

Working towards a new relationship:

a consultation on priorities for
reducing the administrative burden of
the tax system on small business

March 2005

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tax system on small business

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Summary

The integration of the Inland Revenue and HM Customs and Excise creates an opportunity to deliver real benefits for small businesses. This paper sets out some of the steps already being taken to reduce the administrative burdens of tax on small businesses and to improve the relationship they have with the tax authorities. The paper also describes future developments and asks small businesses, their representatives and advisers for their views on priorities.

The consultation period begins today and will run until 30th June 2005.

Please ensure that your comments on this Consultation Document, and replies to the questions in it reach us by 30th June 2005.

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FOREWORD

The integration of HM Customs and Excise and the Inland Revenue provides a unique opportunity to modernise our tax system and to achieve a step-change in simplification of the relationship between the tax authorities and business. It is smaller businesses that can find the costs of compliance the most difficult to absorb. They therefore have the most to gain from better delivery and administration of the tax system.

My vision for HM Revenue and Customs (HMRC) is one in which small businesses know where they stand, with simple information on what they owe, what they have already paid and what they need to pay available when and in the form that they need it. The work programme set out in this document will inevitably take some years. But it holds out the clear prospect that small businesses will in future: have to provide information to HMRC only once; have to spend less time dealing with inspections; be able to benefit from a range of modern flexible payment options; have the benefit of a single point of contact with the new department; and have access to co-ordinated, clear and helpful support and education when and in the form they need it.

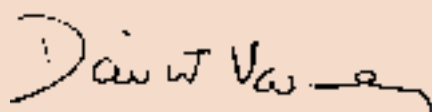
This consultation paper is published alongside Philip Hampton's review into the impact of inspection and enforcement of government regulation. As a tax authority rather than a regulator, HMRC was not included in the remit of the review. Nevertheless, there is a strong read-across between our approaches. The existing revenue departments have already made significant progress in implementing the principles of a risk-based approach to all administrative burdens, less burdensome form-filling, smarter and better enforcement, and swifter and more effective penalties. The new department will further embed and entrench these principles in everything we do.

I am determined to focus HMRC's resources to help those who want to comply to do so as easily as possible. Through effective risk assessment, HMRC will be better able to target those who seek an unfair advantage by avoiding their obligations to contribute their share of the revenue that funds vital public services – and to reduce the burden of inspection and compliance on legitimate taxpayers.

I have asked my deputy, Paul Gray, to be personally responsible for ensuring that we deliver compliance cost savings for small businesses and a real improvement in their experience of the tax system. In December I created a new small business unit to ensure that small business needs lie at the heart of the new department. I also set up a high-level advisory group with significant private sector membership to guide the work of the unit.

Progress here will be measured against stretching targets for administration cost reductions that we will develop, set and publish. Working in partnership with HM Treasury, we will also look for measures that will make the tax system easier for small businesses to understand and comply with.

I know that the key to building a successful business is to focus on understanding customers and meeting their needs. This must be done through a dialogue with small business. This paper offers small businesses and their advisors an opportunity to tell us about what they need from us, and what our priorities should be in responding to those needs.



DAVID VARNEY

INTRODUCTION

1.1 The Government announced in the 2004 Budget that, following the recommendations of the O'Donnell Review,¹ HM Customs and Excise and the Inland Revenue would be integrated to form a new department. The review highlighted how small businesses, many of which are customers of both existing departments, have the most to gain from a co-ordinated approach to support and compliance. The creation of the new department offers a unique opportunity to deliver real benefits for small business: reducing the administrative burdens of tax, and improving the relationship with the tax authorities.

1.2 In December 2004, the Government announced the creation of a small business unit to ensure that the needs of small business lie at the heart of the new department. A key priority for the unit has been to develop clear objectives for realising these benefits, and the steps that would be necessary to achieve those objectives.

1.3 Improved risk assessment underpins many of the reforms, whether in the area of information provision, targeted support and guidance, or inspection. Better risk assessment will mean the department can improve the relationship with business and deliver better services. It will also lead to reduced administration and inspection burdens on compliant businesses, while ensuring that those who seek to obtain an unfair competitive advantage by avoiding paying their share of the revenues that support vital public services are dealt with more swiftly and effectively.

1.4 These objectives complement the discussion launched in December 2004 when the Government published *Small companies, the self-employed, and the tax system: a discussion paper*.² Real simplification of the tax system will need a combination of policy reforms and better delivery, with improvements to enhance delivery made even as discussion continues on the future strategic policy direction on the personal and corporation tax regimes as they relate to small businesses.

1.5 This paper is published alongside Philip Hampton's review into the impact of inspection and enforcement of government regulations.³ That review highlighted the importance of effective risk assessment in reducing the administrative costs imposed on business. As tax authorities rather than regulators, HM Customs and Excise and the Inland Revenue were not covered by that review. But risk assessment has a vital role in the delivery of the tax system. The objectives set out in this paper for the new integrated department are consistent with the Hampton principles, and the new department will build upon progress already made in reducing compliance costs for small business by entrenching and embedding risk assessment in everything it does, from form filling to enforcement. Further details on the Hampton Review are set out in Section 2.

¹ Available at www.hm-treasury.gov.uk

² Available at www.hm-treasury.gov.uk

³ Available at www.hm-treasury.gov.uk

What will change for small businesses?

1.6 The reforms set out in this paper will mean that small business needs will be at the heart of new policy and operational developments. As a result businesses will understand their tax liabilities more easily and:

- **provide information only once**, with information, where possible, flowing seamlessly from business systems to those of the new department without the need for forms or returns;
- **benefit from a range of modern flexible payment options** that suit their business needs;
- **spend less time dealing with inspections**, with no inspection without a reason and all enforcement activity informed by more sophisticated risk assessment;
- **enjoy a single point of contact** with the new department for all their tax affairs, either on-line or by phone. This will give them or their advisor access to the details of their tax account – the same details the department’s staff will see; and
- benefit from **co-ordinated, clear and helpful support and education** that will help them comply with their tax obligations at key stages in the development of their business.

1.7 These objectives have been based on what small businesses, their advisors and other representatives have already said about the approaches they think the new department should take to reducing the costs of compliance.³ They reflect a world where contact between business and the department is simple and streamlined, with business, their advisors, and officials having the same joined-up ‘whole customer view’ of all the affairs of a business as is described in the O’Donnell Review. Section 3 seeks views from small businesses and their advisors on their priorities for change, so that the department can take them into account as it develops its implementation plans.

1.8 Delivering these outcomes will be challenging. Implementation will require potentially complex changes to existing IT systems, substantial training programmes, and legal reforms. For example, whole customer view which will provide a platform to deliver many of the longer term improvements, will require significant new computer systems to underpin it.

1.9 Subject to the outcome of this consultation, the department will work to implement the necessary changes for this and its other objectives over the medium-term. Paragraph 1.11 sets out some of the immediate changes that small businesses will see in the short-term that will help achieve these objectives.

1.10 The department is committed in the near-term to developing and publishing stretching targets for real reductions in the costs of administration that the tax system imposes on businesses. Deputy Chairman Paul Gray will be personally accountable for ensuring that the new department listens to small business, develops its processes to make dealing with tax administration easier for small business, and sets and meets its targets for reducing compliance costs.

³ *Less Taxing Tax*, Small Business Service, 2004, available at sbs.gov.uk/content/finance/less-taxing-tax.pdf

Immediate Steps

I.11 Section 3 sets out the steps the new department will take to make a more immediate difference to small business. It will cut administrative burdens and time wasted on paperwork by:

- **abolishing payment of tax credits via employers** between November 2005 and April 2006 – reducing annual payroll costs that hit the smallest employers hardest by an estimated £90 million;
- **cutting, from this April, the tax return for 500,000 of the smallest businesses** from sixteen to four pages. This will save them £5 million in compliance costs, including 350,000 hours saved across the economy;
- **publishing in April a redesigned “Form 42”⁴** with changes made specifically to help newly incorporated companies;
- **reducing time spent dealing with inspections** with trials to improve risk assessment further– the first of which is starting in April and which will focus on joining up inspections of PAYE and VAT;
- immediately offering businesses the ability to **pay VAT by direct debit** as well as **manage registration, filing and payment on-line**; and
- **rolling out a programme to assess the impact on small business of significant operational changes**, so that every time the new department changes a form, or changes a business practice, in ways that could significantly impact on businesses, a full assessment of the impact will be made and published. This programme will be in addition to assessing the impact of legislative changes through regulatory impact assessments and post-implementation reviews. The first operational impact assessment, on the self-assessment short return, has already been published.⁵

I.12 The new department will improve its relationship with and understanding of small business taxpayers by ensuring senior staff responsible for policy and operations for small business spend time with a small business to gain an understanding of its issues. Front line staff will receive training and IT support to allow them to improve further the quality and consistency of advice to businesses.

⁴Form 42 is used by employers to tell the Inland Revenue about transactions in employment related shares and securities, including share options.

⁵ Available at <http://newinternet.inrev.gov.uk/menus/consult.htm>

I.13 The department will also improve businesses' understanding of the tax system by:

- **tailoring support and education** so businesses get their tax right from the start. This summer emerging findings will be available from a trial, running since the end of last year in Stratford, East London – and shortly to be rolled out in Scotland – where new and growing businesses are offered help when they need it most (such as at start-up, when they become VAT registered, or when they take on their first employee). If successful the programme will be a priority for national implementation;
- offering from April an **updated guide to tax for business start-ups** – bringing together information about direct and indirect taxes in a user-friendly and convenient way for the first time;
- working in tandem with the British Chambers of Commerce to provide **better targeted information on the VAT Flat Rate Scheme** so that all eligible businesses are aware that they can use it to save up to £600 a year in reduced paperwork and compliance costs; and
- providing **a CD Rom on VAT for new businesses**. Available from summer 2005 this will replace large volumes of paper notices and leaflets, with a modern, interactive, electronic package of advice, support and guidance.

I.14 The rest of this paper sets out further details of the Government's objectives for reducing administrative burdens and improving the relationship between businesses and the tax authorities. Section 2 outlines the importance of small businesses to the UK economy, and the steps already taken by the Government to support its economic and growth objectives as they affect small businesses. It also outlines the principles of the Hampton Review.

I.15 Section 3 seeks views from small businesses and their advisors on the steps that the new department is planning to take to implement the Government's objectives of reducing administrative burdens and building a better relationship between the tax authorities and small businesses. Section 4 summarises the consultation questions.

2

SMALL BUSINESS AND THE ECONOMY

2.1 This paper considers the administrative burden on all small business from micro- to medium-sized enterprises.¹ There are some 4 million small businesses in the UK today, more than 99 per cent of all UK businesses, using a range of different legal forms. Just over 3 million people earn some of their income from self-employment, of whom some 2.3 million are mainly or solely self-employed. Around 600,000 are in partnerships. And nearly 900,000 companies are small businesses.

2.2 The diversity of the small business population means that the tax system needs to retain flexibility if it is to support the range of small business needs. This support is important. Small business employs around 12 million people in the UK, more than half the private sector workforce, and creates wealth and employment opportunities for all – particularly in deprived areas.

2.3 Small business plays an important role in delivering enhanced economic growth and opportunities for all. A strong and dynamic entrepreneurial base is an essential driver of productivity and prosperity in a modern economy, and underpins the economic flexibility that allows the UK to compete effectively in a globalised economy.²

Box 2.1 Productivity and small business

- **Productivity among small businesses has risen by at least 3.5 per cent in each of the last three years, outstripping the mean productivity rise in large business of 2 to 3 per cent.**
- **Small businesses contribute 52.4 per cent of the total UK annual business turnover of £2,200 billion.**

Source: www.dti.gov.uk/psa_target.html; www.sbs.gov.uk/content/analytical/statistics/smestats2003.xls

2.4 Recognising the importance of small business in the economy, since 1997 the Government has taken a number of steps to support small business by:

- cutting the small companies rate of corporation tax to 19 per cent from 23 per cent, and introducing a zero rate of corporation tax for companies that retain up to the first £10,000 of taxable profits;
- introducing Research and Development (R&D) tax credits for small business, with a payable element for small companies not in profit;
- cutting the long term capital gains tax (CGT) rate to 10 per cent for the sale of business assets;
- introducing 40 per cent first year capital allowances on small business plant and machinery expenditure; and
- introducing a range of simplified tax schemes for small business – that, for instance, can cut the administrative burden of VAT and save businesses up to £600 a year each in reduced record keeping and form filling.

¹ There is no single definition of 'Small Business'. Throughout this paper the term is used to refer to the range of small and medium-sized enterprises (SME). The Department of Trade and Industry uses the following definitions of SME for statistical purposes:

micro firm: 0–9 employees
small firm: 0–49 employees (includes micro)
medium firm: 50–249 employees.

² *Enterprise Britain*, HM Treasury, 2002.

Reducing compliance costs **2.5** The Government is committed to continuing to support small businesses. Building on the foundations of economic stability and prosperity created since 1997, the Government is setting out a challenging agenda for reducing compliance costs for business.

2.6 The administrative burdens of complying with regulations, and other legal obligations such as taxation, will tend to fall relatively more heavily upon smaller businesses than their larger competitors. This is because larger businesses generally are able to achieve economies of scale, and can therefore absorb some of the fixed costs of complying with their tax obligations more easily than smaller ones, so these costs will generally represent a smaller proportion of total turnover or total staff time.³

2.7 The Government recognises the potential economic cost that administrative burdens can represent to both individual businesses and to the economy as a whole. Every hour spent dealing with tax or complying with regulations is an hour not spent running the business and generating wealth for the economy. That is why as well as announcing the integration of the Inland Revenue and HM Customs and Excise, at Budget 2004 the Chancellor of the Exchequer asked Philip Hampton to lead a review of the impact of inspection and enforcement by regulatory bodies.

The Hampton Review **2.8** The conclusions of that review are published today alongside this paper and identify a set of principles that should underpin all activities by regulators across the public sector.⁴ Hampton calls for a risk-based approach to compliance to reduce the administration costs for business, with comprehensive risk assessment methodologies, which should allow for fewer, better targeted inspections so that no inspection takes place without a reason. Because facilitating compliance will lead to better longer-term outcomes, businesses should receive more and better tailored advice, and be dealt with by the regulator proportionately, fairly and openly. For example, businesses should be consulted before new forms are introduced, and forms should follow design guidelines so that they are simpler and quicker for firms to fill in. In order to reduce the number of forms that businesses have to fill in and ensure businesses need provide information only once, regulators should have better data sharing systems, and eliminate duplicate information requests. To ensure that action is targeted against the wilfully non-compliant quickly and effectively, the penalty regime should reflect risk.

2.9 The tax authorities were not within the remit of the Hampton Review in recognition of the different nature of the enforcement of the tax system from the inspection and enforcement of government regulations. However, many of the principles set out by Philip Hampton apply equally to the activities of the tax authorities. Therefore the new department will entrench and embed those principles, building on the many examples of good practice already developed by the two existing revenue departments.

³ For examples of how the administrative burdens of complying with tax obligations fall more heavily on small businesses see: *The Tax Compliance Costs for Employers of PAYE and National Insurance in 1995-96*, The Centre for Fiscal Studies, University of Bath, 1998, and *Administrative and Compliance Costs of Taxation*, Sandford et al, Fiscal Publications 1989.

⁴ Available at www.hm-treasury.gov.uk

2.10 To benchmark and monitor progress in delivering on these principles, both departments are already developing stretching targets for making reductions in the administrative burden imposed on compliant small businesses by the tax system. These targets will be consistent with the new department's objectives to provide a level playing field for all business and to collect the tax due. They will be published and progress against them monitored.

2.11 Small businesses, like all taxpayers, must pay the right amount of tax at the right time to support the provision of vital public services. Dealing with tax is a necessary consequence of being in business. But it is important that small businesses should be able to establish what they owe and pay it in as simple and efficient a way as if paying for everyday expenses such as the rent or electricity.

2.12 Those who want to comply with their obligations should be able to do so as easily as possible, confident that swift and effective action will be taken against those who try to enjoy a competitive advantage by not paying their share. Getting it right from the start means that businesses are more likely to comply voluntarily, and the new department will provide additional support to new and growing businesses.

2.13 Although providing good support at key points in the business lifecycle can improve the prospects of future compliance, it needs to be supported by efforts to make the tax system itself easy and simple to comprehend. The new department will work closely with HM Treasury to identify further measures to make the tax system easier for small businesses to understand and comply with.

2.14 The new department will have choices about how it allocates its resources in order to deliver these objectives. As well as commenting on what is being proposed in the following sections, respondents are asked to indicate which of the ideas are more important to them and why.

3

DELIVERING ON THE OBJECTIVES

3.1 The integration of HM Customs and Excise and the Inland Revenue provides an opportunity to reduce the administrative burdens on small business. There are some immediate steps that will deliver real improvements quickly – for example, in reduced paperwork and new payment options. While these are steps in the right direction they will not on their own deliver the strategic change that small business should expect. That will take longer because it requires significant investment in IT and changes to the law. The new department will also work closely with HM Treasury to identify further measures to make the tax system easier for small business to understand and comply with.

REDUCING ADMINISTRATIVE BURDENS

3.2 The new department will build on its risk-based approach to forms, inspections and enforcement, embedding and entrenching the Hampton principles, and reducing the administrative burdens of the tax system on small business.

3.3 This section sets out some immediate steps as well as medium-term proposals to reduce the administrative burdens the tax system imposes on business. It focuses on the areas businesses have said they find most burdensome – completing forms and returns, making payments, and audit and inspection regimes.

3.4 Implementing the changes that will underpin these compliance cost savings will take time. The two existing departments have already developed sound risk assessment techniques, but have done so largely independently. The integration offers them an opportunity for the first time to take a view of an individual business across different taxes to develop a better understanding of where the risks to the Exchequer lie. With this understanding, the new department will be better placed to focus its activities on those businesses who represent a greater risk of non-compliance – offering help and education to those who do not understand their obligations, while taking swifter and more effective action against those who wilfully fail to meet them.

SIMPLIFYING FORMS

Information provided only once

3.5 Small businesses have identified forms and returns as a priority area for improvement. In line with the principles of the Hampton Review, the new department's long term goal will be that businesses need to provide information only once. Already the departments consult with business representatives on changes to forms and returns. This will continue, with the new Small Business Advisory Group's input helping the new department identify those existing forms that give rise to significant concerns. Views from small business and their advisors on this issue are welcome.

3.6 Increasingly, as information technology develops to enable departmental systems to communicate directly with those of agents and customers, the need for forms should reduce. As small businesses and their advisors increasingly adopt these technologies, the department will be able to reduce many of the costs associated with paper forms. But it will take time for these technologies to be widely adopted, and so in the short term small business can expect the following improvements:

- from April 2005 around half a million self-employed people¹ will receive a four page tax return instead of the current sixteen page form. This is supported by simple guidance and is much easier and quicker to complete than the main return;
- further simplification of the main self assessment return and statement of account are planned. This will be done in consultation with self assessment customers and representative bodies;
- filing the short return over the telephone using voice recognition software is already being tested with customers;
- representative bodies have said that small businesses have often struggled to complete form 42.² A revised design will be available from April 2005. In particular a special section for newly incorporated companies has been introduced which should make the process much easier. There will also be more detailed on-line guidance with worked examples that will help all companies to get completion of this form right;
- form P46 is being redesigned to simplify completion for both employers and employees. It should be introduced in 2006 and will enable more employees to be allocated a cumulative tax code number when they start a new job. This will reduce the need for later queries and adjustments that are currently a source of inconvenience to employers and employees alike;
- the Inland Revenue is investing in its e-filing service for corporation tax. Within 12 months, companies and their agents will be able to make enquiries on-line, and submit their accounts electronically, along with their CT600 form and their tax computation, using XBRL³; and
- options are being investigated for the use of intelligent-form technology to improve the electronic filing service for companies and their agents of the annual submission of their tax computation and their accounts along with the CT600 form; up to 500,000 small companies with straightforward affairs could benefit from this development.

Questions:

- Q1** Which forms give rise to the greatest burdens for businesses, and why? How might they be improved?
- Q2** Do the existing on-line services offered by Revenue or Customs meet small businesses' needs? What are the main areas for improvement that would encourage more small businesses and their advisors to file returns electronically?

¹ The new return will be available for self-employed people with a low turnover and relatively straightforward affairs.

² Form 42 is used by employers to tell the Inland Revenue about transactions in employment related shares and securities, including share options.

³ XBRL is an XML based IT standard for business financial reporting.

MAKING PAYMENTS EASIER

A range of modern and flexible payment options

3.7 Small business representatives often report that the timing of tax payments can have a detrimental impact on the business cash-flow. The Government has already introduced a range of tax and non-tax measures to support the cash-flow needs of small business, including late payment legislation, a range of simplification schemes for VAT, as well as commissioning independent research. This section seeks views on whether the new department should be doing more to deliver a choice of modern and flexible payment options that better suit business needs.

3.8 It is important that all businesses should, wherever possible, pay their taxes on time to keep the playing field level for all. But businesses will sometimes find themselves in difficulty in making their tax payments. In many cases this could be through no fault of the business – for instance if a debtor has not paid on time. If businesses get into difficulty with making their payments the new department's aim will be, wherever possible, to help them find a way to pay what they owe that gets them back on track. There are limits to how far the revenue departments can and should go to accommodate business, and a balance needs to be struck. The Government would welcome views on whether the current balance is right between providing a level playing field for all, and providing flexibility for businesses.

VAT simplification schemes

3.9 Many businesses welcome the flexibilities offered by the existing revenue departments. For example, there are several schemes designed specifically to reduce the administrative burdens of VAT administration and payment. These are described in Box 3.1. Businesses can mix the three schemes – tailoring a solution for their particular business needs.

Box 3.1: VAT Simplification schemes

- **The Flat Rate Scheme is open to any small business with an annual turnover of up to £150,000*. The scheme allows businesses to calculate the VAT they owe by applying a single percentage – determined by their trade sector – to their turnover. There is a lower percentage for businesses during their first year of trading. The Flat Rate Scheme can save time, make VAT returns simpler to complete, and allow businesses to see how much VAT they owe at any point.**
- **The Cash Accounting Scheme is open to small businesses with an annual turnover up to £660,000*. Cash Accounting Scheme businesses only have to pay VAT when they themselves have been paid by their customers – but similarly they can only reclaim VAT when they have paid their suppliers. This scheme helps businesses' cash-flow and gives automatic relief on the VAT element of bad debts.**
- **The Annual Accounting Scheme is also open to small businesses with an annual turnover up to £660,000*. Annual Accounting Scheme businesses complete just one VAT return each year instead of the normal four. The VAT itself is paid 'little and often' – in instalments over the year with a final balancing payment. This scheme cuts VAT administration for businesses and the smaller regular payments can ease the cash-flow impact of VAT.**

* 2004-05 turnover figures.

3.10 These schemes respond to small business concerns on the administration of VAT. But not all small businesses take advantage of the different schemes and options already available.

3.11 To encourage more businesses to take advantage of the schemes the new department will shortly launch a new marketing campaign. This will ensure that eligible businesses are aware of their entitlements to use the schemes. Events will be run in close co-operation with the British Chambers of Commerce. This re-launch will:

- raise awareness of the advantages of the schemes and their interrelationship.
- educate business advisors, accountants and business managers on the ‘menu’ of schemes available to them.
- target low take-up sectors.

3.12 The Government would welcome comments on what it might do to enhance further the existing range of simplification schemes available to small business.

Alignment of dates and definitions

3.13 Different taxes have different payment dates, are triggered at different thresholds and are governed by different definitions within the legislation. This can cause problems and confusion. The new department will work with business representatives to see where alignment would make the tax system simpler to operate and easier to understand.

Questions

- Q3** Should the department be doing more to offer modern and flexible payment options for small businesses?
- Q4** Is the current balance right between providing a level playing field for all, and providing payment flexibilities for businesses?
- Q5** What might enhance the existing range of VAT simplification schemes available to small businesses?
- Q6** To what extent do different payment dates for different taxes give rise to problems for businesses?

RISK-BASED AUDIT

No inspection without a reason

3.14 Inland Revenue and HM Customs currently risk assess their audit activities so that resources are directed to the areas where risk of deliberate non-payment of taxes is highest, where there appears to be a problem or where help seems to be needed. In line with the approach set out in the Hampton Review, the new department will develop more sophisticated risk-based approaches to audit and inspection, incorporating a small number of random enquiries in order to ensure the integrity of the system and improve the department’s understanding of risks. Better risk assessment will mean that the vast majority of businesses who are low risk should not be audited, and that the department uses its resources to best effect.

3.15 For the tiny minority of small businesses that are audited by the tax authorities, there have been calls for co-ordination of visits to inspect records (for example for PAYE and VAT) to save time and effort by the business in preparation. Conversely, some small businesses have said that they prefer to keep records inspection separate for different taxes, arguing that it is not the inspection that creates the cost for business, but the length of time taken to conclude an enquiry. Views on this issue would be welcomed.

3.16 In either case, the new department will reduce the costs to businesses of visits and make sure business time is used as effectively as possible and that tax enquiries are completed quickly.

3.17 To take this forward, Inland Revenue and HM Customs are trialling joint visits to businesses. Evaluation of these trials will establish whether:

- customers feel this is a less daunting experience;
- joint visits can reduce administrative burdens; and
- there has been an effect on compliance levels among those visited.

Powers consultation 3.18 Inland Revenue and Customs use different powers under different legislation for administering taxes. Consultation on the powers that will be available to the new department, and the appeal rights and other safeguards for taxpayers, is to begin shortly. As part of this review it may be possible to rationalise powers so audit and inspection activity can be further streamlined and better co-ordinated. Details of the consultation will be announced on both Inland Revenue and HM Customs websites.

Questions:

- Q7** Would businesses prefer to have one visit to inspect all business records for all taxes, or separate visits for different taxes?
- Q8** What other steps might be taken to reduce the burdens on business that result from inspections and enquiries?

BUILDING A BETTER RELATIONSHIP

3.19 Understanding customers and meeting their needs will be central to the new department. Small businesses have said they see a better relationship with the tax authorities as one of their key priorities.⁴ Responding to that, the next section sets out how the new department will begin to make the cultural changes needed to improve its relationship with small business.

Getting it right from the start

3.20 If businesses can get their tax right from the start – whether they are setting up, taking on employees, or seeking finance – this saves them time and money. It also means they are more likely to comply with their legal obligations as they grow and expand. And in many cases, the discipline of getting business affairs right for tax can pay dividends in terms of better business practice more generally – for example maintaining good records for VAT means that the business is more likely to be able to understand its cash-flow. In many areas the record keeping needed for tax purposes is no different from normal good business practice, and the additional burdens arising from the tax system are therefore minimal.

3.21 The sort of proactive advice and support to business already offered to business by both HM Customs and Excise and Inland Revenue, consistent with the Hampton principles, can add real value to a new business by improving its practices and helping it organise its affairs better. The updated guide to starting up in business is a good example of how the new department will make this happen.

⁴Less Taxing Tax, Small Business Service, 2004, available at www.sbs.gov.uk.

3.22 But more can be done here to build on existing good practice. The new department will need to improve its understanding of the support needs of small business. Inland Revenue and HM Customs have already started trials of new approaches to supporting businesses on an integrated basis. One, which offers joined-up education and support for new and growing businesses, was started in Stratford, East London at the end of 2004. It proactively targets tailored support and help at businesses at key pressure points – starting-up, taking on an employee for the first time, registering for VAT, or becoming incorporated. Its objective is to help businesses manage these transitions. It offers a variety of types of help and support appropriate to that stage in the business lifecycle, on both direct and indirect taxes.

3.23 The trial has recently been extended to West and Central Scotland with the support of the Scottish Executive and the two Enterprise Agencies in Scotland. There will be an evaluation of the results of these trials and if they are positive, rollout on a wider scale will be a priority. Tailoring support to the needs of small businesses is consistent with the development of coaching for ambitious firms with high growth prospects that has been set out by the Regional Development Agencies in a framework for High Growth Business Coaching.

Improving communication

3.24 As the way in which small businesses deal with the new department becomes simpler and more streamlined they will need to contact the department less often. For this to be a reality it will be more important than ever that small businesses get what they need first time. A positive experience when a small business first makes contact will foster a relationship of trust and confidence for the future.

Current on-line services

3.25 There is a range of on-line services already available for businesses and individuals to use to make their tax affairs easier to deal with. Within individual taxes, these services allow some small businesses or their advisors to see an overview of all relevant tax records:

- self-employed individuals can go on-line to view their self assessment statement, their current liabilities, the payments they have made and the date and amount of the next payment due. They can ask questions, request a repayment, change a payment on account, or change their personal details electronically at the times that suit them best. They can receive notice of receipt of their self assessment return or their tax payments by e-mail or text message;
- incorporated small businesses can view their current corporation tax liabilities and the payments they have made. In future they will be provided with a full range of services similar to those already available to self employed individuals;
- agents representing small businesses, whether or not they are incorporated, can go on-line to look at their clients' details;
- all small businesses can use the e-VAT on-line service to register for VAT and make their VAT return;
- there is now available a new e-VAT facility allowing businesses to manage their cashflow through direct debit payments;
- there is an electronic VAT declarations facility that allows businesses to file from their accounting software directly into HM Customs systems;

- small businesses who are employers can submit their End of Year PAYE returns electronically and can also submit In Year returns and forms and receive notices electronically. In future they will be provided with services to view their up to date PAYE payment and liability position; and
- a programme of incentives (up to £825 over the years 2005-2009) is in place to encourage small employers to deal with PAYE on-line.

Box 3.2: Increased use of on-line filing, including direct information exchange

- **On-line filing of the Self Assessment tax return has increased from 76,287 for 2000-01 to over 1.2 million for 2003-04;**
- **Self Assessment Payments over the Internet have increased from 3,570 totalling £4.4 million for 2000-01 to 179,171 totalling £267 million for 2003-04; and**
- **For Employers, 8,666 2001-02 end of year returns were filed on-line. To date (3 March 2005), 89,642 2003-04 returns have been made via the Internet.**

Source: Inland Revenue's own figures last updated 28/02/05, 19/02/05 and 03/03/05 respectively.

Whole Customer View 3.26 Central to the O'Donnell Review, that identified small business as the sector with most to gain from the integration of the Inland Revenue and HM Customs and Excise, was the concept of a 'whole customer view' (WCV). It is this development that will mean that the existing services set out above that are currently available for one tax will be available for all tax records. WCV would:

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

3.27 Work is now underway to develop the IT systems that would underpin this. The potential benefits of achieving these outcomes are significant – for instance WCV could provide the platform for a single account through which taxpayers would be able to manage their payments and liabilities in a way that will better meet their needs.

3.28 Building on modern business techniques of Customer Relationship Management, WCV offers the opportunity to provide a complete view of a customer's account (the amounts of tax due and the amounts that have been paid) and a record of all of their contacts with the new department covering both direct and indirect taxes. This will mean that when a small business needs to make an enquiry, or asks for advice and support, all the information needed to deal with the enquiry will be available to the department's staff in one place immediately. We will also ensure that the small business or its advisor will have access to the same view of its affairs as the contact dealing with the enquiry.

3.29 Work has begun to understand the IT investment that will be needed in order to pull together information from the range of existing legacy systems and to quantify the full range of benefits for business and the new department that WCV offers. Any changes to existing systems will need to be planned, tested and monitored to minimise the risks to the new department's ability to provide existing services. Although WCV is unlikely to be available before 2009-10, the outcome of the feasibility study now underway will be available in time for an update in the next Pre-Budget Report.

Question:

Q9 How high a priority is delivery of Whole Customer View to small businesses and their advisors?

Accurate Records 3.30 Reliable, accurate data will be essential for the new department to have an effective relationship with all its customers. The new department will use the opportunity of the integration of the two departments to cross-check the accuracy of the data both existing departments currently hold. This is the foundation stone for the delivery of the whole customer view and all the benefits that flow from that. This will mean that in future small businesses will consistently receive only appropriate information, have an easily understood reference number system, and authentication for those who carry out their transactions on-line will be streamlined.

A single point of contact 3.31 A single website will be launched when the new department comes into being.⁶ This will provide a single entry point to all the material now on the separate websites of the two departments. Users will have clear signposts to all the information and services they need.

3.32 The new department will then work with representatives of all customer groups to design and deliver a fully integrated website. Building on experience with businesslink.gov will ensure the new website meets the needs of all businesses, with the needs of small business being a priority.

Guidance for starting-up in business 3.33 For new businesses Inland Revenue and HM Customs are producing an updated guide to starting in business: *Are you thinking of working for yourself?* This will contain information and guidance on both direct and indirect taxes in a new, user-friendly and convenient form. From the launch of the new department it will be accessible through the new department's website as well as through the existing businesslink.gov portal. Those who prefer can ask for a paper copy.

Guidance for claiming R&D tax credits 3.34 Where Government has provided incentives for small business they must be easy to understand and access. One successful incentive is the Research and Development (R&D) tax credit. In conjunction with the Small Business Service, the Inland Revenue has developed a new guide for small companies claiming the R&D tax credit, providing help in plain English to claimant companies along with practical examples of what does and does not count as qualifying expenditure to help them determine better their eligibility. The new guidance will be piloted with bodies representing small business and, subject to their views, published in the summer.

TARGETED SERVICES

3.35 There is scope to tailor the services better for some specific groups that the department deals with. Paragraphs 3.36 – 3.41 cover services for intermediaries, paragraphs 3.42 – 3.48 those provided to small employers, and paragraphs 3.49 – 3.51 set out details of a review of the department's links with medium-sized businesses.

Services for intermediaries

3.36 Most small businesses choose to use an intermediary to deal with some or all of their tax affairs. Around 85 per cent are represented by an accountant or other tax advisor. For this reason it is important for the new department to get its relationship and range of services for intermediaries right because that will deliver efficiencies for both small business and the department.

⁶Following Royal Assent of the Commissioners for Revenue and Customs Bill 2005.

3.37 Services already available for agents include on-line access to client account details for small business customers and the facility to submit returns for small business clients and employers.

3.38 From 2005-06, there will also be enhanced services for intermediaries including:

- a new e-VAT facility allowing them to submit declarations and manage the case flow of their clients with direct debit; and
- batched filing of clients' VAT returns.

3.39 For the future the new department will develop further enhancements to on-line services for agents that will allow them proactively to manage clients' accounts for self assessment, company tax and employers' PAYE.

3.40 A key feature of the strategy for improving services to agents is to facilitate seamless flows of information from their software to the new department. At present some 90% of self assessment returns sent on behalf of clients are submitted via commercial software products. Longer term the department is keen to deliver information from its systems direct to the agents' software, eliminating the need for paper notices to the agent altogether.

3.41 The Government would expect to see the benefits of reduced costs for intermediaries being passed on to small businesses through lower fees or an improvement in the quality and quantity of general business advice.

Questions:

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

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

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

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

SMALL BUSINESSES AS EMPLOYERS

3.42 Many small businesses are also employers. They have a range of responsibilities that they are required to administer through the payroll. These include collecting pay as you earn tax (PAYE) and national insurance contributions (NICs) on behalf of their employees, paying employers' NICs and a range of statutory payments (e.g. Statutory Maternity Pay).

Box 3.3**Small businesses account for more than half of UK employment (58.2%)**

- There are 2.52 million sole proprietors – 350,000 have employees
- There are 540,000 partnerships – 210,000 have employees
- There are 960,000 companies – 600,000 have employees
- 2.9 million small businesses have no employees

Source: DTI Statistical Press Release 26 August 2004.

3.43 Many of the issues faced by small employers were addressed by Patrick Carter's Review of Payroll Services that was commissioned in Budget 2002. This review recommended a package of measures to improve payroll service for all employers, including a set of incentives of up to £825 over five years to off-set the impact of the introduction of mandatory electronic filing for end-of-year PAYE returns.

3.44 The level of the incentives for the first two years was pitched so that, for a micro employer with up to 4 employees, it would approximately cover the annual cost of engaging a payroll intermediary or purchasing a payroll software package.

Reducing payroll costs

3.45 Already some steps have been taken to reduce payroll burdens. From February 2005, new employers will receive their employer reference numbers in their New Employer Starter Pack within a couple of days of contacting the Inland Revenue. This avoids the inconvenience to new employers of making repeat telephone calls and facilitates early contact between the new employer, their employees and their local office. It also supports registration for on-line filing and assists new employers in meeting their responsibilities.

3.46 Employers have been specifically invited to comment on ways to make the proposed extensions to maternity pay and benefits less burdensome in the consultation paper published on 28 February.⁷ From November 2005 payment of tax credits through the employer will be phased out.

Guidance for employers

3.47 Employers already receive the guidance they need, for example to implement Budget changes, on a CD-ROM rather than on paper. The CD-ROM has been much improved this year, with more calculators and training modules, and 85 per cent of employers are now accessing their guidance electronically or via an intermediary, rather than on paper.

3.48 But more could be done. In particular, it has been suggested that some small businesses may see payroll as intimidating and complex. Anecdotal evidence suggests that as a result some may choose not to expand rather than assume the responsibilities of taking someone on. If true, this would be a significant impediment to businesses achieving their full growth potential. There is also evidence to suggest that some employers ignore their payroll obligations, taking on labour informally and avoiding tax and NICs. This means that legitimate employers operate at a disadvantage and employees in the informal economy are denied their entitlements to contributory and other benefits.

⁷ *Work and Families: Choice and Flexibility* available at <http://dti.gov.uk/er/workandfamilies.htm>.

Questions

- Q14** What drives the costs of administering the Government's payroll reporting requirements? What are the main implications of employers' resourcing that come with these requirements?
- Q15** What are the benefits of using intermediaries to deal with payroll? Do these benefits to business always outweigh the cost? Are there best practice examples available that might help small employers attain the optimum cost/benefit balance?
- Q16** What more can be done to encourage small employers to make greater use of intermediaries to administer payroll or aspects of payroll?
- Q17** To what extent do businesses artificially constrain their growth as a result of the tasks associated with taking on their first employee? What could be done within the existing tax and benefits system to minimise this?
- Q18** How can we best encourage small employers to take greater advantages of the benefits of technology? Are there best practice examples available that might help small employers achieve the optimum cost/benefit balance?

Review of links with medium-sized businesses

3.49 Medium-sized businesses may have some needs that are different from those of smaller businesses. As announced at the Pre-Budget Report 2004 the Small Business Unit is already conducting a review of links between these businesses and the revenue departments, providing an additional opportunity for them to make their needs known. The review's objective is to achieve the type of successful cultural shift in the relationship between medium-sized businesses and the new department that followed the Review of Links with Large Business undertaken in 2001.

3.50 The Review will focus on businesses where the founder-managers direct others to run the business, rather than manage directly themselves.⁸ The review's terms of reference are set out in Annex B. A team drawn from Inland Revenue, Customs and Excise and the private sector has begun to take the review forward. Businesses will be invited to contribute in a number of different ways – on-line, by responding to a questionnaire, or through face-to-face discussions or workshops. And there will be a review of Revenue and Customs' approach to enquiry work.

3.51 The conclusions of the review, which will be reported at the next Pre-Budget Report, will influence the future operational policy-making process and delivery as it affects medium-sized businesses. Many of the lessons learned will also improve the ways in which the new department will work with small business more generally.

If you want to participate in the review of medium-sized businesses please send your details to Mark.Kelly@ir.gsi.gov.uk

⁸This focus means that the review will consider a broader range of businesses than are included in the DTI definition (firms with between 50 and 249 employees).

4

SUMMARY OF QUESTIONS

4.1 This paper has set out a number of questions for small businesses and their advisors. As well as commenting on the issues raised, respondents are invited to indicate their relative priority.

- Q.1** Which forms give rise to the greatest burdens for businesses, and why? How might they be improved?
- Q.2** Do the existing on-line services offered by Revenue or Customs meet small businesses' needs? What are the main areas for improvement that would encourage more small businesses and their advisors to file returns electronically?
- Q.3** Should the department be doing more to offer modern and flexible payment options for small businesses?
- Q.4** Is the current balance right between providing a level playing field for all, and providing payment flexibilities for businesses?
- Q.5** What might enhance the existing range of VAT simplification schemes available to small businesses?
- Q.6** To what extent do different payment dates for different taxes give rise to problems for businesses?
- Q.7** Would businesses prefer to have one visit to inspect all business records for all taxes, or separate visits for different taxes?
- Q.8** What other steps might be taken to reduce the burdens on business that result from inspections and enquiries?
- Q.9** How high a priority is delivering Whole Customer View to small businesses and their advisers?
- Q.10** How do small businesses and intermediaries prefer to obtain the information they need?
- Q.11** If the department needs to prioritise early action to improve channels of communication, should it focus on a better website, better designed leaflets, or improved phone contact services?
- Q.12** Is having a single view of clients' accounts with HMRC be a priority service for intermediaries?
- Q.13** What can the government do to further reduce the costs of using intermediaries and to ensure that those savings are passed through to small business?
- Q.14** What drives the cost of administering the Government's payroll reporting requirements? What are the main implications for employers' resourcing that come with these requirements?
- Q.15** What are the benefits of using intermediaries to deal with payroll? Do these benefits to business always outweigh the cost? Are there best practice examples available that might help small employers attain the optimum cost/benefit balance?

- Q.16** What more can be done to encourage small employers to make greater use of intermediaries to administer payroll or aspects of payroll?
- Q.17** To what extent do businesses artificially constrain their growth as a result of the tasks associated with taking on their first employee? What could be done within the existing tax and benefits system to minimise this?
- Q.18** How can we best encourage small employers to take greater advantage of the benefits of technology? Are there best practice examples available that might help small employers achieve the optimum cost/benefit balance?

A

THE CODE OF PRACTICE ON WRITTEN CONSULTATIONS

5.1 About the consultation process – the consultation criteria:

- Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
- Be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses
- Ensure that your consultation is clear, concise and widely accessible.
- Give feedback regarding the responses received and how the consultation process influenced the policy.
- Monitor the department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
- Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

5.2 The Inland Revenue and HM Customs and Excise confirm that where possible, these consultation criteria have been, and will continue to be, followed.

5.3 A partial regulatory impact assessment for this consultation is available at www.ir.gov.uk and www.hmce.gov.uk. Hard copies are available upon request.

COMPLAINTS

5.4 If you have any complaints about any element of the consultation process leading from the issue of this document, please contact:

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SW1A 2BQ

Tel: 020 7147 2382

Fax: 020 7147 238

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B

EXTERNAL MEMBERS OF SMALL BUSINESS ADVISORY GROUP

The external members of the Small Business Advisory Group are:

- **Francesca Lagerberg**, Chair, Small Business Tax Committee & Deputy Chairman, Tax Faculty, Institute of Chartered Accountants of England and Wales
- **William Sargent**, joint Chief Executive of Framestore CFC & Chair, Small Business Council
- **Steve Sharratt**, Chairman of a number of small businesses and Vice Chair of the CBI SME Council
- **Roger Southam**, Chairman and Chief Executive of the Chainbow Group
- **Simon Sweetman**, Vice Chairman, Tax Policy Unit, Federation of Small Business
- **Martin Wyn Griffith**, Chief Executive of the Small Business Service

C

REVIEW OF LINKS WITH MEDIUM-SIZED BUSINESSES – TERMS OF REFERENCE

B.1 Following the merger of the Inland Revenue and HM Customs & Excise, this review will look for ways of reducing the administrative burden medium-sized businesses will face in their dealings with HM Revenue and Customs.

B.2 The review will focus on businesses where day-to-day operations have been devolved from the founder/controlling-director to a management team, and will work within existing legislation and infrastructure.

B.3 In particular, the review team will meet and listen to medium-sized businesses and staff in the new department and seek to identify:

- duplication that can now be removed;
- procedures that are burdensome and can be streamlined or could be conducted more efficiently as an e-service;
- better lines of communication to enable this sector to help improve both the operational and administrative policy process; and
- improvements in the enquiry process, through a review of recently settled enquiry cases.

