arrears, and take earlier action against those that seek an unfair advantage through late payment;
- risk assessment – enabling HMRC to get a better understanding of a business's affairs and develop more sophisticated risk assessment techniques that will allow it to target both enforcement and support resources more effectively.

SUPPORT, EDUCATION AND GUIDANCE

Understanding customers and meeting their needs is central to the way HMRC is taking forward its support programmes for small business. This is particularly the case where a business is starting up and/or growing, taking on its first employee, becoming VAT registered, or becoming incorporated in order to seek finance.

For newly VAT-registered businesses HMRC has just launched a CD-ROM that will help them get their VAT right from the start. Improvements next year to the Employer's CD-ROM will make the process of operating payroll easier, especially for the smallest businesses without payroll software. In the longer term HMRC will design, with business, an operational support strategy that will identify key trigger points that will allow the department to target the right support to the right business at the right time.

HMRC is also responding to business feedback by delivering better guidance in a number of areas:

- simplified guidance has been issued on how to claim Research and Development Tax Credit;
- from 2006 an online employment status indicator (available from November 2005 as “view only”) will help businesses decide whether someone who works for them is employed or self-employed;
- longer term, a project has begun, building on the lessons of businesslink.gov,⁵ to work with business to deliver a substantially improved HMRC website with improved content and navigation.

⁵ www.businesslink.gov.uk

INTRODUCTION AND BACKGROUND

1.1 The consultation paper “Working Towards a New Relationship” published at Budget 2005 explained that HMRC would put the requirements of small business at the heart of the new department. This means making sure small business needs are reflected in all new policy and operational developments, and their feedback is used to improve existing services. Using the views of small businesses, their advisers and representatives, HMRC will focus on helping businesses to understand their tax liabilities more easily and:

- **provide information only once**, where and when possible, with it flowing seamlessly from the systems businesses use to ours without the need for forms or returns.
- **benefit from a range of modern flexible payment options** that suit the needs of the business.
- **spend less time dealing with inspection**, with all targeted enforcement activity informed by more sophisticated risk assessment.
- **enjoy a single point of contact** for all their tax affairs, either online or by phone. This will give businesses and their advisers access to the details of their tax account – the same details that the department will see.
- **benefit from co-ordinated, clear and helpful support and education** that will help them comply with their tax obligations.

1.2 The paper sought views by 30 June 2005 on how these objectives could best be achieved. A summary of the main points to emerge from the consultation has been published today on the HMRC website¹. In addition to the responses to the paper, we have worked with the Small Business Advisory Group whose membership was announced at Budget 2005 and is included at Annex A. This report outlines the short and long term programme of change we have developed.

Making customer focus work

1.3 The consultation made clear our intention to start a new relationship with business. Essential to achieving this was a change in the organisational structure of HMRC. The Small and Medium Enterprises and Employers Unit is one of four customer-focussed units within HMRC – the others deal with large business and employers, individuals and frontiers. “Customer” is used for simplicity and covers a wide range of businesses, advisers and individuals who interact with us to make returns and claims, pay tax, receive credits, undertake international trade etc.

¹ <http://www.hmrc.gov.uk/whatsnew.htm>

The role of the Units is to focus on identifying and understanding the needs and behaviours of customers, and the risks associated with them, so that HMRC:

- makes it easier for customers to comply;
- improves the customer experience;
- improves compliance; and
- reduces the cost of compliance.

The Hampton Review

1.4 Our consultation paper was published alongside Philip Hampton’s review into the impact of inspection and enforcement of government regulations. Although HMRC was not covered by the terms of this review, our objectives are consistent with the recommendations of the report and its inspection and enforcement principles. We will improve risk assessment processes so that our resources concentrate on those who present the highest risk of non-compliance, and focus help and support on those who wish to comply.

Reducing administrative burdens

1.5 An integral part of our change programme focusses on reducing the administrative burdens that tax regimes place on small businesses. To know where best to target our efforts we need to establish where the burden is heaviest and where the regimes pinch most. We have therefore adopted a measuring method pioneered in the Netherlands and recommended by the Better Regulation Task Force in their report “Regulation – Less is more” published in March 2005. This system identifies the regulations that impose obligations on business, then measures and quantifies them.

1.6 The measurement programme is under way and will report in spring 2006. That will produce a baseline for the administrative burden of tax for small businesses, and HMRC will publish targets to reduce it, together with clear milestones against which progress can be measured.

1.7 Areas in which progress is already being made to reduce the burden of the tax system on small businesses include the following:

- **Alcohol Trade:** HMRC will be repealing outdated or redundant requirements. We are also considering radical reform of the duty deferment guarantee system, and working with the alcohol trade to identify further opportunities for deregulation. It is estimated this could offer significant savings for businesses in the alcohol, oil and tobacco sectors.
- **Stamp Duty Land Tax:** In response to representations from customer groups, HMRC has taken steps to improve and simplify the service provided to conveyancing practitioners submitting land transaction returns. We also now offer an e-channel for delivery of the land transaction return, which provides for instant submission of a correctly completed return. In coming months we will explore with practitioners ways to simplify the stamp duty land tax treatment of complex transactions such as dealings in commercial leases and partnership interests.

Review of links with medium-sized businesses

1.8 The Review of Links with Medium-sized Businesses (RMB), announced at Pre-Budget Report 2004, will report shortly. Not surprisingly, many medium-sized businesses' areas of concern coincided with those of smaller business. In other areas medium-sized business had specific concerns which will also be set out in the forthcoming report.

1.9 The findings of the review are consistent with the wider work being taken forward by HMRC, particularly the Committee on Powers, Safeguards and Deterrents, and in the operational units within HMRC that have identified the need to replace the existing one size fits all enquiry process with a broader range of more targeted interventions.

1.10 The aim of the Powers review is to provide a framework of law and practice for HMRC that supports the Government's objectives of a tax system that is fair and better adapted to the needs of customers. It will consider the scope for aligning and rationalising existing powers to make it easier for individuals and businesses to comply with their tax obligations and receive the tax credits to which they are entitled. It will also consider how best to obtain the information needed for better risk assessment and for better-targeted compliance activities.

1.11 A key conclusion of the RMB report is that the creation of HMRC presents an opportunity for a radical re-think of the enquiry processes across all taxes. We need to look critically at these processes in the light of the Hampton Review, to develop the best model to encourage general compliance whilst being least burdensome for those businesses affected.

1.12 The enquiry process we develop will need to move towards a more targeted, segmented, risk-based process, with a more varied range of interventions to better match the types of risk presented. HMRC should adopt modern methodologies and seek a real shift in its relationship with business, similar to that seen following the Review of Links with Large Business in 2001².

² <http://www.hmrc.gov.uk/pbr2001/businesslinks.pdf>

2

CONSULTATION RESPONSES

2.1 We were pleased that many businesses and their representatives took the time to share their views on the questions asked in the consultation paper. Responses included:

- 37 from accountants, from sole practitioners to a top national partnership;
- 22 from representative bodies, with over 750,000 members; and
- 28 from small business owners or directors.

2.2 The majority answered all 18 questions in the paper, and some offered feedback and views on wider issues. A summary of the responses is available on our website <http://www.hmrc.gov.uk/whatsnew.htm>. We thank the respondents for taking the time to help us. We value highly the constructive suggestions and ideas that we have received and will be taking these forward as part of our work plan to inform short, medium and longer-term activities.

3

PROVIDING INFORMATION ONLY ONCE

Simplifying forms

3.1 One of our primary goals is that business will need to provide the same information only once, and that this information is used in the most efficient way. In the longer term, information technology development should facilitate this and so reduce the need for paper returns and forms. In the meantime, forms and their completion remain a fact of business life, whether interacting with Government, customers, suppliers or agents. We have embedded the principles of the Hampton Review in our rolling programme for reviewing forms, to ensure their fitness of use. We are increasing usability testing as an integral part of the standards we apply to all new tax forms. This allows us to understand what makes a form simple to complete, and the available guidance easy to understand.

3.2 The consultation responses highlighted some of the areas where we should focus our attention. Easing the administration of payroll and statutory payments was identified as a key area. Although respondents told us that tax administration was not the biggest burden for a small business when taking on its first employee, small business did highlight real concerns about some processes and forms.

Simplifying payroll

3.3 We have already begun a programme of improvement to make payroll administration simpler:

- we have developed and introduced a calculator within the Employer's CD-ROM to calculate Statutory Maternity Pay (SMP), and are supplementing that with similar calculators for Statutory Paternity Pay and Statutory Adoption Pay that will be available from February 2006;
- we have introduced an online calculator for SMP; and
- we are looking at the feasibility of electronic payment of claims for SMP reimbursement to employers.

CD-ROM for form P11

3.4 Many employers identified that they needed help with form P11 on which they record week by week (or month by month) the pay for each employee and the resulting liabilities to tax and national insurance, together with amounts paid or collected in respect of student loans, Statutory Sick Pay, etc. While commercial software and professional assistance are available to simplify this task, a sizeable number of employers continue to complete the P11 manually, in the process tackling some complex allocations and calculations. Errors are often made which require more time and effort to correct at a later date. To assist these employers, from February 2006 the Employer's CD-ROM will include an interactive P11 to automate many of the procedural steps involved, and eliminate significant numbers of arithmetical or transcription errors.

Form P46

3.5 Form P46 has to be completed by employers when they take on staff who are unable to produce a form P45 containing their latest pay and tax details. The data on these forms are frequently not good enough to enable HMRC to match the new employee to their previous record, leading to an incorrect PAYE code being sent to the employer, who may then have to spend time with the employee correcting the mistake.

3.6 To reduce the burden on employers, from April 2006 we are issuing a clearer and simpler form. This will benefit both the employer and the employee, with an estimated one million fewer enquiries to employers about their employees' tax affairs, saving employers some £10 million per year.

Benefits and Expenses 3.7 Form P11D, the employer's return of benefits and expenses received by an employee, was the form most frequently mentioned by respondents. The most common complaint was the requirement for the employer to enter expenses received by employees that were subsequently, and correctly, claimed on that person's tax return as legitimate business expenses. We accept the need to consider what changes could be made to the form P11D and associated procedures in order to ease the administrative burden on employers.

3.8 We announced in the summer the raising of the advisory fuel rates for business mileage paid by the employee on a company car. Many employers have dispensations that save them reporting some expenses paid to employees. Previously, any changes that an employer made to the mileage rate paid would require an application for a new dispensation. For employers who pay the revised rate, there is now no need to apply for a new dispensation. Either side can still review other aspects of existing dispensations in the normal way.

Form 42 3.9 Form 42 is the form on which employers report annually their transactions in employment-related securities, mainly shares and share options. Small businesses have in recent consultations identified that the rules in this area, and the form itself, are complex and difficult for them to understand without professional advice, which leads to costs for each business of up to £200 per form to report the first issue of shares.

3.10 We have been able to make a better assessment of risk from forms already received, and that, combined with the views expressed through the consultation, has led us to accept the case for change. From today, we should be able to achieve a reduction in excess of 90 per cent in the number of forms requiring completion by new companies as we will no longer require a form for the first issue of shares in the majority of cases, saving an estimated 300,000 companies up to £200 per form. This will be kept under review. We will also relax the reporting requirements for certain share acquisitions by directors. For those businesses that still need to complete the form, we are developing a new interactive combined guidance and form package that we are aiming to make available on the Employer's CD-ROM next spring.

Registering for VAT

3.11 The proportion of VAT registration applications, on paper and online, rejected due to incomplete or inaccurate information remains too high. This causes frustration and delay for both business and HMRC. We will always require safeguards to ensure that new VAT numbers are allocated only to genuine new businesses, because some are acquired for fraudulent purposes. Research started in October to identify the reasons for the high error rates. We will use the outcome of that to inform changes to the existing form and guidance that will make it easier to get it right first time. In the longer term, under our Whole Customer View project, we are looking at the feasibility of business needing to register only once for all taxes.

CD-ROM for VAT 3.12 At the end of November we launched a CD-ROM for newly VAT registered businesses, that provides a road map of basic advice and support to help them to get their VAT right from the start.

The self-assessment tax return

Making completion simpler

3.13 From April 2005 we reduced the size of the self-assessment (SA) tax return from 16 pages to 4 for 500,000 of our smallest self-employed customers, saving them some £5m in compliance costs. From April 2006 we will be piloting with 7,500 businesses a new, shorter and simpler version of the main SA return, with clearer help and guidance to make it easier for businesses to understand and complete. Once launched, this will benefit more than 2 million businesses.

3.14 In addition, we have also been working to make the Statement of Account, received by all SA taxpayers, easier to understand. Following positive feedback around the new design during user testing, we now plan to deliver the revised, simplified and easier to understand version in 2006-7.

Filing online

3.15 Responses, particularly from accountants, referred to the need to file additional documents, such as accounts and explanatory notes, when filing SA returns online. The existing SA online service already allows some additional information to be submitted via the 'white space' box. Responding to requests for this additional service, and to encourage greater use of online channels by accountants and other tax agents, we will introduce in 2006 the facility for customers to attach pdf documents to their SA returns.

3.16 Our SA, Corporation Tax and Pay-As-You-Earn online filing services already allow for the direct transfer of data from businesses' commercial tax preparation software into HMRC systems (using XML). We are looking at ways of extending this facility to other taxes and joining up our requirements with other parts of government. We are also developing an Active Computational form to enable small companies with simple affairs to prepare their computations online using an Active Adobe form. The company will then be able to submit this with their CT600 return and accounts to HMRC. We plan to have a demonstrator to show to companies and agents before Christmas and, subject to feedback, to release the service early next year.

Improving processes

Consultation with Companies House

3.17 From 2006 we will be able to receive company accounts and computational data in XBRL rather than pdf format (XBRL – Extensible Business Reporting Language – is an XML based IT standard for business financial reporting.) It will allow us to accept accounts prepared by businesses using the Companies House web filing service. We are currently exploring the possibility of a single process for filing company accounts for both HMRC and Companies House purposes and what further improvements might be achievable. As a first step we are consulting on the alignment of filing dates for accounts and returns and, to give businesses certainty sooner, on aligning the enquiry date with the filing date. Looking further ahead, we will continue to work with accountants and the software industry to streamline the exchange of information between business and Government.

Agent authorisation

3.18 Form 64-8 authorises agents to act on behalf of businesses when dealing with us for some, but not all, tax issues. Agents would like the form to be more comprehensive. In addition, there are concerns about the time taken to process the form. We are therefore researching, in consultation with agents' representatives, the authorisation system to agree an action plan by the end of this year.

3.19 In the meantime, a new online authorisation process was launched in November. This allows agents to set up and maintain their client authorisations for PAYE, Corporation Tax (CT) and SA. And, from April 2006, agents using commercial SA

filing products will be able to file their clients' returns without completing a Form 64-8. This functionality, which is already in place for PAYE online filing, will be extended to the CT online filing service later in the year.

R&D Tax Credits – simplifying applications

3.20 Research and Development (R&D) Tax Credits were introduced by the Government to encourage investment in innovation by businesses. Despite their popularity, with 4,500 small and medium enterprises claiming £250 million each year in R&D Tax Credit, we received feedback that completing an application was difficult and time consuming. To make claiming easier for business, we have recently issued simplified step-by-step guidance on how to make a claim for R&D tax credits.

Online services

3.21 Businesses want us to stabilise and improve our existing online services, especially at peak filing times such as for end of year PAYE, and SA returns. We know that on occasions, particularly at peak periods running up to filing deadlines, there can be problems accessing our transactional services. We are making substantial investment to ensure our infrastructure has the capacity to meet demand during the whole year, including these peaks. We have started a rolling programme of enhancements across all our online services; this will ensure additional capacity to enable us to deal better with the large filing peaks we face across a number of our online services.

3.22 We are planning major improvements to our website. We started this process by commissioning an independent review, which will focus specifically on the experience of our customers in finding information, transacting with us, and navigating around the site. We will carry out a strategic study of how information is presented on our website with the aim of making it clearer, simpler and more comprehensible for our customers. These changes should improve our customers' ability to find the information they need and to obtain success at their first point of contact. In the short term we are taking on board comments about dating page changes in our guidance.

3.23 We also continue to work closely with businesslink.gov¹, the cross- government website for business. Businesslink.gov has attracted high customer satisfaction ratings and extremely positive feedback. We will be drawing on the lessons learnt in the businesslink.gov project in developing our HMRC website content.

¹ www.businesslink.gov.uk

4

RISK-BASED AUDIT - SPENDING LESS TIME DEALING WITH INSPECTIONS

HMRC interventions:

Enquiries

Enquiries are opened under HMRC powers to check a tax return and follow formal procedures that cover the rights and responsibilities of both the Department and the taxpayer. These are set out in Code of Practice 11¹. The purpose of formal enquiries is to make sure that the returns of those individuals or companies are correct, and that they have paid the right amount of tax. Some enquiries are selected at random, but most are selected according to an assessment of risk, for example, because the information on the return looks wrong, or because it raises questions. Business records relating to the tax return under enquiry are inspected, the taxpayer may be invited to a meeting to discuss the return, or we may visit.

Reviews

Officers may visit businesses to check that employers are operating PAYE and NICs correctly. Officers may inspect, copy, take extracts from and remove records and documents produced for inspection.

Visits

We carry out inspection visits to ensure that businesses have paid the correct amount of VAT and excise/import duties. To guide the selection of cases, we use risk-assessment techniques and processes to target better those businesses most at risk of not complying with their obligations. For example, businesses that send HMRC incorrect returns or do not pay on time will be more likely to receive a visit.

Other interventions

Under its duty of “care and management” HMRC may contact customers who appear to require specific educational or information interventions. Such interventions may include:

- writing to businesses and individuals to help with future returns, and compliance with employment procedures;
- telephoning businesses and individuals offering support and advice to assist with the completion and submission of returns or payments of tax; and
- providing workshops on specific areas such as employer payroll responsibilities.

4.1 The Hampton report outlined the need for greater risk assessment to minimise the impact on compliant businesses, reducing the time they need to spend dealing with inspections. And for those small businesses that do experience a visit or enquiry, the process must be as quick, focussed and efficient as possible.

4.2 To embed this approach and to ensure uniformity of practice, responsibility for risk assessment has been brought together into a single, national compliance directorate, and the management of direct and indirect taxes work integrated within distinct operational compliance directorates. Further, we will ensure that the design of

¹ <http://www.hmrc.gov.uk/leaflets/cop11.pdf>

a new enquiry process for HMRC is underpinned by the Hampton principles, uses sophisticated risk assessment and is targeted at the least compliant.

4.3 HMRC understands that interventions such as visits to check on the operation of PAYE and VAT, or enquiries into the accounts of a business, can seem stressful for a business. We aim to minimise this as far as possible, consistent with our responsibilities to ensure a business pays the right amount of tax. We asked for suggestions to improve the intervention process for both business and the department. We also sought views on the case for single or separate visits for different taxes, as well as on how to make such interventions less burdensome for businesses. The suggestions received fit broadly within three areas:

- focussing on the non-compliant;
- the working of an enquiry or visit; and
- the rationale behind the concept of interventions.

Focussing on the non-compliant

4.4 Respondents wanted us to spend less time and resource making enquiries into smaller businesses and to concentrate more on the larger cases where the potential yield was greater. But in terms of risk assessment, this approach needs to be balanced against addressing a number of smaller risks across a large number of smaller businesses in ways that ensure fairness for compliant businesses. They also wanted more refined and accurate risk assessment in the selection of cases for enquiry. We accept this and have started work to further improve our risk assessment processes.

The working of an enquiry

4.5 Many suggestions were received about the working of enquiries and audits. Underlying these responses was the need for greater openness and clarity during an enquiry, i.e. a clear enquiry plan at the outset and openness about the risks to be addressed. There was also a desire for an early warning of potential penalties, and a greater understanding of business priorities, together with greater commercial awareness. During an enquiry, respondents wanted a focus on serious issues, a sense of proportion, and for the enquiry to be closed as early as possible when risks identified had been satisfactorily addressed.

The rationale behind an enquiry

4.6 Businesses want an assumption of innocence towards any business selected for an enquiry where there is no evidence of understatement of tax. They also want a less confrontational atmosphere. They also advocated a tougher approach to the seriously non-compliant. Many considered that we should use enquiries as educational or enabling opportunities – collecting tax that was due but putting things right for the future with an acceptance that many errors are mistakes rather than attempts at fraud. These views contrast with those about risk assessment which indicate we should be enquiring only into businesses that present a high risk. It seems that this view relates to the concept of “assurance” – the treatment of enquiries as an opportunity to correct errors or mistakes, putting things right for the future, rather than penalising the past. We accept that HMRC’s responses could sometimes be better tailored to the circumstances where errors are found, graduated according to whether it is a case of innocent error, lack of proper care or deliberate evasion.

4.7 These findings were very similar to the outcome of the research carried out in the Review of Links with Medium-sized Businesses. The results of the review and the consultation will inform work on HMRC's new enquiry process, which will be subject to further consultation. As a first stage we are working to re-engineer our interventions processes to make them more flexible, risk focussed and effective, making them an integrated part of helping ensure future compliance by the business. Further changes will require legislation.

Auditing payroll records

4.8 To help reduce compliance costs and burdens for employers, we will the use of an electronic payroll analysis tool. This has already been successfully piloted with larger employers and we will now use it for businesses with more than 20 employees. It allows fast and detailed analysis of records, providing a full audit trail, with no limit to the size of the records examined, and has built in safeguards against any corruption of the original data. It enables the majority of tests and checks previously carried out on the business premises to be completed prior to the visit. There are advantages for both the employer and HMRC:

- less time on the premises reviewing paper records;
- greater assurance that the payroll is correct and that our checks are consistent; and
- cost reduction through not having to provide large quantities of paper records.

4.9 On occasions when manual checks remain necessary, we will usually be able to notify the employer in advance of the records that need to be examined. These can then be extracted in advance of the visit, saving time on the day.

Shared workspace

4.10 To improve our enquiry process we have successfully piloted a secure electronic shared workspace which allows business advisers and agents to correspond with HMRC online. Used during enquiries, it enables the sharing of analysis and the updating of common records electronically. The pilot has shown a substantial reduction in the time taken to settle an enquiry, giving businesses certainty sooner. We will be extending the scheme on a wider basis in 2006 to see if the results can be replicated more widely and with different customer groups.

4.11 HMRC has already started work to identify where we can improve our targeting of both risk and compliance:

Current trials

SME Risk Trial 4.12 This trial sought:

- to improve the targeting of risk and selection of interventions by HMRC, gearing resource to risk;
- to establish best practice on joint risk targeting and selection;
- to test and evaluate a holistic approach to interventions.

4.13 This trial established that there would be real benefits in terms of compliance and customer service in creating a unified approach to risk assessment across the department.

Joint Visit Trial 4.14 The trial focussed on where the benefits anticipated from the integration of HM Customs and Excise and the Inland Revenue might most readily be derived to:

- improve customer service levels;
- achieve greater efficiency and resource saving for HMRC; and
- reduce the time business spends dealing with us.

4.15 We are testing the extent of overlapping risks across taxes, and comparing the effectiveness and efficiency of having single officer or team visits. The aim is to improve the customer experience and develop best practice in selecting and working cases for joint inspection. Although the information gained will be valuable, there are limitations to the usefulness of this trial as cases can be worked in this way only with the consent of the business.

Informal Economy Trial 4.16 We continue to target those businesses that seek an unfair advantage by not complying with their tax obligations by:

- testing an integrated team approach towards businesses operating within the informal economy;
- commissioning projects that most effectively reduce tax gaps, thus helping level the playing field for the majority of businesses that are compliant; and
- through a co-ordination unit, establishing the most appropriate form of compliance, enabling or educational intervention.

We will evaluate this trial shortly.

Proposed trials

4.17 We want to make our compliance programme more effective, both in selecting those businesses that are most at risk of being non-compliant, and in identifying those businesses who operate wholly within the informal economy. To improve our effectiveness in these areas we will continue to develop, pilot and evaluate new ways to identify risk. Areas we want to test include:

- new cost effective, efficient forms of intervention designed to address specific risks and issues, whilst minimising disruption for the legitimate business;
- a common approach to testing the reliability of business systems, providing assurance to both HMRC and the business; and
- joint activity in respect of enquiry work across Income Tax, Corporation Tax, Pay As You Earn and Value Added Tax.

Working Together programme

4.18 During our enquiries it is usually the case that we will deal primarily with the agent rather than the business. During an enquiry, a good working relationship between the parties is important, as it is between HMRC and the accountancy profession generally. Key here is the Working Together Programme, where we and members of the accountancy profession meet regularly to discuss the current issues that affect our relationship.

4.19 Working Together is a programme of activities and meetings that is an important source of information about how systems and processes affect our customers, and how these can be improved. Information from the Working Together programme has been instrumental in improving the guidance and service we provide.

4.20 Working Together has recognised that enquiry work and visits are perhaps the most contentious and expensive area for the profession, the customer and HMRC. Mutual understanding of the pressures and constraints on both sides is key to the smooth running of the enquiry process and the improvement of the customer experience. Working Together has designed joint workshops covering key areas of the enquiry process with a view to dispelling myths about enquiries and encouraging an atmosphere of constructive co-operation.

4.21 A recent workshop on enquiries into company accounts has received very favourable coverage in the accountancy press and is now being rolled out nationally. Building on this success, a workshop to address how meetings are conducted during enquiries has been designed and is now being piloted.

4.22 The creation of HMRC presents us with the opportunity to build on the achievements of Working Together in both the indirect and direct tax fields, and we are currently reviewing the best way in which this important initiative might be taken forward.

5

MAKING PAYMENTS EASIER - A RANGE OF MODERN AND FLEXIBLE OPTIONS

Business cash flow **5.1** Cash flow is critical to small business and the Budget 2005 Consultation paper sought views on whether the new department should be doing more to deliver a choice of modern and flexible payment options that better suit business needs.

5.2 The independent cash flow research commissioned by HMRC will be published soon. The results coincide with what business told us during our consultation in that the regular payments a business has to make, such as PAYE and VAT, cause fewer problems to cash flow than those paid annually or twice yearly such as Corporation Tax or Income Tax.

Payment options **5.3** We asked if work needed to be done to align the different payment dates of various taxes. Overwhelmingly, the response was that having different dates for the main taxes, such as PAYE, VAT, Income Tax and Corporation Tax helped business. Many businesses and representative bodies responded that, although remembering the various dates could cause problems, the help to cash flow more than out-weighed any other consideration.

5.4 A number of responses sought a facility to make monthly payments on account for taxes into a business account, with a balancing payment at the year-end. In the long term we are exploring the possibility of a single account across all our business tax regimes, which would allow set off and a single view of the tax account. But that would require considerable legislative and information technology change, since different regimes have a variety of rules and their own IT system.

Payment methods **5.5** Some respondents asked to be able to pay tax by either debit or credit card. There would be significant issues to be considered if the department accepted payment by credit card for direct taxes and VAT. These centre mainly on the Merchant Acquiring Charge and the passing of the commission payable onto the cardholder, possibly as a convenience charge. Further development of this idea is pending further research on the legislative requirements of the convenience charge. The facility to pay tax via debit card already exists for those who choose to pay their SA, PAYE or Stamp Duty Land Tax liabilities over the Internet.

Payment methods

HMRC customers have a range of payment methods available to them. Using an Internet service called "BillPay", customers can pay Self-Assessment, PAYE and Stamp Duty by Debit Card. Alternatively, customers can use their bank's Internet/Telephone banking service or BACS Direct Credit to pay electronically. HMRC can also accept CHAPS payments. HMRC accepts payments made at a bank in person and most duties can also be paid at the Post Office, by Debit Card as well as by cheque. Contributors and traders have the option of paying Class2 NICs and VAT by Direct Debit. HMRC also has the facility to process cheques received via the post.

6

IMPROVING COMMUNICATION - ENJOYING A SINGLE POINT OF CONTACT

6.1 Through whichever channel is chosen, the first contact that a small or medium business has with HMRC invariably sets the tone for future contact – right from the start information and help should be easily accessible, clear, accurate and relevant.

6.2 We are developing with small business a comprehensive description of the customer experience that they and their representatives can expect. Starting in April 2006 with a strategy for education and support, the customer experience will be defined by standards. During the rest of 2006 we will develop a robust measures framework that will show how well we perform against our promise.

6.3 To do this effectively we need to gain a better understanding of businesses' current experience of the range of our services, and to involve them and their representatives in working up the new standard to ensure that it is properly customer focussed. We have been reviewing what customers have told us about their needs, and we are continuing to test our understanding of these needs through research amongst the business community. This research will be completed in March 2006 and it will enable us to design a standard for the Customer Experience which is truly reflective of what businesses actually need from the Department in terms of service and support.

Whole Customer View

6.4 Underpinning the progress planned over the coming years is the development of Whole Customer View. This is particularly the case for developing a single point of contact which will give business:

- easy access to a clear and complete picture of their affairs with HMRC, including payments, liabilities and entitlements;
- the ability to deal with HMRC easily, efficiently and effectively across the range of their affairs in the ways that suit them; and
- understanding of how to get help, and the right support and guidance for their circumstances.

6.5 More details of the Whole Customer View can be found on <http://www.hmrc.gov.uk/whatsnew.htm>.

6.6 Tangible improvements in the service that HMRC can provide to its business customers will be visible as the programme develops over the coming years. The areas we have focussed on initially, because they reflect the issues businesses have identified as important to them, are:

- **unified registration** – a single process to cover multiple HMRC regimes so that businesses can register for one or more according to their circumstances, and need not repeat information for future registrations;
- **change of circumstances** – business would need to tell us only once of any change in basic information about the business, such as business name, address or agent; and

- **contact management** – a full record of the contacts and interactions between the business and HMRC. This would help staff to provide a more effective service to business in their immediate contacts with HMRC but would also enable HMRC to tailor support to individual businesses and to improve processes and support overall, including improved risk assessment and enforcement.

6.7 Later developments are likely to include:

- **single customer account** – a single financial picture for all duties and taxes that a business has to pay, showing liabilities and payments as well as enabling monthly payments on account to be made;
- **debt management** – with a single account and contact history in place, an informed view of all arrears can be taken to establish the best means of resolution and, where appropriate, assist the business to reach an arrangement to include all tax owed;
- **unified case administration** – to ensure consistent and co-ordinated case administration by HMRC of all taxes for a business; and
- **risk assessment** – with more information about a business in one place, better risk assessment can be carried out. This will allow us to target HMRC resource on businesses where the compliance risks are high. The more compliant will be less likely to have the burden of either an inspection or an enquiry, leaving them with more time and resource to concentrate on running their business.

6.8 All these activities will require substantial IT change and investment. The next stage involves working with customers to establish the full business case to determine whether the programme will offer value to the taxpayer. The analysis will include further research and consultation. It will also identify any legislative change needed. This work needs to go hand in hand with the Review of Powers, Safeguards and Deterrents.

7

DEVELOPING EDUCATION AND SUPPORT - BENEFITING FROM CLEAR AND HELPFUL SUPPORT AND EDUCATION

7.1 Understanding customers and meeting their needs is central to the way HMRC is taking forward its support programme for small businesses. This is particularly the case where a business is starting up and/or growing, taking on its first employee, becoming VAT registered, or becoming incorporated in order to seek finance.

7.2 The responses from the consultation exercise have shown that businesses prefer us to improve and consolidate the standard of existing services before we move on to others.

Customer experience

7.3 HMRC must understand better the help and guidance that businesses need. This will help them to reduce the time they spend dealing with their tax obligations. We aim to make significant improvements in the quality of service we provide and better to target the help and support on businesses at the right time. All businesses are unique and have different and diverse needs: some want to deal with us direct, while others prefer to engage agents to handle their tax affairs. Some have no need for help, some ask us for support, while others do not realise that they may benefit from guidance we can provide. It is therefore important that we identify what assistance a business may need and how best to offer our support to that business.

Joint Education Trial

7.4 We are currently testing in East London and West Scotland how best we might deliver services to selected businesses. Our aim is to offer specific educational support to new businesses, businesses newly registered for VAT, new companies and new employers. The level of support offered ranges from general advice in the form of literature to specific support in the form of workshops and seminars. We are also planning to test our ability to 'segment' businesses in terms of their preferred use of online services. This level of detail will help us improve the quality of support provided by our online service.

7.5 The trial is providing us with useful evidence in our design of an educational support strategy for all businesses. The strategy will identify the triggers that show that a business has reached a certain stage where a new tax obligation arises. By recognising when this stage has been reached, we hope to be able to target the right support to the right business at the right time.

Telephone services

7.6 A recurring theme in the responses was the availability of quality technical assistance by telephone. Respondents wanted to be able to access information, help and guidance from well-trained, knowledgeable members of staff. This was particularly important for new businesses and those taking on a new obligation, for example registering for VAT, or taking on their first employee.

7.7 HMRC provides dedicated telephone help for questions about VAT and for employers and contractors, and specific lines for accountants to contact us at busy periods. We have recently held a trial in one of our contact centres where a dedicated service was made available for local accountants. We are reviewing the outcome of this and considering further options. In the meantime we are working to improve the accessibility and quality of our telephone services to business customers.

7.8 In the summer, we launched an advertising campaign aimed at the newly self-employed, encouraging customers to use the help-line that is available to them. There are around 3 million self-employed people, and an estimated 500,000 start each year. This help-line enables this group to receive tailored help and guidance about starting in business when they need it.

VAT registration

7.9 For businesses registering for VAT, we have launched a new CD-ROM that provides a road map of basic advice and support to help newly registered businesses get VAT right from the start.

Online services

7.10 As outlined in Chapter 3, HMRC is making a broad range of improvements to its online services. A particular focus of this work is improvement to the range and quality of the business support programme. Many of the respondents wanted improvements to the services provided to enable business to be more certain about a decision made.

7.11 One such area is employment status, where a business needs to know whether to treat someone as an employee or sub-contractor. We are developing an online tool – the Employment Status Indicator – that will provide this service and be fully available in 2006. From November, a *view only* service has been available on the Internet. When fully available, provided that the questions have been answered factually and truthfully, the decision reached by the Employment Status Indicator tool will be binding on HMRC.

7.12 HMRC is also exploring with banks the potential for using online banking services to assist businesses with fulfilling their tax obligations.

8

SIMPLIFICATION - MAKING IT EASIER TO GET IT RIGHT

8.1 Two of the key drivers behind the deregulation and simplification agenda in HMRC are the Better Regulation Task Force (BRTF) report, “Less is More”¹, and the Hampton Report, both published at Budget 2005. The BRTF report focussed on regulation and how to reduce it, while the Hampton Report, “Reducing Administrative Burdens”, looked at regulatory inspection and enforcement and recommended rationalising regulators, and improving risk assessment, enforcement and inspection.

8.2 As HMRC is not a business regulator, we were outside the scope of both reports, but many of the principles and objectives apply equally to a tax authority, and we have embraced the recommendations of both reports and are moving forward within the spirit of them both.

8.3 In particular, we have committed to measuring the administrative burden of the tax system on small business and setting stretching but realistic targets for reductions. We have already completed the first phase, mapping all regulations that HMRC is responsible for that impose a burden on business, and have now started to measure their cost. This work was started by KPMG in September and will produce a baseline figure for administrative costs for business, against which a target for a reduction will be set and announced next spring.

8.4 The BRTF also recommended the introduction of a new mechanism for business to submit proposals for simplification to Government. HMRC has adopted a separate, but parallel process to that of other Government departments. We will work to the same timetable for responses for administrative proposals, but suggestions relating to tax policy will be treated as Budget representations.

8.5 We have also begun to identify legislative measures that deregulate, consolidate and rationalise the processes involved in tax administration, as well as looking to identify the administrative measures that improve the processes and products that small businesses deal with.

Tax Law Rewrite **8.6** The Tax Law Rewrite Project was set up in 1996 to redraft UK primary direct tax legislation in clearer, simpler language to make it easier to understand and interpret. Legislation is restructured into a more logical order, using shorter sentences, modern language, clearer signposts to related provisions and more consistent definitions. The project has produced three Acts: Capital Allowances Act 2001, Income Tax (Earnings and Pensions) Act 2003 and Income Tax (Trading and Other Income) Act 2005. A further Bill will be published in draft in 2006. The PAYE Regulations were redrafted in similar style in 2003.

Impact Assessments **8.7** We have already committed to publishing Operational Impact Assessments (OIAs) whenever a change is proposed to a form or business practice that could significantly impact on business. We are now developing a rolling programme of Post Implementation Reviews that will confirm whether or not the compliance cost assumptions made in production of Regulatory Impact Assessments (RIAs) or OIAs have proved to be accurate.

¹ <http://www.brtf.gov.uk/reports/lessismoreentry.asp>

Stamp Duty Land Tax 8.8 Responding to representations from customers, we have taken steps to improve and simplify the service provided to conveyancing practitioners submitting land transaction returns for Stamp Duty Land Tax. We now also offer an e-channel for online delivery of the land transaction return, which provides for submission of a correctly completed return direct to our system.

8.9 In the coming months, we will be exploring with customers how we can simplify the processes around complex transactions such as commercial leases and partnership issues.

Excise Duties 8.10 We intend to introduce legislation to repeal or simplify nearly 30 regulations for alcohol producers to facilitate legitimate business activity and reduce administrative burdens. The Government will be working with business to identify further opportunities for excise deregulation. Reform of the Excise Duty Deferment Guarantee Scheme, could offer significant savings to businesses in the alcohol, oil and tobacco sectors.

8.11 As well as working to streamline and modernise the regulations imposed on the alcohol industry, as part of the wider simplification agenda, HMRC is taking forward a project to identify opportunities for further deregulatory initiatives in the excise regimes.

9

CONCLUSION

9.1 The results of our consultation with small businesses, their advisers and relevant representative bodies have given us valuable information about their priorities for improving our services. We are committed to deliver against the vision set out at Budget 2005, a vision to which businesses have given their broad support. The targets we will set and publish next year will allow business to monitor our performance in doing so. Next year we will publish the results of the exercise to measure the administrative burden on business of dealing with their tax obligations. This information will allow us to identify where the burden is greatest and to set targets for reducing it, with clear milestones for delivery over time.

A

EXTERNAL MEMBERS OF THE SMALL BUSINESS ADVISORY GROUP

A.1 External members of the Small Business Advisory Group:

Jonathan M Beckerlegge, ACCA Council member

Francesca Lagerberg, Chair Small Business Tax Committee & Deputy Chairman, Tax Faculty, Institute of Chartered Accountants of England and Wales

Julie Kenny, Managing Director of Pyronix Ltd and Chair of the Small Business Council

Samantha Mann, Policy and Research Officer, Institute of Payroll and Pensions Management

Steve Sharratt, Chairman of a number of small businesses and Vice Chair of the CBI SME Council

Roger Southam, Chairman and Chief Executive of the Chainbow Group

Simon Sweetman, Vice Chairman, Tax Policy Unit, Federation of Small Business

Martin Wyn Griffith, Chief Executive of the Small Business Service

