



House of Commons
Committee of Public Accounts

Helping newly registered businesses meet their tax obligations

Fifty-third Report of Session 2006–07

*Report, together with formal minutes, oral and
written evidence*

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The Committee of Public Accounts

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Helen Goodman MP (*Labour, Bishop Auckland*)
Mr Sadiq Khan MP (*Labour, Tooting*)

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Committee staff

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Contents

Report	<i>Page</i>
Summary	3
Conclusions and Recommendations	5
1 Simplifying Registration	7
2 Improving compliance by newly registered businesses	10
The compliance record of newly registered businesses	10
The effects of the Department's help on compliance	11
3 Making compliance easier	13
Guidance and advice	13
Simplifying the requirements of businesses	14
Formal minutes	16
Witnesses	17
List of written evidence	17
List of Reports from the Committee of Public Accounts 2006–07	18

Summary

Around 700,000 new businesses start up each year. They have to register with HM Revenue & Customs (the Department) for each tax as it becomes due—usually at different times. There are around 1.2 million registrations each year. The Department expects registered businesses to file their tax returns on time, calculate the right amount of tax due and pay it on time.

The Department spends over £10 million a year on staff engaged in registering new businesses, and a further £23 million in providing help through its website, printed guidance, telephone helplines, workshops and seminars.

Newly registered businesses are a diverse group. Some are setting up in business for the first time, others have previous experience. Some manage their tax affairs themselves, others rely on an agent or other assistance. Attitudes to compliance also vary. But those who get their tax right the first time are more likely to continue to comply as they grow and their tax obligations increase. Compliance can be more onerous for new and smaller businesses which have most to gain from assistance and simplified requirements.

New businesses incur late filing penalties of over £8 million on Income Tax Self Assessment and Corporation Tax. The proportion of new businesses filing their returns on time is generally lower than for the business population as a whole. On the accuracy of returns and paying on time, such a comparison gives a mixed picture and is less clear because of gaps in the Department's data. The available data shows that the levels achieved on both by newly registered businesses are between 53% and 69%.

The requirement to register separately for each tax duplicates effort for businesses and the Department in providing and processing the same information more than once. In Canada and Australia the tax authorities offer single registration for all taxes, allowing businesses to provide basic information only once and additional details as and when needed for specific taxes. In 2004–05 the Department imposed penalties totalling £6.7 million in nearly 70,000 cases of late registration for Class 2 National Insurance Contributions and VAT.

Over two thirds of tax registrations are in paper form. Businesses have been able to register online for VAT since 2004, for PAYE since 2006 and for Income Tax Self Assessment since February 2007. Take up on VAT is around 20%, and on PAYE 25%. In Australia 96% of new businesses register for tax online. 85% of registrations with Companies House are conducted online in the UK.

The Department publishes guidance targeted at newly registered businesses. But it requires an average reading age of at least 16 to 17 years old while over 5 million adults have literacy skills well below this level.

On the basis of a report by the Comptroller and Auditor General¹, the Committee examined HM Revenue & Customs on simplifying registration; improving compliance by newly registered businesses; and making compliance easier.

¹ C&AG's Report, *Helping newly registered businesses meet their tax obligations*, HC (2006–07) 98

Conclusions and Recommendations

- 1. Businesses have to register separately for each tax, and provide the same information, which duplicates effort for them and the Department.** To conform with international best practice, the Department should introduce a single registration system. Registration should also be available online with appropriate validation checks to facilitate accurate completion of the form.
- 2. Only 20% of businesses currently register online for VAT and 25% for PAYE.** Online registration is easier and cheaper for businesses and the Department. In Australia, 96% of businesses register online for a business tax number and 85% of registrations with Companies House are conducted online in the UK. To increase the take up of online registration the Department should advertise the benefits to businesses, for example on the Business Link website.
- 3. Businesses have to use different reference numbers for each tax in their contacts with the Department.** The Department plans to introduce a “customer index” to link its data on taxpayers, but this will not help businesses to simplify their tax affairs. It should introduce a unique identifier to make it easier for businesses to deal with the Department, and to provide a basis for linking services to businesses across the Department and, in due course, across government.
- 4. The Department does not have readily available data on the extent to which different groups of taxpayers meet their obligations.** As a result, it is poorly placed to assess priorities, and the costs and benefits of action to improve compliance. The Department should analyse the compliance record of different taxpayer groups and of the track record of individual businesses so it can target its work and assess its effects.
- 5. 61% of new businesses file their PAYE/National Insurance returns on time, compared to 80% of the business population as a whole.** Rates for filing other tax forms on time are also lower among new businesses. The Australian Tax Office has concentrated on helping new businesses with inexperienced owners who are least likely to understand their tax, leading to improvements in compliance levels. In targeting its efforts to increase compliance, the Department should give due weight to the level of risk associated with new businesses.
- 6. Nearly 50% businesses do not pay PAYE/National Insurance contributions on time.** The Department cannot impose a penalty or interest for late monthly payments of PAYE/National Insurance contributions during the year. It can do so only on balances due at the end of the tax year. Unlike some other taxes, the Department is also unable to impose penalties on businesses that register late for PAYE. It should seek powers to remedy this situation.
- 7. The Department’s guidance requires an average reading age of at least 16 or 17 years to understand it, but over 5 million adults have literacy skills well below this level.** The Department should make its guidance easier to understand by using plain English and improving the layout.

- 8. Workshops and seminars giving advice on tax obligations do not run to full capacity and only around 8% of newly registered businesses attend.** There is a high rate of late cancellations. The Department needs to make it easier for new businesses to obtain the advice they need. It should:
- explore alternative methods of providing workshops and seminars to increase take up, including online and outside normal working hours;
 - make its website easier to use; and
 - work closely with the organisations that new businesses consult for business advice to provide help through those channels.
- 9. The Department operates two helplines for the newly self employed, one for new employers and seven more covering different taxes that all businesses can contact.** Businesses have to contact different helplines for advice on different taxes. It should work towards a one stop telephone system to cover all taxes. The Department needs to develop the technical and operational capability to give helpline staff access to taxpayers' computer records and to route enquiries to advisers with the requisite expertise.
- 10. Only around one half of small businesses are aware of the different schemes available to simplify the tax requirements for small businesses.** If all those eligible took advantage of just two of the schemes they would save at least £50 million a year. The number of different schemes and how they can be used in combination makes it difficult for businesses to decide whether they are beneficial. To improve take up, the Department should advertise more widely the financial benefits to businesses of using them. It should also assess the costs and benefits of introducing a single simplified VAT scheme.

1 Simplifying Registration

1. Around 700,000 new businesses start up each year. They have to register separately with the Department as different taxes become due, which can be at different times. For example, as they take on employees they will need to operate PAYE and if their turnover exceeds £61,000 they become liable for VAT. Even if a business needs to register for a number of different taxes at the same time, it must do so separately for each. There are around 1.2 million registrations a year (**Figure 1**).²

Figure 1: The number of tax registrations in 2004-05

Tax		New registrations	Number deregistering	Total registered
Self employment (Income Tax Self assessment)	Sole traders	330,000	389,000	3,065,000
	Partnerships	41,000	57,000	
Corporation tax		330,000	185,000	1,600,000
PAYE		272,000	97,000	1,163,000
VAT		270,000	170,000	1,825,000
Total		1,243,000	898,000	7,653,000

Source: C&AG's report, *HM Revenue & Customs: Helping newly registered businesses meet their tax obligations*

2. The Department deploys over 400 staff to register businesses, costing over £10 million a year. In 2005–06, around 70% of businesses registered by completing a paper form. They have been able to register online for VAT since December 2004, PAYE since June 2006 and for Income Tax Self Assessment since February 2007. By April 2007 20% of businesses had registered online for VAT and 25% for PAYE. The Department estimates that it would save around £1.7 million a year if online registration for VAT increased to 50%. In Australia, 96% of businesses register for a business tax number online. 85% of registrations with Companies House are conducted online in the UK.³

3. The main incentive for businesses to register online is that it is easier than completing a paper form. For example, in registering for VAT online the address is automatically completed after entering the post code. The completed form is also easily submitted to the Department with immediate acknowledgement of its receipt, providing businesses with greater certainty that the Department has received the registration. The Department has not considered offering any other incentives to businesses to complete registration forms online. Lord Carter's Review of HMRC Online Services noted that the vast majority of businesses are now using IT and the internet on a day to day basis. He recommended that available resources should be focused on improving the services rather than providing new financial incentives.⁴

4. The separate registration processes have evolved as the Department has developed separate computer systems for each tax over the years. Separate registrations are

² Ibid, para 2.5

³ Qq 14, 44, C&AG's Report, paras 2.5–2.6

⁴ Ibid, para 2.10; Qq 24–30; Ev 14

inconvenient for businesses who must provide the same information more than once. The Department acknowledged that it is some way behind the practices of other tax authorities, such as Canada and Australia, where businesses can register once for all taxes, and complete their registration online. Major changes to the Department's systems would be required to implement a similar system.⁵

5. Businesses are issued with different reference numbers for Income Tax, PAYE, VAT and Corporation Tax which they need to use in contacting the Department. The Department cannot access data on a business across the taxes and so lacks an overview of the tax position of a business. It is developing a "customer index" that should enable it to link internally all the reference numbers for an individual business.⁶

6. The 2006 Review of HMRC Online Services by Lord Carter of Coles⁷ stressed the importance of a single business identifier to be used for all types of tax as well as for interactions with other government departments to achieve more joined up services. Sir David Varney's report on Service Transformation⁸ also recommended steps to improve the capability and capacity of government to establish business identity and share relevant information to meet the government's commitment for businesses to provide information only once. A number of other tax authorities use a single business identifier. The Department expected that by 2010–11 businesses would only have to provide information once, which would be used to update all the different tax systems.⁹

7. The Department's registration forms vary in complexity. The easiest to complete paper form is for National Insurance contributions/Income Tax Self Assessment registrations. It is a short form and requires little guidance to complete. The VAT registration form is the most difficult because it contains technical terms and complex concepts. The Department has recently redesigned this form to make it easier, and two thirds of businesses now complete the form correctly compared to around one half of businesses previously. The Department incurs further costs in seeking additional information from businesses that have completed the form incorrectly.¹⁰

8. Errors also occur in online VAT registrations because the Department's system lacks validation checks. There are no mechanisms to prevent the bypassing of boxes that should be completed. Additional documents required by the Department cannot be submitted online. If the Department does not receive these supplementary papers by post within five days the application is classified as incomplete.¹¹

9. Businesses are required to register with the Department soon after becoming liable for each tax. For example, sole traders and partnerships should register with the Department within three months of becoming self employed. The Department can impose a penalty on

⁵ Qq 7, 12, 84

⁶ C&AG's Report, para 2.13

⁷ *Review of HMRC Online Services*, Lord Carter of Coles, HMRC, March 2006

⁸ *Service transformation: A better service for citizens and business, a better deal for the taxpayer*, Sir David Varney, HM Treasury, December 2006

⁹ Qq 6, 9–10, 114–115

¹⁰ C&AG's Report, paras 2.8 and 2.9; Qq 50, 51, 86–87

¹¹ Qq 79–83

businesses registering late for VAT and Class 2 National Insurance contributions. Similar penalties for Corporation Tax were introduced in July 2004 but there are no penalties for registering late for PAYE. In 2004–05 the Department imposed penalties totalling £6.7 million in nearly 70,000 cases of late registration for Class 2 National Insurance contributions and VAT. No penalties have been imposed so far for late registration on Corporation Tax.¹²

¹² C&AG's Report, para 2.3

2 Improving compliance by newly registered businesses

The compliance record of newly registered businesses

10. The Department expects all businesses to file their returns on time, calculate the right amount of tax due, and pay it on time. Newly registered businesses are a diverse group. Some are setting up in business for the first time, others have previous experience. Some manage their tax affairs themselves; others rely on an agent or other assistance. Attitudes to compliance also vary.¹³

11. In dealing with tax obligations for the first time, new businesses may be unfamiliar with what is expected and they may need particular help in getting their tax affairs right. At the same time they face a number of other pressures on their time and resources. New businesses that get their tax right first time are more likely to continue to comply as they grow and their obligations increase.¹⁴

12. The Department has some data on the extent to which businesses in general comply, but it cannot easily analyse compliance by newly registered businesses as a group because of the way its computer systems were originally set up. Nor is the Department able to assess the track record of individual businesses. As a result it is poorly placed to assess priorities, and the costs and benefits of action to improve compliance.¹⁵

13. The latest available data show that the proportion of new businesses filing their returns on time is generally lower than for the business population as a whole (**Figure 2**). Newly registered businesses incur penalties of around £3.1 million a year because they file late on Income Tax Self Assessment and £5.5 million a year on Corporation Tax. If the Department could improve the filing performance of new businesses to the level achieved by the general business population it would receive an additional 119,000 returns on time.¹⁶

Figure 2: Compliance with different tax obligations for all businesses and newly registered businesses

	Income Tax Self Assessment (2003–04)		PAYE/Class 1 National Insurance Contributions (2003–04 and 2004–05)		Corporation Tax (2004–05)		VAT2 (2004–05)	
	All businesses	New businesses	All businesses	New businesses	All businesses	New businesses	All businesses	New businesses
Filing tax return on time	89%	79%	80%	61%	77%	72%	85%	80%
Accurate returns	46%	54%	63%	69%	61%	Not Available	65%	Not Available
Paying on time	Not available	Not Available	53%	Not Available	60%	64%	60%	53%

Source: C&AG's Report, HM Revenue & Customs: Helping newly registered businesses meet their tax obligations

¹³ C&AG's Report, paras 1.1, 1.4

¹⁴ *ibid*, para 1.3; Q 34

¹⁵ Qq 8, 77

¹⁶ C&AG's Report, paras 1.10–1.12

14. On accuracy of returns and paying on time, comparisons between newly registered businesses and the business population as a whole give a mixed picture. A large proportion of businesses are failing to pay the correct amount of tax. Self employed people are more likely to file inaccurate returns with only 54% calculating the correct amount of tax in 2003–04. The Department has found that around 40% of returns on Corporation Tax under assess tax by an average of around £2,700. One third of newly registered businesses pay their Corporation Tax late and almost one half pay VAT late, owing the Department an average of £6,200 in VAT after 12 months of trading. The Department does not know the cost to the Exchequer of late payments.¹⁷

The effects of the Department's help on compliance

15. The Department has an objective to achieve by 2007–08 a measurable improvement in new and growing businesses' ability to deal with their tax affairs. Since 2003–04 it has contacted businesses within 12 months of VAT registration to instil good compliance habits before they file their first return. The Department also telephones those who have failed to file returns to remind them of their obligations and provide them with guidance and advice on their responsibilities.¹⁸

16. In 2004 and 2005 the Department examined whether the help provided to newly registered businesses improved compliance. It compared the compliance record of over 100,000 businesses which had received help with 64,000 businesses which had not. Of those receiving help, 6% more businesses filed their VAT returns on time and 9% more paid on time compared to those that received no help (**Figure 3**). The average amount of VAT declared by businesses in the two groups did not differ significantly.¹⁹

17. Until April 2006, the Department's Business Support Teams informed businesses registering for PAYE and Income Tax Self Assessment of the range of support provided. They had a target to ensure that 90% of newly registered businesses filed on time if a representative from the business attended a workshop. On PAYE just over 70% of new employers attending a workshop filed on time, compared with just over 60% for all newly registered employers.²⁰

18. In 2006 the Department reorganised its support to businesses. It aims to target education at all newly registered businesses, in particular those that do not use a tax agent. The Australian Tax Office has improved compliance by concentrating help on those who were entirely new to business. It tracks their compliance for up to 2 years, and takes swift action on non compliance.²¹

¹⁷ Qq 14, 17, 62, 119

¹⁸ C&AG's Report, para 1.5

¹⁹ Q 38, C&AG's Report, para 1.22

²⁰ Ibid, para 1.23

²¹ Ibid, para 1.24, Qq 14–15, 34

Figure 3: The results of the Department's research into whether education and support improves compliance on VAT for newly registered businesses

Aspect of compliance	Businesses which are compliant		
	Support received from the Department (%)	No support from the Department (%)	Difference (%)
Businesses submitting their VAT return on time	92	86	+6
Businesses making payments on time	85	76	+9
Businesses owing the Department VAT after 12 months	4	8.6	-4.6
Businesses deregistering in their first year	3.3	7.4	-4.1

Source: C&AG's report, *HM Revenue & Customs: Helping newly registered businesses meet their tax obligations*

19. The Department considered that those seeking help tend to be those who are more inclined to comply, and therefore the challenge it faced was in providing help to businesses that were less likely to be compliant. Whilst some of its practices were similar to those in Australia, the Department believed that tracking those new to business for 2 years would require significant additional resources. The poor compliance record of the newly registered self employed suggests that they are a group in need of continuing support (see Figure 2).²²

20. The Department expects businesses to pay their taxes when they are due. If they do not, the Department sends a demand letter. It also telephones them to ask for payment and to provide advice on paying on time in the future. Nearly one half of businesses do not pay PAYE/National Insurance contributions on time. The Department cannot impose a penalty or interest for late monthly payments of PAYE/National Insurance contributions during the year. It can do so only on balances due at the end of the tax year. If an employer has not paid over the national insurance contributions collected, the Department nevertheless credits the employees' records as long as it has received the employer's return. Where its records show that an individual has not paid or been credited with sufficient contributions in the year for that year to qualify for state pension, the Department sends a deficiency notice inviting the individual to check that their records are correct. In 2006–07 the Department issued 4.7 million notices relating to the 2004–05 tax year. The Department is currently reviewing whether to provide additional support to help new employers meet their PAYE obligations.²³

²² Qq 35–37, 39–43

²³ C&AG's Report, para 1.16, Qq 116–117; Ev 14

3 Making compliance easier

Guidance and advice

21. The Department aims to make it as easy as possible for businesses to comply by providing clear and accessible guidance and forms that are straightforward to complete. It spends over £23 million a year providing a range of help through its website, printed guidance, telephone helplines, workshops and seminars. It is currently developing a new strategy to provide clear, coordinated and helpful support at the right time to small and medium enterprises, primarily targeting those that make unintentional mistakes.²⁴

22. In 2005–06 the Department spent over £6 million on providing 14,000 workshops and seminars which were attended by nearly 75,000 business representatives or around 8% of newly registered businesses. 98% of those attending felt more confident in complying with their obligations as a result. On average five people attend each workshop whereas the capacity is up to 15. Workshops are held during normal business hours. A pilot study in 2004 suggested there was little demand for workshops at other times. Less than half of those who say they will attend actually do so on the day. To make the educational material more accessible to businesses the Department is considering whether to provide it online. New businesses often seek advice from financial advisers, accountants and Business Link, which provide channels of contact the Department could use to help businesses register and comply with their tax obligations.²⁵

23. The Department produces guidance on Income Tax Self Assessment, PAYE, VAT and Corporation Tax which is targeted specifically at newly registered businesses. It is important that information in booklets and leaflets can be understood by taxpayers from a wide range of backgrounds and levels of education. But the Department's guidance requires an average reading age of at least 16 or 17 years. Over 5 million adults have literacy skills well below this level. The high reading age is due partly to the complexity of the subject and the use of technical terms to give accurate advice but also to the use of long sentences and many acronyms. The Department produces its forms in English and Welsh only but offers an interpretation service to assist customers whose first language is not English.²⁶

24. The Department wants businesses to obtain tax information of a general nature from its website. The website is convenient for businesses to use because it is available seven days a week, 24 hours a day. It is also cost effective for the Department compared with telephone calls. The Department estimates that the staff costs involved in running the website are £900,000 a year, and it has around 30 million hits a year.²⁷

25. The Department recognised that its website is not easy to use and plans to improve it by focusing on the most heavily used sections. There was scope to improve the links to

²⁴ Ibid, paras 1.2, 1.5

²⁵ Qq 88–89, 96–103, 111, C&AG's Report, para 3.3

²⁶ C&AG's Report, paras 3.9, 3.11; Qq 47–48, 54, 110; Ev 14

²⁷ C&AG's Report, paras 3.6; Qq 21, 54; Ev 14

information a business may need. The Business Link website provides information for businesses across government and includes a number of online tools to help businesses with their tax obligations, which are easier to use than written guidance. One tool helps businesses identify the dates when they need to file returns and make payments to the Department and allows them to set up email alerts based on the results. Since April 2007 the Department has taken over responsibility for the Business Link website. The Report on Service Transformation recommended that Business Link should be recognised as the primary e-channel for business and offer high quality services on a par with the best of the private sector.²⁸

26. The Department operates three telephone helplines to provide dedicated support to newly registered businesses at an estimated cost of around £4 million a year. These offer help to the newly self employed and new employers, and deal with some three million telephone calls a year. It operates a further 7 helplines covering specific taxes that all businesses can contact for information. The Report on Service Transformation recommended one stop contact centres across government to meet business needs. The Department is currently exploring the scope for reducing the number of different helplines and telephone numbers to offer a more joined up service, and in the longer term a single initial point of telephone contact with the Department. It will need to develop the technical and operational capability to provide helpline staff with access to taxpayers' computer records for all taxes, and to route enquiries to advisers with the requisite expert knowledge.²⁹

Simplifying the requirements of businesses

27. The Department recognises that the costs of compliance can be more onerous for smaller businesses and that they have most to gain from simplified requirements. In March 2005 the Department issued a consultation document on *Working towards a new relationship: reducing the administrative burden of the tax system on small business*,³⁰ which set out proposals for simplifying the relationship between the Department and business to reduce costs. Since then the Department has introduced a number of measures to simplify the tax requirements for small businesses such as reducing the number of enquiries about employees' tax affairs.³¹

28. In 2005-06 the Department estimated the administrative burdens of the taxation system on businesses to be £5 billion a year. The top ten obligations cost businesses £2.1 billion. Businesses with less than 10 employees bear just over one half of this burden. The Department has targets to reduce the administrative burden on business of dealing with the Department's forms and returns by at least 10% over a five year period. It also plans to reduce the burden of its audits and inspections by 10% over three years and at least 15% over five years.³²

²⁸ C&AG's Report, para 3.7, Qq 23, 54

²⁹ C&AG's Report, para 3.12, 3.14; Q 77

³⁰ *Working towards a new relationship: a consultation on priorities for reducing the administrative burden of the tax system on small business*, HM Treasury, March 2005

³¹ C&AG's Report, para 1.6

³² *Ibid*, para 1.7 to 1.8; Q 3

29. The Department offers a number of schemes, mainly on VAT, aimed at simplifying the tax requirements for small businesses (**Figure 4**). Take up by businesses has been low, although there has been an increase in the last year on the VAT cash accounting scheme. In April 2007 the Department increased the turnover limits for eligible businesses to join the cash accounting scheme from £825,000 to £1.6 million, and it expects take up to increase further as a result. Businesses could make significant cost savings by operating the VAT annual accounting scheme in conjunction with the flat rate scheme. But only 1,800 do so. If all eligible businesses took advantage of these schemes they would save £50 million a year.³³

Figure 4: Take up by businesses for the simplified schemes by the end of 31 March 2006

Scheme	Number of businesses eligible	Number of businesses using the scheme	%
VAT: Cash Accounting Scheme	733,000	159,500	22
VAT: Flat Rate Accounting Scheme	705,000	110,000	16
VAT: Annual Accounting Scheme	1,000,000	10,500	1
PAYE: Quarterly Returns Scheme	Not available	Not available	
Income Tax Self Assessment: three line accounting	Not available	Not available	

Source: C&AG's Report, HM Revenue & Customs: Helping newly registered businesses meet their tax obligations

30. A survey by the Department found that nearly all accountants were aware of the schemes but that only around one half of VAT registered businesses knew of the Flat Rate and Cash Accounting Schemes, and 39% knew of the Annual Accounting Scheme. The PAYE Quarterly Payments Scheme is not widely promoted by the Department. The number of different schemes and ways they can be used in combination means that it is not always easy for businesses to identify the benefits of using them.³⁴

³³ Q 5, C&AG's Report, para 3.20

³⁴ Ibid, paras 3.21-3.22

Formal minutes

Monday 9 July 2007

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon

Mr David Curry

Mr Ian Davidson

Mr Philip Dunne

Ian Lucas

Mr Austin Mitchell

Mr Don Touhig

Draft Report

Draft Report (Helping newly registered businesses meet their tax obligations), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 30 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Fifty-third Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned until Wednesday 10 October at 3.30 pm.]

Witnesses

Monday 23 April 2007

Page

Paul Gray CB, Chairman, and **Theresa Middleton**, Director, Small and Medium Enterprises and Employers, HM Revenue and Customs.

Ev 1

List of written evidence

HM Revenue and Customs

Ev 14

List of Reports from the Committee of Public Accounts 2006–07

First Report	Tsunami: Provision of support for humanitarian assistance	HC 25 (Cm 7018)
Second Report	Improving literacy and numeracy in schools (Northern Ireland)	HC 108 (Cm 7035)
Third Report	Collections Management in the National Museums and Galleries of Northern Ireland	HC 109 (Cm 7035)
Fourth Report	Gas distribution networks: Ofgem's role in their sale, restructuring and future regulation	HC 110 (Cm 7019)
Fifth Report	Postcomm and the quality of mail services	HC 111 (Cm 7018)
Sixth Report	Gaining and retaining a job: the Department for Work and Pensions support for disabled people	HC 112 (Cm 7019)
Seventh Report	Department for Work and Pensions: Using leaflets to communicate with the public about services and entitlements	HC 133 (Cm 7020)
Eighth Report	Tackling Child Obesity—First Steps	HC 157 (Cm 7020)
Ninth Report	The Paddington Health Campus Scheme	HC 244 (Cm 7076)
Tenth Report	Fines Collection	HC 245 (Cm 7020)
Eleventh Report	Supporting Small Business	HC 262 (Cm 7076)
Twelfth Report	Excess Votes 2005–06	HC 346
Thirteenth Report	Smarter Food Procurement in the Public Sector	HC 357 (Cm 7077)
Fourteenth Report	Ministry of Defence: Delivering digital tactical communications through the Bowman CIP Programme	HC 358 (Cm 7077)
Fifteenth Report	The termination of the PFI contract for the National Physical Laboratory	HC 359 (Cm 7077)
Sixteenth Report	The Provision of Out-of-Hours Care in England	HC 360 (Cm 7077)
Seventeenth Report	Financial Management of the NHS	HC 361 (Cm 7077)
Eighteenth Report	DFID: Working with Non-Governmental and other Civil Society Organisations to promote development	HC 64 (Cm 7077)
Nineteenth Report	A Foot on the Ladder: Low Cost Home Ownership Assistance	HC 134 (Cm 7077)
Twentieth Report	Department of Health: The National Programme for IT in the NHS	HC 390 (Cm 7152)
Twenty-first Report	Progress in Combat Identification	HC 486 (Cm 7151)
Twenty-second Report	Tax credits	HC 487 (Cm 7151)
Twenty-third Report	The office accommodation of the Department for Culture, Media and Sport and its sponsored bodies	HC 488 (Cm 7152)
Twenty-fourth Report	Ofwat: Meeting the demand for water	HC 286 (Cm 7151)
Twenty-fifth Report	Update on PFI debt refinancing and the PFI equity market	HC 158 (Cm 7152)
Twenty-sixth Report	Department for Work and Pensions: Progress in tackling pensioner poverty—encouraging take-up of entitlements	HC 169 (Cm 7152)
Twenty-seventh Report	Delivering successful IT-enabled business change	HC 113 (Cm 7216)
Twenty-eighth Report	ASPIRE—the re-competition of outsourced IT services	HC 179 (Cm 7216)
Twenty-ninth Report	Department of Health: Improving the use of temporary nursing staff in NHS acute and foundation trusts	HC 142 (Cm 7216)
Thirtieth Report	The Modernisation of the West Coast Main Line	HC 189 (Cm 7216)
Thirty-first Report	Central government's use of consultants	HC 309 (Cm 7216)
Thirty-second Report	The right of access to open countryside	HC 91 (Cm 7216)
Thirty-third Report	Assessing the value for money of OGCbuying.solutions	HC 275 (Cm 7216)
Thirty-fourth Report	Recruitment and Retention in the Armed Forces	HC 43 (Cm 7216)
Thirty-fifth Report	BBC outsourcing: the contract between the BBC and Siemens Business Service	HC 118
Thirty-sixth Report	Reserve Forces	HC 729 (Cm 7216)

Thirty-seventh Report	Child Support Agency: Implementation of the Child Support Reforms	HC 812 (Cm 7216)
Thirty-eighth Report	Sure Start Children's Centres	HC 261 (Cm 7216)
Thirty-ninth Report	Preparations for the London Olympic and Paralympic Games—risk assessment and management	HC 377 (Cm 7216)
Fortieth Report	Dr Foster Intelligence: A joint venture between the Information Centre and Dr Foster LLP	HC 368 (Cm 7216)
Forty-first Report	Improving procurement in further education colleges in England	HC 477
Forty-second Report	The Shareholder Executive and Public Sector Businesses	HC 409
Forty-third Report	The Restructuring of British Energy	HC 892 (Cm 7216)
Forty-fourth Report	Tackling Anti-Social Behaviour	HC 246 (Cm 7216)
Forty-fifth Report	Standard Report on the Accounts of the Revenue and Customs: Missing Trader Fraud	HC 250 (Cm 7216)
Forty-sixth Report	Ministry of Defence: Major Projects Report 2006	HC 295
Forty-seventh Report	Improving quality and safety—Progress in implementing clinical governance in primary care: Lessons for the new Primary Care Trusts	HC 302
Forty-eighth Report	The Efficiency Programme: a Second Review of Progress	HC 349
Forty-ninth Report	Identity and Passport Service: Introduction of e-Passports	HC 362
Fiftieth Report	Assets Recovery Agency	HC 391
Fifty-first Report	Legal Services Commission: Legal aid and mediation for people involved in family breakdown	HC 396
Fifty-second Report	The Academies Programme	HC 402
Fifty-third Report	Helping newly registered businesses meet their tax obligations	HC 489

The reference number of the Treasury Minute to each Report is printed in brackets after the HC printing number

Oral evidence

Taken before the Committee of Public Accounts

on Monday 23 April 2007

Members present:

Mr Edward Leigh (Chairman)

Mr Ian Davidson
Mr Sadiq Khan
Mr Austin Mitchell

Rt. hon. Mr Alan Williams
Mr Iain Wright
Mr Derek Wyatt

Sir John Bourn KCB, Comptroller and Auditor General, **Tim Burr**, Deputy Comptroller and Auditor General, National Audit Office and **Jane Wheeler**, Director, National Audit Office were in attendance.

Marius Gallaher, Alternate Treasury Office of Accounts, was in attendance.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL:

HELPING NEWLY REGISTERED BUSINESSES MEET THEIR TAX OBLIGATIONS (HC 98)

Witnesses: **Paul Gray CB**, Chairman, HM Revenue and Customs and **Theresa Middleton**, Director, HM Revenue and Customs Small and Medium Enterprises and Employers, gave evidence.

Q1 Chairman: Good afternoon and welcome to the Public Accounts Committee, where today we are considering the Comptroller and Auditor General's Report, *Helping newly registered businesses meet their tax obligations*. We welcome Paul Gray, the newly appointed Chairman of Her Majesty's Revenue and Customs. Congratulations on being confirmed in your position, Mr Gray. As this is the first time that you have appeared before our Committee, please tell us some of your plans in your new job. What is your priority?

Paul Gray: The key priority is to press forward with the modernisation programme as we reach the further stages of the merger of the two former departments. The first couple of years have been concerned with the initial bringing together of the former tax and customs departments. There is now a Spending Review settlement that will take us through to 2011, and we are drawing up detailed plans for that period that are aimed at delivering more of the benefits of the merger that were outlined in the O'Donnell Report and at continuing the process of reduction of overall organisational costs—by 5% a year in real terms—while at the same time progressively improving our performance both in the area of business that is the subject of today's sitting and in many other areas.

Q2 Chairman: Thank you for that answer. However, forgive me for saying so but it was given from a rather bureaucratic point of view. What I am interested in are your plans for simplification of the tax system so that we can raise revenue and reduce costs. We are looking at that in particular this afternoon. Do you want to say something about it and whether it is one of your priorities?

Paul Gray: My priority is to make sure that I administer the tax system in accordance with the current legislation to the best of HMRC's ability.

Q3 Chairman: A lot of progress towards simplification can be made within the existing policy constraints. That is what we are talking about this afternoon.

Paul Gray: We can certainly make progress, and I see our job as being to make sure that we are much smarter and more effective in identifying areas in which we intervene, and to deliver on the targets for reducing business burdens that inevitably result from the tax system. I am now operating within the framework of explicit constraints to do just that. It is a matter of being more effective, intervening where we need to do so and not intervening where it is unnecessary.

Q4 Chairman: A PAC Report on Tax Credits will, I think, be published just before the recess but there may not be a hearing on that subject until after the summer recess, many months away. As it is a matter of such acute concern to our constituents, and as you happen to be sitting in front of us, will you forgive me for asking about your plans to simplify tax credits and make them more consumer-friendly?

Paul Gray: We are right in the middle of implementing a series of changes that were announced in the 2005 Pre-Budget Report, which involve significant adjustments to and simplification of the system. The key task, as I see it, for me is to ensure that we get more consistent and effective at administering the system for the 6 million families who benefit from it and, in particular, to ensure that, with regard to those categories of the customer base who find the system more difficult to deal with, we become smarter at identifying those people who are likely to find the system more difficult and demanding. We are working with the ombudsman, her offices, the HMRC adjudicator and her office to implement those plans.

HM Revenue and Customs

Q5 Chairman: Let us look, in terms of simplification, to the Report. Paragraph 3.20, on page 27, shows a low take-up of your tax simplification schemes. Is that because, frankly, you have not made matters any simpler for business? Does that explain the low take-up?

Paul Gray: The take-up of the different schemes varies. The take-up has increased significantly over the past year or two—for example, the cash accounting system saw an increase of about 30% in the take-up between 2005 and 2006. With that cash accounting scheme for VAT, we have just introduced some changes with effect from 1 April of this year under which the turnover levels under which businesses are eligible for the scheme will be increased significantly—to roughly double those turnover limits. Take-up has been increasing. A number of changes have been made to make the schemes more attractive, but at the end of the day the schemes are optional and businesses can choose whether or not they want to take them up. They are not obligatory. We seek to give choices to people who find such characteristics more conducive to work with.

Q6 Chairman: Looking forwards to 2010, when you will have been in office for three years, how much simpler will it be for businesses to deal with your organisation, do you think?

Paul Gray: Significantly more simple. One of the key sets of recommendations from the NAO's helpful Report is relevant here. A significant part of our vision for the future is that rather than having all our systems predominantly defined by the particular tax product, and businesses having to interact separately with us in relation to each of those tax products, we will progressively move to a position whereby business customers will come to us once with a change of circumstance and we will take that on board across the range of taxes. I do not know whether we will have reached that position in full by 2010—it might take us another year or so to reach that position. However, that is the direction of travel.

Q7 Chairman: On the theme of making things easier for business, the paragraphs that begin with paragraph 2.11 on page 20 concern streamlining registration and show that there is not a single online tax registration facility. Why not?

Paul Gray: It relates to what I was saying. In the past, in both former departments—Revenue and Customs—the systems have been drawn up based on single tax products. That is not satisfactory as a direction of travel for the future. We want to introduce a regime such as you have mentioned. It is a major change; it is not something that I wish to rush at like a bull at a gate so that the change in systems falls over. However, it is clearly a key place that we want to get to and was one of the characteristics identified by the O'Donnell Report identified as to where an integrated tax department could reach in the medium term. That is what I am committed to do.

Q8 Chairman: Paragraph 1.9 and figure 2 deal with compliance record of newly registered businesses. The paragraph mentions: “gaps in the Department's data.” Why is your record of compliance so incomplete? Is this not key? How can you target your efforts without having those data to hand?

Paul Gray: The piece of data that we do not have is the identification in our compliance records of whether or not we are dealing with a newly registered business. We receive lots of information when new businesses first contact us, and we target a lot of interventions to help them at that point. The way in which the systems have been designed means that we have full and timely information about the compliance record of all businesses, and we target our actions and interventions on the basis of that information. However, during the early years of a business's life our system does not have an identifier that specifically identifies a business as a new one.

In figure 2, the NAO was seeking to pull together the data that we have specifically on the compliance record of new businesses. To be able to do that, we have to rely on the random enquiry process following the end of particular tax years, when our economists and statisticians collect and examine a sample of cases. That can only be done some time after the year in question, thus for various of these taxes the figures are for 2004-05 and 2003-04 rather than more timely data. We have more timely data across the whole range of businesses, on which we base our targeting and interventions.

Q9 Chairman: That lastly begs the question as to why you do not have a single business identifier. Figure 8 on page 21 is entitled “Unique business numbers in Australia”. It states: “Over four years the Australian Tax Office introduced the Australian Business Number, a unique 11-digit number”. It seems such an obvious thing to do and it is a surprise that you have not yet done it.

Paul Gray: As I have said, that is a direction in which we should go; for better or worse, we have not done so previously. We are now committed to doing that, as we can identify the resources and get robust plans—

Q10 Chairman: That begs other questions: when will that happen? When will it be fully in place?

Paul Gray: As I said, it might be done by 2010, although it is perhaps more likely that it will be 2011 by the time that we have been able fully to roll out such a system. The implementation period for a scheme of that sort is probably at least two years, and we must ensure that we get robust plans in place.

Q11 Chairman: Thank you very much.

Q12 Mr Wright: I want to pursue some of the Chairman's themes. On paragraph 10, with the greatest respect, your answers about duplication were vague and non-committal. Why is it that in the 21st century when people want to register a business, they have to register separately for each tax? That

 HM Revenue and Customs

costs both the business and the department in terms of bureaucracy and duplication of effort. Why is that? Why is more not being done to avoid that?

Paul Gray: I have tried to say that we are committed to getting to a position. It has not been done in the past because the systems have been designed on an individual tax basis. I understand where you are coming from on this question, and I agree about the position that we ought to reach. Equally, I do not want to commit to doing something in a tearing hurry only for it to end up being unsuccessfully implemented. We need to do this not only as rapidly as we can, but as safely as we can.

Q13 Mr Wright: Is it the case that when schemes have been put in place to simplify matters, the take-up has been very low, as the Chairman has said? Is that because things are unduly complicated? Is that because you are not advising businesses appropriately? Paragraph b1 on page 9 relates to online filing, and states: "Take up was around 13% at the end of March 2006 and had increased to 16% by July." Why was that the case?

Paul Gray: We are strongly committed to moving as rapidly as we can in the direction of online filing. In fact, since the Report was published, online VAT registration has already reached 20%, while the PAYE figure, which was 10% in the Report, is now 25%. These are relatively new processes and we are putting them in place as rapidly as we can.

With regard to online business with the department, Lord Carter undertook a major series of reviews. Following his recommendations, we have gone for a mandatory approach in relation to large businesses, but we have not gone for mandation for smaller businesses—not at this stage, at any rate—recognising the potentially larger burden on them. Over the next year or so, and on a much more rapid time scale than we shall be able to achieve for single registration, I would anticipate very big increases in the proportion of people filing online, even without mandation for small businesses.

Q14 Mr Wright: I was at a meeting last week with the Economic Secretary to the Treasury, at which he talked about the Government's policy on a risk-based approach to regulation. That seems entirely fair, but I do not get the sense from this Report that that approach is being taken. For example, paragraph 1.15 on page 14 says: "In the main, the Department assesses newly registered businesses as posing low risks to the revenue and only carries out checks on individual businesses where high risks are identified." That seems to be at odds with international practice. For example, the Australian Taxation Office seems to be very good at saying, "We'll put you on the right track straightaway." The figures for accurate returns in table 2 show that 54% of self-assessed income tax returns by new businesses are correct, which seems extraordinarily low. Under the risk-based approach, should not new businesses be classed as relatively high risk, and helped and targeted appropriately?

Paul Gray: We are talking about two parallel things here. Paragraph 1.15 primarily talks about where we make interventions to assess against compliance risk or non-compliance. For new businesses, as well as for more established businesses, we take into account a range of risk factors that are entirely consistent with the approach.

As for helping and supporting new businesses at the point of establishment, we do put in place quite a lot of—I hope—helpful prompts and supports. Following the discussions on the preparation of this Report, we are reinforcing quite a number of those activities and introducing a number of targeted prompts specifically for new businesses, both by offering general seminars and guidance, and also by introducing last year—and reinforcing this year—things such as targeted telephone and e-mail traffic to new businesses.

Q15 Mr Wright: Forgive me, Mr Gray, but time is pressing. If you are a new business, you have got to work 24 hours a day to build up your reputation, revenue and customers. Revenue and Customs putting on a seminar is hardly going to get you away from the business that you are trying to build up, in order to ensure tax compliance. What more rigorous steps can the Department take to assist and to ensure that new businesses are actually complying?

Paul Gray: I have talked about a range of things, some of which are similar to what our colleagues in Australia do. The contrast between us and Australia is perhaps not as great as you may think. We are actually targeting a whole lot of early contacts and support towards new businesses. For employers, we are sending them employer packs, while for those who are self-employed, we are giving them comprehensive guidance at the point at which they register. As I say, we are following that up with a whole lot of prompts. We find that the take-up in response to targeted offers of help is relatively modest, so we are now thinking about whether there are new things that we can do—much better online guidance, for example, is a direction in which we are now moving, and that obviously links into the point that we were making earlier about online registration as well.

Q16 Mr Wright: Can I just finish off with the issue of paying on time and the costs to the Exchequer? I understand that recently the threshold for the cash accounting scheme doubled, and that should help in terms of paying VAT when you receive the payment from your customers rather than when it is due. Do you anticipate that that doubling of the threshold will help take-up?

Paul Gray: It is certainly designed to do so and clearly offers the opportunity to double the size range of businesses. We do not have a precise target for that; it has been introduced to help and support. At the end of the day, it is up to businesses to make the choice of whether they wish to do it on that or the conventional basis. However, in all our guidance we are pointing to that as an opportunity and giving people encouragement to take it up if they want to.

HM Revenue and Customs

Q17 Mr Wright: In terms of the cost to the Exchequer, I was intrigued by paragraph 1.17, which states: “One third of newly registered businesses pay their Corporation Tax late and almost one half pay VAT late—owing the Department an average of £6,200 in VAT after 12 months of trading.” How much is the total cost to the Exchequer per year of those late payments in terms of cash flow and of the Government having to go to the money markets to borrow? What estimate does the department give of that cost?

Paul Gray: I cannot give you a precise figure on those accounted for by new businesses. The data also show that although those quite high proportions pay late, most pay only slightly late and the overall cost is therefore relatively modest. But I am afraid that I cannot give a precise figure from my head.

Q18 Mr Wright: What about a back-of-the-fag-packet calculation? We could say that an average of £6,200 is owed in VAT after 12 months of trading. Table 5 shows 270,000 in new registrations—so half of that. That is £1.67 billion to the Exchequer. Is that overstating the case or is it about right?

Paul Gray: That does not take into account possibilities of interest payments on late payments and other offsets of that sort. Not having done that similar calculation myself, I am not sure whether—

Q19 Mr Wright: Could you provide the Committee with that?

Paul Gray: Yes.¹

Q20 Mr Wright: I would certainly like my constituency to have that £1.67 billion, if it is on offer. That is a considerable cost to the Exchequer that we would not have to deal with.

Q21 Derek Wyatt: Good afternoon. I see that your website costs £900,000 a year to run, which strikes me as a huge amount. How many people are involved in the website?

Paul Gray: In terms of administering it?

Derek Wyatt: Yes.

Paul Gray: I am sorry; I do not have that figure with me, but I can let you have it.²

Q22 Derek Wyatt: Is it 10, 20, 30 or 100?

Paul Gray: It would be something of that sort, but a significant proportion of the costs of operating the website are the transactional costs. Given the scale of our business and the number of interactions, we

are talking about a very big operation. The staff cost in terms of supporting is probably a relatively modest proportion.

Q23 Derek Wyatt: Page 23 states: “The Department recognises that its website is not easy to use and is currently improving it.” What is happening? What is next? That was December and here we are in April.

Paul Gray: We are putting a range of changes in place. We are focusing primarily on the most heavily used parts of the website. In parallel, we are also now taking on across Government the responsibility for the Business Link generic e-portal for businesses, which is currently administered by the DTI. Since 1 April, that has been transferred to HMRC. A lot of our changes focus on making sure that we are providing a comprehensive web portal, not only with our own information but with relevant information for businesses right across Government.

Q24 Derek Wyatt: When I am told to use online booking for my air flights and so on, I am incentivised because I get a reduction. Is there any incentive scheme for me to go online to register and to record my information?

Paul Gray: During earlier questions I was talking in the context of Lord Carter’s review and its proposals for the encouragement and mandation of online business. There were some incentive payments as part of that process, but in terms of regular contact and transactional business, we do not offer a general discount or premium for choice of channel. I think that for a public authority it is a rather interesting issue to debate—

Q25 Derek Wyatt: You fine us for being late.

Paul Gray: Yes.

Q26 Derek Wyatt: You make money from people who file late, so you could recycle that money and incentivise it.

Paul Gray: It is certainly possible that we could do that. I think there are—

Q27 Derek Wyatt: Do you have the authority to do that, or do you need us to do that?

Paul Gray: I am not sure that I do have legislative authority to do that at the moment, but I think that that tax policy issue is interesting. I can see the advantages to which you point, but there are possibly some counter-arguments in the context of the collection of tax payments due.

Q28 Derek Wyatt: But if we are early, we get the interest, so it must be in our interest for everyone to be early. Do Australia, Canada or any American states incentivise registering?

Paul Gray: I am not sure. I am not aware that they do. I do not know whether Theresa Middleton, my colleague, has any information on that.

Theresa Middleton: I do not, but it might be worth adding that there are some softer benefits that people can get from transacting with us online, rather than getting a deduction off tax. They can have the

¹ Ev 14–15

² *Note by witness:* The £900,000 quoted in the transcript relates solely to staff costs involved in running the website, we are unable to provide a definitive figure for the wider overheads. However, there are 27 civil servants specifically involved in managing and operating the HMRC website, both in terms of the content and the transactions. Other staff work on the HMRC website from the IT supplier end and from the wider HMRC business in terms of writing the majority of the content for the website, but these numbers vary depending on the level of change and support required and are normally engaged on other work besides the HMRC website.

 HM Revenue and Customs

certainty of knowing that what they have sent to us has been received because they will get confirmation online into their inbox, and things are processed more quickly. Certainty is very important for business customers, and we have found that they welcome that. They do not get money off, but they get something else.

Q29 Derek Wyatt: As Iain Wright knows, entrepreneurs are busy people, and they need as much help as possible in their first three years. That would be a marvellous thing to do. Can we ask you to think about it and come back to us?

Paul Gray: Yes.³

Q30 Derek Wyatt: Can you come back quickly—within a month?

Paul Gray: It is certainly an issue I can reflect on. I think there are legislative and policy implications, as well as purely administrative and operational ones.

Q31 Derek Wyatt: Can you explain what your relationship is with other countries in Europe? Do you talk all the time? Are you in constant contact? Is there some federation of Government agencies in this area? How do you know where best practice is—that is what I am getting at—and are we at the top, or in the top five? Who does the accounts and says, “You are appalling,” “You are very good,” or “You are whatever”?

Paul Gray: There is a very active network of international groups, a number of which are under the auspices of the OECD, not just in Europe but obviously covering the developed world more generally.

Q32 Derek Wyatt: Are there league tables?

Paul Gray: There are no overall league tables. I think that different people’s performance varies according to the different characteristics. As the Report has brought out in relation to small businesses and particularly to the unique identifier and single registration issue that we were discussing, we are somewhat behind a number of other countries on that development. In other respects, I think we would be regarded as being more at the leading edge, and we certainly have a large number of contacts from other countries that are looking at and trying to learn from some of our better practice.

Q33 Derek Wyatt: Thank you.

Q34 Mr Khan: If the Report is right, 700,000 new businesses start up each year. There is also a figure for those that deregister, but that is the number of new businesses that start up each year. The Report also tells us that if new businesses get their tax right the first time, they are likely to continue getting it right, which presumably means that for HMRC there is less maintenance and less chasing up later on. We are also told by the NAO that Australia sees to things *vis-à-vis* new businesses pretty well, concentrating help on new businesses. For the first

two years, in particular, it tracks new businesses and gives them the additional help they need, and it takes swift action *vis-à-vis* education, information and assistance, if required by the new businesses, which leads to the excellent results they have, in relative terms, I suspect, in relation to returns. Why are not we putting more of our eggs in that basket?

Paul Gray: I shall make two points on that. First, although there is a lot that is very well worth considering in the Australian approach, I do not think that there is rigorous data to demonstrate that its approach generates, overall, a better compliance result. Many of the things that we have introduced already or are planning to introduce have a great deal of similarity with the Australian approach. We are looking to make very intensive contacts with new businesses at the point that they are formed, but in deciding the overall balance of our effort, we have concluded, up to this point, that to put more and more resources into making contact with every new business during those first two years in the way that the Australians do—on the basis that they are new and that is the only criterion that is considered—could involve a significant additional resource for us.

Q35 Mr Khan: Appendix 2, which is a very—

Paul Gray: It gives a picture.

Q36 Mr Khan: It gives a picture of the Australian Tax Office’s approach to new business taxpayers. Just to be clear, are you saying that the leap from where we are in the UK to that model is a disproportionate expenditure that cannot be justified by the benefits we would obtain?

Paul Gray: I am saying that there are significant similarities. For example, just as the Australians seek to identify whether or not a new business has a tax agent, in which case, as shown on the right hand side of the chart, they do not put as much effort into it, we do exactly the same thing. We identify whether they have an agent. If they do, we are less intensive and we work with the agent. If they do not have an agent, we make direct contact with them and seek to encourage them to come to workshops and we send them material. We offer them the education options in that third or fourth box.

Q37 Mr Khan: I have not seen workshops anywhere on the Australian model. Mr Wright and Mr Wyatt have made the point that if you are a small business person, the idea of going to a half-day or full-day workshop must be the worst thing you could possibly imagine. The model talks about educational material being sent to businesses, calls being made to businesses to assess their needs, and contact being made. Do you do those sorts of things?

Paul Gray: We do all those sorts of things. The difference between the two approaches is that during the first couple of years, the Australians consistently focus regular interventions on all new businesses. We do not do it to that degree of intensity because although we think newness is an important risk criterion, if I can use the terminology that Mr Wright used, it is not the only criterion to take into

³ Ev 15–16

 HM Revenue and Customs

account when assessing whether a business needs support or an intervention. There are quite a lot of new businesses that, with or without some initial support and help from us, have a very good record. However, quite a lot of established businesses do not, and need that—

Q38 Mr Khan: I want to ask you about figure 3 on page 16. It is clear from the aspects of compliance discussed there that where support is received from the Department, benefits are obtained. Businesses are more likely to return VAT on time and make payments. They are also less likely to owe VAT after 12 months or to deregister if they are given support by HMRC. Do the benefits and differences that we see—with +9% at one extreme and -4.1% being the least percentage improvement—justify the resources that you are putting into businesses? Should we be seeing bigger differences? Do you see the point I am making?

Paul Gray: I do see the point you are making. The difficulty with the analysis is that it looks only at the difference that we can make by putting more resource into that particular category of business—those that are new.

Q39 Mr Khan: They are new this year, but if they get into a good habit and they are not new in three years' time, they are more likely to pay VAT on time and make their returns. Do you see what I mean?

Paul Gray: Yes.

Q40 Mr Khan: Although the benefits may be only 9% this year when they are a new business, if they become a creature of good and best practice, you can see the benefits in years to come, cannot you?

Paul Gray: Yes.

Q41 Mr Khan: The NAO tells us that once you get into the habit of being a good tax paying business, you tend to keep it.

Paul Gray: One of the other characteristics that we found is that the people who are most willing to accept support from us tend to be the naturally more compliant. The real difficulty is how we get to the businesses that do not wish to be compliant. I am not disputing the conclusion that you draw from the table.

Q42 Mr Khan: Do you suspect that they would probably be compliant anyway?

Paul Gray: Well, they want to comply, and they therefore appear to have a stronger wish to seek help and support.

Q43 Mr Khan: Talking of the hard to reach businesses, what work are you doing with the shadow economy? The NAO gives us figures, so you know that a large number of businesses—self-employed, sole traders, partnerships—de-register each year. The number of sole traders that de-registered in 2004-05 exceeded the number of new registrations. There is a reference in the Report to

the suspicion that there may be an element of the shadow economy in all that. What work are you doing to target them?

Paul Gray: That is very much at the heart of our work on risk profiling. We are trying to get increasingly sophisticated data matching and other techniques to identify those cases that we should pursue. They include categories such as de-registrations.

Q44 Mr Khan: I was surprised by your answer about the Australian Tax Office online system. Is 96% the figure that it gives for those who register online? If you look at figure 6 on page 19, it is not possible to register by telephone for corporation tax, online for self-employment and corporation tax, or by telephone for VAT. Do you think that if you made it easier for businesses to register, it might improve the number of companies and businesses that register? It also might help you to deal with de-registration.

Paul Gray: It would help, which is why over the past year we have put a lot more effort into encouraging that form of registration—hence the significant pick-up in the figures that I was discussing with Mr Wright.

Q45 Mr Khan: How soon before you can register online as a self-employed person?

Theresa Middleton: They can do it now—just since February.

Q46 Mr Khan: And corporation tax?

Paul Gray: That, I think, we have not got in place now, but we should very shortly.

Theresa Middleton: For corporation tax, the business registers with Companies House and Companies House automatically notifies HMRC of all new company registrations.

Q47 Mr Khan: Thank you. The NAO Report refers to the number of adults for whom literacy is a problem. It says that the average age of some of the material may be too difficult for them to grapple with, and it refers to the steps that you are taking to try to reduce and simplify the material. How soon before you reach your target of a reading age of 11 years for the material?

Paul Gray: We are trying to get that as soon as we can. We face an inevitable challenge: getting the right balance between giving accurate guidance and help, and matching it to those different reading ages. There may be some areas where it is quite difficult to get the balance right.

Q48 Mr Khan: How soon before you improve things to the point where you are happy that you have done as much as you can?

Paul Gray: Over the course of the next year or so, we are hoping to go through all our guidance material and to get our best shot at that.

Q49 Mr Khan: Thank you Mr Gray. Thank you Chairman.

HM Revenue and Customs

Q50 Mr Davidson: I will start with something that arises from the question of missing trader fraud. The Report indicates that the system is made quite complex in order to try and deal with that. To what extent does that spill over to the rules that have to be applied to much smaller companies, which are unlikely by their nature to be involved in missing trader fraud?

Paul Gray: As you say, the existence of the missing trader problem means that we are being more diligent on VAT registration, because getting a registration is a key step if somebody wishes to perpetrate fraud. During the past year we have put a lot of effort into simplifying the VAT registration process. After discussion and consultation with external bodies, we reviewed and simplified the VAT-registration application form, from which the early results are encouraging. Only 30% of old forms were completed accurately, but that is now up to 66%.

Q51 Mr Davidson: I understand some of that, but what I want to pursue is how you are striking the balance between making the system simple and comprehensible for somebody who, for instance, wants to enter self-employment in my constituency as a joiner, and ensuring that all the loopholes are plugged so that another of my constituents cannot import or export enormous amounts of mobile phones. That is the point, because clearly the rules for one type of person are not appropriate for the other, and I wonder whether there is a way to discriminate. I am not sure whether different rules apply to different trades, for example.

Paul Gray: We adopt a three-pronged approach in trying to strike what is a difficult balance. One is to simplify the forms, so that the joiner in your constituency is not faced by a form that is unreasonably difficult to get to grips with. We have done that and it is showing good signs of success. The second approach is that we are trying to update the registration rules to ensure that they better reflect the circumstances of different types of business. Thirdly, we are trying to get increasingly smart about our risk assessment rules and processes, because the key to the balance you mention is whether we can spot the dodgy applications or not. That goes back to what Mr Khan was asking about the way in which we are trying to make the data underlying our risk assessment more sophisticated.

Theresa Middleton: The UK has one of the highest VAT registration thresholds in Europe, which means that many small businesses—possibly even a slight majority—do not need to register for VAT. That is one of the main ways of keeping the complexity of VAT out of the smallest businesses. Many new businesses do not need to register immediately, because they do not have the requisite turnover—the threshold increased to £64,000 in the most recent Budget.

Paul Gray: I guess there is also the issue of the simplification schemes that have already been mentioned. They are another attempt to make compliance easier.

Q52 Mr Davidson: That is right. I can tell you who the rascals are in my constituency, though I am not sure that the method would be one that it would be sound to apply nationally.

Paul Gray: If you would like to write to me that would be very welcome.

Q53 Mr Khan: There is a hotline.

Q54 Mr Davidson: Indeed. Page 25 of the Report gives information about reading ages and complexity and so on. Given that, in a constituency such as mine, educational levels are varied, there is clearly an issue with some of the forms being too difficult and complex, and with required reading ages being high. The final sentence of paragraph 3.11 says, “some of the more technical information will not be easily understood by some taxpayers.” Is it the case that some of the more technical information requires to be understood by all taxpayers—particularly the guy trying to get off the ground, whether he is a joiner or a painter or something similar? Is it not the case that big rafts of information are not applicable to them and could be deleted from the forms that they must fill in?

Paul Gray: That is certainly true on an individual basis, but being able to identify precisely what should and should not be on the form for every applicant is quite tricky. The burden of our approach should be to build on what we are doing, which is, first, to simplify the forms—I have talked about the VAT form, but we have also introduced a new short tax return for self-assessment, which has been a big help for newer small businesses—and, secondly, to get the guidance tailored to the best of our ability, making it as simple as we can, while retaining its accuracy. For example, Mr Wyatt talked about the website. There is definitely the potential to improve the way in which the website information works in the respect that you are talking about, namely by giving links—in other words, if you need to know more about this, press this link. That is the approach. Getting the right journeys for people is no easy task when we are dealing with so many different types of people, but that is exactly the sort of thing that we are trying to do.

Q55 Mr Davidson: May I turn to the question of your links with other Departments? This is a point that I have picked up before, but you have links with, for example, the Home Office, in comparing information that is provided by people who may be seeking indefinite leave to remain for a spouse. As I have mentioned before, I am aware of circumstances where people have the rule that their spouse cannot be a charge on public funds. They produce accounts for me and other MPs indicating that they make or have enormous sums of money. However, when they discuss their claims for things like the working families tax credit and the running costs of their business, you would think that they were working their shop or venture as a charity, because the income that they make is so small. There are clearly different sets of accounts being produced for different people. It appears that you obviously are

HM Revenue and Customs

not able to access, or do not access, the information that is made available to the Home Office, otherwise you would be picking up some of these issues. What is being done to close this loophole?

Paul Gray: We are looking to make much better use of the information that can be shared between Departments. As was mentioned when we had this discussion in another context, there are some areas where we do not have legal gateways to exchange information, and obviously I cannot make use of illegal gateways. Where there are legal gateways, we are looking to get a lot better and more consistent at making use of that information, whether it is through the Home Office or the Department for Work and Pensions, where there are also lots of relevant read-acrosses to be made.

Q56 Mr Davidson: Can I just clarify this difference between legal and not legal gateways? What is stopping the not legal gateways from being legal gateways? Is it just that we have not agreed to accept them as such or is there some other barrier, which I have not picked up?

Paul Gray: No, it is a matter of whether Government and Parliament wish to amend the necessary legislation, in order to—

Q57 Mr Davidson: Sure, but are there any particular gateways that are currently not open to you that you wish were open, and which you have asked to be opened?

Paul Gray: Certainly, this is an issue that I can keep under review, and I will offer advice to Ministers—

Q58 Mr Davidson: Sorry, is that a no or a yes? Are there any gateways that you wish were open to you?

Paul Gray: There are no specific ones at the moment that I regard as a particular barrier, but the issue is obviously something that we look at regularly—

Q59 Mr Davidson: So all the ones that I have mentioned, to do with the Home Office, in fact are barriers that are open to you?

Paul Gray: As when we had this discussion before, the issue is often whether Departments are making as effective use of the gateways as—

Q60 Mr Davidson: The question of whether the gateway is open to you is different from the question of whether you are using it. I just want to be clear about whether there are any gateways that you believe would be helpful to you, but which you cannot access.

Paul Gray: There is nothing significant at the moment that, if we did not make as good use as possible of the gateway—

Q61 Mr Davidson: Fine. So if there is any information or read-across from another Department that you are not using, that is because you are inefficient or because you are choosing not to use it, not because you are not allowed to use it.

Paul Gray: That is basically it, yes.

Q62 Mr Davidson: May I just turn to the question of the effectiveness of some of the information that people are providing? I seem to remember that there was an indication in the Report of average errors and the like, which I presume tended to be errors in favour of the taxpayer rather than errors in your favour. Is that right? Paragraph 1.15 on page 14 states: “Self-employed people are in general more likely to file inaccurate returns”. It goes on: “The Department’s random enquiry programme detected errors by companies in around 40% of returns, with under-assessments of tax of around £2,700 on average.” The average is always against paying the tax, is it?

Paul Gray: It tends to be, yes. But not universally—

Q63 Mr Davidson: I accept that, but is that average because of deliberate attempts to underpay tax, or is there something in the way in which the rules are constructed that makes it easier for people to err on that side rather than the other?

Paul Gray: I do not think that I would identify anything in the rules that makes it easier to go that way rather than the other. The average covers a multitude of sins and non-sins. In some cases, no doubt, people are succumbing to a temptation to under-declare, and in other cases, there is pure error. In our interventions and our support arrangements, we seek to distinguish and identify between the two. Where we think that it is an honest mistake, we seek to get it put right and to educate people for the future. If we think that it is not an honest mistake, we take a rather less charitable view.

Q64 Mr Davidson: What is the balance between sins and non-sins? Is it 10% of one and 90% of the other? In which direction?

Paul Gray: I am not sure that I have an aggregate figure in my head. I suspect that there are more cases of error, rather than sinning, but there are significant parts of both elements.

Theresa Middleton: For the business population as a whole—not for new businesses—around half, as shown in the Report, is non-compliant in some way. The overwhelming bulk of that half is made up by lots of low-level error, while a proportion, which is in the minority, is caused by significant evasion. The challenge for us is to be able to target the right intervention to help those who are making mistakes—some are making mistakes through their agents—to get them right, but to target our most experienced and skilled resources on the people who deliberately seek to underpay.

Q65 Mr Davidson: Right. What areas of the economy—which professions, trades and so on—are predominantly thought to be at highest risk of committing deliberate sins? I remember that, when we had someone from the CSA in front of us, they suggested that they were extremely sorry for taxi drivers who appeared to have incomes that were so low that they appeared to be conducting their

HM Revenue and Customs

business as a charity for the popular good. Are there four or five areas of the economy that are of highest risk?

Paul Gray: There is not a clear league table of that sort. There are certainly some areas of activity where more aspects of the tax system are relevant. That would tend to increase the risks of error and non-error. We certainly seek to identify patterns that emerge and to put those into our risk profiling.

Q66 Mr Davidson: That is a very generous answer, but I was looking for some specifics. Which are the three or four trades or professions that are most at risk of committing deliberate error? Where would they be in your risk profile? Where do the farmers fit in? In every other dealing that we have with farmers, we find that they are prone to err on their own side rather than that of the Government. Are they the same with their taxes as well?

Paul Gray: Frankly, most trades and professions will have a proportion of people who fall into that category. To try to draw up a simple league table by trades is to oversimplify the rather complex picture.

Q67 Mr Davidson: Very diplomatic.

Q68 Chairman: So farmers are no worse than anybody else. Is that what you are saying?

Paul Gray: Or possibly no better.

Q69 Mr Mitchell: I wonder whether it is partly a question of the image and attitude of the Revenue. It is not notorious for being a friendly, amiable, open organisation.

In fact, it has a much more of a stern, draconian image, constantly anxious when giving advice, to cover its own backside and protect the revenue. If you were a more open and accommodating organisation, many of the problems would not arise.

Paul Gray: We are seeking to make sure that we differentiate the approach appropriately. A lot of the burden of this Report, with which I am very happy and which I have discussed with some of your colleagues already, is about offering much more support and guidance to people who actually want to get things right. That is how I am seeking to steer the organisation. The majority of people in most walks of life want to do the right thing by their tax paying obligations. By making our systems and processes more customer-focused, that is a direction in which we are seeking to move, while cracking down very hard—even in a draconian way, to use your word—on those deliberately seeking to defraud us.

Q70 Mr Mitchell: That is true; that is what you need to do. However, it has still not been done yet. I contrast my experience here with my experience of the New Zealand tax authorities, which are always relatively open. For me, the forms are accessible and pretty easy to fill in. In Britain, I get so terrified that I always feel it necessary to appoint an accountant as a protective mechanism to keep you lot from me.

Paul Gray: I am not sure that I recognise that exact description, although I accept the general point. One of the things that I am committed to is seeking to move the organisation to be more focused on the needs of its customers and to be more open, helpful and supportive for the majority, where that is the case. I think that we have made a start on that, although we have not got anything like as far as I would like to get to.

Q71 Mr Mitchell: There is a long way to go. I get the impression that the advice and help that is offered to new businesses is often moralistic—“Get the return in on time, register on time and be good boys”—rather than helpful and supportive.

Paul Gray: I am not sure that I accept that. There may be some of that in historic tradition, but we are certainly seeking to do this in a genuinely supportive and helpful way, while being very straightforward with people about what they need to do.

Q72 Mr Mitchell: Why can you not appoint mentors to new businesses? Would the costs be enormous? The mentor could give them one-stop advice and tell them how to do things.

Paul Gray: We already work with quite a number of organisations that are seeking to give such help.

Q73 Mr Mitchell: But not other organisations.

Paul Gray: There are organisations—

Q74 Mr Mitchell: There are, such as Business Link, but I did not mean them. Why can you not appoint mentors?

Paul Gray: That is effectively what we are seeking to do. We have not used the formal word “mentors”, but our staff who are in contact with individual businesses are seeking to give that kind of help. Frankly, we could not afford the resources to hand out a mentor to every businesses, but that is the sort of direction in which we are trying to go.

Q75 Mr Mitchell: It is Government policy that everybody should want to encourage small businesses and nurture them as the mighty oaks of the future. It would be a good beginning if the tax authorities did the same.

Paul Gray: The measures that we have already taken—

Q76 Mr Mitchell: You could bring them up in the way of rectitude, too.

Paul Gray: Indeed. But the Report acknowledges some of the measures that we have taken. It urges us to take other measures, and we are seeking to take them. They are taking us in that direction.

Q77 Mr Mitchell: As I read the Report, many of the faults in the relationship lie with you, rather than with the small businesses, whether the small businesses are inclined to understate their obligations or whatever. You cannot pick out new businesses from your IT to examine the record, compare and contrast and see what the problems are. You require separate systems for each tax,

 HM Revenue and Customs

which is complicating and baffling. Your helplines cannot see all the problems through; you cannot have one-stop helplines and you cannot register online. Those are faults of the Revenue, not of the clients.

Paul Gray: They have been faults in the past, and we are addressing them. We have talked about our activities online, where we are now—

Q78 Mr Mitchell: But not quickly enough.

Paul Gray: Well, we are moving as quickly as we reasonably can, and I have been very happy to sign up to the Report's further recommendations that emerged from our dialogue with the NAO. They are very much the directions in which we want to travel. I am occasionally frustrated that we are not in a position to do things more rapidly, but I want to do them as quickly and as safely as we can.

Q79 Mr Mitchell: I see that people who register online make as many errors as people who register on paper. However, I cannot see why. In paragraph 2.10, the problem seems to be yours again, rather than that of the people who register. It says: "The error rates for registrations completed online are, however, similar to those on the paper forms because a lack of computer validation checks allows applicants to bypass boxes". That is a fault on your system.

Paul Gray: Yes.

Q80 Mr Mitchell: So the errors are not on the part of the person filling in the form; you cannot check them.

Paul Gray: Some of them are not. The system that supports our VAT online system needs further work to build in those capabilities. I am entirely open about that, and it is something that we need to do. It is not the same as saying that we are responsible for all errors in online filing. Our tools are not as good as those that we are trying to get. We will be able to spot automatically some of the errors that we do not spot at the moment.

Q81 Mr Mitchell: If there was a system to warn people that they were not filling in all the boxes, it would make life much easier.

Paul Gray: It would, and that is what we are going to do.

Q82 Mr Mitchell: What is the problem with sending in the supplementary papers by post? If they do not come within five days, it is scrapped. Given the propensity of the Revenue for losing papers, that seems unreasonable.

Paul Gray: I do not dissent from that, and that is why the following sentence in the Report says that this is an issue that we are looking at to seek to resolve.

Q83 Mr Mitchell: But to reconcile what has come in by post with what has come in via the net is a fairly straightforward task, is it not?

Paul Gray: It is. It is a task of significant scale, given the size of our operation, but that is exactly why we are seeking to get it sorted out.

Q84 Mr Mitchell: Paragraph 2.15 says that the other countries studied all had single registration forms. Why have we been so long in introducing that?

Paul Gray: It is something that we discussed earlier with Mr Wright and Mr Khan. Both the predecessor departments did not have that facility; they operated their systems on an individual tax basis. We are now looking at how rapidly we can develop such a system. The Report also shows that, for all those countries, of which a number are significantly smaller than the UK, it was a major enterprise that took several years. It will take us several years to get there, but as I indicated earlier, it is a destination that we are committed to reaching.

Q85 Mr Mitchell: Is it that expensive to provide businesses with a unique business number? It cost £20 million in Australia, which does not seem to be a huge sum for something that must be very convenient.

Paul Gray: It is not just about cost issues; there are very complex systems issues to ensure that we operate effectively, starting from a position at which the information is stored and operated on a range of different IT systems.

Q86 Mr Mitchell: VAT seems to be a major cause of the problem, because the forms are far too complicated. Would you accept that?

Paul Gray: As I was saying to one of your colleagues, we accept that the earlier VAT registration form was unnecessarily complex, which is why we have massively simplified it and why the accuracy rate under the new form is double the rate under the former form.

Q87 Mr Mitchell: But most of the errors occur on eight questions. Why cannot you simplify that?

Paul Gray: That is what we have done in the new form.

Q88 Mr Williams: Mr Gray, I see that you hold 14,000 workshops a year, costing £66 million, so it costs approximately £430 per workshop. Does that sound correct?

Paul Gray: That is about right.

Q89 Mr Williams: And you get only five people attending, so it works out at about £80 a head to run the workshops. Why are they held during normal business hours? Is it not likely that most small business people cannot spare time to leave their business during the day, and the workshops are probably not held nearby, so they have to travel and to park, and may even have to take time for lunch and so on? I can remember these questions being asked about schemes for small businesses 15 or 20 years ago, yet still they are held during work time. Have you tried experimenting with out-of-work hours?

 HM Revenue and Customs

Paul Gray: We have looked at the options—

Q90 Mr Williams: You have looked at them, but have you experimented?

Paul Gray: I think that we have done experiments, have we not—

Q91 Mr Williams: You think you have, or have you?

Paul Gray: I am just asking my colleague. We can check this fact. I think we have run some experiments with workshops outside the regular nine-to-five slot, but we are still finding—this is the point I making, Mr Williams—that the take-up rate for workshops is relatively low, which is why—

Q92 Mr Williams: Yes, but how does the take-up rate out of hours compare with the take-up rate in hours?

Paul Gray: I am afraid that I have not got those figures in my head, but I can let you have them.⁴

Q93 Mr Williams: I should have thought that they are fairly obvious figures to have.

Paul Gray: Can I let you have them?

Q94 Mr Williams: If, for many years, you have known that people are not attending during work hours, and if you held experimental workshops out of hours, I should have thought that the department would have put the two ideas together and said, “Oh look, this one is more efficient than that,” or: “That one is more efficient than this.” Does the department not ask questions like that?

Paul Gray: I think we seek to. There is a point here that, for many businesses, the notion of normal work hours has become much more flexible.

Q95 Mr Williams: Oh yes, we understand that, if someone runs a business such as a food business and so on, but the point relates to main business hours. You must have some analysis somewhere—I am astonished if you have not—of the effectiveness of running the workshops outside what are called normal business hours, but you tell me that you do not have any figures to hand.

Paul Gray: I have not got the figures to hand, but I think that we have done an analysis—

Q96 Mr Williams: If you have got them to hand, can you give them to me?

Paul Gray: Yes.

Q97 Mr Williams: Now.

Paul Gray: Theresa, do you have them?

Theresa Middleton: No, but what I can tell you, which may help, is that, during 2008, we are going to pilot some online workshops that people can tap into at a time that suits them.

Q98 Mr Williams: Yes, but I am not talking about online and so on. That is a different issue. I am talking now not exactly about a novel idea. As I said,

I can remember that, when I was in government dealing with regional assistance and industrial support and asking questions about that in opposition, the work hours issue was always a problem. Why have you not, by now, worked out whether it is more cost efficient to run them in hours or out of hours, and what the relative benefit is of doing them outside normal hours?

Paul Gray: The main conclusion that is emerging—this came up in the questions that Mr Wright asked me—is that the idea of a workshop requiring physical attendance is clearly not attractive, understandably, to a large number of businesses, which is why we are looking at other ways of trying to deliver that kind of support, hence the notion of using online facilities.

Q99 Mr Williams: What staggers me is that you are looking at it. Why has it not been looked at? Why was it not looked at 10 years ago, when the figures must have been somewhat similar, or even worse, or perhaps better, which would be even more worrying?

Paul Gray: As I say, we have piloted out-of-hours, and in general the evidence seems to be that they are not much more successful than those in core hours, which is why we are now looking—

Q100 Mr Williams: But if they are not much more successful, but they are getting to people who do not come in the normal time, would it not make sense therefore to run both systems side by side, and perhaps you would increase the 8% of new business men coming, which is all you get at the moment? If 8% come during normal working hours and, even if only half as many came afterwards, it would still be cost beneficial, would it not?

Paul Gray: It would, but let us look at the choice between those two options. We are increasingly looking, in an online age, at whether we can be more effective and reach a lot more people.

Q101 Mr Williams: Yes, but a lot of the people will not be online. It is all right for people who are online, but a lot of them will not be.

Paul Gray: No, but that is why, by mixing and matching a range of them, we can increase our effectiveness. As you have said, the cost of laying on such things is quite significant. We have to judge whether that offers sensible value for money within the overall context of the resources that we have.

Theresa Middleton: Increasingly, business customers are online and the challenge for HMRC is to identify which segments are not and are unlikely to move in that direction, so that they are not left behind in our plans to make more information available 24/7.

Q102 Mr Williams: Do not misunderstand me; I am all in favour of putting it online. I know that you have tried and that it has not been all that successful, but at least you tried. What puzzles me is that you are not trying to cope with the failures and the reasons for the failures of your existing system.

⁴ Ev 16

 HM Revenue and Customs

Paul Gray: We are, as I say, and I apologise, Mr Williams, that I have not got with me the precise results of our evaluation of out-of-hours as well as in-hours, but if I may I can let you have a note on that after the hearing.

Q103 Mr Williams: But it should be self-evident not to you as a person, but as an organisation, that if 11 out of 12 of this year's new business people are not going to the courses and 11 out of 12 of last year's did not, nor did 11 out of 12 of the previous year's and probably 11 out of 12 of next year's will not, the problem is building up, not being solved.

Paul Gray: Which is why we are seeking to put more effort into all the other ways that we offer education, guidance and support, with the CDs and the various forms of written material that we send out, as well as the online facilities.

Q104 Mr Williams: So in view of the chaos that has been so far described, what on earth leads you to think that setting a target for next year of 90% of small businesses finding it easier to complete their tax returns will suddenly happen? What miracle will take place in the next 12 months that will transform the whole system?

Paul Gray: I am not sure that I recognise your description of chaos.

Q105 Mr Williams: Well, you do not recognise a miracle either.

Paul Gray: In terms of the ease with which small business is finding the filling in of our forms, the results of our latest customer survey suggest that small businesses are finding it increasingly easy to do their business with us. To be honest, I do not think that it will require a miracle for us to reach that target. Theresa, do you want to add anything?

Theresa Middleton: No.

Q106 Mr Williams: From where we are sitting, the transposition from 8% of new business men in a workshop this year to 90% finding it easier next year sounds like a miracle to me.

Paul Gray: They are two rather different figures.

Theresa Middleton: The target for the ease of completing tax returns is for those businesses that are small and do it themselves and do not use an agent. Within that, there will be new business men, but it is not a population of new. It is a population of small, and we are at target level. The reason why we think that we are at target level is the VAT population. The VAT return has only nine boxes. It is acknowledged as being one of the more straightforward forms to fill in.

The second reason is the introduction of the short self-assessment return. It is a four-page form. A few years ago, we were not at that level, but we have made some significant changes to forms, which we believe is why more businesses are saying that they find it easy to do it.

Q107 Mr Williams: Is it not likely, for the reasons that Mr Davidson put forward, that more than 10% will not want to find it easier to use? They need the excuse of confusion.

Paul Gray: There is a proportion who fall in that category.

Q108 Mr Williams: A high proportion, or a small proportion?

Paul Gray: It is difficult to put a figure on that.

Q109 Mr Williams: Well, if it is difficult to put a figure on it, you cannot give a 90% target can you?

Paul Gray: Well, we can have a 90% target in relation to the survey population. We ask people a question; they give us an answer. We seek to select the survey representatively across the population as a whole.

Q110 Mr Williams: I am running out of time. I know that I am overlapping. Again following on the point that Mr Davidson raised, a vibrant part of the small business sector is outside normal business—the catering food area. A large part of that is ethnically operated. Mr Davidson referred to the technicality of the form in English. To what extent do your forms mean anything to people from ethnic communities? Such people may have little understanding of technical English, so what support is given? Are these forms available in different languages, and if so, could you supply a written list of the relevant languages?⁵

Paul Gray: We can certainly give you that material. One of the other things that we are doing is seeking to work closely with a range of organisations that help ethnic minorities and other potentially disadvantaged groups. We want to ensure that we work with the people who know most about those parts of the economy and can give us the best advice on how we design our processes to support them.

Q111 Mr Williams: Is any statistical analysis of the effectiveness of your workshops done? It is only 8% who attend your workshops, so have any correlations been made to establish whether such workshops are even beneficial? If so, how do they compare?

Paul Gray: That is part of the overall evidence, to which one of your colleagues drew attention in the Report, in respect of identifying the relatively higher levels of compliance of people who have been given support and guidance. Workshops are just one of the elements that have contributed to that. We can develop that point specifically in the note on workshops that I have promised you.

Q112 Mr Williams: Will you allow me some other questions, Chairman?

⁵ Ev 16–17

 HM Revenue and Customs

Chairman: Yes.

Q113 Mr Williams: I had to dive out earlier because I brought Wednesday's notes with me rather than today's. You might have had far more difficulty in dealing with my points, so consider yourself lucky, Mr Gray.

Paul Gray: I am most grateful.

Q114 Mr Williams: The option of a unique business identification number may have been dealt with by the Chairman.

Chairman: It was.

Mr Williams: In that case, I shall leave that point.

Chairman: I never knowingly leave out a good question, so have another go.

Q115 Mr Williams: Why is this problem so insoluble? Why can you not introduce the measure, Mr Gray? It would ease the administration and analysis situation.

Paul Gray: It is not insoluble. As I have said to some of your colleagues, it is certainly a position that we are committed to reaching. This is a complex technical challenge, as other countries who have introduced that system have found. The NAO Report brought out that point. In that respect, we are behind the pace set by some other countries, but we want to get to that position, and we shall do so in a number of years' time.

Q116 Mr Williams: My final question addresses a completely different aspect. The briefing from the NAO states that the Revenue: "does not impose a penalty or interest for late monthly payments of PAYE/National Insurance contributions except for any balance due at the year end". Do you automatically then impose a penalty at the end of the year if the payments are not being made? All of us know of constituents who have found, after working for someone for several years, that they have no entitlement because the money that has been deducted has not been paid in. How quickly do you follow up the warning signal that PAYE and national insurance might not be being paid? How ready are you to take legal action on that?

Paul Gray: We come at that problem from two directions. We get the end of year returns from employers, and in the May-June of the following year, we check whether aggregate payments have been made. Where they have not been made, we follow them up, and apply appropriate interest and penalties. The other angle from which we come at this—I believe that this is that point you are trying to get at—relates to the individual PAYE and national insurance records of the individual employees. Regarding that, as the aggregate records for employers are broken down and allocated to individual employee's national insurance records, we now routinely send out what are called deficiency notices to individuals who, according to our records, have not accrued a full years' entitlement and give a warning to people if they appear not to have a full record. So we are feeding back information to individual employees and contributors, which gives

them the opportunity to identify whether they think that their payment should have been made, as well as allowing us to monitor the overall compliance on the aggregate employer returns.

Q117 Mr Williams: Thank you, Chairman; I have considerably overrun my time.

Mr Gray, could you just submit a note following up from that point that indicates the volume of warning and what statistical evidence you can give us about incidents of concern at your end when payment is not being made and where there is a follow-up with prosecution or other actions against those who are failing to pay? Would it be possible to provide that?

Paul Gray: I certainly will.⁶

Q118 Chairman: Mr Mitchell has a supplementary question.

Q119 Mr Mitchell: Just to clear the matter up, I wonder how far it is part of a long struggle against the self-employed. I have an image of small new businesses battling against red tape, hung down with obligations and finding difficulty in complying with the regime. On the other hand, those who are self-employed may be a load of fiddlers looking for every loophole that they can get. Certainly, when I was the most famous television personality in Yorkshire, I was also the best dressed person in Yorkshire because I had a tax allowance for clothes. I was hung down with Paul Smith suits—I would have fitted in brilliantly with the new Labour Front Bench.

I see that only 46% of the self-employed submit the correct return, so how far is there a distinction between small businesses finding it difficult to comply and needing a more relaxed approach and the self-employed, who must be viewed stringently.

Paul Gray: We do not make such a distinction of approach—

Q120 Mr Mitchell: You do not recognise any of the distinctions of approach.

Paul Gray: But in talking about new businesses, we are talking about a combination of the self-employed, in one-man or one-woman businesses, and small employers. What we are seeking to do in all the schemes that we are talking about is operate on an even-handed basis between the two. We are giving similar levels of guidance and support to both. All the initiatives that I have talked about, and that are brought out in the Report, are mirrored for both the self-employed and small employers.

Theresa Middleton: Can I add to that? When people set up, they decide whether to set up as self-employed or as a company, and that is reflected in the Report. As a business grows, it has to come into contact with other regimes; it takes somebody on for the first time and so becomes an employer, or it gets up to the VAT threshold that we were talking about earlier and needs to register for VAT. The Report is intended to cover not only the very new businesses, but those that grow and take on a new obligation for

⁶ Ev 17–18

 HM Revenue and Customs

the first time. We are covering all of that and identifying the need of the business at the point when it is either brand new or taking on a new obligation.

Q121 Mr Mitchell: I see that you are not worried about errors by newly registered companies. You do not have any figures, but you consider that “any errors are likely to be small because such companies tend to have low profits.” If they have low profits, is there a case for giving them a corporation tax holiday for the first year of their establishment? Would that be expensive? Can you provide any figures?

Paul Gray: I certainly cannot provide any figures off the top of my head. That is a kind of policy issue, which—⁷

⁷ *Note by witness:* HMRC estimates the cost of providing an exemption for the first year of establishment of companies with low profits to be approximately £800m per annum.

We do not consider there is a case for such corporation tax holiday because:

- If would give a competitive advantage to companies over their unincorporated equivalents,
- Many new small companies were previously unincorporated businesses—there is no economic case for providing a tax holiday merely because of a change of legal form;
- Companies already enjoy a longer period before having to pay corporation tax—9 months and one day after the end of the first accounting period—that their unincorporated equivalents.

Q122 Mr Mitchell: Yes it is, but could you provide figures on what it would cost if we did it?

Paul Gray: I will see whether we can. I do not know whether we have accurate data.

Q123 Mr Mitchell: Thank you.

Q124 Chairman: Thank you, Mr Gray, for coming to see us. That closes a huge issue. Around 700,000 new business start up every year, but the objective of your great new department is described as being to “demonstrate a measurable improvement in new and growing businesses’ ability to deal correctly with their tax affairs.” That is so vague it is hard to know how it could be measured. We look to you, particularly with reference to the questions that you have been asked about the new single business reference number and other simplification measures, to try to get a grip on this, so that you can enable new businesses to have much simpler tax affairs. We look to you to make progress on that front.

Paul Gray: Thank you, and that is certainly my aim.
Chairman: Thank you.

 Supplementary memorandum submitted by HM Revenue and Customs

Questions 17–19 (Mr Iain Wright): *How much is the total cost to the Exchequer per year of those late payments in terms of cash flow and of the Government having to go to the money markets to borrow? What estimate does the Department give of that cost*

HMRC received around £77 billion in VAT and £44 billion in Corporation Tax (CT) during 2006–07. It is certain that some element of these receipts will have been paid late, but we are unable to measure the exact amount. One reason behind this is that significant amounts of tax are paid in advance of us knowing the final liability (ie payments on account). Given the scale of total receipts, any estimate we make will also be subject to a wide margin of error. Our systems do not allow us to distinguish between receipts from new businesses and those that are more established.

We know the stock of debt at a point in time, but this can mask considerable flows in and out of the debt balance over time, and this could seriously misstate the amount of late payments over a period. The VAT debt balance at March 2007 stood at £5.2 billion and the CT balance at £1.4 billion. We expect to collect the majority of this. The 2005–06 HMRC Trust Statement reports we remitted and wrote-off some £1.5 billion of VAT and £238 million of CT, with the majority of this down to insolvency. Whilst significant, these amounts only account for 2% and less than 1% of total receipts of VAT and CT respectively.

We have carried out an analysis that shows that the proportion of new VAT traders who have fully paid rises from 53% at the due date to over 85% within a month of the due date. This analysis covers the number of traders who pay on time rather than the amounts paid on time.

Impact on Government Borrowing

HMRC produces forecasts of tax receipts as opposed to liabilities, based on what we expect to collect. These forecasts, taken alongside other income and planned expenditure, forms the basis of the Government borrowing requirement, as outlined in the Budget and PBR. If there are major structural changes to the amounts owed to HMRC, this would affect the overall government borrowing requirement and hence the interest paid on that borrowing.

HMRC will charge interest on CT late payments (currently running at 7.5%). We will also charge default surcharge (a civil penalty) on late VAT returns and/or payments. The surcharge is calculated as a percentage of the VAT that is unpaid at the due date. For the first late payment during a surcharge period the surcharge will be 2% of the tax outstanding at the due date. The rate of surcharge will then increase progressively to 5%, 10% and 15% for further payment defaults in a surcharge period.

We provide daily cash-flow forecasts to the Debt Management Office (DMO) via HMT's daily Exchequer Transactions forecasts. These daily forecasts take account of when we expect to receive payment (including the impact of late payments). Most late payments (in terms of value) are received very shortly (normally a few days) after the relevant due dates.

The DMO will use these daily forecasts to make advance arrangements for their market operations. On days when the government's cash revenue is less than its cash expenditure the DMO must balance the shortfall from its market operations. Conversely, when there is a cash surplus the DMO needs to lend this out (or repay prior borrowing).

The DMO's objective in carrying out these operations is to minimise the cost of offsetting the Government's net cash flows over time, while operating in a risk framework approved by Ministers.

Any errors in the daily forecasts due to the timing of tax payments will affect the cost of borrowing but given the inherent uncertainty in these forecasts, it is not possible to establish precisely the cost of such forecasting errors that are attributable to such changes.

Effective modelling of this process is a very difficult task, and as such there is nothing readily available. Any modelling will need to balance actual daily receipts against actual daily expenditure requirements and balance periods of surplus against those of deficit.

In summary:

- Our overall forecast of receipts determines the overall fiscal position. If there are known structural changes to the rate at which taxpayers settle their liabilities, this would be taken into account in the overall government borrowing requirement.
- The timing of entering the money markets to borrow or lend in order to manage the overall cash flow is affected by HMRC's daily forecasts. Again, short-term movements in the timing of tax payments may lead to errors in these daily forecasts and have an effect on the cost of borrowing.
- The cost of these changes would be the difference between what we charge for late payments and what we pay on short term government borrowing.
- The complexity of Government finances and forecast errors make it almost impossible to split out the impact of late payments on the costs of government borrowing.

Questions 24–29 (Mr. Derek Wyatt): *Is there any incentive scheme for new businesses to register, record and file tax information on line? Can we ask HMRC to think about the practicalities of providing incentives and come back to us*

- In March 2006, Lord Carter of Coles' Review of HMRC Online Services identified that the most important thing HMRC need to do to drive take-up of online services is to focus on building robust services. He also noted that the vast majority of businesses are now using IT and the internet on a day to day basis. For this reason, he recommended that the funds and resources we have available should be focused on improving the services rather than providing new financial incentives. The Government has accepted his recommendations.
- The phased implementation of requirements for employers to file their PAYE end of year returns online commenced in 2005 (for 2004–05 returns). As part of that package small employers are being offered tax free incentive payments over a five year period to encourage them to make the transition to online filing early and help them with any transition costs. Details of the amounts available in each year to 2008–09 are given below.
- Most VAT traders get an extra seven days to file online and pay electronically. A further three working days is allowed on top of that for direct debit payments.
- From 2008 those filing Income Tax Self Assessment returns online will have three months longer than those filing on paper.
- Use of online services offers inherent benefits of greater certainty and time and resource savings. For example, online filers get a receipt confirming that their return has been received and passed validation—the recent usability research suggested that this was a benefit customers valued highly.

Further detail on the existing PAYE incentives are:

- The dates by which employers are obliged to file the End Of Year Returns online:
 - 250 or more employees from 2004–05, due by 19 May 2005.
 - 50–249 employees from 2005–06, due by 19 May 2006.
 - Fewer than 50 employees from 2009–10, by 19 May 2010.

- Small employers with fewer than 50 employees could get up to £825 tax free over five years for taking up online filing (of their Annual Return) before 2010, as follows:

2004–05	£250
2005–06	£250
2006–07	£150
2007–08	£100
2008–09	£75

The phased introduction of requirements for employers also to file in-year forms online (eg P45s and P46s) will start in 2009.

- From April 2009 large and medium sized employers will be required to file in year forms online.
- From April 2011 small employers will be required to file in-year forms online.

Questions 88–93 (Mr Alan Williams): *How does the take-up rate of out of hours workshop (for new business) compare with the take-up rate for in hours workshops*

We do not have a direct comparison between workshops delivered during normal working hours and out of working hours, because at present we do not offer out of hours workshops. We ran a pilot project in 2003–04 to ascertain the level of demand for out of hours workshops and one-to-ones across businesses and employers in the new, small and medium sectors, but the take up was very low and would not have justified the cost.

The pilot was run between November 2003 and March 2004 targeting 2,971 businesses that registered between November 2003 and March 2004 and to whom we would have marketed our normal hours service.

We used direct mail to advertise the out of hours service, which ran between December 2003 and March 2004. We sent a flyer with a questionnaire to the target audience outlining the service on offer. The letter made clear that this was a local initiative and asked them if and when they would prefer to attend a workshop or consultation. The letters contained postage paid envelopes to ensure the best response.

We had 80 replies to the letters and flyers (a 2.7% response rate), which is not low for an unsolicited flyer and comparable to the response rates for other direct mail activity. We telephoned those businesses from whom we had not received a reply within three weeks. Of the 2,555 businesses contacted by phone 942 (37%) said that they were happy to be surveyed.

The responses from the 1,022 businesses that returned the flyers and took part in the telephone survey are as follows:

- 573 (56%) would attend a workshop during normal working hours.
- 317 (31%) would attend a workshop on a weekday evening.
- 163 (16%) would attend at workshop on a weekend.

However, nationally, only 6 businesses actually booked a workshop out of normal hours.

— Wales	3
— Northern England	1
— Central England	0
— Northern Ireland	0
— London	0
— Scotland	2

Due to the low take up and the cost of providing the service, the decision was taken not to roll out a full programme of workshops and one-to-one consultations in the evenings or at weekends.

Question 110 (Mr Alan Williams): *What support is given to ethnic minority businesses in terms of helping them to understand and fill in the forms required? Are these forms available in different languages and if so, could you supply a written list of the relevant languages*

Forms are only currently available in English and Welsh, however, the department offers an Interpretation service to assist customers for whom English is not their first language. This service is:

- available throughout the whole of our Enquiry Centre Network and telephone Contact Centres.
- is available 24 hours a day 365 days a year although the main hours of operation are 8.00am to 8.00pm.
- If they need to be seen within an Enquiry Centre—an appointment would be made and we would use “thebigword” who are our recognised supplier for translation services. This service is provided via a three way telephone link.

Although the forms are only available in English and Welsh the new Construction Industry Scheme (CIS) factsheets (CIS342-344) are available in the following languages:

- Albanian
- Bulgarian
- Czech
- Hungarian
- Latvian
- Lithuanian
- Polish
- Portuguese
- Romanian
- Russian
- Slovakian
- Turkish.

The department is undertaking a review of which, if any, of its products need to be made available in other languages to assist customers.

Questions 116–117 (Mr Alan Williams): *Could you submit a note that indicates the volume of warning and what statistical evidence you can give us about incidents of concern at your end when payment is not being made and where there is a follow up with prosecution or other actions against those who are failing to pay*

Where an employer fails to make payment of PAYE liabilities during the Income Tax Year, signals generated by Debt Management and Banking (DMB) IT systems trigger the issue of a series of reminders. The timing, frequency and number of reminders and the type of any subsequent actions depends on the amount we estimate the employer is due to pay.

HMRC is currently reviewing our processes for supporting new employers to provide additional and earlier support and education to enable them to meet both their PAYE payment and filing obligations.

Where payment remains unpaid after the reminder, DMB follow up with telephone contact and where necessary legal actions to enforce payment.

Interest is not charged on payments made late during the Income Tax Year but sanctions can be taken against large employers.

On receipt of the Employers Annual Return, DMB IT systems compare the amounts the employer has paid during the year with the amounts shown to be due on the return. Where there is a shortfall DMB IT systems immediately trigger the issue of a series of reminders. The frequency and number of reminders depends on the amount the employer is due to pay.

DMB issued approximately 630,000 of these reminders for 2005–06 underpayments.

Where the sum due remains unpaid after the reminder, DMB follow up with telephone contact and where necessary legal actions to enforce payment.

Except for Dstraint activity (which may include listing goods for seizure), we do not have a breakdown of our other enforcement actions (County Court Proceedings, Summary Proceedings and Summary Warrant) relating solely to PAYE.

However, as an example, during 2005–06, for Dstraint activity, DMB commenced 137,395 PAYE actions of which 2,867 resulted in levy (which can lead to the removal of goods for sale).

Deficiency Notices

Where our records show that an individual hasn't paid or been credited with sufficient National Insurance Contributions in any one tax year for that year to qualify for state pension the Department sends out a Deficiency Notice. This invites the contributor to check and confirm that our records are correct. In 2006–07 4.7 million such notices were sent out in relation to the 2004–05 tax year (2005–06: 3.6 million returns relating to the 2003–04 tax year).

If an individual thinks our records are wrong then they are asked to provide supporting documentation (eg P60, payslips etc) to allow our National Insurance Contributions Office (NICO) to trace the missing contributions and update the individual's contribution record. If the individual doesn't have the P60 or payslips NICO can search internal HMRC IT systems to trace the Employer's annual return. If the contributions still cannot be traced, NICO will contact the employer to request details.

Part of the question is about possible disadvantage to individuals arising from employers not paying to HMRC deductions made from their employees. In fact there is no PAYE or NI (National Insurance) disadvantage to individuals if we get the annual return, but don't get payments. Providing we get the return, deductions are credited to employees' records once that return is processed. That crediting is not contingent upon the employer having paid the deductions to HMRC.
