

PO-CH/NL/0269
PART A

Part A

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Begins : 25/8/88.

Ends : 4/11/88.



PO -CH /NL/0269



PART A

Chancellor's (Lawson) Papers:

SUB CONTRACTORS
EFFICIENCY SCRUTINY

Disposal Directions : 25 Years

11/10/95.

PO -CH /NL/0269

PART A

PART A



FROM: R C M SATCHWELL
DATE: 25 August 1988

PS/IR

cc PS/Chancellor
Mr Culpin
Miss Hay

Mr Sullivan)
Mr Green) IR

SUB-CONTRACTORS EFFICIENCY SCRUTINY

The Financial Secretary had a discussion yesterday with Mr Green about his report on the efficiency scrutiny of the sub-contractors deduction and exemption scheme. Mr Sullivan and Miss Hay were also present.

2. The Financial Secretary said he had been impressed by the effort put into the study by Mr Green and by the quality of his report. He was not yet in a position to make firm decisions about its recommendations, but wished to have a preliminary discussion about the major issues before Mr Green went off on holiday. On a first read, these appeared to be; whether the scheme should remain, the balance of increases and reductions in regulatory burdens, possible improvements in compliance, the extent of the staff savings due to improvements in administrative efficiency, resulting from the proposed changes, and the need for legislation.

3. Mr Green said that his investigations had convinced him that the scheme should stay, since it resulted in a large number of people paying tax who otherwise would not. For instance 20% of people under the scheme paid tax amounting to some £100m, but subsequently made no tax return; without a scheme, this money would almost certainly be lost. And this figure did not include all those people who were induced to comply with the scheme because they would otherwise lose out on their entitlement to a tax refund.

Mr Green guesstimated that the overall amount of tax at risk was of the order of £300m - £500m a year.

4. On compliance and regulation, Mr Green's main proposal involved replacing the 3 year rule for exemption certificates based simply on evidence of payment of tax, irrespective of employment status, with a combination of a 1 year rule associated with self-employment only, together with a turnover test limiting exemption certificates to only those individuals and partnerships with an annual turnover in excess of £15,000. At the same time, the deduction rate should be reduced so as to reflect more closely the likely tax liability of the main classes of taxpayers. Together he expected the measures would, in the long run, reduce the number of those with exemption certificates from 620K to about 300K and increase those on deduction from 250K to about 400K.

5. The Financial Secretary said he was concerned that the package might appear less than liberal. The carrot of the reduction in the 3 year rule seemed to be outweighed by the tightening of the rules elsewhere. This was likely to concern the EDU. Mr Green said that the tightening would mean that the exemption scheme would focus on those who were genuinely self-employed, rather than those supplying only their own labour. It would not restrict an individual's ability to work, merely his ability to work without deduction of tax. Moreover, if, once the effects had worked through, a large number of people in the construction industry were ineligible for exemption certificates, this would break the "ticket to work" practice, which was the EDU's real worry. The changes would also be particularly beneficial to school leavers and others needing full exemption certificates, who would face an automatic year of deduction but would then have a chance of obtaining a full certificate more quickly than under the 3 year rule. The EDU would on the other hand presumably welcome the proposal that large non-construction organisations be helped by the raising of the limit to £1 million. The Financial Secretary said he would think further about regulatory aspects of the package and the exemption certificate criteria in particular.

6. The Financial Secretary wondered in passing why the proposed turnover limit had been set at £15,000 rather than (say) the VAT limit for small companies. Mr Green said that initially he had thought of aligning these; but the higher rate would in practice exclude many individuals who were genuinely self-employed, and who would suffer consequent cash flow problems.

7. On staff, the Financial Secretary asked whether the 265 ^{full time equivalent} fte mentioned in the report were real savings. Mr Green said they were; and were the direct result of streamlining the exemption certificate issue system, and relaxing other rules such as the submission of vouchers, the limit for non-construction companies and the changes in certificate eligibility criteria. In the longer term, more savings could be expected from the combination of further reducing the paper in the system, cutting down on repayments by lowering the deduction rate, and centralising administration. These should outweigh any increase in costs arising from other aspects of the effect of the reduction in the deduction rate; though he had not had time in the 90 days available to undertake a full analysis of possible savings. The Financial Secretary said that a more detailed study of these longer-term effects would be useful, as would an analysis of the impact of any "chipping away" by the EDU of the proposed eg new exemption criteria, and any possible quantification of the revenue or other gains from enhanced compliance. This latter would be particularly relevant in the context of Northern Ireland.

8. The Financial Secretary said he had yet to come to a view on the questions of consultation and legislation; they would depend on decisions taken over policy. But he stressed that the option of implementing all the changes in the 1989 Finance Bill was very much alive, even though the timetable for issuing a consultative document would be quite tight. He said he would hold a further meeting about the scrutiny following Mr Green's return from holiday on 19 September. In the meantime, Revenue officials should start working up in greater detail some of the proposals and recommendations in the report; though on the understanding that the Financial Secretary wished to reflect further before endorsing them.

9. Finally, on the question of TUS consultation, the Financial Secretary asked the Revenue to reflect further on the timing and content of any release of the scrutiny to the Unions. This would need careful handling in light of the sensitive policy issues involved.

R. C. M. S.

~~R C M SATCHWELL
Private Secretary~~

21 AUG 1988



MP

EFFICIENCY UNIT

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Rt Hon Norman Lamont MP
Financial Secretary to the Treasury

31 August 1988

| | |
|---------------------|-----------------|
| FINANCIAL SECRETARY | |
| REC | 31 AUG 1988 |
| ACTION | Mr. T. Green II |
| COPIES TO | PPS, Miss. Hay |
| | Mr. Crawley II |
| | Mr. Sullivan II |

2

Dear Norman,

EFFICIENCY SCRUTINY OF THE SUB-CONTRACTORS SCHEME

Ps / II.

I have seen the report of this scrutiny. It is another good piece of work which should produce very worthwhile benefits for the department. There are also radical ideas for the future which you will want to pursue.

It is clear that the sub-contractors scheme has over the years developed over-complex systems and procedures which no longer efficiently serve the purpose for which the scheme was introduced. The recommendations should lead to a scheme which is better directed and saves time, effort and cost for both the department and the industry. I can understand that there will be sensitivities both inside and outside the department about a number of the recommendations. They will need to be followed up vigorously if the real benefits of the scrutiny are not to be dissipated.

The recommendations are sensibly split into packages which can be implemented independently of each other so that progress can be made without waiting for legislation. This should enable the department to present you with a positive and well timetabled Action Plan which I look forward to seeing in the Autumn.

The suggestion about moving to a 'Pay As You Go' system for a wider range of Schedule D taxpayers is a very interesting one. I would be grateful if the Unit could be kept in touch with the work which the department does to pursue the idea.

Yours truly

ROBIN IBBS



C.
Simply to be aware this is going on, and may lead to proposals for a consultative document + legislation next year. FST is holding a meeting in mid-Sept. AMH

FROM: FINANCIAL SECRETARY

DATE: 31 August 1988

Thanks.
V. promising.
P.S. make effort
5 have
There is no
1989 FB.
M.

CHANCELLOR

SUB - CONTRACTORS EFFICIENCY SCRUTINY

(2 huge volumes, retained)
The efficiency scrutiny of the sub-contractors deduction and exemption scheme arrived just before I went on holiday, so I have only had time to come to a preliminary view on it. However, it seems to me an excellent piece of work; though I think we need to look more closely at some of the detailed proposals.

The scrutiny recommends retention of the scheme because of the risk to the tax take (which the author, Mr Green, guesstimated would be of the order of £300m-£500m a year), but suggests radical changes in the way the scheme is operated. These would produce an estimated 265 staff savings during the PES period, by reducing the number of exemption certificates issued by the Revenue and cutting out other paperwork. This is a valuable partial offset to the staff costs of independent taxation.

The main changes would involve replacing the current 3 year rule for exemption certificates with a 1 year rule, but limited to self-employment status, together with a turnover test limiting exemption to those with an annual turnover in excess of £15,000 a year. At the same time, the deduction rate would be reduced so as to reflect more closely the likely tax liability of the main classes of taxpayers. These measures will shift around 200,000 people from exemption to deduction status.

In the long run, other measures could produce more staff savings. The lowering of the compliance costs of the scheme, and the abolition of the special 714S certificates (issued mainly to school leavers), are two other proposals which will benefit the industry, and should therefore be welcomed by David Young.

David will also applaud the reduction of the time test from 3 years to 1, since this has long been one of the EDU's main bones of contention. On the other hand, the tightening at the same time of other aspects of the rules, notably the change to self-employment status only, will no doubt have less appeal. DTI may therefore try to push us further than we would wish, which might jeopardise the staff savings. We will have to handle the EDU carefully.

I have authorised officials to work up some of the recommendations in more detail and quantify their impact, particularly the scope for staff savings in the longer term. I will hold another meeting when Mr Green returns from holiday in September to discuss these and come to a view on the way forward. This may require the issue of a consultative document, since at least some of the proposals would require legislation. I do not think we should rule out including measures in the 1989 Finance Bill, though the timetable would be tight. However, the Revenue will be submitting further advice on this in time for the September meeting.



NORMAN LAMONT



FROM: MISS M P WALLACE

DATE: 9 September 1988

mp

PS/FINANCIAL SECRETARY

SUB - CONTRACTORS EFFICIENCY SCRUTINY

The Chancellor was most grateful for the Financial Secretary's minute of 31 August. He has commented that these proposals look very promising, and he would like every effort made to have them in the 1989 Finance Bill.

M.P.W.

MOIRA WALLACE

Private Secretary

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pmf

FROM: R C M SATCHWELL

DATE: 19 September 1988

MISS JAMES - IR

cc PS/Chancellor

Mr Culpin

Mr Hoare

Miss Hay

Mr Tyrie

Mr Beighton)

Mr Cherry)

Mr Crawley)

Mr Roberts) IR

Mr Sullivan)

Mr Green)

PS/IR

SUB - CONTRACTORS EFFICIENCY SCRUTINY

You are due to meet with the Financial Secretary next Tuesday 27 September to discuss the follow-up to Mr Green's report.

The Financial Secretary has asked me to stress that Ministers are very keen for measures to be included in the 1989 Finance Bill if possible. He would therefore like to discuss;

- the effects that timetable would have on the Action Plan, and the implications for our consultations with the industry
- the breakdown between measures which would have to be detailed in primary legislation and those requiring only enabling legislation - the details to be included in regulations
- the need for retrospection (if, for example, we moved to a system of exemption certificates based on 1 year's self-employment, what would happen to those sub-contractors who had completed 2 of the 3 years under the current rule?)

- the level of the revised deduction rate
- details of where the 265 fte staff savings mentioned in the report will be made and the timing of the savings
- the possible savings from the longer-term measures outlined in the report - including centralisation.
- any read - across to Northern Ireland

R.C.M.S.

R C M SATCHWELL
Private Secretary

CONFIDENTIAL



pmf

FROM: R C M SATCHWELL
DATE: 29 September 1988

MISS JAMES - IR

cc PS/Chancellor
Mr Culpin
Mr Hoare
Miss Hay
Mr Tyrie

Mr Battishill)
Mr Beighton)
Mr Cherry)
Mr Crawley)
Mr Roberts) IR
Mr Sullivan)
Mr Green)
PS/IR

SUB-CONTRACTORS EFFICIENCY SCRUTINY

The Financial Secretary had a meeting on Tuesday with you and others to discuss the follow-up to Mr Green's report.

The Financial Secretary said that Ministers were very keen for measures to be included where possible in the 1989 Finance Bill. You said that it would be possible to do quite a lot this year; but you doubted whether the revised system could be fully operational before 1991/2. Mr Sullivan said that all of the changes in secondary legislation (which reduced paperwork and resulted in the 265 fte short-term staff savings identified in the report) could be done in 1989; as could much of the primary legislation covering deregulatory aspects, including those relating to the size of company required to operate the scheme.

The most difficult element in legislative terms was the change in the eligibility rules from 3 years employment to 1 year of self-employment, together with a turnover test. These would have to be watertight if the compliance gains were to be achieved. They would also have to be stated clearly and objectively in the legislation in order to avoid giving the Appeal Commissioners undue discretion as to renewal of certificates. Your concern was that a tough compliance test should not be undermined by "soft" appeal decisions. Mr Sullivan was concerned that hurried legislation in 1989 might leave insufficient time to get the new rules "right".

The Financial Secretary said that there would be significant advantage in including the changes in eligibility this year. A deferral until 1990 would lose much of the attractions of a "package of measures"; whereas an announcement in the 1989 Budget followed by legislation in 1990 simply gave people who would lose certificates the opportunity to lobby against the change. Mr Green recognised this but said that there were also disadvantages. There might well be complaints that an immediate change did not give people fair warning of the new regime. A year's delay would also eliminate any retrospection. A detailed announcement ahead of implementation could cause forestalling problems - the Revenue would consider this aspect further.

The Financial Secretary asked whether it would be necessary to issue a formal consultative document. Mr Green said that a formal document was not necessary, but that the industry would welcome a written statement of the Government's proposed changes. You thought that it would be desirable to issue a statement at the beginning of November.

The Financial Secretary asked about the proposed level of the deduction rate. You said that we needed to be careful here. You were not convinced that 20% would eliminate all of the over deduction; 15% or 16% might be needed. Though that in turn would increase the first year only cashflow loss to the Exchequer from around £100 million to closer to £200 million.

The Financial Secretary asked about the possible savings from longer-term measures. You said that you had had talks with the computer people about installing a new computer in 1992. Centralisation would lead to greater efficiency. But if the eligibility and deduction rate changes were implemented ahead of centralisation, there might be frictional costs for tax districts which could eat into the 265 fte staff savings. The Financial Secretary said that it was important that the 265 fte staff savings were not reduced. He would like more work to be done on the longer-term questions, quantifying both the staffing implications and the benefits on the compliance side.

Mr Sullivan said that the EDU would welcome most of the package but probably not the changes in the eligibility rules. Mr Green agreed to provide a note on the presentation of the case to the EDU. Discussions with the unions would take place after the EDU had been squared.

Summing up, the Financial Secretary said that he would like an early note setting out the legislative and administrative programme, covering both timing and content. He would speak to Northern Ireland Ministers in the light of this.

R. C. M. S.

R C M SATCHWELL
Private Secretary



Inland Revenue

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Savings and
Investment Division
Somerset House

FROM: C D SULLIVAN
DATE: 14 OCTOBER 1988

FINANCIAL SECRETARY

SUBCONTRACTOR SCHEME EFFICIENCY SCRUTINY: HANDLING THE EDU

1. Mr Green's note attached covers the handling question you raised at our meeting on 27 September.
2. The EDU should mildly welcome reductions in the scope of the scheme. They should give a more positive response to reducing the deduction rate, and to reducing the voucher and deduction scheme paperwork - subject to examining details of new procedures. However, they may ask why we cannot go further in reducing paperwork. The scrutineer recommended a feasibility study on that for the longer term. If such a study were to recommend the abolition of vouchers it would render unnecessary the Scrutineer's proposals to reduce voucher flow. We would therefore prefer to conduct the study in the shorter term. But that will not be possible on the faster timetable.
3. The main pressure from the EDU will come on the certificate eligibility rules. These changes are intended to deny certificates to people who, for good or ill, get them now. Their main concern will be over new applicants, including school leavers. You are aware of their worries on the "3 year employment rule" which prevents around 5,000 applicants a year from getting a certificate. The scrutineer is seeking, over time, to shift some 200,000 onto deduction.
4. The scrutineer's recommended replacement for the 3-year rule - one year's self employment plus tests such as for a minimum turnover will not work as it stands in outline. The

scrutineer recognises this. If there were easy solutions they would already be before you. Without extra or alternative hurdles for applicants, the shift to deduction will not work: and the EDU will not welcome the further restrictions.

5. EDU should also be interested in the certificate renewal rules. Here the scrutineer proposes a much tougher line on refusing certificates to subcontractors with a poor record of paying tax or rendering returns. Where a subcontractor himself engages labour, a certificate is almost essential for cash flow purposes (unlike labour-only subcontractors). So withdrawing certificates from established businesses is likely to close them down.

6. Mr Green's paper gives more detail of EDU and Department of Employment concerns. He suggests ways of showing that his proposals are sensitive to those concerns. We endorse the positive presentation and the principle of the shift to deduction. But it would be optimistic to assume that presentation alone will disarm the EDU.

7. We agree that the EDU should be given the unabridged Report, together with our detailed reactions.

TIMING

8. On balance, we think it is better to know the strength and direction of EDU feeling before putting detailed proposals to the industry. On both timing and presentational grounds, we would prefer not to risk having to return to the industry with different proposals as a result of EDU pressure. Other Government Departments (OGDs) also have an interest - the NIO, the DoE and the Department of Employment. We think it best to go to these Departments at the same time as to the EDU, rather than wait for the EDU reaction. You will recall NIO interests are likely to be opposite to the EDU's.

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9. In some ways, it would be preferable to await EDU responses before putting the report to Trade Union Side. However, that would be in breach of a standing agreement to consult TUS no later than other interested parties. We therefore recommend that proposals should go to the EDU, OGDs and TUS at the same time.

Frank B. Dunbar

b.p.

C D SULLIVAN



Inland Revenue

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Compliance and
Collection Division
Somerset House

ppp

FROM: C D SULLIVAN
DATE: 14 OCTOBER 1988

FINANCIAL SECRETARY

SUBCONTRACTOR SCHEME EFFICIENCY SCRUTINY - LETTER FROM SIR
ROBIN IBBS

1. Sir Robin Ibbs' letter of 31 August to you welcomes the scrutiny recommendations and exhorts vigorous and early implementation. The letter specifically focuses on a suggestion in the scrutiny report that does not feature in the list of recommendations since it was outside the scrutineer's terms of reference. That is the idea of a "pay as you go" (PAYG) system for a range of Schedule D taxpayers.
2. Under this, the self-employed could work under deduction as uncertificated subcontractors do. But instead of having to render business accounts and be assessed to Schedule D, the deduction would satisfy all responsibilities to the Revenue in respect of that source of income.
3. As Sir Robin implies, this is a very radical proposal. In principle, it could yield substantial efficiency and deregulation gains by cutting out Schedule D procedures with little direct added value. There would be big deregulation gains for the traders involved: but those hiring them would have to operate new deduction schemes. The overwhelming majority of accounts of small traders are accepted without question. Those small traders who have already paid tax under deduction might be felt one of the less pressing categories for examination.

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4. There are a wide range of practical and operational problems that would need study in examining the feasibility of the proposal. Important points would be whether the scheme was voluntary; whether it only applied to those with no other sources of trading income; and whether tax over deducted could be reclaimed if the trader did choose to submit accounts. However, the presentational aspects are also important. The lower tiers of subcontracting are an area where worries of black economy activity and dole fraud are commonplace. So an official "no questions asked" policy for taxing such subcontractors, or traders more widely, could come under substantial criticism.

5. There is a linkage with the deduction rate used. Even with basic rate deduction, a significant minority of subcontractors do not render business accounts. Dropping the deduction rate will increase this number. So in practice a low deduction rate will effectively mean a PAYG scheme. Chasing subcontractors only known to us from contractor's returns would be resource-intensive even where possible: and such investigation would not be expected to yield revenues.

6. PAYG schemes could only be practicable in activities with reasonably reliable and sustained hirer - worker relationships so that deductions would be properly recorded and passed to the Exchequer. We recommend that this wider proposal remain outside the mainstream of the subcontractor scrutiny recommendations.

7. We would be grateful if you could indicate if you share Sir Robin's initial attraction to the PAYG proposal. You will recall that one of this year's efficiency scrutinies is a review of Schedule D procedures. The deliberately-wide terms of reference would allow work in this area if the scrutineer sees it as a worthwhile lead to follow up.

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8. I attach a non-committal draft reply for you to sent Sir Robin's successor.

Frank B. Dunbar.
[Signature]

b.b.

C D SULLIVAN

CONFIDENTIAL

DRAFT FOR FST TO SEND SIR ANGUS FRASER

EFFICIENCY SCRUTINY OF THE SUBCONTRACTORS SCHEME

1. Sir Robin Ibbs wrote to me on 31 August about the subcontractor scheme efficiency scrutiny.
2. I have now had two meetings with the scrutineer and my officials. Like Sir Robin, I am very encouraged by the apparent scope for efficiency gains as well as for deregulation benefits.
3. I am grateful for Sir Robin's recognition of the sensitivities of a number of the scrutiny recommendations. Some of the difficulties are technical, in the sense of getting legislation and procedures fair but effective. Others are in the presentation of significant changes that will not be universally popular, and with unusually large and direct impact on taxpayers by efficiency scrutiny standards.
4. I note Sir Robin's comments about staged implementation of the recommendations. We are actively thinking about the most effective timetable, amongst other issues.
5. I shall ensure the Unit are kept in touch with developments.



Inland Revenue

Oil and Financial Division
Somerset House

FROM E GREEN

DATE 14 OCTOBER 1988

FINANCIAL SECRETARY

EFFICIENCY SCRUTINY: SUBCONTRACTORS DEDUCTION AND EXEMPTION SCHEME

1. At your meeting on 27 September 1988 you asked me for a note on how best to present the Report's findings and recommendations to the EDU. The emphasis being to show the exemption criteria package in a positive light as liberalisation and to tackle the "licence to work" objections.

2. The Department of Employment and EDU have different interests but their objections to the present scheme are similar. The Department of Employment have two major concerns in this area; the operation of the Enterprise Allowance Scheme and promotion of self employment. They have identified some cases where enterprise allowance has been given to a small business which has then been unable to obtain an exemption certificate. They see this as being philosophically unacceptable; one government department issuing financial incentives while another department inhibits cashflow.

3. In the case of promotion of self employment both departments have similar complaints. They centre round the so called three year rule. This rule was constructed to prevent itinerant workers who had little or no UK tax history obtaining an exemption certificate. The essence of the rule is that for an individual to qualify for exemption he has to demonstrate a continuous UK employment or self employment record for three years within the six years preceding the application. Breaks of a maximum of six months in aggregate only are allowed in this period of three years. EDU and the Department of Employment feel this is unfair when many may fail simply by having been out of work. They also feel that this is a bureaucratic obstacle to

"genuine people" - as they put it - starting their own businesses. However, this has not been borne out in practice. The number of self-employed in the industry has grown by over 200,000 in the last 5 years.

4. There are two other issues. The cashflow problems caused to businesses by deduction at source and the attitude of some contractors who prefer to employ exempt subcontractors rather than those for whom they have to operate the deduction scheme. Contractors sometimes use the absence of a certificate as an excuse when deciding not to take someone on. This latter issue is normally referred to as the "ticket to work" syndrome.

5. While unemployment has been relatively high many contractors would only engage sub-contractors who held an exemption certificate. This meant there was no need to operate the deduction scheme. Exemption was perceived to be cheaper administratively.

6. The attitude was in part helped by Revenue acquiescence. This was partly due to heavy workloads and difficulties encountered in taking appeals against certificate refusals before unhelpful appeal commissioners. From being essentially a deduction scheme there was a gradual change to essentially an exemption scheme.

7. The boom in the construction industry over the last 2/3 years has led to skill shortage in some trades. Contractors have been more inclined to take on non-exempt workers. In short, if they have the right skills at the right price then they get work. Significantly, industry representatives have admitted to me that they have in the past operated such embargoes, but no longer. The problem still exists, but is less prevalent. However, if the scheme returns to being predominately a deduction scheme the "ticket to work" syndrome should be far less relevant. Contractors would not be able to pick and choose and discriminate against the non-exempt.

8. You thought that the best approach is likely to be to take a positive view of the changes in the way in which they address all these concerns. The terms of reference recognised the impact of the scheme on the Revenue and the Industry alike and in addressing the need for improved efficiency and reduced cost the Scrutineer has taken both the Revenue and Industry's position into account as far as this is possible where interests conflict.

9. The EDU has consistently opposed parts of the present scheme. How they are apprised of its contents will therefore need to be treated with caution. There are things which they should welcome - such as the change to the three year rule and reduction in the deduction rate. But there are others which they may react to adversely; the £15000 turnover test and restriction of eligibility for exemption to those who already have business experience. The measures are best presented as a complementary package. In part aiming to deregulate:-

- reducing paper
- taking large businesses out of the scheme as much as possible
- reducing deductions
- shortening the time genuine businesses wait for exemption

while recognising that anti-abuse measures are built in to protect substantial Government revenues.

10. Firstly it will be necessary to make it clear that without a scheme of some sort revenue will be put at risk. The potential loss of something between £m300 and £m500 should be sufficient to persuade them that a return to a free for all is unrealistic. They could complain that construction industry workers are being treated differently to other self employed people who are allowed to pay their tax in arrear by assessment. However, it would not be unfair to point out that there have been particular problems

of non compliance in the industry. This is the Revenue's major concern and Parliament has consistently recognised these problems.

11. The EDU and the Department of Employment emphasise the importance of encouraging self employment as a good thing in itself. They see the scheme as inhibiting its spread and also inhibiting the growth of businesses. However, the Revenue's compliance concerns and the EDU's fears for genuine businesses are not mutually exclusive. We can show the changes in a positive light by demonstrating that the new exemption rules are targetted towards the type of genuine businesses which they seek to encourage. To do this it will be necessary to draw a distinction between the small business and the labour-only subcontractor. Indeed, the Department of Employment draw this distinction themselves in the operation of the Enterprise Allowance. Labour-only subcontractors do not qualify for the allowance. The genuine business has overheads; plant, machinery, employees, subcontractors, materials etc. It may not have all these but it almost certainly will have at least one. The labour-only subcontractor brings only his labour and in varying respects often operates in circumstances and relationships with his hirer which are not unlike that which exists between employer and employee.

12. There is more likelihood of the genuine business complying with tax requirements. It tends to be a more permanent enterprise. It can therefore be found when tax collecting is necessary. The labour-only man may be here today and gone tomorrow. Deduction at source is therefore a practical solution.

13. I feel that we should present the package to the EDU as a three part construction.

£15,000 turnover test; targets exemption at the genuine small business with modest overheads (maybe one worker and some materials etc). Those below this figure are more likely to be labour-only because it is unlikely that somebody on less than

£15,000 would have sufficient margin to be able to employ another individual and purchase the necessary materials etc. The translation of the broad proposal of the turnover test into hard legislation may require a shift of emphasis with some anti-avoidance measures being introduced.

Restricting tax history tests to Schedule D (self-employed) compliance of the minimum of 1 year only; this scraps the three year rule and employment break criteria. It reduces the time that a new business spends on deduction. In the past it has been possible for people to claim exemption using their employment history. This test however has proved unsatisfactory in indicating the likelihood of an individual's ability to meet the discipline of record keeping and budgeting for tax payments that is essential when self-employment is involved. Few businesses appear overnight fully formed. Therefore, the one year test is unlikely to prove a hindrance to the real entrepreneur (though it may sway his behaviour - for instance whether he buys or leases large capital items at the outset.) It is more likely that the business will grow at such a pace that when the business needs an exemption certificate to ensure that its cashflow is not squeezed because it is paying overheads it will be able to demonstrate a twelve months history and provide adequate proof of an increased turnover. This is something that we hope to build into the rules. We hope this change will be particularly welcome to the EDU as it goes a long way towards meeting their concern about the three year rule.

Reduce the deduction rate; in essence the reduction to a one year compliance test shortens the time during which a subcontractor suffers deduction and the £15,000 turnover test ensures that the genuine business achieves exemption. However, that still leaves individuals on deduction either for the initial year or permanently if they are labour-only and do not satisfy the turnover criteria. The current deduction rate makes no allowance whatsoever for personal allowances or incidental expenses. It therefore leads to overpayment by the taxpayer who works solely under deduction. This imposes financial

stringencies upon him over and above that sought from, for example, the employed population. To complete the package of measures it is therefore not only important to reduce the barriers to exemption but also to make any time spent on deduction appear equitable in terms of the likely eventual tax liability. Thus the deduction rate will be reduced to a level which is more likely to reflect generally individuals' final tax liabilities.

14. These three elements comprise the main structure for an integrated approach to the numerous problems which the current scheme has, in part, created.

15. The EDU may ask about the proposed compliance rules on certificate renewals. If so, we can reassure them that we have no intention of introducing rules that could lead to difficulties for businesses that employ labour and need certificates for cashflow reasons, as a result of minor tax defaults.

16. If you are content with this kind of approach, the next questions are whether, when and how to release the report to the EDU.

17. The existence of the scrutiny is known to the construction industry. It will be mentioned in next month's Deregulation White paper. We therefore think the EDU will press very strongly to see the whole report. Unless you are determined to withstand this pressure, we see no advantage, when working to a tight implementation timetable, in substantially delaying release.

18. On the other hand, we think you will want to make the running on presentation, rather than for the EDU to be given the report without much comment. That points to a fairly full cover note.

19. Since the EDU will need to know details of proposals before they are likely to give detailed reactions, we cannot give

them the report until we are in a position to amplify the recommendations that will concern them.

20. Accordingly, we suggest that:

- the whole report is sent to EDU and other interested Departments; being Northern Ireland office, Department of Employment and Department of Environment
- the report is sent in strict confidence, in view of the matters relating to internal Revenue procedures in the pursuit of abuse
- the report is accompanied by a document amplifying the technical detail of key proposals, and presenting the recommendation positively and along the lines of this submission.

21. If you are content with this approach, it would mean a submission to you at the end of this month. You might well want a covering letter sent at Ministerial rather than official level.


E GREEN



Inland Revenue

Compliance and
Collection Division
Somerset House

FROM: C D SULLIVAN

DATE: 14 OCTOBER 1988

- 1) MR ROBERTS *art.*
- 2) MR BEIGHTON *JUB*
- 3) FINANCIAL SECRETARY

SUBCONTRACTOR SCHEME EFFICIENCY SCRUTINY - TIMETABLE FOR
IMPLEMENTATION

1. At our meeting on 27 September about the subcontractor scheme efficiency scrutiny, you asked for a note on how the administrative and legislative timetable would look if all the primary legislation was contained in the 1989 Bill rather than spread over 2 years. What follows outlines, in advance of the detail of the scrutiny action plan, the fastest practicable timetable: and draws out some consequences of that accelerated timetable.

TIMETABLE

2. By end-October

- action plan to you

cc Chancellor of the Exchequer
Chief Secretary
Paymaster General
Economic Secretary
Mr Culpin
Mr Gilhooly
Mr Hoare
Miss Hay
Mr Tyrie

Chairman
Mr Beighton
Mr Rogers
Mr Cherry
Mr Crawley
Mr Roberts
Miss James
Mr Martin
Mr Sullivan
Mr Dunbar
Mr Green
PS/IR

CONFIDENTIAL

- detailed proposals on sensitive areas (eg certificate eligibility) to you. These would give more detailed legislative options than an Action Plan would contain

By early November

- Scrutiny Report plus detailed proposals and positive presentation to EDU with request for comments by mid-November.
- Report plus detailed proposals to DoE, D.Emp and NIO
- Report to Trade Union Side.

By mid-November

- approved action plan to Efficiency Unit
- industry representative bodies invited to meeting if EDU response favourable: and sent papers giving proposals in detail in advance of meeting

Early December

- meetings with representative bodies

Before Christmas

Treasury Ministers' decisions on major proposals.

January 1989 - March 1989

Instructions to Parliamentary Counsel on 12 pages of primary legislation.

March 1989

- Budget announcement

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December 1989

- Secondary legislation on voucher and SC60 flow controls, self-vouching, scope of scheme, consequential of certificate eligibility changes etc - laid without further consultation. (If further consultation, add another 2 months to this stage and to June 1990 entry below: and increase short-term staff cost by 10.)

August 1989 - March 1990

- work on Inland Revenue administrative procedures, publicity for industry, leaflets, major staff training exercise for tax districts, especially for new eligibility rules. (500 out of 600 tax districts affected; 800,000 taxpayers affected.)

April 1990

- entry into force date for rules for new certificate applicants (and still earlier than scrutineer's timetable) and lower deduction rate. Earliest date for entry into force for certificate renewal rules and abolition of 714S limited certificates (for school leavers etc)

June 1990

- earliest entry into force for reduced voucher and SC60 flow regime regulations

April 1991

- strongly preferable entry into force for certificate renewals and abolition of 714S: and consequential changes to regulations.

Early 1990s

- feasibility study on centralisation, with a view to detailed implementation in late 1990s

CONSEQUENCES

Consultation

3. As you will see from paragraph 8 of my note on handling the EDU, we think that the Report should be released to all interested Government departments and TUS simultaneously.

4. You will note that the timetable makes no allowance for significant disagreement, for example with the EDU or in consultation. Real dispute could make it very difficult to legislate in 1989 in the area of disagreement especially if the EDU or the industry were arguing for superficially plausible alternatives.

5. We think the problem here will be with the EDU rather than industry representative bodies. Contractors and larger subcontractors will want:

- to be reassured that they will have adequate warning (as they are getting for the VAT changes) of the detail of the new procedures, so they can change their own systems
- to see how these proposals interact with the wider VAT arrangements

- to see if they can suggest easier ways for them of achieving our detailed objectives
- to ensure that existing contracts and working relationships are not unduly disrupted
- and to ensure the new rules do not bear harshly on minor default

Other than the EDU, the Department of Employment and perhaps the NFSE, we are unlikely to hear much about the subcontractor at risk of being denied a certificate.

Staff Costs

6. Advancing consultation and drafting work on the certificate eligibility rules means that the administrative and regulatory changes that yield the short-term savings slip. The same handful of people are primarily involved in working up the details and getting them implemented in tax districts and elsewhere. We think this will defer some, but not all, of the short-term changes by between 3 and 6 months. Some savings, such as reduced checks on certificate applications under existing rules, would probably not be achieved before new rules and forms were introduced. Other savings, dependent on computer reprogramming and hence late in the short-term timescale, would not be much affected.

7. In addition, there will be frictional costs. These will be mainly felt in tax districts. They will largely result from the new eligibility rules. There are two strands to this. One is that there will be a rush of applicants trying to get certificates under the old rules. We think this is unavoidable under any practicable entry into force regime. It is more a question of how big, and how concentrated, the problem will be. The staff costs are potentially significant. For example, 25,000 extra applicants spread evenly over a year would require around 40 extra staff.

8. A concentrated rush would be very disruptive. Catching the industry largely unawares would reduce the forestalling but increase the level of complaints and appeals against certificate refusal under the new rules. A longer period may increase the overall level of forestalling but produce less unmanageable workloads in districts. Publicity for the increased attractions of working under deduction, and reconsideration of whether the turnover test could apply to renewals as well as new applicants, would reduce the forestalling.

9. The other strand is the frictional cost of the new rules themselves, as districts, taxpayers and appeal Commissioners come to terms with who does and does not get an initial or a renewal certificate. On the timetable outlined, this could mean 25, 45 and 30 staff respectively in 1990/91 to 1992/93. The earlier the change is introduced, the earlier this cost is incurred.

10. All these staffing effects are very difficult to estimate, but our best guess is that the combination of all these factors would mean a significant reduction in the projected 1989/90 staff savings and that the savings by the end of 1990/91 would be nearer 200 than 265.

Revenue Effects

11. There will be a first-year revenue cost if the deduction rate is cut at the same time as the certificate rules are tightened. This is because all those working under deduction benefit immediately, while the countervailing shift to deduction only accrues over a period of time. To some extent this will happen whatever year the change is announced. There is an interaction with the date of introduction and hence the degree of forestalling: with the deduction rate chosen: with whether the new eligibility rules for initial and renewal applications are changed at the same time and with the perceived attractions of working

under deduction. It is difficult therefore to estimate the likely cost but £100M is probably the upper limit (half what we postulated at the meeting of 27 September for a 10 point cut in the deduction rate without new certificate eligibility rules).

12. From the view point of pressure on Revenue and industry resources, it would be preferable for the new deduction rate and new certificate eligibility rules to come into effect in April 1990 rather than November 1989. That would also defer the financial effects.

13. You will note we recommend deferring introduction of the new renewals rule and abolition of the 714S certificate until, preferably, April 1991 at the earliest. That should avoid the most justified complaints of changing the rules in mid-game, but could increase the 1990/91 cost to nearer the £100M maximum.

Centralisation

14. Apart from the routine processing of vouchers sent in by contractors, the subcontractor scheme operates manually within the Revenue. So it will be a paper-based anachronism in a computerised world. The scrutineer recommended a feasibility study of a centralised computer-based system. We agree that this offers the prospect of taking routine clerical work out of Tax Districts, especially those in the South-East, and doing it better. Computerisation also allows for radical change in current administrative procedures.

15. However, as the scrutineer recognises, full computerisation of the scheme would be complex. This is not so much because of complexity in the subcontractor scheme, but because extensive interfaces with other computerised parts of the tax system would be needed. So it cannot be an option for the short or medium-term. Even for the longer term, it would be dependent on a detailed feasibility study

and satisfactory financial case. So for the short to medium term at least, the subcontractor scheme will have to be run largely manually.

Long Term Benefits

16. At our meeting on 27 September you asked that we give some more thought to the staffing consequences and compliance benefits in the longer term. We have been giving thought since the scrutiny to the staffing implications of shifting people from exemption to deduction in advance of centralisation. It is too early to be certain but, frictional costs aside, we suspect this shift will be broadly staff neutral. The action plan manager has further work in hand on both these questions.

Conclusion

17. We would be grateful for your confirmation, or otherwise, in the light of these considerations that you favour enacting the revised certificate eligibility rules in 1989 for implementation starting 1990.

Frank B. Dumbear.

b.p. C D SULLIVAN



Inland Revenue

The Board Room
Somerset House
London WC2R 1LB

From: L J H BEIGHTON

14 October 1988

FINANCIAL SECRETARY

SUBCONTRACTORS ; EFFICIENCY SCRUTINY

The attached notes deal with the points raised at your meeting on 27 September on the subcontractors efficiency scrutiny. As they explain, your proposed faster timetable for implementing the scrutineer's recommendations:

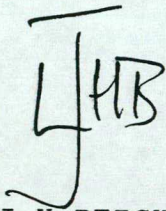
- i) is very tight indeed and allows little time for unexpected snags or delays, in particular in getting the agreement of the EDU or considering any alternative proposals they may put forward. Given the conflicting views of other Departments, Ministerial agreement may be difficult to secure;
- ii) brings forward offsetting transitional costs: the PES settlement just agreed assumed savings of £400,000 in 1989/90 which would be at risk, while the full 265 staff savings arising from the scrutiny recommendations will be put back from 1990/91 to 1993/94;

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- i) puts a substantial operational and training burden on the Schedule D sections of tax offices at much the same time in early 1990 as they will come under maximum strain in gearing up for the introduction of independent taxation;
- iv) puts back the proposed study into the feasibility of abolishing vouchers. (There is no time to include that study in your faster timetable.) That would be a pity because if such a study suggested that abolition were feasible, there could be additional staff savings and the effect might be deregulatory.

The cash flow cost to the Exchequer of introducing the proposals as early as possible is difficult to quantify but could be as high as £M100 in 1990/91. This is broadly the same as, but it arrives earlier than, under the scrutineer's timetable.

You will wish to weigh these implications in any decision to go ahead with the scrutiny proposals on an accelerated timetable.

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L J H BEIGHTON



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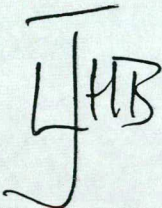
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Frank B. Dunbar.

p.p. C D SULLIVAN



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Compliance and
Collection Division
Somerset House

FROM: C D SULLIVAN

DATE: 14 OCTOBER 1988

FINANCIAL SECRETARY

SUBCONTRACTOR SCHEME EFFICIENCY SCRUTINY - LETTER FROM SIR
ROBIN IBBS

1. Sir Robin Ibbs' letter of 31 August to you welcomes the scrutiny recommendations and exhorts vigorous and early implementation. The letter specifically focuses on a suggestion in the scrutiny report that does not feature in the list of recommendations since it was outside the scrutineer's terms of reference. That is the idea of a "pay as you go" (PAYG) system for a range of Schedule D taxpayers.
2. Under this, the self-employed could work under deduction as uncertificated subcontractors do. But instead of having to render business accounts and be assessed to Schedule D, the deduction would satisfy all responsibilities to the Revenue in respect of that source of income.
3. As Sir Robin implies, this is a very radical proposal. In principle, it could yield substantial efficiency and deregulation gains by cutting out Schedule D procedures with little direct added value. There would be big deregulation gains for the traders involved: but those hiring them would have to operate new deduction schemes. The overwhelming majority of accounts of small traders are accepted without question. Those small traders who have already paid tax under deduction might be felt one of the less pressing categories for examination.

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4. There are a wide range of practical and operational problems that would need study in examining the feasibility of the proposal. Important points would be whether the scheme was voluntary; whether it only applied to those with no other sources of trading income; and whether tax over deducted could be reclaimed if the trader did choose to submit accounts. However, the presentational aspects are also important. The lower tiers of subcontracting are an area where worries of black economy activity and dole fraud are commonplace. So an official "no questions asked" policy for taxing such subcontractors, or traders more widely, could come under substantial criticism.
5. There is a linkage with the deduction rate used. Even with basic rate deduction, a significant minority of subcontractors do not render business accounts. Dropping the deduction rate will increase this number. So in practice a low deduction rate will effectively mean a PAYG scheme. Chasing subcontractors only known to us from contractor's returns would be resource-intensive even where possible: and such investigation would not be expected to yield revenues.
6. PAYG schemes could only be practicable in activities with reasonably reliable and sustained hirer - worker relationships so that deductions would be properly recorded and passed to the Exchequer. We recommend that this wider proposal remain outside the mainstream of the subcontractor scrutiny recommendations.
7. We would be grateful if you could indicate if you share Sir Robin's initial attraction to the PAYG proposal. You will recall that one of this year's efficiency scrutinies is a review of Schedule D procedures. The deliberately-wide terms of reference would allow work in this area if the scrutineer sees it as a worthwhile lead to follow up.

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8. I attach a non-committal draft reply for you to sent Sir Robin's successor.

Frank B. Dunbar.

b.b.

C D SULLIVAN

CONFIDENTIAL

DRAFT FOR FST TO SEND SIR ANGUS FRASER

EFFICIENCY SCRUTINY OF THE SUBCONTRACTORS SCHEME

1. Sir Robin Ibbs wrote to me on 31 August about the subcontractor scheme efficiency scrutiny.
2. I have now had two meetings with the scrutineer and my officials. Like Sir Robin, I am very encouraged by the apparent scope for efficiency gains as well as for deregulation benefits.
3. I am grateful for Sir Robin's recognition of the sensitivities of a number of the scrutiny recommendations. Some of the difficulties are technical, in the sense of getting legislation and procedures fair but effective. Others are in the presentation of significant changes that will not be universally popular, and with unusually large and direct impact on taxpayers by efficiency scrutiny standards.
4. I note Sir Robin's comments about staged implementation of the recommendations. We are actively thinking about the most effective timetable, amongst other issues.
5. I shall ensure the Unit are kept in touch with developments.



FROM E GREEN

DATE 14 OCTOBER 1988

FINANCIAL SECRETARY

EFFICIENCY SCRUTINY: SUBCONTRACTORS DEDUCTION AND EXEMPTION SCHEME

1. At your meeting on 27 September 1988 you asked me for a note on how best to present the Report's findings and recommendations to the EDU. The emphasis being to show the exemption criteria package in a positive light as liberalisation and to tackle the "licence to work" objections.

2. The Department of Employment and EDU have different interests but their objections to the present scheme are similar. The Department of Employment have two major concerns in this area; the operation of the Enterprise Allowance Scheme and promotion of self employment. They have identified some cases where enterprise allowance has been given to a small business which has then been unable to obtain an exemption certificate. They see this as being philosophically unacceptable; one government department issuing financial incentives while another department inhibits cashflow.

3. In the case of promotion of self employment both departments have similar complaints. They centre round the so called three year rule. This rule was constructed to prevent itinerant workers who had little or no UK tax history obtaining an exemption certificate. The essence of the rule is that for an individual to qualify for exemption he has to demonstrate a continuous UK employment or self employment record for three years within the six years preceding the application. Breaks of a maximum of six months in aggregate only are allowed in this period of three years. EDU and the Department of Employment feel this is unfair when many may fail simply by having been out of work. They also feel that this is a bureaucratic obstacle to

"genuine people" - as they put it - starting their own businesses. However, this has not been borne out in practice. The number of self-employed in the industry has grown by over 200,000 in the last 5 years.

4. There are two other issues. The cashflow problems caused to businesses by deduction at source and the attitude of some contractors who prefer to employ exempt subcontractors rather than those for whom they have to operate the deduction scheme. Contractors sometimes use the absence of a certificate as an excuse when deciding not to take someone on. This latter issue is normally referred to as the "ticket to work" syndrome.

5. While unemployment has been relatively high many contractors would only engage sub-contractors who held an exemption certificate. This meant there was no need to operate the deduction scheme. Exemption was perceived to be cheaper administratively.

6. The attitude was in part helped by Revenue acquiescence. This was partly due to heavy workloads and difficulties encountered in taking appeals against certificate refusals before unhelpful appeal commissioners. From being essentially a deduction scheme there was a gradual change to essentially an exemption scheme.

7. The boom in the construction industry over the last 2/3 years has led to skill shortage in some trades. Contractors have been more inclined to take on non-exempt workers. In short, if they have the right skills at the right price then they get work. Significantly, industry representatives have admitted to me that they have in the past operated such embargoes, but no longer. The problem still exists, but is less prevalent. However, if the scheme returns to being predominately a deduction scheme the "ticket to work" syndrome should be far less relevant. Contractors would not be able to pick and choose and discriminate against the non-exempt.

8. You thought that the best approach is likely to be to take a positive view of the changes in the way in which they address all these concerns. The terms of reference recognised the impact of the scheme on the Revenue and the Industry alike and in addressing the need for improved efficiency and reduced cost the Scrutineer has taken both the Revenue and Industry's position into account as far as this is possible where interests conflict.

9. The EDU has consistently opposed parts of the present scheme. How they are apprised of its contents will therefore need to be treated with caution. There are things which they should welcome - such as the change to the three year rule and reduction in the deduction rate. But there are others which they may react to adversely; the £15000 turnover test and restriction of eligibility for exemption to those who already have business experience. The measures are best presented as a complementary package. In part aiming to deregulate:-

- reducing paper
- taking large businesses out of the scheme as much as possible
- reducing deductions
- shortening the time genuine businesses wait for exemption

while recognising that anti-abuse measures are built in to protect substantial Government revenues.

10. Firstly it will be necessary to make it clear that without a scheme of some sort revenue will be put at risk. The potential loss of something between £m300 and £m500 should be sufficient to persuade them that a return to a free for all is unrealistic. They could complain that construction industry workers are being treated differently to other self employed people who are allowed to pay their tax in arrear by assessment. However, it would not be unfair to point out that there have been particular problems

of non compliance in the industry. This is the Revenue's major concern and Parliament has consistently recognised these problems.

11. The EDU and the Department of Employment emphasise the importance of encouraging self employment as a good thing in itself. They see the scheme as inhibiting its spread and also inhibiting the growth of businesses. However, the Revenue's compliance concerns and the EDU's fears for genuine businesses are not mutually exclusive. We can show the changes in a positive light by demonstrating that the new exemption rules are targetted towards the type of genuine businesses which they seek to encourage. To do this it will be necessary to draw a distinction between the small business and the labour-only subcontractor. Indeed, the Department of Employment draw this distinction themselves in the operation of the Enterprise Allowance. Labour-only subcontractors do not qualify for the allowance. The genuine business has overheads; plant, machinery, employees, subcontractors, materials etc. It may not have all these but it almost certainly will have at least one. The labour-only subcontractor brings only his labour and in varying respects often operates in circumstances and relationships with his hirer which are not unlike that which exists between employer and employee.

12. There is more likelihood of the genuine business complying with tax requirements. It tends to be a more permanent enterprise. It can therefore be found when tax collecting is necessary. The labour-only man may be here today and gone tomorrow. Deduction at source is therefore a practical solution.

13. I feel that we should present the package to the EDU as a three part construction.

£15,000 turnover test; targets exemption at the genuine small business with modest overheads (maybe one worker and some materials etc). Those below this figure are more likely to be labour-only because it is unlikely that somebody on less than

£15,000 would have sufficient margin to be able to employ another individual and purchase the necessary materials etc. The translation of the broad proposal of the turnover test into hard legislation may require a shift of emphasis with some anti-avoidance measures being introduced.

Restricting tax history tests to Schedule D (self-employed) compliance of the minimum of 1 year only; this scraps the three year rule and employment break criteria. It reduces the time that a new business spends on deduction. In the past it has been possible for people to claim exemption using their employment history. This test however has proved unsatisfactory in indicating the likelihood of an individual's ability to meet the discipline of record keeping and budgeting for tax payments that is essential when self-employment is involved. Few businesses appear overnight fully formed. Therefore, the one year test is unlikely to prove a hindrance to the real entrepreneur (though it may sway his behaviour - for instance whether he buys or leases large capital items at the outset.) It is more likely that the business will grow at such a pace that when the business needs an exemption certificate to ensure that its cashflow is not squeezed because it is paying overheads it will be able to demonstrate a twelve months history and provide adequate proof of an increased turnover. This is something that we hope to build into the rules. We hope this change will be particularly welcome to the EDU as it goes a long way towards meeting their concern about the three year rule.

Reduce the deduction rate; in essence the reduction to a one year compliance test shortens the time during which a subcontractor suffers deduction and the £15,000 turnover test ensures that the genuine business achieves exemption. However, that still leaves individuals on deduction either for the initial year or permanently if they are labour-only and do not satisfy the turnover criteria. The current deduction rate makes no allowance whatsoever for personal allowances or incidental expenses. It therefore leads to overpayment by the taxpayer who works solely under deduction. This imposes financial

stringencies upon him over and above that sought from, for example, the employed population. To complete the package of measures it is therefore not only important to reduce the barriers to exemption but also to make any time spent on deduction appear equitable in terms of the likely eventual tax liability. Thus the deduction rate will be reduced to a level which is more likely to reflect generally individuals' final tax liabilities.

14. These three elements comprise the main structure for an integrated approach to the numerous problems which the current scheme has, in part, created.

15. The EDU may ask about the proposed compliance rules on certificate renewals. If so, we can reassure them that we have no intention of introducing rules that could lead to difficulties for businesses that employ labour and need certificates for cashflow reasons, as a result of minor tax defaults.

16. If you are content with this kind of approach, the next questions are whether, when and how to release the report to the EDU.

17. The existence of the scrutiny is known to the construction industry. It will be mentioned in next month's Deregulation White paper. We therefore think the EDU will press very strongly to see the whole report. Unless you are determined to withstand this pressure, we see no advantage, when working to a tight implementation timetable, in substantially delaying release.

18. On the other hand, we think you will want to make the running on presentation, rather than for the EDU to be given the report without much comment. That points to a fairly full cover note.

19. Since the EDU will need to know details of proposals before they are likely to give detailed reactions, we cannot give

them the report until we are in a position to amplify the recommendations that will concern them.

20. Accordingly, we suggest that:

- the whole report is sent to EDU and other interested Departments; being Northern Ireland office, Department of Employment and Department of Environment
- the report is sent in strict confidence, in view of the matters relating to internal Revenue procedures in the pursuit of abuse
- the report is accompanied by a document amplifying the technical detail of key proposals, and presenting the recommendation positively and along the lines of this submission.

21. If you are content with this approach, it would mean a submission to you at the end of this month. You might well want a covering letter sent at Ministerial rather than official level.


E GREEN

CONFIDENTIAL



cc: PPS, Miss Hay,
Mr T. Green - IR,
Mr Crawley - IR,
Mr Sullivan - IR,
PS / IR.

PLP
25th October 1988

Sir Angus Fraser
Efficiency Unit
70 Whitehall
LONDON
SW1A 2AS

Dear Angus

Sir Robin Ibbs wrote to me on 31 August about the subcontractor scheme efficiency scrutiny.

I have now had two meetings with the scrutineer and my officials. Like Sir Robin, I am very encouraged by the apparent scope for efficiency gains as well as for deregulation benefits.

I am grateful for Sir Robin's recognition of the sensitivities of a number of the scrutiny recommendations. Some of the difficulties are technical, in the sense of getting legislation and procedures fair but effective. Others are in the presentation of significant changes that will not be universally popular, and with unusually large and direct impact on taxpayers by efficiency scrutiny standards.

I note Sir Robin's comments about staged implementation of the recommendations. We are actively thinking about the most effective timetable, amongst other issues.

I shall ensure the Unit are kept in touch with developments.

*Yours
Norman*

NORMAN LAMONT

CONFIDENTIAL



FROM:

FINANCIAL SECRETARY

DATE:

31 October 1988

CHANCELLOR

cc

Chief Secretary
 Paymaster General
 Economic Secretary
 Mr Culpin
 Mr Gilhooly
 Mr Hoare
 Miss Hay
 Mr Tyrrie

Mr Beighton - IR

Mr Sullivan - IR

PS/IR

SUB-CONTRACTORS EFFICIENCY SCRUTINY

You will recall that I put to you the efficiency scrutiny of the sub-contractors deduction and exemption scheme, with a strong recommendation that we should endorse its findings and implement them in the 1989 Finance Bill.

The proposals were essentially in two parts:

- a package of short-term efficiency measures which will reduce the cost of the scheme for both the industry and the Revenue, and will result in an estimated 265 staff savings during the PES period.
- a change in the eligibility rules for acquiring an exemption certificate, from 3 years' employment to 1 year's self-employment, together with a turnover test limiting exemption to those with an annual turnover in excess of £15,000 a year. In the long run this will shift around 200,000 people from exemption to deduction status.

I have kept the pressure on for change in 1989. However, the Inland Revenue are very nervous about putting all of the proposals in next year's Budget. Although the short-term measures require a little primary legislation and some secondary legislation, there should be no difficulty with them, since they are deregulatory and

*IT
I am returning to you. RBC's statement, p. 11*

Ch/ Surely postponing the eligibility changes for a year will give at least as much opportunity for opponents (i.e. the trade) to block the changes as making them through will cause the EDU to protest? I think the Revenue are exaggerating the EDU problem - a firm letter from you/ FST at the outset should put them in place.

bf. 4/11

2/11

so will be welcome to both the industry and the EDU. The problem lies with the change to the eligibility rules, which may well be opposed by the EDU on deregulation grounds. I firmly believe that the tightening of the rules in this area is justified by the fact that the system as a whole will become more efficient (a view which was strongly supported by Sir Robin Ibbs). But the Revenue are concerned that the time spent fighting this battle with the EDU and then consulting with the industry will divert resources from the other issues, and so delay the short term staff savings. They would therefore like to postpone the changes to the eligibility rules until the 1990 Finance Bill. A draft of what you might say in your Budget Speech is attached. (This is obviously too long, but it is only an indication).

On balance I see advantage in a two-stage approach. It implements a substantial amount of deregulation, and guarantees us the staff savings now, which are important. It also allows us sufficient time to have proper consultation with the industry and the EDU and so ensure that the new eligibility rules are agreed and watertight.

There is also the question of when to make the change in the deduction rate, so that it reflects more closely the likely tax liability of the main classes of taxpayer. We have substantial flexibility on this, and could introduce it in either Budget. I would be inclined to wait so that it coincides with the changes in the eligibility rules, and so acts as a sweetener.



NORMAN LAMONT

(Backbench
laughter)

"I now turn to the special tax regime for subcontractors in the construction industry. Some parts of this diverse, important and successful sector of the economy have had a sustained history of poor tax compliance. So special measures have long been felt necessary to assist the Inland Revenue in combating tax evasion. Many self-employed are required to work under deduction. Others must use official invoices, known as "715s"; and identifying certificates, known as "714s".

The scheme has to balance burdens on firms, commonly small firms, against effectiveness in dealing with tax evasion. The last major overhaul of the scheme came into force in 1977. Since then much has changed in the industry. The number of individuals with "714" certificates has trebled. So the overall cost of the scheme's procedures, for both industry and the Inland Revenue, has greatly increased.

Following consultations with industry representatives, I propose a package of measures which will both reduce burdens on industry and allow the Inland Revenue to target its resources more effectively. For example, subcontractors will no longer have to give an official 715 invoice for every payment, no matter how small. The present experimental arrangements for computer-generated returns will be extended. I estimate that these and other measures set out in the Inland Revenue Press Release will save the industry around [3 million] pieces of paper a year.

I also propose that large construction companies should be removed from the definition of "subcontractor"; and that [far fewer] large non-construction companies should have to operate the scheme as if they were contractors.

These measures should significantly reduce the industry's costs of complying with the scheme. Together with internal procedural changes resulting from an efficiency scrutiny, they should give useful reductions in routine work for the Inland Revenue. [Nevertheless, with less paper to chase, plus new measures to discourage fraud, the Revenue's ability to detect possible tax fraud should actually improve.]

I am also authorising the Inland Revenue to consult, this summer, with the industry on whether the present eligibility rules for both initial and renewed "714" certificates are appropriate and effective in ensuring sound tax compliance by this sector of the self-employed; and on whether the present basic rate of tax deduction from those without certificates takes sufficient account of the level of reliefs and deductions normally available."

C O N F I D E N T I A L

FROM: ROBERT CULPIN
DATE: 3 November 1988

CHANCELLOR

SUB-CONTRACTORS

Ch. I was particularly worried about the (R) FST approach setting us up for a year of whingeing by the building trade. Robert's para 4 sets out the way of overcoming this difficulty. Content to proceed as suggested by FST but with Robert's gloss?

I don't pretend to be on top of sub-contractors but, with one reservation, I agree with the Financial Secretary.

2. I attach a crib. I have a few comments.

3. First, we can deregulate and save staff in 1989 with scarcely any Finance Bill legislation. We can do that by regulation. We should get on and bank it.

4. Second, the experts have never suggested biting off more than that in 1989. The Financial Secretary asked whether we might bring forward some longer term structural proposals, but has now decided we shouldn't. There is no real question of postponing anything.

5. Third, the structural reforms look sensible, but they do require substantial Finance Bill legislation, and do not deregulate or save staff. So I don't see great political benefit in accelerating them. The case for the agreed timetable is not really that anyone is scared of the EDU: it is that the Revenue need time to get things right. I am sure they do: some of the advice so far looks only semi-baked.

6. Fourth - and this is where I depart a bit from the Financial Secretary - the last thing we want is to set ourselves up for a year of lobbying against the structural reforms. So I should certainly not trail them conspicuously in the Budget speech, with all the blather the Revenue have drafted. Clearly we must think about presentation nearer the time. But I guess the thing to do is probably to get the 1989 regulations out of the way first, with (obviously) some publicity at the time, but maybe not a lot of fanfare in the Budget itself, and only then to consult about the structural reforms, in a low key way, and without too much time for opposition to build up.

ROBERT CULPIN

*J 3/11
vkr.*

SUBCONTRACTORS SCRUTINY

The recommendations split into two packages;

- (i) short term measures requiring very little primary legislation but regulations; these have the following benefits
 - (a) staff savings of 265 in the PES period
 - (b) small deregulatory effect
 - (c) likely to be welcome to Industry and EDU.

The scrutineer recommended these be implemented by regulations in 1989. FST's note recommends accepting this timetable.

- (ii) Longer term measures requiring substantial primary legislation. These involve tightening up the eligibility criteria and the renewal (compliance) rules. The intention is to improve the effectiveness of the scheme (and shift from exemption to deduction around 200,000 people in the longer term). This will require a lot of work to draw up sensible, workable rules.

The scrutineer recommended that these measures be implemented by legislation in 1990 to take effect from 1991.

The FST was attracted by the idea of a larger subcontractors package in 1989 and asked the Revenue to consider accelerating the scrutineer's timetable. Officials recommended against this.

The FST has recorded one reason for their view in his note viz that it would divert Revenue resources from implementing the short term measures so pushing back the staff savings. He also touched on the other reasons. These are:

- (i) the need for consultation
- (ii) the need for the Revenue to have time to draw up coherent, watertight, and workable rules. (The scrutineer set the framework, but detailed work is required.)

FST has now recommended sticking to the scrutineer's original timetable ie not accelerating but not postponing.

As far as consultation goes, we do not want a long period of "moaning" but we want discussions - based on detailed proposals - with those who have to operate the scheme. We also want to give subcontractors fair warning that we mean business so that they can get their act together and avoid losing their certificates. (Loss would mean going to the wall for some largish and respectable businesses who would fail to meet strict compliance tests if they were applied now.)

FP would favour a general announcement in the Budget that Ministers are considering the eligibility rules and that they will be bringing forward proposals in due course for consultations prior to FB 1990. But the period of "moaning" would be limited by not issuing proposals too far ahead of the FB 1990.


MARY HAY



FROM: J M G TAYLOR
DATE: 4 November 1988

PS/FINANCIAL SECRETARY

DWP

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Culpin
Mr Gilhooly
Mr Hoare
Miss Hay
Mr Tyrrie

Mr Beighton - IR
Mr Sullivan - IR
PS/IR

SUB-CONTRACTORS EFFICIENCY SCRUTINY

The Chancellor was grateful for the Financial Secretary's note of 31 October.

2. He agrees with the Financial Secretary's general conclusion that we should adopt a two stage approach to implementing the efficiency scrutiny of the sub-contractors deduction and exemption scheme. He agrees that we should implement the package of short-term efficiency measures in the 1989 Finance Bill. However, he would not want to provoke a year of lobbying against the structural reforms, and he is therefore inclined not to trail them conspicuously in the Budget Speech. We shall need to think about presentation later, but this should be generally in a low key.

A handwritten signature, likely 'JMG', in dark ink.

J M G TAYLOR