PO-CH/NL/0571
PART A

PO CH/NL/0571
PART A

CONFIDENTIAL

IMPLENTATION OF THE
KEITH REPORT.

PO CH/NL/0571
PART A

DD's 25yrs NA 5/1/21

BR/14

FROM: A W KUCZYS

DATE: 7 FEBRUARY 1986

This letter will do – many thanks. But I may also want to write to L.Y. to explain why the 6 yr rule is welcome. N.

CHANCELLOR

IMPLEMENTATION OF THE KEITH REPORT

David Howard's minute of 31 January explains, in answer to your question, why the six year rule is necessary. The Minister of State and the Financial Secretary agree with Customs.

2. You wanted to write to Lord Young with a beefed up passage for inclusion in his "lifting the burden" paper. I attach a very short draft. Is this what you had in mind? Or would you prefer a fuller letter?

AWK

A W KUCZYS

BR/013

~~CONFIDENTIAL~~

~~DRAFT~~ LETTER FROM CHANCELLOR TO LORD YOUNG, SECRETARY OF STATE FOR EMPLOYMENT

IMPLEMENTATION OF THE KEITH REPORT

We had a brief word last month about your letter to me of 28 November. I said that we would ensure that the effects of new provisions resulting from Keith are carefully monitored. You will want to include a short passage on Keith in your forthcoming White Paper, including an assurance on this score, and I suggest something on the following lines:

> "The default surcharge on persistently late payment of VAT is to be introduced on 1 October 1986. After this date businesses which pay their VAT late twice will receive a written warning and on a third default without a clear year's interval of timely payment will have a surcharge added to their VAT liabilities. The law provides, however, that a late payment does not count for surcharge purposes if the taxpayer has a reasonable excuse. If the taxpayer's plea of reasonable excuse is not accepted by Customs and Excise, he has the right of appeal to the independent VAT Tribunal. Customs and Excise are particularly concerned that the surcharge is seen to operate fairly, and they will be ensuring that before its introduction every registered VAT business is informed as to how it works and will so have an opportunity to review its accounting and payment system. They will also be closely monitoring the operation and effects of the surcharge and, after a year of practical experience, the system will be brought under review by Ministers before the 1988 Budget."

2. I think it is important now to let the new system come fully into operation, before we try to make further changes.

NIGEL LAWSON

2150/32

PERSONAL

Talk to Vivien

FINANCIAL SECRETARY TO THE TREASURY

FROM: VIVIEN LIFE
DATE: 9 SEPTEMBER 1985

PRINCIPAL PRIVATE SECRETARY

cc PS/Economic Secretary

C. Helpful.

KEITH IMPLEMENTATION

Ro 9/9.

1. You mentioned to me the Chancellor's concern about whether we should in fact be doing Keith for the Inland Revenue in next years Financial Bill. I have not at this stage mentioned this concern to the Revenue, since, judging on past performance, this will lead them to muster their forces to argue unanimously for retaining Inland Revenue Keith in the Bill. Their argument is that if they miss this chance they will hit a pre-election period and may not get another opportunity until 1989.

2. They will also no doubt draw our attention to the fact that the Chancellor gave an unequivocal commitment to include Inland Revenue Keith in the 1986 Finance Bill when describing the VAT Keith changes in his 1985 Budget speech.

3. However, I have commissioned from the Revenue a note on the state of play on Keith and specifically on which items could be implemented straight away and which need to be delayed. This should provide background to decisions on what, if anything, should be included this year.

VAT

VIVIEN LIFE

PERSONAL

V LIFE → PPS 9-9-85

RT8

CONFIDENTIAL

FROM: A W KUCZYS
DATE: 30 October 1985

CHANCELLOR

KEITH

You asked for the meeting to discuss Clive Corlett's draft minute to the Prime Minister and the Economic Secretary's comments on it. Subsequently Clive Corlett has put in a further minute responding to three of the EST's points.

2. I think the first question is whether you want to send the Prime Minister a long minute of this sort. An alternative would be to raise the subject orally with her at a bilateral, drawing on the draft as a speaking note, and possibly following up with a minute on these lines. Assuming that you send the Prime Minister a minute, with or without speaking to her first, the questions are -

(a) Will something on the lines of Clive Corlett's draft do?

(b) You wanted to get across clearly to the Prime Minister the point that, with legislation in 1987, the measures would not actually begin to take effect until well into 1988 - ie. after the election. At present the draft does not make this point clearly, although it may in any case be one that you could more suitably make orally to the Prime Minister.

(c) You thought it might be helpful to attach a synopsis of the proposed consultative document, which you would still want to get out quickly. You could ask the Revenue to provide this, possibly instead of the present summary of Keith recommendations; but there is a danger that the Prime Minister will in any case only read the cover note.

3. The result of the meeting might be that the Revenue would be asked to redraft the note for the PM quickly in the light of discussion, and clear it with the Economic Secretary.

A W KUCZYS

NOTE OF A MEETING HELD IN 11 DOWNING STREET ON 31 OCTOBER 1985

Those present:

Chancellor
Financial Secretary
Economic Secretary
Sir P Middleton
Miss Sinclair
Mr Cropper

Mr Isaac (IR)
Mr Corlett (IR)

IMPLEMENTATION OF THE KEITH REPORT

The meeting discussed the draft minute for the Chancellor to send to the Prime Minister circulated by Mr Corlett on 25 October.

2. The Economic Secretary explained that he was having detailed discussions on the proposed legislation with Inland Revenue. He agreed with the Revenue that the legislation should be presented as a single package, not spread over two years, but it was now inpracticable to aim for inclusion in the 1986 Finance Bill. Mr Isaac agreed, but said that we were now coming under increasing outside pressure to make an announcement of some sort.

3. The Chancellor said he agreed that it was sensible to present these measures as a single package, and that an announcement of the intention to defer legislation until 1987 should be made as soon as possible. Two questions which needed to be settled were:-

(a) when should we aim to put out the consultative document (it was important to avoid too long a consultation period)?

(b) whether the date of the next Election affected the prospects for legislation in 1987? The important point here was when those parts of the package which would adversely affect taxpayers would bite.

4. On the second of these points, Mr Isaac said there was some choice. The main element in the package was the charge on late payment of PAYE, which could not take effect until 1990. But other aspects could either take effect from Royal Assent, or from the following April, or from a later date. In his view, tax practitioners were anxious to see what was in store for them - which pointed to early consultation - but would then want plenty of time to absorb the changes - which pointed to a late implementation date. The Chancellor said that these points should be reflected in the minute to the Prime Minister.

5. The Economic Secretary said he would like the Keith proposal on directors' PAYE considered for the 1986 Budget, although it might seem more sensible to incorporate it in the 1987 package. Mr Isaac said that this proposal had actually been delayed by the existence of Keith, and that it could be implemented without consultation. The Chancellor concluded that he would not bring this particular point to the Prime Minister's attention, but if he was unable to persuade the Prime Minister on the merits of the whole package in 1987, then this measure should be considered as a Starter for 1986.

6. There was some discussion of the benefits to be gained from the Keith package. It was not a major Revenue raiser. Mr Corlett said that, at a cost of 65 pages of legislation, it would only bring in about £50 million a year in penalties and interest, plus an unquantifiable benefit of additional tax collected. In the longer term there would be administrative savings from the "pay and file" proposal.

Draft minute to Prime Minister

7. In discussion, the Chancellor made some drafting points on the minute to the Prime Minister. In particular, the present annex should be replaced by a synopsis of the consultative document proposals in schedular form, and without going into detail. If

there were any important points in the present annex not brought out in the main note, they should be incorporated in the latter.

Conclusions

8. Mr Corlett was asked to redraft the minute to the Prime Minister in the light of the discussion. The aim would then be to announce the decision to defer legislation by a year - perhaps by Written Answer - as soon as possible after the Chancellor had secured the Prime Minister's agreement. The consultative document, including draft Clauses, should be published in the Summer of 1986, after the Committee Stage of the Finance Bill - perhaps in July or August. Before that, the Revenue could consult the representative bodies on a confidential basis, so that the draft legislation when published would already be substantially agreed.

A tax amnesty

9. The Prime Minister had asked separately for a note on the idea of a "tax amnesty". Mr Corlett explained that, for an amnesty to work, there had to be the prospect of increased Revenue powers to give people an incentive to come forward. He had therefore seen this request as inextricably linked with the Keith proposals. The Financial Secretary pointed out that the Keith Report had explicitly rejected the idea of an amnesty.

10. The Chancellor said that the Prime Minister had not raised the idea of an amnesty in the context of Keith, but rather as a means of helping people who felt "trapped" in the Black Economy because of all the back tax and penalties they would have to pay if they came forward. He asked Mr Corlett to provide a separate draft note for the Prime Minister, as soon as possible, on this basis.

AWK

A W KUCZYS
November 1985

3762/9

BUDGET CONFIDENTIAL

FROM: P D P BARNES
DATE: 12 March 1987

PS/CHANCELLOR

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Cropper
Mr Ross Goobey
Mr Corlett, IR

KEITH: PAY AND FILE: SYMMETRY

Thank you for your minute of 12 March, which the Economic Secretary has seen.

2. The Chancellor is right that "until" means "unless".

PB

P D P BARNES
Private Secretary

Corlett on EST comments

FROM: P D P BARNES
DATE: 4 December 1986

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Financial Seceretary
PS/Minister of State
Miss Sinclair
Mr Cropper

KEITH : PUBLICATION OF CONSULTATIVE DOCUMENT

You will have seen Mr Corlett's submission to the Economic Secretary of today's date (below)

2. The Economic Secretary would be grateful for the views of the Chancellor and other Ministers about the wisdom of making a provisional commitment to legislate on Pay and File and PAYE/sub-contractors in their 1987 finance bill. He thinks it would be wiser to make the commitment less categorical, along the lines of "the Government is considering giving priority to ... in the 1987 Finance Bill." X

3. The Economic Secretary would also prefer to avoid the morning of the day of Oral Questions for the publication of the consultative document. Y

4. It would be helpful if it were possible to have Ministers' views by early tomorrow morning in order to allow the Revenue time to make arrangements for publication. I apologise for the short notice.

Ch

I think EST is right on 'Y'.
But as to 'X', I don't think the draft press release does commit us to legislation in 1987.
(However, no harm in toning it down as EST suggests)
AWK

PB

P D P BARNES
Private Secretary

Inland Revenue

Policy Division
Somerset House

FROM: C W CORLETT
FAX No. 6766
EXTN. 6614
4 December 1986

1. MR ISAAC Seen in draft

2. ECONOMIC SECRETARY

KEITH : PUBLICATION OF CONSULTATIVE DOCUMENT

1. The Keith Consultative Document should be ready for publication by HMSO in the middle of next week. We provisionally suggest Thursday 11 December, subject to clearance with No 10 (which I assume your Office will arrange).

2. Decisions are now needed on -

i. what (if anything) should be said about a possible 1987 Finance Bill package

ii. the terms of the announcement and publicity arrangements (if any).

---

cc Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State
Sir Peter Middleton
Mr Cassell
Mr Scholar
Miss Sinclair
Mr Towers
Mr Cropper
Mr Ross Goobey
Mr Tyrie
Mr Graham - Parliamentary Counsel
PS/Customs & Excise

Mr Battishill
Mr Isaac
Mr Rogers
Mr Pollard
Mr Miller
Mr Beighton
Mr McGivern
Mr Houghton
Mr Pitts
Mr Cherry
Mr Sullivan
Mr Roberts
Mr Matheson
Mr Stewart
Mr Elliott
Mr Bush
Mr Hinson
Ms Tyrrell
Mr O'Hare
Miss Barlow
PS/IR
Mr Corlett

1987 Finance Bill

3. While recognising the general case for avoiding Finance Bill commitments at this stage, it is difficult to see how the Document can be published without some indication of the Government's legislative intentions -

- In the absence of any statement, it might well be assumed outside that all the Clauses are liable to be included in the forthcoming Bill. That could create unnecessary concern, and even hostility, given the the relatively short time available for consultation.

- Neither we nor the representative bodies would be able to handle proposals on that sort of scale within the next couple of months.

4. In practice, the likelihood is that Ministers would be drawn anyway, by external pressure, into making an early announcement about the prospects for 1987. It would be better for the statement to be made without duress, on publication.

PQ, Press Notice and Briefing

5. The Consultative Document simply invites views on its contents, giving neither indication of timing and packaging nor dates by which comments should be made. If you agree that some statement should be made, we assume that you will do that by way of an arranged PQ and an associated press release, on the day of publication; and we assume you do not wish for a high profile launch.

6. Accordingly, I attach -

a. A draft PQ and A which announces

publication; makes it clear that there is no question of implementing the whole of Keith in a single Finance Bill; indicates that Ministers are considering (but have not yet decided on) including an initial package (pay and file, and PAYE/subcontractors) in the 1987 Bill; and invites comments on that package by mid-February and on the rest of the proposals on a much longer timescale (next October).

b. A draft press notice which draws out the main points from the Statement; gives a brief description of the proposals for Finance Bill 1987; and annexes the full text of the Answer, a summary of the main proposals in the Document and a signpost to the draft clauses on pay and file/PAYE/subcontractors.

7. You will want to consider whether the draft statement catches the right tone. It is a deliberately flattish presentation. And, unless you thought otherwise, we would not see this as an occasion for a Revenue press conference at Somerset House, though we might want to talk to one or two journalists from the specialist Press. We also think it would be a good idea for us to speak to a few influential practitioners, such as John Avery Jones, Iain Stitt, Robin Ivison, Roger White and Philip Hardman, to try to encourage a positive response.

The provisional 1987 package

8. You may find it helpful to have a reminder of what the 1987 package would consist of, in the light of provisional proposals in the announcement.

Pay and File (including penalty assessment)

9. The basic Pay and File Clauses (9 in all) make up, first, the "Pay" element of payment in advance of assessment and mirror image interest; and, second, the "File" element

of 12 month time limit for production of returns and accounts and the late filing penalty.

10. But the Pay and File package also includes three draft clauses which, as an alternative to the present cumbersome procedures, would enable us to assess and recover penalties in approximately the same way as we presently assess and recover tax. They would also provide the taxpayer with a right of appeal against a penalty assessment.

11. Pay and File requires the support of these latter provisions, which are essential to its cost effective operation. They were, however, drafted as part of the overall Keith design and therefore apply, not just to Pay and File, but also to the whole gamut of penalties in the Taxes Management Act. The clauses could, if Ministers so wish, be amended to restrict them to Pay and File only, but it would be useful to retain their generally uncontroversial streamlining and simplification of the penalty machinery. So we recommend waiting and seeing what the reaction is to them in their wider form.

12. Part of a fourth clause would also be needed to prevent a mismatch between the new provisions for recovery of assessed penalties and the existing provisions for recovery of penalties by proceedings. Again, we think it would be simplest to ask for early comments on the whole clause. A fifth clause deals with a minor technical defect in existing legislation relevant to 'pay and file' penalties.

13. Other Finance Bill measures might well interact with the drafting of the "Pay and File" clauses as they affect pre-1985 companies. Whether or not this was so, there would be no effect on the terms of the consultative document and this press release. But some re-drafting might be necessary when it comes to the Finance Bill.

14. It is not possible to be specific at this stage as to when pay and file could be introduced, mainly because - as

you know - it is dependent upon the progress of our departmental computerisation programme, especially BROCS (which is the project which replaces and modernises the various computer systems we have at present for dealing with tax payments). Our judgment at present is that the necessary basic computer support in our assessment and collection system should be available by 1992, and it might then be possible to slot pay and file into the timetable - rephasing accordingly some of the other enhancements to the collection system. There will in any event be some costs in developing pay and file, starting some 3 years before implementation. It will not be possible to take firm decisions on the timing of implementation of pay and file until we are further down the track with those parts of our new computer system which are needed to support its development.

PAYE/subcontractors

15. The PAYE/subcontractors part of the package comprises -

a. interest on PAYE paid late in the limited circumstances where the Inspector has had to assess the amount due because PAYE has not been properly applied at the right time by the employer. This will mostly relate to tax on payments to a minority of directors in small, director-controlled, companies where there has been consistent delay of (often) up to 2 or 3 years in applying PAYE. It will apply also to some other cases. The interest charge will commence from a date 14 days after the end of the income tax year to which the tax relates.

b. a power to clarify what constitutes a "payment" for PAYE purposes. In addition to cash, payment would include the crediting (with or without a fetter) of sums to the account of an employee (including a director) and the voting of remuneration (whether paid or not);

c. a number of sub-contractor provisions, including -

- a requirement for companies which have an exemption certificate to notify the Revenue where there is any change in control of the company

- an interest charge on assessments made by the Inspector to recover money which a contractor should have deducted from payments to sub-contractors but did not.

16. You may recall that the original 'package A' we suggested last July contained several other measures - about notification of sources of income, Schedule E returns, interest on overdue tax and a criminal offence of moonlighting. These measures were added to 'Pay and File' and PAYE fairly much as makeweights to provide relatively balanced packages. Without a public indication of how packages in subsequent years would be comprised, this package would be difficult to defend. We imagine you would not now want to give such an indication. There are difficult areas in some of these measures, on which longer consultation might not come amiss. We therefore recommend reducing package A to its 'Pay and File' element (needed for forward planning) and its PAYE and subcontractor element (with an appreciable future year cash flow yield) as in paragraphs 8-13 above.

Keith Committee members

17. The consultative document will, of course, be of considerable interest to the surviving members of the Keith Committee. You may agree that it would be an appropriate gesture to send each of them a complimentary copy. If so, and you would prefer to write to them direct, we shall prepare covering letters for you to send on publication. Alternatively the copies could be sent from here.

Conclusion

18. We seek your views on whether -

i. we should plan for publication on 11 December, (subject to clearance with No 10);

ii. there should be some Ministerial indication that a "Pay and File" and PAYE/subcontractor package is a possible candidate for the 1987 Bill, while the rest of the Keith package is not;

iii. the terms of the attached draft statement and press release are acceptable.

iv. you or we should send copies of the document to the members of the Keith Committee.

C W CORLETT

INLAND REVENUE

Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01-438 6692 OR 6706

December 1986

RESPONSE TO KEITH COMMITTEE REPORT

Ian Stewart MP, Economic Secretary to the Treasury, announced the publication today of detailed proposals in response to the Keith Committee's recommendations on the Inland Revenue's enforcement powers.

In reply to a Parliamentary Question the Economic Secretary made clear that the proposals outlined in the Inland Revenue's Consultative Document could not be implemented in a single Finance Bill. He said "Subject to reactions to the proposals, the Government are considering the inclusion in the 1987 Finance Bill of those clauses which would streamline the administration of corporation tax and improve the effectiveness of the PAYE and sub-contractor deduction schemes."

(The full text of the Parliamentary Question and Answer is in the attached annex).

MAIN POINTS OF THE PROPOSALS

1. The Inland Revenue Consultative Document makes proposals in response to the recommendations of the Keith Committee on income tax, capital gains tax and corporation tax. A summary of the proposals and a description of the consultative document are contained in the annex.

Proposals for 1987

2. The proposals being considered for possible legislation in 1987 are:

Streamlining the administration of corporation tax (referred to as "Pay and File");

- a company to pay its tax by a fixed date, whether or not an assessment has been made;
- interest to run from the same fixed date
  - on tax paid late by the company
  - on tax repaid to the company;

- the changes to come into effect when new Inland Revenue computer systems now being developed are operational;

Improving effectiveness of the PAYE and sub-contractor deduction scheme

- interest to be charged on PAYE and sub-contractor deductions paid late where, because the scheme has not been operated properly, a formal assessment has had to be made;

- clarification of the circumstances in which PAYE tax should be deducted;

- measures to improve the control of sub-contractors' tax certificates, including a new right of appeal.

The annex shows which of the draft clauses in the consultative document are relevant to these proposals.

Comments on these proposals are invited by 13 February 1987.

Other proposals

3. The annex sets out all the main proposals. These touch on the following areas:

- notification of liability to tax;

- personal income tax returns;

- business accounts and returns;

- PAYE and sub-contractor deduction scheme;

- information needed to establish tax liability;

- privacy;

- penalties for tax offences;

- re-opening of assessments.

Comments on these proposals are requested by 31 October 1987

4. Comments on all proposals should be sent to Inland Revenue, Policy Division 2, Room 17 New Wing, Somerset House, London, WC2R 1LB.

5. The Consultative Document "The Inland Revenue and the Taxpayer" is available from Her Majesty's Stationery Office, price £8.50.

operational for some years. Further details are given in an Inland Revenue press release issued today.

Comments on the clauses which are being considered for inclusion in the 1987 Finance Bill are invited by 13 February 1987. Comments on the rest of the consultative document are invited by 31 October 1987.

NOTES FOR EDITORS

1. The Keith Committee on the Enforcement Powers of the Revenue Departments was set up in July 1980 to enquire into the tax enforcement powers of the Board of Inland Revenue and Board of Customs and Excise. It was chaired by a Law Lord, Lord Keith of Kinkel PC. The Committee took evidence from bodies representing industry, trade, the professions and trade unions, as well as from individuals and from the Revenue Departments.

2, The Committee's Report is in 4 Volumes. Volumes 1 and 2 were published (Cmnd 8822) on 23 March 1983 and covered income tax, corporation tax, capital gains tax and VAT. Volume 3 (Cmnd 9120) was published on 18 January 1984 and dealt with development land tax, petroleum revenue tax, capital transfer tax and stamp duties. Volume 4 (Cmnd 9940) was published on 13 February 1984 and dealt with customs duties, excise duties and car tax.

3. Following publication of the first two volumes, Ministers invited interested parties to submit comments by the end of 1983, as a result of which consultations were held with a number of representative bodies.

4. In November 1984, Customs and Excise issued a consultative document on the VAT recommendations, which was followed by legislation in the 1985 Finance Act.

5. Further consultations have taken place during the past 2 years on the much larger number of recommendations on income tax, capital gains tax and corporation tax.

6. The full text of the Parliamentary Question and Answer was as follows:-

To ask Mr Chancellor of the Exchequer - when it is intended to publish draft proposals for implementing the Inland Revenue aspects of Volumes 1 and 2 of the Keith Committee Report.

The Inland Revenue are, with my approval, today issuing a consultative document, entitled "The Inland Revenue and the Taxpayer", containing detailed proposals in response to the income tax, capital gains tax and corporation tax recommendations of the Keith Committee. These proposals follow detailed consultations with a number of representative bodies over the last two years.

The extent of the Committee's review, which covered the whole range of the Inland Revenue's enforcement powers, is reflected in the 46 draft clauses and 2 Schedules included in the consultative document. It is not feasible to implement changes of this magnitude in a single Finance Bill. Subject to reactions to the proposals, the Government are considering the inclusion in the 1987 Finance Bill of those clauses which streamline the administration of corporation tax and improve the effectiveness of the PAYE and sub-contractor deduction schemes. The corporation tax proposals are part of a wider programme of reform, including new computer systems, which will not be

THE INLAND REVENUE AND THE TAXPAYER

This annex outlines the structure of the consultative document; summarises its main proposals; and indicates which of its draft clauses are relevant to matters for possible inclusion in the 1987 Finance Bill.

STRUCTURE OF THE CONSULTATIVE DOCUMENT

The document has six sections and three appendices.

Section 1 is a detailed overview of the proposals and how they would change present law or practice in the tax compliance and enforcement fields.

Section 2 summarises these proposals. This summary is reproduced below.

Section 3 provides a detailed technical commentary on the draft clauses contained in **Section 4.**

Section 5 discusses recommendations by the Keith Committee which need no legislation to implement them.

Section 6 discusses recommendations which are rejected or which are felt to need further consideration.

Appendix I tabulates the Keith Committee recommendations and indicates the response.

Appendix II describes the nature and terms of reference of the Keith Committee.

Appendix III describes the process of consultation that has been undertaken since the Report was published.

PROPOSALS

Of the Keith Committee's 99 recommendations, the proposals involve accepting 72 in whole or in part, though sometimes with modifications. 18 recommendations are thought to require further consideration. 13 recommendations are wholly or partly rejected. The following is a summary of the main proposals:

Notification of liability to tax

- It should be made clearer in law that there is a general obligation to tell the Inland Revenue about every source of income.

- The amount of the penalty for failing to declare a source of income should be related to the amount of tax involved.

- Comments are invited on whether to introduce a new summary criminal offence to be used against those who deliberately fail to declare their sources of income to the Inland Revenue.

Personal Income Tax Returns

- The Inland Revenue should carry out a pilot scheme to test whether issuing tax returns to more people is an effective way of bringing to light income which has not been declared.

Business Accounts and Returns

- A company should be required by law to send to the Inland Revenue a copy of its accounts with its return.

- There should be a move to a "pay and file" system for corporation tax, under which a company would pay its tax on a provisional basis on a fixed date, generally before filing its return and accounts. Interest would be paid by, or charged to, the company from that date on over or underpayments when the final liability is settled.

- A daily penalty would be payable where accounts were not submitted within 12 months.

- An additional tax related penalty would be imposed where the delay exceeded 12 months.

- There should be a new form of penalty, related to the amount of tax involved, where a company had delayed sending in returns of advance corporation tax and company income tax payments.

Business Books and Records

- Businesses should be required to keep books and records for tax purposes, and to retain them for 6 years.

- Businesses should be required, if necessary, to produce those books and records for inspection by the Inland Revenue.

- It should be made clear that where the Inland Revenue are able to obtain information they should have the same right of access to that information when held on a business's computers.

PAYE: and Sub-contractor Deduction Scheme

- Interest should be charged on PAYE tax paid late, in a limited range of cases where the employer has failed to operate PAYE properly and the tax has had to be formally assessed on him by the Inspector.

- The circumstances in which PAYE tax should be deducted from certain payments (such as fees or bonuses voted or credited to a director) should be clarified.

- The rules of the deduction scheme for sub-contractors working in the construction industry should be kept broadly in line with those for PAYE.

Information needed to establish tax liability

- The Inland Revenue should be permitted to ask for information relevant to tax liabilities without first obtaining the permission of an Appeal Commissioner, except where a private individual is asked to supply information about another person (a 'third party').

- Except where fraud is suspected, the Inland Revenue should always notify a taxpayer if they have asked a third party for information about him.

- Anyone asked to supply information should have a right of appeal to the Appeal Commissioners against disclosing it.

- Any taxpayer about whom information is sought should have a right to appeal to the Appeal Commissioners that the third party should not have to disclose it.

- The Inland Revenue should in certain circumstances reimburse a third party's costs in providing information about another taxpayer.

- Comments are invited on whether the Inland Revenue should be able to obtain information relevant to tax from other Government departments and public authorities, and if so what controls on the scope and type of information would be required to protect the individual.

Privacy

- The Inland Revenue's present ability to search premises should be restricted by giving a Circuit Judge from whom a search warrant must at present be obtained the power to specify when a search can be carried out.

- Where the premises to be searched are those of an unsuspected third party, the Judge should have the right to grant an order requiring production of the information, as an alternative to granting a search warrant.

- Where the Inland Revenue have a warrant to search premises they should, subject to appropriate safeguards, be able to search persons on those premises.

- A Circuit Judge should be able to specify the number of Inland Revenue officers who may take part in a search.

- The protection of legal professional privilege should be generally available for advice on tax matters.

- Comments are invited on the suggested scheme to subject legal privilege to a limited restriction, in order to enable facts relevant to tax to be established.

- Comments are invited on whether to allow protection, equivalent to legal privilege, for tax advice given by certain tax agents.

Penalties for Tax Offences

- There should be three categories of tax offence where incorrect tax returns are made -

    a. fraud

    b. negligence

    c. negligence where the omission is less than £1000.

- The maximum penalty for fraud should be reduced from 200 per cent to 100 per cent of the tax evaded.

- Where a taxpayer co-operates in the investigation of a fraud, the Inland Revenue should be enabled by law to mitigate the penalty down to 50 per cent of the tax underpaid.

- The maximum penalty for negligence should be reduced from 100 per cent to 40 per cent of the tax underpaid.

- To reflect taxpayer co-operation in the investigation, the Inland Revenue should be enabled by law to mitigate the penalty for negligence down to 20 per cent of the tax underpaid.

- There should be no penalty where a taxpayer's negligent omission of income or gains is less than £1000, unless the offence is repeated.

- There should be no penalties where a taxpayer makes an innocent error.

- The procedures under which the Inland Revenue charge penalties should be simplified, by enabling the penalties to be included in an assessment.

- Taxpayers should have the right of appeal against an assessment for penalties.

- Comments are invited about whether the penalty for negligence should be capable of being mitigated further by law, that is to below 20 per cent, where a taxpayer has voluntarily disclosed an omission from his return.

Reopening of Assessments

- The circumstances in which the Inland Revenue should be able to make an assessment to recover tax where a person has not been properly assessed should be set out in legislation.

- A taxpayer receiving such an assessment should have the right to make or revise a claim for relief for the period to which the assessment relates.

PROPOSALS BEING CONSIDERED FOR POSSIBLE LEGISLATION IN 1987

Only some of the draft clauses in the consultative document are relevant to the areas the Government are considering for the 1987 Finance Bill.

Streamlining the administration of corporation tax

Clauses 4, 18, 25-28, 30-33, 38, 40 and 45 are relevant to the "Pay and File" system mentioned above and discussed in more detail in the consultative document.

Some of these clauses, as currently drafted, would have effect beyond "Pay and File". For example, clauses 25-27 support the cost-effective operation of "Pay and File", by allowing penalties to be recovered by assessment in much the same way as tax is assessed and recovered, but would have general effect; and part of clause 28 would be needed to prevent a mismatch between these penalty assessing provisions and the existing regime for recovering penalties.

Other clauses contain measures not central to "Pay and File". For example, clauses 32 and 38, as currently drafted, contain provisions involving Section 286 of the Income and Corporation Taxes Act 1970, which are not candidates for early legislation.

Improving the effectiveness of the PAYE and sub-contractor deduction schemes

Clause 41 would allow an interest charge to be imposed on PAYE paid late, in the limited circumstances where the Inspector has formally determined the amount due because PAYE had not been properly applied at the right time by the employer. The interest charged would commence 14 days after the end of the tax year to which the tax relates. The provision would most commonly involve payments to directors in small companies.

Clause 41 would also allow for the meaning of "payment" for PAYE purposes to be clarified - for example, where sums are credited to an employee's account or remuneration is voted.

Under clause 42, companies with a sub-contractor tax exemption certificate would be required to notify the Revenue of a change of company control, with a Revenue sanction of withdrawal of the company's certificate. There would be a new right of appeal against the Revenue's cancellation of sub-contractor certificates. The Revenue would be empowered to require the production etc of contractor's records.

The clause 41 PAYE regulation-making powers would also allow for an interest charge on assessments made by the Inspector to recover money which a contractor should have deducted from payments to sub-contractors.

ARRANGED PQ

To ask Mr Chancellor of the Exchequer - when it is intended to publish draft proposals for implementing the Inland Revenue aspects of Volumes 1 and 2 of the Keith Committee Report.

The Inland Revenue are, with my approval, today issuing a consultative document, entitled "The Inland Revenue and the Taxpayer", containing detailed proposals in response to the income tax, capital gains tax and corporation tax recommendations of the Keith Committee. These proposals follow detailed consultations with a number of representative bodies over the last two years.

The extent of the Committee's review, which covered the whole range of the Inland Revenue's enforcement powers, is reflected in the 46 draft clauses and 2 Schedules included in the consultative document. It is not feasible to implement changes of this magnitude in a single Finance Bill. Subject to reactions to the proposals, the Government are considering the inclusion in the 1987 Finance Bill of those clauses which streamline the administration of corporation tax and improve the effectiveness of the PAYE and sub-contractor deduction schemes. The corporation tax proposals are part of a wider programme of reform, including new computer systems which will not be operational for some years. Further details are given in an Inland Revenue press release issued today.

Comments on the clauses which are being considered for inclusion in the 1987 Finance Bill are invited by 13 February 1987. Comments on the rest of the consultative document are invited by 31 October 1987.

2CDS22

Inland Revenue

Policy Division
Somerset House

FROM J O'HARE
EXT 6694
DATE 12 DECEMBER 1986

PS/CHANCELLOR OF THE EXCHEQUER

KEITH COMMITTEE : CONSULTATIVE DOCUMENT

1. The Inland Revenue response to the Keith Committee's recommendations affecting direct taxes in volumes 1 and 2 of its Report has been published today.

2. I enclose a copy of the Consultative Document which the Chancellor may wish to see. If he does not wish to retain this I should be grateful if you would return the copy to me.

3. I also enclose a copy of our Press Release.

J O'HARE

Nigel

PS return the book to Mr O'Hare

AJK

INLAND REVENUE

Press Release

INLAND REVENUE PRESS OFFICE, SOMERSET HOUSE, STRAND, LONDON WC2R 1LB
PHONE: 01–438 6692 OR 6706

12 December 1986

RESPONSE TO KEITH COMMITTEE REPORT

Ian Stewart MP, Economic Secretary to the Treasury, announced the publication today of detailed proposals in response to the Keith Committee's recommendations on the Inland Revenue's powers.

In reply to a Parliamentary Question the Economic Secretary made clear that it would not be feasible to implement changes of the magnitude outlined in the Inland Revenue's Consultative Document in a single Finance Bill. He said "Subject to reactions to the proposals, the Government are considering giving priority to those clauses which would streamline the administration of corporation tax and improve the effectiveness of the PAYE and sub-contractor deduction schemes."

(The text of the Written Answer is in the Notes for Editors).

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1. The Inland Revenue Consultative Document makes proposals in response to the recommendations of the Keith Committee on income tax, capital gains tax and corporation tax. A summary of the proposals and a description of the consultative document are contained in the attached annex.

Possible Priority proposals

2. The proposals to which the Government are considering giving priority are:

Streamlining the administration of corporation tax (referred to as "Pay and File");

- a company to pay its tax by a fixed date, whether or not an assessment has been made;
- interest to run from the same fixed date
  - on tax paid late by the company
  - on tax repaid to the company;

/ The changes

- the changes to come into effect when new Inland Revenue computer systems now being developed are operational;

Improving effectiveness of the PAYE and sub-contractor deduction schemes

- interest to be charged on PAYE and sub-contractor deductions paid late where, because the scheme has not been operated properly, a formal assessment has had to be made;

- clarification of the circumstances in which PAYE tax should be deducted;

- measures to improve the control of sub-contractors' tax certificates, including a new right of appeal.

The annex shows which of the draft clauses in the consultative document are relevant to these proposals.

Comments on these proposals are invited by 13 February 1987.

Other proposals

3. The annex also sets out all the main proposals. These touch on the following areas:

- notification of liability to tax;

- personal income tax returns;

- business accounts and returns;

- PAYE and sub-contractor deduction schemes;

- information needed to establish tax liability;

- privacy;

- penalties for tax offences;

- re-opening of assessments.

Comments on the remaining proposals are invited by 31 October 1987

4. Comments on all proposals should be sent to Inland Revenue, Policy Division 2, Room 17 New Wing, Somerset House, London, WC2R 1LB.

5. The Consultative Document "The Inland Revenue and the Taxpayer" is available from Her Majesty's Stationery Office, price £8.50.

/NOTES FOR EDITORS

NOTES FOR EDITORS

The Keith Report

1. The Keith Committee on the Enforcement Powers of the Revenue Departments was set up in July 1980 to enquire into the tax enforcement powers of the Board of Inland Revenue and Board of Customs and Excise. It was chaired by a Law Lord, Lord Keith of Kinkel PC. The Committee took evidence from bodies representing industry, trade, the professions and trade unions, as well as from individuals and from the Revenue Departments.

2. The Committee's Report is in 4 Volumes. Volumes 1 and 2 were published (Cmnd 8822) on 23 March 1983 and covered income tax, corporation tax, capital gains tax and VAT. Volume 3 (Cmnd 9120) was published on 18 January 1984 and dealt with development land tax, petroleum revenue tax, capital transfer tax and stamp duties. Volume 4 (Cmnd 9940) was published on 13 February 1984 and dealt with customs duties, excise duties and car tax.

3. Following publication of the first two volumes, Ministers invited interested parties to submit comments by the end of 1983, as a result of which consultations were held with a number of representative bodies.

4. In November 1984, Customs and Excise issued a consultative document on the VAT recommendations, which was followed by legislation in the 1985 Finance Act.

5. Further consultations have taken place during the past 2 years on the much larger number of recommendations on income tax, capital gains tax and corporation tax.

The Written Answer

6. The text of the Written Answer given by the Economic Secretary to the Treasury, Mr Ian Stewart was:

"The Inland Revenue are, with my approval, today issuing a consultative document, entitled "The Inland Revenue and the Taxpayer", containing detailed proposals in response to the income tax, capital gains tax and corporation tax recommendations of the Keith Committee. These proposals follow detailed consultations with a number of representative bodies over the last two years.

/The extent

The extent of the Committee's review, which covered the whole range of the Inland Revenue's powers, is reflected in the 46 draft clauses and 2 Schedules included in the consultative document. It is not feasible to implement changes of this magnitude in a single Finance Bill. Subject to reactions to the proposals, the Government are considering giving priority to those clauses which streamline the administration of corporation tax and improve the effectiveness of the PAYE and sub-contractor deduction schemes. The corporation tax proposals are part of a wider programme of reform, including new computer systems, which will not be operational for some years. Further details are given in an Inland Revenue press release issued today."

/Annex

THE INLAND REVENUE AND THE TAXPAYER

This annex outlines the structure of the consultative document; summarises its main proposals; and indicates to which of its draft clauses the Government are considering giving priority.

STRUCTURE OF THE CONSULTATIVE DOCUMENT

The document has six sections and three appendices.

Section 1 is a detailed overview of the proposals and how they would change present law or practice in the tax compliance and enforcement fields.

Section 2 summarises these proposals. This summary is reproduced below.

Section 3 provides a detailed technical commentary on the draft clauses contained in **Section 4.**

Section 5 discusses recommendations by the Keith Committee which need no legislation to implement them.

Section 6 discusses recommendations which are rejected or which are felt to need further consideration.

Appendix I tabulates the Keith Committee recommendations and indicates the response.

Appendix II describes the nature and terms of reference of the Keith Committee.

Appendix III describes the process of consultation that has been undertaken since the Report was published.

/PROPOSALS

PROPOSALS

Of the Keith Committee's 99 recommendations, the proposals involve accepting 72 in whole or in part, though sometimes with modifications. 18 recommendations are thought to require further consideration. 13 recommendations are wholly or partly rejected.

The following is a summary of the main proposals:

Notification of liability to tax

- It should be made clearer in law that there is a general obligation to tell the Inland Revenue about every source of income.

- The amount of the penalty for failing to declare a source of income should be related to the amount of tax involved.

- Comments are invited on whether to introduce a new summary criminal offence to be used against those who deliberately fail to declare their sources of income to the Inland Revenue.

Personal Income Tax Returns

- The Inland Revenue should carry out a pilot scheme to test whether issuing tax returns to more people is an effective way of bringing to light income which has not been declared.

Business Accounts and Returns

- A company should be required by law to send to the Inland Revenue a copy of its accounts with its return.

- There should be a move to a "Pay and File" system for corporation tax, under which a company would pay its tax on a provisional basis on a fixed date, generally before filing its return and accounts. Interest would be paid by, or charged to, the company from that date on over or underpayments when the final liability is settled.

- A daily penalty would be payable where accounts were not submitted within 12 months.

- An additional tax related penalty would be imposed where the delay exceeded 12 months.

/ - There

- There should be a new form of penalty, related to the amount of tax involved, where a company had delayed sending in returns of advance corporation tax and company income tax payments.

Business Books and Records

- Businesses should be required to keep books and records for tax purposes, and to retain them for 6 years.

- Businesses should be required, if necessary, to produce those books and records for inspection by the Inland Revenue.

- It should be made clear that where the Inland Revenue are able to obtain information they should have the same right of access to that information when held on a business's computers.

PAYE: and Sub-contractor Deduction Schemes

- Interest should be charged on PAYE tax paid late, in a limited range of cases where the employer has failed to operate PAYE properly and the tax has had to be formally assessed on him by the Inspector.

- The circumstances in which PAYE tax should be deducted from certain payments (such as fees or bonuses voted or credited to a director) should be clarified.

- The rules of the deduction scheme for sub-contractors working in the construction industry should be kept broadly in line with those for PAYE.

Information needed to establish tax liability

- The Inland Revenue should be permitted to ask for information relevant to tax liabilities without first obtaining the permission of an Appeal Commissioner, except where a private individual is asked to supply information about another person (a 'third party').

- Except where fraud is suspected, the Inland Revenue should always notify a taxpayer if they have asked a third party for information about him.

- Anyone asked to supply information should have a right of appeal to the Appeal Commissioners against disclosing it.

- Any taxpayer about whom information is sought should have a right to appeal to the Appeal Commissioners that the third party should not have to disclose it.

/ - The Inland Revenue

- The Inland Revenue should in certain circumstances reimburse a third party's costs in providing information about another taxpayer.

- Comments are invited on whether the Inland Revenue should be able to obtain information relevant to tax from other Government departments and public authorities, and if so what controls on the scope and type of information would be required to protect the individual.

Privacy

- The Inland Revenue's present ability to search premises should be restricted by giving a Circuit Judge from whom a search warrant must at present be obtained the power to specify when a search can be carried out.

- Where the premises to be searched are those of an unsuspected third party, the Judge should have the right to grant an order requiring production of the information, as an alternative to granting a search warrant.

- Where the Inland Revenue have a warrant to search premises they should, subject to appropriate safeguards, be able to search persons on those premises.

- A Circuit Judge should be able to specify the number of Inland Revenue officers who may take part in a search.

- The protection of legal professional privilege should be generally available for advice on tax matters.

- Comments are invited on the suggested scheme to subject legal privilege to a limited restriction, in order to enable facts relevant to tax to be established.

- Comments are invited on whether to allow protection, equivalent to legal privilege, for tax advice given by certain tax agents.

Penalties for Tax Offences

- There should be three categories of tax offence where incorrect tax returns are made -

    a. fraud

    b. negligence

    c. negligence where the omission is less than £1000.

/ - The maximum

- The maximum penalty for fraud should be reduced from 200 per cent to 100 per cent of the tax evaded.

- Where a taxpayer co-operates in the investigation of a fraud, the Inland Revenue should be enabled by law to mitigate the penalty down to 50 per cent of the tax underpaid.

- The maximum penalty for negligence should be reduced from 100 per cent to 40 per cent of the tax underpaid.

- To reflect taxpayer co-operation in the investigation, the Inland Revenue should be enabled by law to mitigate the penalty for negligence down to 20 per cent of the tax underpaid.

- There should be no penalty where a taxpayer's negligent omission of income or gains is less than £1000, unless the offence is repeated.

- There should be no penalties where a taxpayer makes an innocent error.

- The procedures under which the Inland Revenue charge penalties should be simplified, by enabling the penalties to be included in an assessment.

- Taxpayers should have the right of appeal against an assessment for penalties.

- Comments are invited about whether the penalty for negligence should be capable of being mitigated further by law, that is to below 20 per cent, where a taxpayer has voluntarily disclosed an omission from his return.

Reopening of Assessments

- The circumstances in which the Inland Revenue should be able to make an assessment to recover tax where a person has not been properly assessed should be set out in legislation.

- A taxpayer receiving such an assessment should have the right to make or revise a claim for relief for the period to which the assessment relates.

/PROPOSALS

PROPOSALS BEING CONSIDERED FOR PRIORITY

Only some of the draft clauses in the consultative document are relevant to the areas the Government are considering giving priority to.

Streamlining the administration of corporation tax

Clauses 4, 18, 25-28, 30-33, 38, 40 and 45 are relevant to the "Pay and File" system mentioned above and discussed in more detail in the consultative document.

Some of these clauses, as currently drafted, would have effect beyond "Pay and File". For example, clauses 25-27 support the cost-effective operation of "Pay and File", by allowing penalties to be recovered by assessment in much the same way as tax is assessed and recovered, but would have general effect; and part of clause 28 would be needed to prevent a mismatch between these penalty assessing provisions and the existing regime for recovering penalties.

Other clauses contain measures not central to "Pay and File". For example, clauses 32 and 38, as currently drafted, contain provisions involving Section 286 of the Income and Corporation Taxes Act 1970, which are not priority proposals.

Improving the effectiveness of the PAYE and sub-contractor deduction schemes

Clause 41 would allow an interest charge to be imposed on PAYE paid late, in the limited circumstances where the Inspector has formally determined the amount due because PAYE had not been properly applied at the right time by the employer. The interest charged would commence 14 days after the end of the tax year to which the tax relates. The provision would most commonly involve payments to directors in small companies.

Clause 41 would also allow for the meaning of "payment" for PAYE purposes to be clarified - for example, where sums are credited to an employee's account or remuneration is voted.

Under clause 42, companies with a sub-contractor tax exemption certificate would be required to notify the Revenue of a change of company control, with a Revenue sanction of withdrawal of the company's certificate. There would be a new right of appeal against the Revenue's cancellation of sub-contractor certificates. The Revenue would be empowered to require the production etc of contractor's records.

The clause 41 PAYE regulation-making powers would also allow for an interest charge on assessments made by the Inspector to recover money which a contractor should have deducted from payments to sub-contractors.

3761/049

Covering
BUDGET CONFIDENTIAL

FROM: P D P BARNES

DATE: 11 MARCH 1987

PS/CHANCELLOR

KEITH: PAY AND FILE: ASYMMETRIC INTEREST RATES

The Chancellor asked (your minute of 6 March) how the Economic Secretary felt about defending Asymmetry in Committee.

2. The Chancellor may like to see paragraph 15 of the attached notes of the Economic Secretary's meeting on Keith.

PB

P D P BARNES
Private Secretary

3746/71

BUDGET CONFIDENTIAL

FROM: P D P BARNES
DATE: 11 March 1987

NOTE OF A MEETING HELD IN ROOM 51/2 TREASURY CHAMBERS, PARLIAMENT STREET AT 10.30 am ON FRIDAY 6 MARCH

Those present: Economic Secretary
Miss Sinclair
Mr Romanski
Mr Cropper

Mr Corlett, IR
Mr Shaw, IR
Mr Sullivan, IR

KEITH: PAY AND FILE; PAYE/SUB-CONTRACTORS

The Economic Secretary thanked Mr Corlett for his submission of 3 March covering the three submissions from Messrs Sullivan and Shaw. He also thanked Mr Shaw for his separate submission of 5 March on CT pay and file.

PAYE and Sub-contractors

2. Mr Sullivan said that it was intended to introduce the ability to impose an interest charge in circumstances where PAYE had to be formally assessed. Such a charge would only be imposed after the end of the Tax Year to which the PAYE related and was aimed mainly at the PAYE of company directors. These regulations would be accompanied by others clarifying which payments should be treated as PAYE. Yield predictions were uncertain, as they depended on behavioural assumptions, but were estimated to be of the order of £5 million in 1987-88 and £45 million in 1988-89.

3. The Economic Secretary said that he saw the change as being potentially sensitive, although the clamour against the use of regulations could be discounted as the usual response. He asked the Revenue to let him have a note on whether the provision which clarified when payment occurred for PAYE purposes was aimed simply

against borrowing by directors of money they themselves had lent to their companies, or against net loans by the company to directors, and if so whether the latter was legal. The Economic Secretary said that it would be helpful if consultations on this were to begin as early as possible, and he would decide how to proceed in the light of the response to consultations.

4. On sub-contractors, Mr Sullivan explained that one provision allowed an interest charge where contractors were assessed as liable for the tax on gross payments made to sub-contractors. This was designed to give contractors an incentive to ensure that the status of their payments to their sub-contractors was promptly resolved. The inclusion of enhanced appeal rights meant that the Revenue thought that the provision would probably be revenue-neutral. Two further changes were proposed with the intention of reducing scope for abuse: companies with C Certificates would be obliged to notify the Revenue of a change of control; and the Revenue would be given powers to borrow and inspect contractors' records.

Corporation tax pay and file

De minimis

5. The Economic Secretary said that Mr Shaw's recommendation in his submission of 5 March, that all interest repayments should be made without a de minimis level and that interest should be charged subject to a £30 administrative limit, seemed helpful.

Time limit for returns

6. Mr Shaw said that it would be sensible to allow companies for example with overseas interests longer than 12 months to file their CT returns if the Companies Act allowed them a similar period to deliver their accounts to the Registrar of Companies. However it was also a good idea to limit this to 18 months because this was when the tax-geared penalty started. This upper limit had

only been possible since the decision to introduce a uniform 9-month period for the payment of CT. The Economic Secretary agreed.

7. Mr Shaw argued that the revised penalty for late payments was less complex than the existing daily penalty for late filing and not onerous for a large company until the tax-geared penalties became applicable after 18 months. Even then, the Inspector would accept provisional filing without penalty if the company explained its case. The Economic Secretary agreed.

Starting date

8. The Economic Secretary said that he was surprised that pay and file would not be able to start until 1992. Mr Corlett said that this was because BROCS would take some time to implement, but that ordinary companies were not likely to focus on this until much nearer the time. The Economic Secretary said that the possibility of introducing the Pay and File return form at an earlier date should be left open.

Special cases

9. Mr Shaw said that if no special case were made for Lloyd's tax on the total profits for three years would have to be made in the same year. The Economic Secretary agreed that it would be sensible to make provision for this as for the cases in paragraphs 15(i) and 15(ii). He agreed that no provision should be made at the moment for assessments under the Controlled Foreign Companies legislation.

Tax on loans to directors

10. The Economic Secretary said that he was content that the basis period should be changed to the accounts year. He did not think that, if this was a non-contentious item, there would be any opposition on the ground that it had not been a priority item in the consultative document.

Technical points

11. The Economic Secretary said that he was content for the Revenue to proceed with these, provided that they were technical and would not cause political difficulty.

Interest on tax deducted at source

12. Mr Shaw said that insurance and financial companies had suggested that income received under deduction of tax should be available as a tax credit as soon as it was received, rather than not being able to be used until tax was next paid. The Economic Secretary said that this was a matter for the Financial Secretary.

Mitigation of penalties

13. Mr Shaw said that practitioners felt strongly that all penalties should be mitigable. Miss Sinclair said that the principle of non-mitigation had been established for Customs Keith. Revenue Keith already allowed mitigation of certain types of penalty. But allowing mitigation of these would mean that they would have to be set at a much higher initial level. The Economic Secretary agreed.

Finality (Olin)

14. The Economic Secretary said that consideration of this issue should be deferred as it was non-priority.

Asymmetric interest rates

15. Miss Sinclair said that there were strong reasons for asymmetric interest rates under a system of Pay & File. If rates were symmetrical, then rates set high enough to penalise late payment might be sufficiently attractive to encourage companies deliberately to over-pay, thus using the Revenue as a bank. Mr Shaw

said that although existing legislation allowed for asymmetric rates, rates at the moment were symmetrical. Under present arrangements companies had no incentive to overpay (the Revenue do not pay interest on overpaid tax until a year has passed). Both he and Miss Sinclair thought it desirable to leave open the possibility of asymmetric rates in the future. Under Pay & File companies would have an opportunity to overpay tax on a larger and systematic basis, something which did not exist at present. We needed to be careful about giving them a strong incentive to do this. The Economic Secretary said that asymmetry would be very difficult to defend in Parliament. His inclination was to make it clear that symmetric rates would be preserved until there were clear evidence of abuse. Miss Sinclair said that this need not be inconsistent with legislation which - as now - allowed for the possibility of asymmetry.

Contents of returns

16. The Economic Secretary agreed with Mr Shaw's proposals in paragraphs 34 and 35.

Assessment of penalties

17. The Economic Secretary agreed with the recommendations in paragraph 14 of Mr Sullivan's submission of 3 March.

Next steps

18. The Economic Secretary said that he was content for Parliamentary Counsel to be instructed on the changes. He had no objection to the clauses being shown in draft to the Consultative Group. He did not think that there was any advantage in emphasising the proposals as explicitly being a part of Keith, since Keith was not publicly perceived as being distinct from other Revenue

matters, and to present the proposals as "part of Keith" would encourage people to ask which other parts of Keith would be legislated in subsequent years and when. Specialists would be aware of what was going on in any case.

PB

P D P BARNES
Private Secretary

cc Those present
PS/Chancellor
Mr Cassell
Mr Scholar

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 01-379 7400
Telex 21332
Facsimile 01-240 1578

Director-General
John M M Banham

Secretary
Maurice Hunt

CBI

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
H M Treasury
Parliament Street
London SW1P 3AG

9 November 1987

Our Ref. 13/06

Dear Chancellor,

The Inland Revenue and the Taxpayer

As you will be aware the CBI has made a number of contributions to the review of the enforcement powers of the Revenue Departments first to the Keith Committee and subsequently to Customs and Excise and the Inland Revenue.

I am now enclosing with this letter a copy of the summary of our latest detailed response to the second round of proposals contained in the Inland Revenue Consultative Document of December 1986. Like Keith, we believe that there needs to be a balance between the claims of the administration and protection of taxpayers' rights in establishing and regulating a set of reasonable enforcement powers.

We have identified a number of points of principle and practice in the present proposals which cause us concern and lead us to conclude that, as they stand, the proposals do not achieve that balance.

We have sent our detailed comments and alternative proposals to the Inland Revenue and a copy of this letter to your colleagues at the Treasury.

We would be very pleased to let you have a copy of our full paper and to discuss our concerns with you and your colleagues in more detail.

Yours sincerely
Alan Willingale

A E Willingale
Chairman - Taxation Committee.

Enc.

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Director-General
John M M Banham

Secretary
Maurice Hunt

CBI

THE INLAND REVENUE AND THE TAXPAYER

The Response of the Confederation of British Industry to the Inland Revenue Consultative Document of December 1986

SUMMARY

A The CBI welcomes the opportunity to comment on the second set of the draft clauses and other material contained in the Consultative Document prepared by the Inland Revenue in response to the Keith Report on the enforcement powers of the Revenue Departments. ("Keith").

B We entirely accept that the function of revenue enforcement is to ensure that tax is paid by taxpayers at the time and in the amount that Parliament has prescribed.

C Keith recognised however that a balance was needed between the administrative powers to secure this end and protection of individual taxpayers, companies and persons, against undue or unnecessary intrusion into private affairs and against possible abuse of powers.

D Mindful of this and of the need to control the costs of legislation and regulation on business as part of our strategy of promoting international competitiveness, we have examined the proposed new powers and their likely impact on business both in terms of everyday practice and with regard to matters of principle. Our detailed views are set out in the body of his paper.

E The introduction to the Consultative Document notes that representations in response to Keith suggested that a more flexible system than that recommended by Keith was required and that there needed to be additional strengthening of the safeguards for taxpayers. We agree with those points and have made a number of positive suggestions on how to achieve them.

F We have marshalled our comments around three main themes -

1 The balance between protection of the rights of individual taxpayers and reasonable enforcement powers

Some of our key points are -

a While we fully support the principle of external judicial review of the exercise of enforcement powers we believe that taxpayer protection needs to begin at an earlier stage so that in more cases than presently proposed the taxpayer is not left to rely on rights of appeal but is better protected by preliminary procedures to be complied with by the Revenue.

Typical of these is a requirement on the Revenue to satisfy the independent Appeal Commissioners that there is sufficient case for taking the particular course of action proposed. Such procedures need not involve the taxpayer in incurring costs whereas appeals against process are likely to. The present proposals do not go far enough in this regard.

b We find it difficult to see how the balance advocated by Keith can be properly judged by Parliament if, as many of the proposals envisage, powers to make rules governing taxpayer/Revenue relations are left to be exercised in Regulations prepared by the administration, which are themselves most unlikely to be fully debated in Parliament and not subject to the process of amendment. This difficulty is not addressed in the Consultative Document.

c The automatic penalty system introduced for VAT in 1985 is already creating public concern. We have consistently opposed any move away from the present Inland Revenue system for tax penalties which, in determining the punishment to apply, allows full account to be taken of all the circumstances of the case, including degrees of taxpayer co-operation, whether the matter is settled by agreement between the taxpayer and the Revenue or at a hearing by the independent Appeal Commissioners. We see the unfettered ability of these independent Commissioners to make the punishment fit the crime as essential to the public perception of the fairness of the system. We therefore look for the penalty proposals in the Consultative Document to be modified along these lines.

d Protection of commercial secrets is vital to business as Keith recognised in recommending that before information is passed by the Inland Revenue to foreign revenue authorities, the taxpayer should be able to object to disclosure with a right of appeal to the independent Appeal Commissioners. It is of very great concern to business that this modest proposal is rejected in the Consultative Document.

2 <u>The Compliance Burden on Taxpayers</u>

a Legislative and regulatory burdens on business are a constant source of concern for the CBI. In this regard we believe that considerable additional burdens would be imposed on business if the Consultative Document was to be put into effect as it stands. We note for instance -

- the new power sought by the Revenue to prescribe additional statements and reports to be submitted by businesses on top of their tax returns and accounts;

- the new power to require third parties (that is persons other than the taxpayer himself) to furnish particulars which the Revenue thinks are relevant to another person's tax liability;

- the new power sought by the Revenue to prescribe what accounting records businesses must keep and what particulars they must contain.

b Certainty in tax matters is always important to business and we regret that there are at least two major aspects of the proposals which are in our view seriously deficient in this respect -

- The first concerns the situations in which the Revenue can seek to re-open tax assessments previously finalised ("discovery"). We consider that the purported enactment of the present state of the law on discovery as set out in the draft clauses would in effect reverse it, thereby reducing in some important respects the protection taxpayers currently enjoy.

- Secondly, despite the imposition of stricter obligations on taxpayers to make timely returns there is a no corresponding obligation on the Revenue to finalise tax positions so that taxpayers can close their books.

Both of these points need to be addressed.

We would be pleased to discuss the question of burdens with the Enterprise and Deregulation Unit.

3 The Process of Education of Taxpayers

It is important to ensure that the enforcement regime does not lead to a diminution in the taxpayer/Revenue relationship either as a result of multiple default caused by public ignorance or because the regime is insufficiently taxpayer friendly. Time and care are needed to make it as easy as possible for taxpayers to fulfil their obligations and to ensure that those obligations are themselves no more than strictly necessary. The relevant process of education is likely to take some time and it may well be that a gradual approach to a stiffer regime - based on proven need - is preferable to a big bang approach.

G Conclusion

In the light of our concerns about these topics and the other topics we have identified in our more detailed commentary our conclusion is that, as they stand, many of the proposals in the Consultative Document do not yet provide a sufficiently flexible system nor do they contain sufficient additional strengthening of the safeguards for taxpayers. We believe that further consideration must be given to a number of key points if they are to secure ready acceptance by taxpayers at large and business in particular as constituting a fair reasonable and workable system.

We would welcome the opportunity to discuss our views with Ministers and officials.

Inland Revenue

Policy Division
Somerset House

FROM: D L SHAW
DATE: 23 DECEMBER 1987

1. MR CORLETT 23/12

Ch/FST to deal? yes pse

2. CHANCELLOR

LEGAL PROFESSIONAL PRIVILEGE, KEITH COMMITTEE ON OVERRIDE

1. Sir Hugh Rossi wrote to you on 15 December 1987 asking you to receive a Parliamentary delegation led by himself and Ivan Lawrence. We presume that Ministers will wish to see the delegation, but the Chancellor may prefer to leave this to the Financial Secretary.

2. The delegation is made up of representatives of the legal profession and wishes to express their concern that the Government may decide to implement the Keith recommendation on override of legal privilege in the next Finance Bill.

3. This is one of two inter-locking recommendations of the Keith Committee. Keith recommended that legal professional privilege, which is confined to members of the legal

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cc Financial Secretary
Mr Scholar
Mr Culpin
Mr Cropper
Miss Sinclair
Mr Riley
Mr Isaac
Mr Corlett
Mr Beighton
Mr Shaw
Mr Dunbar
PS/IR

profession, should be extended to members of the accountancy profession for advice on tax matters. Keith balanced this extension of privilege with a recommendation designed to prevent privilege being abused. He recommended an override of privilege where privilege would unreasonably impede the ascertainment of facts necessary to the proper determination of the taxpayer's tax liabilities. This override would be subject to judicial control.

4. This is a very sensitive area. The accountants are strongly in favour of the extension of privilege to them, claim that this is urgently needed to prevent their losing work to lawyers and are pressing for legislation in the next Finance Bill. The lawyers are equally adamant that the privilege override is wrong and should be dropped. And lawyers have, in the past, attacked the extension of privilege to accountants as eroding their role in the Law.

5. We did discuss privilege with the Financial Secretary during the preparation of a package of Keith measures for the Finance Bill. Mr Hayward's note of 29 July 1987 to Mr Corlett records the Financial Secretary's decision that privilege should be ruled out for this year, although the Financial Secretary did recognise that failure to legislate on this issue might be just as controversial as legislation.

6. We should be pleased to provide the Financial Secretary with further briefing should he decide to meet the delegation.

David Shaw

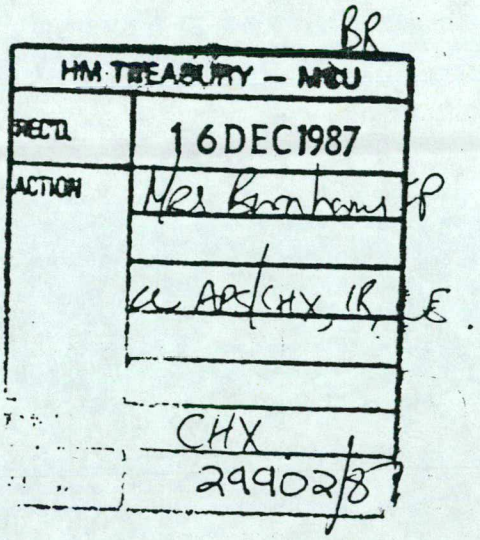
D L SHAW

From: SIR HUGH ROSSI, M.P.

HOUSE OF COMMONS
LONDON SW1A 0AA

15th December 1987

The Rt Hon Nigel Lawson, MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Square
LONDON
SW1P 3AG



Dear Nigel,

Legal Professional Privilege
Keith Committee on Override

As Chairman of the Solicitors' All Party Parliamentary Group I am writing to ask you to receive a Parliamentary delegation led by myself and Ivan Lawrence, QC, MP, Chairman of the All Party Bary Group, but also supported by members of the Bar Council and that of the Law Society.

This request for a meeting arises from our deep concern that the Government may be intending to implement the Keith Committee recommendation on override in next year's Finance Bill.

As you may know the Keith Committee recommended that legal professional privilege should be capable of being set aside by an order of a court or tribunal on the application of the Revenue departments, if the court or tribunal could be satisfied that setting aside privilege was the only way in which the departments could obtain access to information which they needed to assess a taxpayer correctly. This recommendation can be found at Chapter 26.6.5.

Notwithstanding the laudable aims of the Revenue departments, we are strongly opposed in principle to this proposal because we firmly believe that the law on privilege should not be amended piecemeal by changes in fiscal matters alone, and that if there was any case at all for amending it, the matter should be looked at in the context of all the areas of law in which it is relevant.

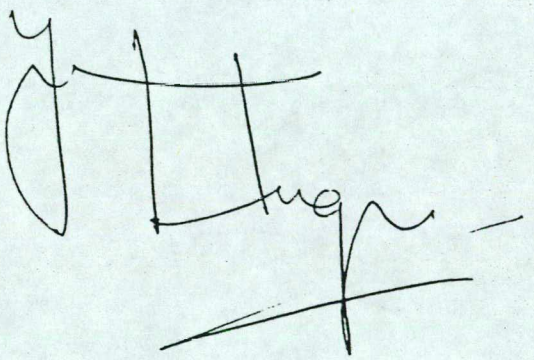
Hitherto, the Lord Chancellor's Department has seen this as very much a Treasury matter.

P.T.O.

15th December 1987

We would therefore greatly welcome an opportunity to meet you to discuss this whole matter in the near future. For your information, I enclose a copy of the brief prepared by the Law Society.

I look forward to hearing from you.



BUDGET CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

FROM: D L SHAW
EXTN: 6300
DATE: 3 FEBRUARY 1988

What would be helpful for the package?

1. MR CORLETT
2. FINANCIAL SECRETARY

PACKAGE OF KEITH COMMITTEE ADMINISTRATIVE IMPROVEMENTS: INFORMATION ABOUT UNNAMED TAXPAYERS (STARTER 452)

1. At your meeting of 19 November to discuss the Keith package for the Finance Bill, you decided to leave one item, the power for the Revenue to obtain information about unnamed taxpayers, for further consideration in light of responses to the consultative document and, if the opportunity arose, further consultation. We understand that Ministers agreed at Chevening that this item should be included, provided we could add additional safeguards restricting its use to cases of serious default.

2. We have now discussed proposals for additional safeguards with the representative bodies and have been able to allay their fears. We believe that the

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cc PS/Chancellor
PS/Paymaster General
PS/Ecomonic Secretary
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Riley
Mr Cropper
Mr Byatt
Mr Hudson
Mr Trevett - C&E
Mr Saunders - Parliamentary Counsel
Mr Isaac
Mr Pollard
Mr Beighton
Mr Roberts
Mr Cherry
Mr Corlett
Mr Page
Mr Duxbury
Mr Hugo
Mr Cleave
Mr Hinson
Mr Eason
Mr Ko
Mr Shaw - P2
Mr Dunbar
PS/IR

introduction of the power with these restrictions will be acceptable to the main representative bodies and recommend that it be included in the package.

The problem

3. There is a lacuna in our information powers which is allowing a lot of large tax liabilities to be hidden from the Inspector and to go unpaid.

4. Briefly, the Taxes Acts permit us (a) to ask payers for the names of all recipients of certain defined types of payments; payments of interest by banks is perhaps the best known example. We can also (b) ask for documents about a named taxpayer - ie we can ask x for documents about his dealings with y. What we cannot do is to ask x for documents giving the names of all the persons (unknown to us) with whom he has had dealings of a sort which does not fall within (a), even if we have good reason to believe that those persons are thereby not paying tax which is due.

5. For instance, this can happen where a firm of tax agents markets a "faulty" tax avoidance scheme and on investigation of the full facts the Revenue finds that the scheme does not work. The agent will have assured his customers that there is no tax liability on the profits covered by the scheme, and no need to include those profits in their tax returns. And there is no assurance, nor great likelihood, that the agents will move their clients to send in amended tax returns, when the bogus scheme is exposed. We then find ourselves in the position that:

- We know that there are sums of money, probably substantial, which are liable to UK tax and have not been included in tax returns.

- We do not know the names of the taxpayers concerned.

- We know the names of the agents and know that they have the necessary information to identify the taxpayers

- But we cannot require the agents to reveal this information.

6. We are often dealing here very much at the margin between "legal" avoidance and "illegal" evasion. What is clear is that, whether or not the promoter of the scheme originally believed it to be legally effective, the outcome is that profits which are legally liable to tax have not been reported to the Revenue.

7. A current example is provided by schemes similar to the "roller" policies which we investigated and stopped as part of the Lloyds investigation. We know that a number of agents are marketing similar schemes which do not work. We believe that their clients will have understated their profits by more than £50 million. We know the names of the agents, but have no means of discovering the names of their clients who have used these schemes.

8. Another current example is a London finance house which we know to have laundered money in a tax evasion scheme. We also know that they have similarly laundered £13 million for other clients but have no means of uncovering their identity.

Keith's view

9. Keith recommended that we should be able to uncover the taxpayers involved. He based his recommendation on a well-known provision in the American tax code. He recommended that we should be

able to issue a notice to a third party requiring him to allow us access to particular documents in respect of a specified class of unnamed taxpayers.

10. He further recommended that this power should have the safeguard that prior permission would be required from a Special Commissioner each time the power was used. The Special Commissioner would have to be satisfied that there were reasonable grounds for believing that the unnamed taxpayer or taxpayers might fail to comply with a provision of the Taxes Acts and that the information sought was not readily available to the Inspector from other sources. This would ensure that there was prior independent review and consideration before the Revenue could use this power.

Consultative Document

11. The Consultative Document on the Keith proposals which we published in December 1985 included a draft clause which exactly followed the Keith proposal.

Responses to the Consultative Document

12. We asked for responses to a short list of priority items before the end of February 1986. These priority items were included in last year's Finance Bill. We asked for responses on the remaining non-priority items, which included the information about unnamed taxpayers, before the end of October 1986.

13. We have received 22 responses on these remaining non-priority items. Of these, 16 made no reference to the information about unnamed taxpayers and were presumably in broad agreement with the measure. The remaining 6 responses, from the Institute of Taxation, Institute of Chartered Accounts, Law Society, National Federation of the Self Employed, CBI and the Chartered Association of Certified Accountants, were hostile to

some extent. Whilst the majority of these recognised the justification for this power, they were concerned that the power, as drafted, could be too wide. They sought assurance that the power would be limited to cases of serious default.

Discussions with the representative bodies

14. We met the major representative bodies on 29 January, including all of those who commented on this provision, to discuss the information powers in general, including information about unnamed taxpayers. I attach a list of the representatives who attended the meeting and the bodies they represent.

15. At the meeting of 29 January, the representative bodies agreed that the power was justified to deal with the sort of serious case described above. But they repeated their concern that the drafting was too wide.

16. We proposed two further statutory safeguards to give belt and braces reassurance that the power would only be used in the most serious of cases.

17. Firstly, a Board's Order would be required before an application could be made to a Special Commissioner. This would ensure that the application had to be personally approved by a very senior member of the Revenue - thereby ensuring strict administrative control.

18. Secondly, an additional test of seriousness would have to be met. Before he approved the notice, the Special Commissioner would have to be satisfied that the default under enquiry would result in "serious prejudice to the proper assessment or collection of tax". This would ensure that the power could only be used in the most serious of cases.

19. The representative bodies welcomed our proposals and agreed that they would provide valuable safeguard against misuse by the Revenue. But they did suggest that one further protection was necessary. They were concerned that in this difficult area, it might be possible for the notice to lack sufficient precision or to impose an unnecessarily onerous burden - perhaps because the Revenue and the Special Commissioner underestimated the difficulty of providing the documents. We accept their point. The necessary safeguard can be provided by allowing the information provider a statutory right of objection to the notice, on the basis that it is too onerous. The notice would then be varied by agreement with the Inspector, or, if agreement could not be reached, by a Special Commissioner.

20. These additional 3 safeguards meet all the concerns that the representative bodies have expressed. The only dissenting voice at the meeting was from the National Federation of Self Employed, but this was in the context of their general view that all Revenue information powers are unnecessary. The NFSE apart, the indications are that the inclusion of the power will, with these additional safeguards, be largely uncontroversial.

Reimbursement of Expenses

21. The inclusion of the information about unnamed taxpayers in the Finance Bill could provoke some argument on the reimbursement of expenses for providing information.

22. As a general rule, the Government does not reimburse the cost of complying with duties imposed by law. It is part of the citizen's normal duty to make information returns as required by law and his compliance costs are not recoverable from the Crown.

23. However, Keith recommended that this general principle should be breached where an independent third party is required to provide the Revenue with information about a named, or an unnamed, taxpayer. By independent third party, Keith meant a person genuinely at arms length from the taxpayer. This was meant to exclude the taxpayer's accountant or any other person who had acted for him in relation to business which is relevant to the Inspector's investigation.

24. Our consultative document on the Keith proposals included a draft clause based on this recommendation. Not surprisingly, this drew no criticism except for a common plea that it did not go far enough and that the Government should reimburse all the costs of any provider of information.

25. There is an important point of principle at stake here, whether any Government Department should reimburse the costs of compliance with a duty imposed by law. We do not think that you would wish to breach this principle in the limited field of information required by the Revenue from an independent third party without considering the precedent that this would set for other Government Departments.

26. A further point which you will wish to take into account is the deadweight cost. Any widening of the information powers to <u>independent</u> third parties under the recommended extension to unnamed taxpayers would be negligible, or non existent. So reimbursement would be for information that is already required to be provided without reimbursement. The main beneficiaries would be the banks, who are the only third parties that we require information from that are likely to come within Keith's definition.

27. If the proposal for reimbursement is pressed in reaction to the new power discussed here, you will be able to say that it is very unlikely that any third

party required to provide information about an unnamed taxpayer would be independent of the taxpayer and eligible for reimbursement under Keith's proposal. In the vast majority of cases, the third party information provider will be the professional marketing the failed scheme. If the wider question of reimbursement of costs to independent third parties under the existing powers is raised, you can either reserve your position pending consideration of the wider issues, or reject Keith's recommendation as being in conflict with the general principle that the Government does not reimburse the costs of complying with a citizen's normal duty.

Length and complexity of the legislation

28. The legislation for the new information power will be no more than half a page, and will be quite straightforward.

The remainder of the Keith package

29. The meeting also allowed us to discuss, inter alia, the other items in the proposed Keith package with the representative bodies, except for the interest charge for PAYE which fell outside the agenda for the meeting. We, of course, gave no indication that they might be in this Budget. These other items - the obligation to notify liability and the power to obtain information from Government Departments - had received little comment in the written representations and had attracted no hostility. No significant criticism of these measures was voiced at the meeting and our proposals to meet the minor points raised in their comments were all regarded as acceptable by the representative bodies.

General shape of the Keith Package

30 If you agree to the inclusion of the information about unnamed taxpayers in the package, it will take the following shape.

- A tightening up of the obligation to notify liability to tax.

- A closing up of lacunae in our powers to obtain information about payments from Government Departments, payments of grants and subsidies out of public funds, details of licenses, information from the Department of National Savings and access to computer records.

- A power to call for information about unnamed taxpayers where serious loss of tax is involved, with the additional safeguards described above.

- An interest charge for PAYE (and NIC) delayed beyond the year end, but not starting before 1992.

31. The inclusion of the information power about unnamed taxpayers will improve the balance of this package. The first two parts of the package are aimed principally at the small defaulter, moonlighting or in the black economy. Without any measure aimed at the major defaulter, you could be accused of being hard on the small miscreant but soft on the serious wrongdoer. The information about unnamed taxpayers, which is aimed specifically at the serious wrongdoer, will redress this balance.

Conclusion

32. We recommend that the information power about unnamed taxpayers, with the additional safeguards of the Board's Order, the test of seriousness and the dispute procedure where the notice is too onerous, but with no reimbursement of costs to independent third parties, be included in the Keith package for the Budget.

David Shaw

D L SHAW

One of the other issues, not in this package, which was discussed at the meeting with the representative bodies was whether legal privilege should be extended in some circumstances to accountants. We shall be briefing you further on this for your meeting with Sir Hugh Rossi on 16 Feb. But you have previously decided that it is not something you want to tackle this year.

Inland Revenue

Policy Division
Somerset House

FROM: MISS A P LEES
ROOM: 20 New Wing
EXTN: 7749
DATE: 25 January 1988

KEITH CONSULTATIVE DOCUMENT
MEETING WITH REPRESENTATIVE BODIES

VENUE: The Board Room
DATE: Friday 29 January
TIME: 10.00 am

CAST: Representative Bodies

I P A STITT	Institute of Taxation
J E BREWSTER	CBI
M O PENNEY	Institute of Chartered Accountants in England & Wales
D R. ALLEN.	Institute of Chartered Accountants in Scotland
MRS M SARGENT	Chartered Association of Certified Accountants
W V W NORRIS	The Law Society (England and Wales)
M H JONES	The Law Society of Scotland
M FORD	British Bankers Association
B SAYLES	British Retailers Association
T LUNDBURG	National Federation of Self-Employed and Small Businesses
K P SMITH	Public Companies Taxation Discussion Group
A E WILLINGALE	

4481/48

BUDGET CONFIDENTIAL

For Overview Hdo

FROM: MISS C E C SINCLAIR
DATE: 5 February 1988

MR A C S ALLAN

cc **Mr Scholar**
Mr Culpin
Miss Evans
Mr Michie

OVERVIEW - 15 FEBRUARY

Could you please add, to whatever agenda you are proposing for 15 February, a progress chasing item on

> "Keith: Revenue power to obtain information about unnamed taxpayers."

The Revenue should be asked to report on the stage reached so far in consultations with outside bodies: Mr Corlett is in the lead.

Carolyn Sinclair

CAROLYN SINCLAIR

ps3/2T

BUDGET CONFIDENTIAL

Pl. cd I see Mr Shaw's minute. AHH

FROM: J M G TAYLOR
DATE: 8 February 1988

PS/FINANCIAL SECRETARY

cc PS/Paymaster General
PS/Economic Secretary
Mr Byatt
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Riley
Mr Hudson
Mr Cropper

Mr Isaac - IR
Mr Pollard - IR
Mr Beighton - IR
Mr Corlett - IR
Mr Shaw - IR

Mr Trevett - C&E
Mr Saunders
Parly. Counsel

PACKAGE OF KEITH COMMITTEE ADMINISTRATIVE IMPROVEMENTS: INFORMATION ABOUT UNNAMED TAXPAYERS (STARTER 452)

The Chancellor has seen Mr Shaw's submission of 3 February 1988. He has asked what yield is expected from the Keith package.

J M G TAYLOR

BUDGET CONFIDENTIAL

Inland Revenue

Policy Division
Somerset House

FROM: D L SHAW
DATE: 9 FEBRUARY 1988

1. MR CORLETT

2. PS/CHANCELLOR

PACKAGE OF KEITH COMMITTEE ADMINISTRATIVE IMPROVEMENTS: INFORMATION ABOUT UNNAMED TAXPAYERS (STARTER 452)

1. Miss Feest has asked me to reply to Mr Taylor's note of 8 February requesting details for the Chancellor of the expected yield from the Keith package.

General shape of the Keith package

2. If the power for information about unnamed taxpayers is included, the package will take the following shape:

- A tightening up of the obligation to notify liability to tax.

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cc PS/Chief Secretary
PS/Paymaster General
PS/Financial Secretary
PS/Economic Secretary
Mr Byatt
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Riley
Mr Hudson
Mr Cropper
Mr Trevett (C&E)
Mr Saunders (OPC)
Mr Isaac
Mr Pollard
Mr Corlett
Mr Beighton
Mr Roberts
Mr Hugo
Mr Duxbury
Mr Shaw (P2)
Mr Eason
Mr Ko
Mr Dearman
Mr A Cole
Mr Dunbar
Mr Green
Miss Barlow
PS/IR

- A closing up of lacunae in our general information powers.

- A power to call for information about unnamed taxpayers where serious loss of tax is involved.

- An interest charge for PAYE (and NIC) delayed beyond the year end, but not starting before 1992.

Expected yield

3. The first two parts of the package are aimed at the small defaulter, moonlighting or in the black economy. These are essentially long term measures to encourage better compliance by the taxpayer and better use of resources by the Revenue. It is not possible to quantify their yield at this stage.

4. The third part, the information about unnamed taxpayers, is aimed principally at the serious defaulter using a failed scheme. This will produce an earlier, and more easily identifiable, yield through uncovering the users of known evasion or failed avoidance schemes. We expect a yield of £10m in 1988/89, £20m in 1989/90 and £30m per annum thereafter.

5. The fourth part, the interest charge for late PAYE (and NIC), cannot be implemented until the necessary computerisation is complete, which will not be before 1992. Once implemented, we expect it to accelerate payments of £5bn by an average of two and a half weeks and to yield at least £50m annually in interest charges for continuing delay.

D L SHAW

FINANCIAL SECRETARY TO THE TREASURY

FROM: MISS S J FEEST
DATE: 9 February 1988

D L SHAW IR

cc PS/Chancellor
PS/Paymaster General
PS/Economic Secretary
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Riley
Mr Cropper
Mr Byatt
Mr Hudson
Mr Trevett C&E
Mr Saunders OPC
PS/IR

PACKAGE OF KEITH COMMITTEE ADMINISTRATIVE IMPROVEMENTS: INFORMATION ABOUT UNNAMED TAXPAYERS (STARTER 452)

The Financial Secretary was grateful for your minute of 3 February and approves the proposals therein.

Susan Feest

SUSAN FEEST
(Assistant Private Secretary)

ps3/5T

BUDGET CONFIDENTIAL

FROM: J M G TAYLOR
DATE: 10 February 1988

MR D L SHAW - Inland Revenue

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Byatt
Mr Scholar
Mr Culpin
Miss Sinclair
Mr Riley
Mr Hudson
Mr Cropper

Mr Trevett (C&E)
Mr Saunders (OPC)

Mr Isaac - IR
Mr Pollard - IR
Mr Corlett - IR
PS/IR

PACKAGE OF KEITH COMMITTEE ADMINISTRATIVE IMPROVEMENTS: INFORMATION ABOUT UNNAMED TAXPAYERS (STARTER 452)

The Chancellor was grateful for your minute of 9 February.

J M G TAYLOR

CORLETT COVER NOTE 6/7

Inland Revenue

Policy Division
Somerset House

FROM: C W CORLETT
FAX No. 6766
EXTN. 6614
6 July 1988

1. MR ISAAC

2. FINANCIAL SECRETARY

KEITH COMMITTEE CONSULTATIVE PAPER

1. With your approval (Miss Feest 11 April), we have now prepared a draft consultative paper (copy attached) dealing with Keith's outstanding recommendations on income tax, capital gains tax and corporation tax - ie those not already dealt with in last year's Finance Act or the current Finance Bill. Most of the detailed work has been done by Mr Shaw and his team from Policy, Management and Technical Divisions.

2. The paper is, I am afraid, quite long. However, considering that it covers about half of Keith's recommendations, that is inevitable. Within that constraint, the object has been to draft it pretty tightly, on the basis that it is directed primarily at the

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cc Chancellor of the Exchequer
Chief Secretary
Economic Secretary
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Cropper
Mr Tyrie
Mr Fryett - Customs & Excise
Mr Trevett - " "
PS/Customs & Excise
Mr Jenkins - Parliamentary Counsel
Mr Gieve
Mr Battishill
Mr Isaac
Mr Painter
Mr Beighton
Mr Rogers
Mr McGivern
Mr Roberts
Mr Cherry
Mr Shaw (P2)
Mr Hugo
Mr Page
Mr Ellictt
Mr Willis
Mr Sutcliffe
Miss Barlow
Mr Dunbar
Miss Lees
Miss McFarlane
PS/IR
Mr Corlett

specialists and representative bodies who have been closely involved throughout. So background explanations (except where we deal with Pay and File and interest on employers' PAYE) is kept to a minimum.

Points to note

3. Although the paper is in generally non-technical language, parts of it necessarily cover some esoteric by-ways of the tax system, and I would not suggest that you should feel obliged to read it all.

4. In his note immediately below, however, Mr Shaw draws out the main points which are likely to create interest (and where you may like to check what is being said).

- Some are issues on which, following further discussions arising out of our December 1986 Consultative Document, changes are proposed which modify or even withdraw the original proposals. These will be generally welcomed outside.

- Others are issues where, despite lengthy discussions, we have not felt able to recommend the changes the representative bodies have been pressing for. Legal professional privilege is one that you will immediately recognise. You will want to look at these conclusions carefully, since they will inevitably be the aspects on which the representative bodies will immediately focus. In order to make it clear that what is said on these important (for the representative bodies) points is not just the view of officials, the paper makes it explicit that the proposals here are ones to which Ministers have signed up.

5. You will naturally be concerned about the likely overall political reaction to the paper. My own assessment

is that, while there will be some complaints that the package is unbalanced because a few important recommendations which would have favoured some outside interests have been rejected, the scope for creating a political campaign will be strictly limited by the extent to which a lot of Keith's original recommendations which would have favoured the Revenue have been toned down or dropped. Furthermore, the lengthy and detailed consultations which have taken place since 1983 (probably more extensive than on almost any other subject) mean that there will be very few surprises in the paper. And, after all, these are, again, only proposals, on which further representations can be made. Overall, therefore, I would judge that publication can be handled in a pretty low-key way, with Ministers claiming a good deal of credit for the way they are proceeding.

Timing

6. Subject to your agreement to the text, publication of the paper during July, before the holiday season gets underway, would allow us to ask for representations by early October. That would give Ministers good time in the autumn to consider the content of any legislative package for the 1989 Finance Bill. (On this, it is worth mentioning that there has been pressure, from the PAC as well as the representative bodies, for the Government to get on and complete Keith quickly and as a whole. The paper can be seen as Ministers keeping that opportunity alive.)

7. On that timetable, it would be very helpful if we could know, by the middle of the month, whether you are content for publication to go ahead.

Drafting

8. Parliamentary Counsel is keen to start drafting next year's Bill, even on a provisional basis, during August. If you approve the publication of the paper, it would therefore

assist if you were able also to authorise us to proceed to instruct Counsel provisionally, concentrating at this stage on those aspects where there is little likelihood of any further changes.

Deregulation Unit

9. Mr Maude and his Unit are interested in what is going on. We shall let you have a letter to send to him, once you have decided to go ahead with publication. Meanwhile we are keeping his officials in the picture.

Publicity

10. As I have said, we would advise a low-key approach. We will let you have a draft press notice once you have approved the draft.

Conclusion

11. The questions for decision are:

a. are you content with the drafting of the consultative paper?

b. may we publish it (subject to a. above)?

c. may we instruct Counsel on a provisional basis?

C W CORLETT

Inland Revenue

Policy Division
Somerset House

FROM: D L SHAW
DATE: 6 JULY 1988

1. MR CORLETT 6/7

2. MR ISAAC

3. FINANCIAL SECRETARY

KEITH: FURTHER PROPOSALS

1. You have agreed that we should prepare a further consultative paper on the remainder of the Keith Committee's recommendations for income tax, capital gains tax and corporation tax. I attach a draft.

2. The purpose of this note is to draw out the more important parts of the paper; to explain in particular where and why we are, in a number of places, revising the proposals made in the original consultative document; and to seek your agreement to the draft of the consultative paper.

GENERAL APPROACH OF THE CONSULTATIVE PAPER

3. Consultations with the representative bodies have been in progress since 1983. We published a consultative document in 1986 making detailed proposals. Even after the packages in the 1987 and 1988 Finance Acts, however, about half of Keith remains outstanding.

4. These outstanding recommendations include some which received a fairly hostile response outside. We have discussed the more contentious with the representative bodies and achieved a fair measure of agreement - both as to which might, on balance, not be proceeded with, and also on

the amendments needed to make others more generally acceptable. So there should be few surprises for those who have been involved in the consultative process. The further consultative paper will give these revised proposals a wider public airing, gauge the reaction to their acceptability, and pave the way to completing most of the legislative programme on Keith's IT, CGT and CT recommendations in the next Finance Bill, should Ministers so decide.

MAIN OBJECTIONS TO 1986 CONSULTATIVE DOCUMENT

5. There were three areas in the 1986 proposals that attracted particular criticism. These were re-opening of assessments, mitigation, and privilege.

Reopening of assessments

6. This issue was looked at in considerable detail by your predecessor and the former Economic Secretary. In brief, the 1986 consultative document included proposals for Keith's recommendation that the basis on which we make "discovery" assessments should be set out in statute rather than rest on the present mixture of case law and departmental practice derived from case law. "Discovery" assessments are made when an Inspector of Taxes discovers that insufficient tax has been paid earlier, for example because the taxpayer's income was greater than had originally been thought or because excessive reliefs had been given.

7. As you will recall from earlier minutes, most recently Mr Beighton's of 24 February on "Reopened tax liabilities: the Revenue's responsibilities", this question has been complicated, since Keith reported, by a decision of the House of Lords in a case relating to a company called Olin Energy Systems. Very briefly the point is this. The essential feature of our practice in considering whether to make discovery assessments is that we do not go back on our word. So if, in the course of settling figures for

assessment, an Inspector had agreed a particular point, we do not subsequently make a discovery assessment if at a later stage we find - with hindsight - that he ought not to have agreed that point. The Olin case was concerned with the question to what extent agreement on a particular point can be inferred in the absence of any express discussion or reference to it in correspondence from the Inspector.

8. The representations on the 1986 consultative document have underlined the point, which we have made in earlier minutes, that there are two views about the scope of the Olin decision. Most of the representative bodies take the view that it means that so long as the relevant information is provided to the Inspector - even if it is one of a list of items in a voluminous schedule of detailed points and figures - then he must be regarded as having agreed it, although there may be no evidence that he considered the matter at all. And it is only a short step from that to arguing, as some representative bodies do argue, that we should only be able to make discovery assessments in cases where the taxpayer was guilty of fraud or default; that is a view which Keith specifically considered and rejected.

9. Our own view of the decision is that it means that the Inspector can only be regarded as having (implicitly) agreed a point which, on the facts of the case, it is clear must have been in his mind when he arrived at his decision. In other words, where there was no discussion or other evidence to suggest that he had considered the particular point, we should nevertheless be precluded from raising a discovery assessment if the point at issue was fundamental to the earlier agreement, and so clearly and accurately set out in the accounts or computations that the Inspector can reasonably be assumed to have considered it.

10. It is quite clear, however, that any attempt to enact the draft clause from the 1986 consultative document would prove unpopular and controversial. We are therefore proposing that this consultative paper should announce that

Ministers do not intend to proceed with the clause at this stage, but that they have asked the Revenue to consider the possibility of issuing a Statement of Practice setting out our view of the law and the circumstances in which Inspectors would normally seek to make discovery assessments. (See paragraphs 1.7 to 1.9.)

11. In making that suggestion we have in mind the material on reopening assessments contained in the draft Statement of Practice which Mr Isaac sent to you under cover of his note of 30 March 1988 and which you have authorised us to discuss in confidence with certain representative bodies.

12. The decision not to legislate on the basis of the 1986 consultative document should generally be welcomed, but we cannot of course guarantee that all the representative bodies will be happy about Ministers proceeding in this way. Some may continue to press for legislation on the wider Olin basis on the grounds that only legislation on that basis will give taxpayers the certainty to which they are entitled.

13. Nevertheless, we think this would be the best way forward. The accountancy bodies, in particular, have told us that a statement incorporating our view of what the Olin case mean would be very helpful. And if we can reach agreement on the terms of the Statement, get it issued, and see how it operates in practice, we shall then be able to report to you in due course about the need for legislation on the point and what scope there may be modifying the original 1986 draft clause.

Penalties and mitigation

14. Briefly, penalties for direct tax offences are, at present, fully mitigable - ie the Revenue is allowed a large degree of discretion over whether penalties should be charged and if so in what amounts (subject only to a maximum). Keith recommended that penalties should be

automatic - that is that they should be charged, without any Revenue discretion, whenever an offence occurred and in amounts determined objectively according to formulae prescribed in legislation.

15. Keith's main reason for wanting automatic penalties was so that the tax system would work more efficiently, with less room for argument and subjective discretion. He wanted taxpayers to have clearly defined obligations, for instance on the dates for filing returns. With automatic penalties, taxpayers would know that if they did not meet their obligations, penalties of set amounts would follow without fail.

16. The representative bodies dislike automatic penalties. They prefer the Revenue having discretion over the amount of the penalty, so that there is room for argument, allowing them to try to get penalties reduced.

17. The revised proposals go some way towards meeting these concerns. But it is not possible to move to a modern, efficient tax system without introducing a fair measure of automaticity.

18. There is a strong case for introducing automatic penalties for regulatory offences (eg late returns) as part of a modern, streamlined and more efficient regime. This is the approach Ministers have followed for VAT (with the package of measures introduced in 1985) and for corporation tax (with the Pay and File system which was legislated for last year).

19. Section 6 of the paper takes this modernisation process a step further with proposals for streamlining the administration of employers' PAYE. These proposals take a gradualistic approach, aiming to tighten up the administrative arrangements step by step over a period of not less than four years.

20. The representative bodies have expressed concern at the possibility of a similar tightening up of the arrangements for individual taxpayers, including unincorporated businesses. The paper accepts that to proceed with automaticity there would be premature. The present tax rules (for instance the rules governing the so-called "previous year" basis of assessment for the unincorporated) would need to be simplified first, and the transition to independent taxation got out of the way. So, whilst a modern streamlined system for income tax remains a long term objective, there are no proposals in the paper for changing the system for the present. (See paragraph 3.12.)

21. However, the paper departs from Keith, and meets the representative bodies' wishes, in relation to penalties for culpable offences such as tax evasion. It accepts the view of the representative bodies that automatic penalties are too inflexible to cope with the very wide range of offences that occur. For instance, the penalty for income tax evasion must cope - at one extreme - with a pensioner, with no understanding of tax, leaving a few pounds of untaxed interest off a return, to - at the other extreme - the most serious and deliberately fraudulent evasion. So the paper proposes that penalties for culpable offences should remain fully mitigable. (See paragraphs 3.1 to 3.8.)

22. The representative bodies will continue to cavil about the automatic penalties that are needed as part of the new, streamlined arrangements for administering tax. The main proposals, however, in this paper concern culpable offences and the revised proposals to keep these penalties fully mitigable should be well received.

Privilege

23. As you will recall from your meetings with a delegation of lawyers led by Sir Hugh Rossi on 16 February and a group of accountants from the Institute of Taxation on 24 March,

this is an issue which arouses strong, and largely irreconcilable, reactions from the professions.

24. What Keith proposed was:

i. that the Courts and Appeal Commissioners should be able to override privilege where this was needed to get at the facts necessary to establish a taxpayer's proper tax liabilities,

ii. that taxpayers (as well as lawyers) should be given protection for privilege, subject to the limitations of the override, and

iii. that the same protection, subject to the same limitations, should be given to tax advice given by accountants.

25. The override is the sine qua non of Keith's recommendations. Its purpose was to counter existing abuses of privilege. But, Keith also saw its implementation as allowing privilege to be extended in the two ways he suggested. And he made it clear that to extend privilege without the override was unacceptable and could even cause the tax system to seize up.

26. As you know, the lawyers bitterly oppose the override. They claim that, even if it is justified for tax, it represents from the broader point of view a growing threat to civil liberties. On the other hand, they would like privilege to be extended to taxpayers - so long as there is no override.

27. The views of accountants are mixed. Some are strongly in favour of the extension of lawyers' privilege to advice by accountants, and are quite happy to accept the override as the price of this. In particular they are concerned that lawyers may be tempted to use this right to privilege as a selling point in stealing tax work from accountants - and

they look with some worry at America where this has happened. Other accountants take a more relaxed view on the basis that the present system works well enough and there is already pretty good protection for them written into the Taxes Acts.

28. Extension of privilege has excited little interest outside the professions. But the lawyers' campaign against the override on civil liberties grounds has been picked up and gained support more widely.

29. Your provisional view, after meeting representatives of both professions, was that it would be better to leave things as they stand. Although this will not wholly satisfy either group, to legislate would be bound to create trouble with one group or the other. Having discussed this again with the representative bodies ourselves, nothing further has emerged which would lead us to recommend that you change your view. There will be complaints that one of Keith's juicy plums for taxpayers (ie better protection for taxpayer's privacy though extending privilege in these two ways) has been squashed by the Revenue. And we shall have to expect the campaign for some form of extension to continue.

30. The approach that the paper follows is therefore to say that Ministers have decided that there should be no changes to legal professional privilege for tax purposes, and that Keith's package as a whole on this issue is being set aside. But as a sweetener to the accountants, the paper proposes changes elsewhere to balance the respective interests of the two professions as far as possible. (See Section 5 and paragraphs 4.27 to 4.31).

OTHER PROPOSALS WHICH COULD PROVE SENSITIVE

Interest arrangements for Pay and File

31. Paragraphs 2.14 to 2.33 contain proposals for the interest arrangements for corporation tax Pay and File.

32. The bodies representing large companies are likely to complain at the extent of the asymmetry in the rates - it is proposed to pay companies base minus one on repayments, but to continue to charge companies base plus two and a half on late payments - and the proposed tax treatment. These are, however, fair for the overwhelming majority of companies. And special rules are included to give large companies and groups a considerable degree of protection against the higher rate of interest charged on late payments and any adverse consequences of the tax treatment. First, they will be able to protect themselves from being charged interest at this rate on tax in dispute either by purchasing certificates of tax deposit or by paying the tax in dispute on account, secure in the knowledge that they will get a fair market rate of return if the tax proves not to be due. Second, large companies and groups will be able to re-arrange their tax liabilities (for tax planning reasons) without incurring interest charges.

Securing assets of tax evaders

33. Paragraphs 3.53 to 3.61 float new ideas for tackling a particular problem which is allowing a lot of evasion to take place. This is where taxpayers move themselves, or their assets, out of the reach of the Courts before their tax affairs can be settled, leaving their tax unpaid.

34. Keith suggested that we adopt the American solution, and allow the Revenue Departments to make special "jeopardy assessments" where this form of evasion was suspected. These would have allowed the Departments to seize and hold assets up to the amount of the likely tax bill until everything was settled.

35. Customs and Excise included proposals for jeopardy assessments in their consultations prior to their 1976 VAT

legislation. These were heavily criticised, particularly by the CBI, on the grounds that they would allow tax to be collected, in some cases, before it would otherwise be due. Ministers withdrew the VAT proposals, saying that the Government saw merit in Keith's recommendation, but accepted that there were difficulties with this approach. Ministers said that the intention was to secure assets until the tax affairs were sorted out, rather than to seize them, and the Department would review how best to achieve this. Customs and Excise have not brought forward fresh proposals of their own, as yet.

36. Briefly, our paper proposes that where there is evidence that a taxpayer is about to move himself or his assets out of the reach of the Courts leaving his tax unpaid, the Revenue should be able to apply to the High Court for an order that the taxpayer gives such security to the Revenue as the Court thinks fit. We would have to satisfy the judge that it was likely that tax would be lost, and the amount of the probable loss, to establish whether, and in what amount, security should be given. The taxpayer would be able to apply to the Court to have the order varied or set aside if he disputed either our estimate of his tax debts or our suspicions over his intentions. Furthermore, provision would be made for the Revenue to pay damages - as is usual in such High Court procedures - in appropriate cases, where its claims were ill-founded.

37. The proposed new procedure is not intended to be used against the small defaulter. It would be used in a handful of cases a year where very substantial amounts of tax were at risk. It is difficult to gauge what the likely reaction will be. The new proposal certainly meets the main objections of the representative bodies to the VAT proposal. It also addresses the obvious wrong of a handful of tax evaders who leave the country each year leaving millions in unpaid tax, whilst avoiding more oppressive alternatives such as exit charges on every individual leaving the country. But it is a touchy subject, as the VAT experience showed. So the proposals are expressed very tentatively in

this paper, leaving Ministers an easy escape route if the reaction is very strongly against.

38. We have kept Customs and Excise informed of our proposals here. If these were to go ahead, it would be necessary at some stage for Ministers to consider whether a similar scheme might be appropriate for Customs and Excise.

Oversight by Commissioners

39. The use of the Revenue's general information powers is subject to oversight by the Appeal Commissioners. At present this is exercised before the event - the Inspector has to get permission from the Commissioners each time the power is to be used. Keith recommended that it should be exercised after the event - by allowing the taxpayer to appeal to the Commissioners against the power being used.

40. All the main representative bodies objected to this change. Given the choice between oversight before and oversight after, they prefer oversight before. The paper therefore suggests that there should be no change. This will not wholly satisfy them. They would prefer oversight both before and after. But this would place an unreasonable burden upon the Revenue and the Commissioners (see paragraphs 4.7 to 4.15).

OTHER PROPOSALS THAT HAVE BEEN DROPPED

41. There are certain other changes which should get a welcome, from some outside opinion at least, as proposals which were criticised have been dropped.

New Criminal Offences

42. There are a limited number of specific Inland Revenue criminal offences. In other cases, where the Revenue prosecutes taxpayers it does so for general law offences - such as theft or cheating the public revenue. Keith

suggested that new specific Revenue criminal offences should be created for dishonesty. The principal effect would be to make it easier for us to prosecute relatively petty offenders in some cases eg in the black economy.

43. Our conclusion is that there is little merit in creating new criminal offences for matters which can be dealt with appropriately and effectively under the general criminal law. The paper therefore suggests that this recommendation be dropped. (See paragraphs 3.51 to 3.52.)

Copies of information to taxpayers

44. Keith wanted businesses that make bulk returns of information to the Revenue (for instance, a bank making a return of interest paid to depositors), to copy the details to each taxpayer involved. This would be very onerous to businesses and has been dropped. (See paragraphs 7.4 to 7.15.)

Requirement to keep records for tax purposes

45. Keith wanted all businesses to be required to keep records for tax purposes and the Revenue to make control visits to check these. These visits were criticised as "fishing expeditions" in the January edition of Small Business.

46. Although there is obvious merit in Keith's recommendation, it would add to the compliance costs of small businesses and to the administrative costs of the Revenue. And for companies we can, at present, rely to a certain extent on the Companies Act requirements. This proposal has, therefore, been shelved (see paragraphs 7.18 to 7.23).

PROPOSALS THAT ARE MISSING

47. Finally, there is one issue that is missing, whose absence may be criticised.

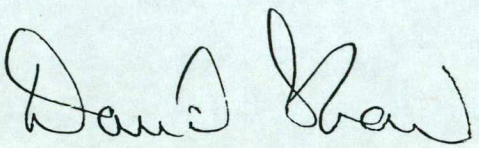
Reports of Special Commissioners Decisions

48. Para 1.10 refers briefly, for completeness, to a separate consultative document or documents to be issued later by the Inland Revenue and the Lord Chancellor's Department on procedures for tax appeals. You agreed that we should deal with appeals separately and until we have the Lord Chancellor's Department signed up to proposals there is no point in your committing yourself to a timetable for consultation.

49. It is unlikely that the lack of proposals here will cause much comment, with one possible exception. The lack of proposals to publish Special Commissioners cases, in anonymised form, may attract criticism. Representative bodies see this as the most important of Keith's recommendations on appeals. They may accuse us of delaying publication because the change would help taxpayers rather than the Revenue.

50. It is not easy to answer this criticism since we are not responsible for the Special Commissioners. We would be content for the main decisions to be published, and the 1983 Finance Bill included provisions to enable publication in anonymous form. But those proposals were dropped when the 1983 Election was called and not reintroduced the following year when the Special Commissioners became the responsibility of the Lord Chancellor. The then Lord Chancellor wished to consider further the implications of such a reform. His officials now wish to issue a separate consultative document on the possibility of the Special Commissioners sitting in public in most cases, which would remove the need for special arrangements to publish cases.

51. We hope to commit the Lord Chancellor's Department to this or to some other action on publication of decisions, and to a timetable, in the separate consultative document on appeals.



D L SHAW

Inland Revenue

Ch/ FST is content with the paper. Now that we have the PM's approval on 'residence', content for me to write as proposed to No 10? dr 21/7

Policy Division
Somerset House

FROM: C W CORLETT
FAX No. 6766
EXTN. 6614
19 July 1988

PRIVATE SECRETARY TO THE FINANCIAL SECRETARY

KEITH CONSULTATIVE PAPER

1. The Financial Secretary is holding a meeting tomorrow afternoon to discuss the draft paper which we submitted on 6 July.

2. We have just completed discussions with Lord Young's officials from the EDU who, subject to a couple of clarifying suggestions which we are happy to accept, are content with the paper. This should clear the way with Lord Young.

3. On that basis, I attach a draft covering letter which, subject to the outcome of tomorrow's meeting and any revisions to the paper which the Financial Secretary may wish to make, could be sent by the Chancellor's Office to No.10.

C W CORLETT

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cc Principal Private Secretary
Mr Culpin
Mr Gilhooly
Mr Cropper
Mr Tyrie
Mr Isaac
Mr Beighton
Mr Shaw (P2)
Miss Barlow
Mr Dunbar
PS/IR
Mr Corlett

DRAFT LETTER TO NO 10

Pse type final for 27 signature
(to Paul Gray)

cc Private Secretary to
the Secretary of State
for Trade & Industry

Draft letter from the Chancellor's Private Secretary to the Prime Minister's Private Secretary

IMPLEMENTATION OF THE KEITH REPORT

In December 1986, with the approval of the Prime Minister and the Chancellor, the Inland Revenue, after confidential discussions with a number of representative bodies, published proposals and draft clauses in response to the Keith Committee's recommendations for modernising tax administration.

This followed

Since then, measures have been brought forward in the last two Budgets to give effect to some of the proposals. None of the measures - all of which reflected the outcome of consultations - has aroused significant controversy.

There have also been continuing discussions on the recommendations still outstanding. In the course of these, certain of the business and professional representatives suggested that a follow-up document should be published, taking stock of the outcome of the further consultations and making our response known to a larger audience. The attached paper, which the Chancellor proposes should be published this summer, is the result of this suggestion.

The public it is aimed at is a specialist and mainly professional one which is already familiar

with the subject matter. This reflects experience with the 1986 document, on which comments came almost exclusively from bodies representing business and the legal and accountancy professions. Past experience also suggests that there will be minimal interest from the daily press and the main coverage will be in professional journals.

A large proportion of the paper is concerned with the comments received on the 1986 proposals. Where these received widespread support, they have been left more or less unchanged. Where there was concern - as for example about the recommendations on penalties for tax evasion, which, even after the Keith approach was modified, were generally seen as too inflexible - this has in many cases been met with revised proposals. The overall approach, therefore, is to seek to modernise the tax system in the main ways which Keith recommended where these were well received, but in other respects leave the existing structure broadly unaltered. This should ensure a generally favourable reception for these aspects of the paper.

The rest of the paper covers matters previously left open for further consideration - principally, the detailed interest arrangements for the 'pay and file' system of corporation tax payment which we are moving towards, and further improvements to the administration of PAYE.

The paper has been seen by officials from the Enterprise and Deregulation Unit, who suggested a

few amendments, but have otherwise expressed themselves content.

No indications are given in the paper of a timetable for legislation. But, after the two packages of the last two Budgets, the Chancellor believes that what is left from the 1986 consultative document may not now be too much for inclusion in a single Finance Bill. This could be next year - although firm decisions on the content of the 1989 Finance Bill are clearly still a long way off. Early publication of the paper involves no committments, but any substantial delay beyond the beginning of the main holiday season is likely to provoke criticism from the interested representative bodies and could restrict options on timing. Subject to the Prime Minister's agreement, the Chancellor would therefore like to have the paper issued around the end of this month.

A copy of this letter goes to Jeremy Godfrey (DTI). ~~[ ] at the Department of Trade and Industry.~~

JMG T—

P— S—

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

25 July 1988

Dear Jonathan,

IMPLEMENTATION OF THE KEITH REPORT

The Prime Minister was most grateful for the sight of the draft consultative document attached to your letter to me of 21 July.

The Prime Minister is pleased to note from section 5 of the draft that the override proposal has been dropped and that it is intended that tax advice given by accountants should enjoy broadly similar protection to that given by lawyers. She is content for the consultative document to be issued as proposed, but may wish to offer further thoughts when she has had the opportunity to study the document more fully.

I am copying this letter to Jeremy Godfrey (Department of Trade and Industry).

Yours,

Paul

(PAUL GRAY)

Jonathan Taylor, Esq.,
HM Treasury.

dti

the department for Enterprise

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

.J M G Taylor Esq
Private Secretary to the
Chancellor of the Exchequer
HM Treasury
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CH/EXCHEQUER
REC'D 01 AUG 1988
ACTION FST
COPIES TO

Direct line 215 5422
Our ref PS5BFA
Your ref
Date 29 July 1988

Dear Mr Taylor,

IMPLEMENTATION OF THE KEITH REPORT

Thank you for copying me your letter of 21 July to Paul Gray. The opportunity for DTI officials to see and comment on the draft was much appreciated. As you say, they were broadly content, feeling that the proposals in it pointed in the right direction and that it provided a good basis for further consultation.

Their comments were of course made on the basis of a preliminary review of the document in the days leading up to its finalisation, and the Department may have more detailed comments to offer in due course in the light of the response from business.

I am sending a copy of this letter to Paul Gray at No 10.

Yours sincerely,

Gareth Jones

GARETH JONES
Private Secretary

the Enterprise initiative

Board Room
H M Customs and Excise
15th Floor Alexander House
21 Victoria Avenue
Southend-on-Sea
SS99 1AA
0702 348944

FROM: C C FINLINSON
DATE: 4 JANUARY 1989

Economic Secretary

cc Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Paymaster General
Mr Call
Mr Culpin
Mr Gilhooley
Mr Michie

DEFAULT SURCHARGE REVIEW

A copy of the Review is attached. The main points are summarised below.

Introduction

1. Default Surcharge was first reviewed as part of a general review of civil penalties before the 1988 Budget (the "Keith Review", dated 30 December 1987). The conclusion then was that it was too early to fully evaluate the impact of surcharge on business and compliance, because the first surcharges on quarterly traders were not assessed until May 1987 and subsequently the picture was distorted by industrial action.

The current review was announced in a written answer to an arranged question addressed to the Chancellor of the Exchequer (Wednesday 13 July 1988, OR Vol. 137, col. 98). Trade and other interested parties were invited to contribute. A list of contributors is at Annex 11 to the report. A list attributing comments to named organisations has not been included in the report but is at Annex A to this covering note. At Annex B is a list of those invited to contribute but who declined or failed to do so.

Conclusions

2. Default Surcharge has proved to be a most effective means of inducing better compliance. The primary object of halving the amount of tax outstanding by 31 March 1989 has been achieved. The proportion of tax outstanding had been reduced from 7.4% in June 1985 to 3.6% on 30 September 1988, therefore some relaxations can now be introduced without appreciably reducing its effectiveness.

3. As was to be expected, automatic penalties for late payment are not popular, but given the radical nature of the change, it has generally been accepted calmly. This is

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CPS Mr Jefferson Smith Mr Fryett Dr McFarlane
Mr Goddard
Mr Hogg
Mr Holloway
Mr Trevett
Mr Wardle
Mr Blomfield

due to some extent to our policy of assessing a surcharge only against traders who are established, continuing in business, and who normally pay tax. We have excluded from the surcharge provisions traders who regularly claim refunds of tax (eg farmers), the first returns from newly registered businesses, traders in the process of deregistering and traders who are insolvent, missing or representing the recently deceased.

4. Despite further representations, we remain firmly of the view that a general power of mitigation would be extremely resource-intensive to operate, both for us and the VAT Tribunals, and would have a negative effect on both compliance and the revenue benefits of the Keith legislation.

5. Representations on reasonable excuse have tended to be dismissive or cynical. This cynicism is not justified by the facts. Statistics up to the end of November 1988 are included in the report; on average we accept more than 25% of excuses offered by traders. Of the relatively few who appeal to the VAT tribunal, only about 20% are successful. We can therefore demonstrate a sensible application of the reasonable excuse provisions, very much to the taxpayer's advantage.

6. It has been suggested that either the law should provide for what is a reasonable excuse, or our internal policy guidelines should be made public. Neither is desirable. A reasonable excuse depends wholly on the individual circumstances of each case, eg what may be a reasonable excuse for a sole proprietor is not necessarily reasonable for a large company. As in the previous review of surcharge we conclude that the reasonable excuse provisions should remain unaltered. A leaflet on reasonable excuse will be issued early in 1989. This will set out what is not a reasonable excuse, as found by the VAT Tribunals, and will give a broad indication of what may be a reasonable excuse.

7. We have again rejected the arguments by the National Federation of the Self Employed, among others, for notification at the time of the first default. It would have little practical effect and would seriously affect the timetable for implementing Keith Phase III. The main problem is the time necessary, about six months, to re-program and test the changes that would have to be made to our computer system. This would result in a substantial loss of revenue from the delay to Keith III measures.

8. Experience has shown that the main improvement in trader compliance is prompted by the issue of a Surcharge Liability Notice (after two defaults) rather than by the subsequent imposition of a surcharge at progressively higher rates. We conclude therefore that the maximum rate could be reduced to 20% without weakening surcharge as a deterrent. The cost of this change is estimated at £18M surcharge per annum.

9. The number of traders at each stage of the surcharge system has remained fairly static, although the companies and individuals involved vary. We are gradually chipping away at the hard core of non-compliance. Annexes 4 and 5 refer.

10. We do not recommend a further review of the surcharge system but it would be appropriate to include default surcharge in any major review of the Keith Penalty system undertaken following the implementation of Keith III.

Recommendations

11. The recommendations of this review are:

	Recommendation	Review reference
11.1	The maximum specified surcharge percentage should be reduced from 30% to 20%. (FA 85 S19(5)(c).)	Paragraph 11.2

11.2	A surcharge should not be assessed when, calculated as a percentage of the tax outstanding, it does not exceed £15.	Paragraph 7.2
11.3	Legal provision should be made to enable the Commissioners to maintain, albeit at a lower rate, those surcharges which would otherwise be cancelled where an SLN is deemed not to have been served. (FA 85 S19(6).)	Paragraph 8.3

The Next Steps

12. Recommendations 11.1 and 11.3 have been submitted to you as possible Finance Bill 1989 clauses. Recommendation 11.2 will be implemented under the discretion given to the Commissioners to manage the tax (Finance Act 1985 S.21(1) "the Commissioners may assess the amount due ... and notify it ... ".

13. You may wish to make a statement in the House. I would, however, be grateful if any Ministerial statement could be delayed until after the end of January 1989.

14. We shall, of course, be pleased to discuss the report with you should you wish.

C C FINLINSON

ANNEX A

A LIST OF CONTRIBUTORS AND A SUMMARY OF THEIR COMMENTS

Association of British Insurers	Extend time limit for compliance.
Barnsley Cannister Company	Mitigation
The Chartered Institute of Management Accountants	Mitigation, insuffiency of funds should be reasonable excuse.
Confederation of British Industry	Mitigation, interest to replace surcharge.
Council on Tribunals	Mitigation
Department of Employment	Mitigation
Department of Trade and Industry (The Enterprise and Deregulation Unit)	Mitigation, notification of first default, interest to replace surcharge, late repayment returns not to count.
D H Bloom & Co	Mitigation, surcharge excessive, interest to replace surcharge
G B Techniques Ltd	Mitigation
Glasgow Chamber of Commerce	Mitigation, extend time limit for compliance
VB Goodman FCA	Extend time limit for compliance
Ian Afflick FCA	Extend time limit for compliance
The Institute of Chartered in England and Wales	Mitigation

The Institute of Chartered Accountants of Scotland	Mitigation, upper limit of 100,000 for surcharge assessment, time related penalties, lack of publicity about surcharge
Institute of Directors	Mitigation, surcharge harsh, repayment returns not to count for defaults
The Institute of Taxation	Mitigation. surcharge excessive, notification of first default. Guidance should be issued about reasonable excuse.
Jackson Son & Co	Mitigation
Matthew Hall plc	Notifiction of first default
The National Chamber of Trade	Lack of publicity about surcharge
The Society of Motor Manufacturers & Traders Ltd	Notification of first default, maximum for surcharge assessments.
VAT Tribunals	Time related penalties, extend time limit for compliance, relate surcharge assessment to average tax paid over 4 returns, increase threshold for cash accounting and annual accounting
Wellington Nurseries	Surcharge excessive, mitigation.

ANNEX B

LIST OF ASSOCIATIONS ETC WHO HAVE NOT RESPONDED TO AN INVITATION

Those who have given a reply but have offered no comments on default surcharge are marked with an asterisk.

Alliance of Small Firms and Self Employed People Ltd
The Association of British Chambers of Commerce
*Association of Independent Businesses
*The Brewers Society
British Amusement Catering Trades Association
British Bankers Association
British Importers Confederation
British Retailers Association
Builders Merchants Confederation
The Chartered Association of Certified Accountants
Chartered Institute of Public Finance and Accountancy
City of London Solicitors Company
*The Forum of Private Business
Gin Rectifiers and Distillers Association
The Institute of Chartered Accountants in Ireland
*The Law Society of England and Wales
The Law Society of Scotland
The National Farmers Union
National Federation of Retail Newsagents
National Federation of Self Employed and Small Businesses Ltd
*The Retail Consortium
The Small Business Bureau
The Society of Conservative Lawyers
The Society of Solicitors in the Supreme Courts of Scotland
Union of Independent Companies

*VAT in Industry Group

VAT Practitioners Group

The Wine and Spirit Association of Great Britain and Northern Ireland.

VCBAA/D2

When, Ken, can we announce Keith has completed? (the 2 main vols.)

Ch.

Keith.

Your question behind.

2. The answer is 'very little'. On Vols I & II, all VAT proposals are dealt with; on direct tax, the only thing left concerns appeals procedures.

3. Vol III is about minor Revenue taxes, most of which are dealt with or defunct (eg. DLT, CTT). Vol IV is about customs, excise, + car taxes. The main outstanding point here, is the possibility of decriminalising some of the more petty types of smuggling (e.g. an extra bottle of whisky over your duty-free allowance).

JR 3/7

Inland Revenue

Compliance and
Collection Division
Somerset House

How much - if any - of KAR remains for you after this year's FB?

FROM: D L SHAW

DATE: 29 JUNE 1989

This is the only point outstanding on the Keith package which has otherwise gone through smoothly. As Mr. Shaw says, the CBI target was a recommendation the Government did not accept. Sir William's amendment would have a number of practical problems and you may care to explain to him in a letter why it would be inappropriate.

1. MR ROBERTS
2. MR BEIGHTON
3. FINANCIAL SECRETARY

CLAUSE 138 - SIR WILLIAM CLARK'S AMENDMENT

1. Sir William Clark moved an amendment to Clause 138 in Committee of Whole House. He withdrew his amendment after you gave a promise to reflect further on what he had said, but without giving any commitment to bring a proposal forward at Report.

Sir William's amendment

2. The effect of Sir William Clark's amendment would be to extend part of the special safeguards introduced last year for notices in respect of unnamed taxpayers - the right of appeal by the third-party to the Special Commissioners on the grounds of onerousness - to notices given to third-parties in respect of named taxpayers under the existing powers.

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cc		
cc	PS/Chancellor	Mr Beighton
	PS/Chief Secretary	Mr Bush
	PS/Paymaster General	Mr Roberts
	PS/Economic Secretary	Mr Hugo
	Mr Gilhooly	Mr Page
	Mrs Chaplin	Mr Shaw
	Mr Tyrie	Mrs Banner
	Miss Hay	PS/IR

3. The main thrust of Sir William's argument was that the present safeguards before the notice is issued, together with the longstop of appeal by judicial review or penalty proceedings, does not provide sufficient safeguards to the third-party against an unreasonably onerous request. Sir William suggested that the third-party should have the right to go before the Special Commissioners to say that the request is far too onerous. Indeed, Sir William went beyond that to suggest that both the third-party and the named taxpayer should be present when the Inspector applies to the Commissioners for consent to use his information powers.

Consultations

4. As far as we can establish, there has been no proposal to this effect during the many years of consultations on the recommendations of the Keith Committee. There has certainly been no such proposal from the main bodies that represent the persons that might normally receive third-party notices, banks and accountants.

5. The CBI tell me that the amendment is not intended to address a known problem. They are not aware of any difficulties with third-party notices in practice. The amendment was inspired by their long standing concern, since the Keith Report was first published, that Keith's new general approach - which would have given the Revenue much wider powers to call for information from third-parties - would have allowed the Revenue to make excessive and unreasonable demands. The Government has, however, rejected the new general approach, and has left the power to call for information about a named taxpayer from a third-party unchanged, apart from closing some minor lacunae.

Comments on Sir William's amendment

6. Sir William's amendment raises no new points, which have not already been exhaustively discussed and dismissed

during nine years of discussions and consultations since the Keith Committee was set up.

7. The interests of the third-party are properly safeguarded under the present procedures. These ensure that he is given an opportunity to make any objections that he has to the information notice, including objections on the grounds that it is unduly onerous, before the application for consent is heard. Any objections that he makes would be heard by the Commissioner and taken into account in deciding whether consent should be given.

8. It is not appropriate to allow either the taxpayer or the third-party to be present at a full inter-partes hearing against an information notice before the Commissioners, as Sir William would wish, since this could prejudice the investigation and breach confidentiality.

9. But this does not deny rights to a wronged taxpayer or third-party. They can appeal against an information notice either by way of judicial review or penalty proceedings, although their rights to obtain stay of an information notice are necessarily circumscribed by the requirements of public interest immunity. This immunity is, however, limited in time, and an injured taxpayer or third-party could sue the Revenue for wrongful intrusion of privacy and obtain damages where appropriate.

10. These procedures, and remedies, correspond to those found generally in English law in relation to the information powers of investigating authorities.

Detailed comments

11. I attach a copy of the debate in the Committee of Whole House and a more detailed discussion of the points raised by Sir William's amendment, in case you wish to see these in full.

Recommendations

12. We do not consider that further safeguards are needed for third-parties, nor that a direct right of appeal would be appropriate. We therefore recommend that no amendment is brought forward at Report.

13. If you accept our recommendations, you may wish to write to Sir William Clark before Report explaining your decision, and your reasons. I should be pleased to provide a draft letter, if you wish.

David Shaw

D L SHAW

Clause 138

POWER TO CALL FOR DOCUMENTS AND INFORMATION

Sir William Clark (Croydon, South): I beg to move amendment No. 23 in page 103, line 45, at end add—

'(7A) In subsection (8B) after the words "under subsection (8A) above" there shall be added the words "or under subsection (3) above".'.

I shall not detain the Committee for long. The amendment is rather technical, but it impinges on the rights of taxpayers vis-á-vis the Inland Revenue. The Committee will recollect that following the Keith report the Inland Revenue has taken powers to require third

[Sir William Clark]

parties to disclose documents and information about individual taxpayers. Not only does the Inland Revenue have that right, but it does not necessarily have to name the taxpayer. For example, the Inland Revenue could ask an insurance company how many insurance policies covering inheritance tax had been taken out in the past six or 12 months. That can put a tremendous cost on third parties.

7.15 pm

The amendment endeavours to give the taxpayer the right of appeal because the Inland Revenue has to go before the commissioners to get permission to ask a third party for information about individual taxpayers, whether or not they name them. "Keith: Further Proposals" which came out last year, recommended that all third parties who were asked for information about a particular taxpayer, whether identified or not, should have the right of appeal, as some of the costs of complying with some of the Inland Revenue's requests to third parties could be pretty onerous. One could envisage that a third party might be asked by the Inland Revenue something about a taxpayer that happened 10 or 15 years ago. That would put an onerous and costly responsibility on that third party.

I hope that my right hon. Friend the Financial Secretary will not resist the amendment as it gives the third party another appeal to which he should be entitled. In my view, the Inland Revenue should not have the right to ask a third party to produce information about a taxpayer if that third party does not have the right to say that the request is far too onerous without being allowed to go before the special commissioners. I am asking only that the third party should be able to go before the special commissioners.

I am sure that my right hon. Friend will say that the third party has the right not to comply with the Inland Revenue's request, and the non-compliance of that request then puts that third party into the penalty area. When that third party is subject to a penalty, he has the right to a hearing. It seems rather ridiculous that a third party, having been asked by the Inland Revenue to supply information, and having replied that the request is far too onerous and that it would be far to expensive to go back five or 10 years, then has to be in the penalty area before he can get a hearing in which he can say to the commissioners that the request is far too onerous.

I hope my right hon. Friend will consider the matter. It is a simple amendment, but it seeks to give more flexibility and certainly more rights to the third party who may have nothing whatsoever to do with the taxpayer being investigated.

Mr. Norman Lamont: My hon. Friend the Member for Croydon, South (Sir W. Clark) has asked an extremely important question. The provisions that we are discussing relate not to unnamed but named taxpayers. I make that clear because I think that my hon. Friend bracketed the two together.

For many years, the Revenue has been allowed to require a third party to provide access to documents in his possession relating to the tax affairs of a named person. This power is not altered by the Bill, other than to remove a small loophole that allows some third parties, in certain circumstances, to be used as safe havens if taxpayers are intent on frustrating the Revenue.

That power is subject to stringent controls. The inspector can require access only to documents that, in the inspector's reasonable opinion, contain information relevant to a tax liability of the person whose affairs are under inquiry. The inspector must first ask the third party to provide access to the documents voluntarily, and give him a reasonable time to comply. Only if this fails can the inspector proceed further. The inspector must next apply to an appeal commissioner, who is independent of the Revenue, for permission to issue a formal notice. The commissioner is required to be satisfied that in all the circumstances the inspector is justified in requiring access to the documents in question before he can give his consent. Only if the commissioner is satisfied can the inspector give a formal notice to the third party requiring him to provide access to the documents in question.

The existing procedures provide protection against any unnecessary or excessive invasion of privacy. In particular, they provide protection against unreasonable burdens on third parties.

The commissioner is required to be satisfied that in all circumstances the inspector is justified in proceeding with his request. This means that he must inquire into whether the request is reasonable and must take account of all representations which have been made. In particular, the informal request by the Revenue to the third party provides the third party with an opportunity to raise any objections that he has to the notice, including objections on the ground that it would be burdensome, which must be reported to the commissioner by the inspector and taken into account.

The Keith committee agreed that this information power should continue to be subject to oversight by the independent appeal commissioners, but Keith thought that the public would be better safeguarded if the present procedures for an informal request and review by the commissioners, in every case before a notice was given, were replaced by a right of appeal to the commissioners after the notice had been given. Most of the respondents in the consultations on the recommendations of the Keith committee disagreed. The overwhelming majority of respondents, including all the bodies representing businesses and the accountancy and legal professions, believed that the existing provisions—with oversight by the commissioners before the event—would provide better safeguards for the taxpayer than oversight after the event through a separate right of appeal.

The Inland Revenue proposed, in the consultative paper published last July, to leave the procedures unchanged. The majority of respondents to that consultative paper agreed. A few suggested that there should be oversight both before the event, and oversight after the event with a new right of appeal. The majority of respondents recognised that this was not necessary, and would put an unreasonable burden on the Revenue and the commissioners. The present procedures provide full safeguards for the taxpayer and it is not necessary to introduce further complications.

My hon. Friend the Member for Croydon, South suggests that a limited right of appeal should be introduced to allow third parties to appeal on the ground that it would be onerous to comply with the notice. When we introduced a new power, in last year's Finance Bill

allowing the Revenue to require access to documents about unnamed taxpayers, we included such a right of appeal. However, there is a distinction in the circumstances. A notice requiring information relating to an unnamed taxpayer can be in respect of a possibly large class of taxpayers. This means that the Revenue and the appeal commissioners may inadvertantly require access to documents relating to a much larger class of taxpayers than was intended. For this reason, we provided a limited right of appeal on the ground that it would be onerous to comply with the notice. The circumstances are different for a notice in respect of a single, named taxpayer.

I am reluctant to accept the amendment. Although the third party does not have a direct right of appeal to the commissioners, he has full and proper right of appeal under the present procedures. First, the third party can appeal directly to the courts by way of judicial review. The Revenue is entitled to require access to documents that may reasonably be required for the purposes of determining the tax liabilities of the named taxpayer. A notice requiring access to more documents than could reasonably be required would be struck out by the courts, as was established in 1974 in Clinch v. Commissioners of Inland Revenue.

Secondly, the third party has an indirect right of appeal to the appeal commissioners. If the third party considers that the notice is unreasonable, he can object to the Revenue, explaining his reasons. The Revenue can accept his reasons and withdraw or modify the notice, or reject them and insist that he complies with the notice. If he refuses to do so, the Revenue can let the matter drop or institute penalty proceedings before the appeal commissioners. The proceedings give the third party an opportunity to appeal against the notice to the appeal commissioners by explaining his reasons for refusing to comply. If the taxpayer's appeal is upheld, there will obviously be no penalty.

I am not persuaded by the amendment. The subject was discussed in consultations on the recommendations of the Keith committee. It was widely recognised that one had a choice of oversight before or after the event, but not both. Although my hon. Friend made some comments about penalty proceedings, there is a long stop by which the taxpayer can gain access to the appeal commissioners.

My hon. Friend was as persuasive as he always is, but I cannot accept the amendment.

Mr. William Clark: My hon. Friend did not say that the third party is not represented before the commissioners. I cannot understand my right hon. Friend saying that the third party has access to the courts. Of course he has, but that is terribly expensive. If I am a third party and the Revenue is inquiring into the tax affairs of someone I knew years ago, I cannot understand why I should be put to the burdensome cost of complying. Who will pay the legal fees? They will fall on me. It would be simpler if my right hon. Friend were to reconsider the issue. It is simple to allow the third party a right of immediate appeal to the commissioners, whereby everyone is protected. It is convoluted to say that there is a long stop and that the third party can argue his case in the penalty proceedings. I do not think that my right hon. Friend can justify that.

Why can the inspector of taxes request a third party's documents from the commissioners without the third party or the named taxpayer being present?

Mr. Norman Lamont: The recommendations are based on the recommendations of the committee under Lord Keith. They were the subject of widespread consultation and there was a degree of consensus for them. However, my hon. Friend is clearly unhappy. I will reflect further on what he has said, but I hope that he will not take that as a commitment to bring a proposal forward on Report.

Sir William Clark: I accept that and I am most grateful to my right hon. Friend. He said that there had been considerable consultation and that the consensus was that this provision was perfectly all right under the Keith proposals. However, the Confederation of British Industry, which represents a tremendous amount of the business interest in this country, is not happy. As my right hon. Friend has promised that he will consider my proposal—I realise he will do so without commitment—I beg to ask leave to withdraw the amendment.

Amendment, by leave, withdrawn.

7.30 pm

Question proposed, That the clause stand part of the Bill.

DETAILED COMMENTS ON SIR WILLIAM CLARK'S AMENDMENT

Background

1. Sir William Clark's amendment relates to the Revenue's powers, in the course of enquiries into a person's tax affairs, to require a third-party to supply access to relevant documents in his keeping.

2. This power was introduced in 1976 as part of a general updating of the Revenue's information powers, which were proving increasingly inadequate to cope with avoidance and evasion.

3. It is recognised that any information power involves an intrusion of privacy. These powers therefore include important safeguards, so as to ensure that they cannot be used in an unreasonable or oppressive fashion.

4. In particular:

- the power can be used only in relation to the tax affairs of a single, named taxpayer;

- the Inspector is allowed access only to documents which, in his reasonable opinion, contain information which is relevant to that person's tax liability;

- the Inspector must first ask the third-party to provide access to the documents voluntarily and allow a reasonable time for him to comply or to make any representations on the request. It is only if he fails to obtain reasonable access that the Inspector can proceed further;

- the Inspector must next apply to an independent Appeal Commissioner for consent

before he can issue a formal notice requiring access to the documents;

- before he gives consent, the Commissioner is required to satisfy himself that in all the circumstances, and taking account of any representations made, that the Inspector is justified in requiring access to the documents.

Keith Committee

5. The Keith Committee was set up, inter alia, to examine the Revenue's information powers. Keith found no evidence that the information powers were either excessive or were misused. But Keith did find that the information powers were too restrictive on the Revenue and recommended first a number of specific improvements to the Revenue's powers and second a new general approach.

Keith's proposals for a new general approach

6. Keith proposed a new general approach whereby all the restrictions on the use of its information powers by the Revenue would be removed and the oversight by the independent Appeal Commissioner would be changed from an ex-parte hearing before the notice is issued to a limited right of appeal and inter-partes hearing after the notice is issued.

7. Under this new approach, the Inspector would be able to issue a formal notice to any person, without prior warning, requiring him to provide any information which the Inspector wished to have. The person would

be able to appeal to the independent Appeal Commissioners against the notice, but only on the following grounds:

- the reasonableness of the Inspector's opinion as to the relevance of the information for tax;

- the existence of any documents required to be produced;

- possession of or power over any such document;

- the reasonableness of the time allowed to produce the information;

- the status of the documents in relation to a claim to confidentiality, legal professional privilege, public interest immunity or immunity in respect of an auditor's papers.

Reactions to Keith's recommendations

8. Keith's recommendations for specific improvements to the information powers were generally non-contenious. Keith's recommendation for a new general approach was, however, very widely criticised. All the representative bodies thought that it gave too much power to the Revenue and could allow the powers to be used in an intrusive and oppressive fashion.

Consultations and legislation on Keith

9. Although Keith's specific improvements were largely non-controversial, there were some criticisms. Modified proposals were worked out with the representative bodies to meet these points. These were mostly concerned with questions of onerousness to

third-parties. For instance, the representative bodies were concerned that the extension to particulars could be onerous for third-parties, and it was therefore restricted to first-parties. And they were concerned that notices in respect of unnamed taxpayers could be unduly onerous in certain circumstances and a separate right of appeal was proposed to cover this.

10. It was decided not to proceed with Keith's new general approach in view of the strong opposition to it. Given the choice between the present system of safeguards, including oversight by an independent Appeal Commissioner in every case before the power can be used, and oversight through a limited right of appeal after the notice has been issued, all of the representative bodies strongly preferred the present system.

11. Some of the specific improvements were legislated last year. The revised proposals for the remaining improvements worked out with the representative bodies, including the rejection of Keith's new general approach and the retention of the present system of safeguards, were published in last year's consultative paper. The revised proposals were very well received in responses to the consultative paper and appear unchanged in this year's Finance Bill.

Information about unnamed taxpayers

12. The existing powers are designed to allow the Revenue to obtain information in the course of enquiries into a person's tax affairs. The person whose affairs are under enquiry must be named in the notice. Keith recommended that the Revenue should also be able to obtain information about unnamed taxpayers, in certain circumstances.

13. The unnamed taxpayer provision is rather different from the other information powers, both in its purpose and its operation. The other information powers are designed to allow the Revenue access to information that it needs in the course of enquiries into a particular taxpayer's affairs. The unnamed taxpayer provision is designed to assist the Revenue to uncover the identity of the taxpayers involved where there is good reason to believe that they will have returned their tax liabilities incorrectly. This might involve identifying a single taxpayer, for instance where he is hiding behind nominees or using an alias, or it might involve identifying a number of taxpayers, for instance where a tax avoidance specialist has marketed a scheme which has proved to be ineffective.

14. The purpose of the power is to allow the Revenue to uncover the true identity of the persons involved. But in order to do this, particularly where the taxpayer or third-party may wish to frustrate the Revenue's enquiries, it is necessary to allow the Revenue access to any document which may contain relevant information. The power is therefore very broad and potentially allows the Revenue access to a wide range of documents relating to a wide range of persons. But this is counter-balanced by additional safeguards both before and after the notice is given. Before the notice is given, the Inspector must satisfy both the Board of Inland Revenue and a Special Commissioner that the matters under investigation are serious and that the documents are needed to identify the taxpayers. And after the notice is given, the person it is given to may appeal to the Special Commissioners on the grounds that it would be onerous for him to comply. The Commissioners are given complete freedom to confirm, vary or cancel the notice.

15. This right of appeal on grounds of onerousness is designed to get round a particular problem with this provision. The purpose of the power is to uncover the true identity of the taxpayers involved. It will normally be necessary to use the power only where the third-party refuses to cooperate with the Revenue's enquiries. This means that the Revenue, and the Commissioners, will sometimes have to cast their net very widely and include a wide range of documents for each of a wide range of persons so as to be reasonably sure of success. This may result in a very onerous obligation. The right of appeal on grounds of onerousness gives the third-party a further opportunity to cooperate and to agree, with the Revenue or the Commissioners, to provide the information that is really needed, for instance to select the essential documents or to provide the names and addresses of the persons involved.

Sir William Clark's amendment

16. The effect of Sir William Clark's amendment would be to extend part of the special safeguards introduced last year for notices in respect of unnamed taxpayers - the right of appeal by the third-party to the Special Commissioners on the grounds of onerousness - to notices given to third-parties in respect of named taxpayers under the existing powers.

17. Sir William's arguments were not wholly clear. For instance, he suggested that these were new powers, which they are not. He bracketed together notices in respect of named taxpayers and notices under the separate, and quite different, unnamed taxpayer provision. He suggested that the Revenue might call for information going back 10 or 15 years, which the Revenue cannot except where the Commissioner is satisfied that there are reasonable grounds for believing that tax has been lost through fraud.

18. But the main thrust of Sir William's argument was that the present safeguards before the notice is issued, together with the longstop of appeal by judicial review or penalty proceedings, does not provide sufficient safeguards to the third-party against an unreasonably onerous request. Sir William suggested that the third-party should have the right to go before the Special Commissioners to say that the request is far too onerous. Indeed, Sir William went beyond that to suggest that both the third-party and the named taxpayer should be present when the Inspector applies to the Commissioners for consent to use his information powers.

Inter-partes hearing

19. Sir William Clark was concerned that the named taxpayer and the third-party are not present when the Inspector makes his application to the Commissioner for consent to use the information power. Sir William sought to redress the balance by allowing the third-party to challenge the notice at a full inter-partes hearing before the Special Commissioners if he considers that it would be too onerous to comply. In effect, Sir William is saying that if a third-party feels that it would be too onerous to comply, he should be able to challenge the Inspector's reasons for wanting the information at a full inter-partes hearing before the Special Commissioners. These arguments are bad in law.

20. It is generally recognised that full inter-partes hearings are not appropriate in relation to information powers for reasons known as public interest immunity. It is for these reasons that the grounds of appeal which would have been allowed under Keith's new general approach would have been heavily circumscribed. In particular, Keith's proposals would not have allowed appeals to be made on the grounds of onerousness.

21. The main reasons that full inter-partes hearings are not appropriate are as follows:

Onus of proof A direct right of appeal would put the onus on the Revenue to prove that its actions were justified. In other words, before the Revenue could obtain further information in order to establish whether a taxpayer's liabilities had been returned correctly, it would have to be able to prove that they had not. This would put the cart before the horse.

Premature disclosure A direct right of appeal would force the Revenue to show its hand at an early stage in an investigation. Premature disclosure of the reasons for the Revenue's enquiries could prejudice the investigation, for instance by allowing the taxpayer to provide explanations which tallied with what was known to the Inspector or to prevent damaging disclosures from being made.

Confidentiality The Revenue owes a duty of confidentiality to the taxpayer and, where appropriate, to informants. This would frequently make it impossible for the Revenue to explain the reasons for its enquiries in an inter-partes hearing. In particular, it would never be appropriate to discuss the affairs of the taxpayer in the presence of a third-party, as would be required by Sir William's amendment.

Differences between rights of appeal under named and unnamed taxpayer provision

22. Sir William's amendment relates to a general information power to obtain access to relevant documents in the course of enquiries into a person's tax affairs. It would be wholly inappropriate to require the Revenue to establish the reasons for its

enquiries at an inter-partes hearing, particularly in the presence of a third-party as would be required by Sir William's amendment. In general, this would both prejudice the investigation and breach confidentiality.

23. These problems do not arise with the unnamed taxpayer provision. The purpose of the enquiry is then clear. It is to establish the identity of the unnamed taxpayer or taxpayers. The Revenue can therefore establish the reasons for its enquiries at an inter-partes hearing without prejudice to the investigation or breach of confidentiality.

24. For instance, the Revenue might typically wish to know from a person involved in certain transactions, the identity of another person who is involved but has acted through an offshore nominee. Or, the Revenue might wish to know from a person who has marketed an avoidance scheme which has been shown to be ineffective, the persons to whom he has sold the scheme. In both cases, the reasons for the Revenue's enquiries can be established at an inter-partes hearing with the third-party present without prejudice to the investigation or breach of confidentiality. Indeed, the reasons for the Revenue's enquiries must be explained to the third-party in order to identify the information that is required.

Rights of injured parties

25. These principles are not peculiar to the powers of the Revenue. They apply to the information powers of investigating authorities in general. The central principle that the safeguards against invasion of privacy should not be allowed to prejudice the investigation is known as public interest immunity. But, it is not an end of the matter, and does not deny rights to an injured party. As with any similar investigative power, an aggrieved third-party could proceed with an action against the Revenue for excess

of power and for trespass. At some stage, which cannot be particularised with precision but which would broadly be when the investigation was complete or where proceedings had not been taken within a reasonable time, the immunity which exists at the stage of initial investigation would lapse. At that stage, the Revenue could be required to specify the reasons for its actions and the issue would be tried in a normal manner. Where the Revenue's actions were not justified, the third-party would be able to recover damages where appropriate.

Further difficulties with the proposed amendment

26. There are a number of other difficulties with Sir William's amendment.

27. In effect, Sir William's amendment would require a court to review a decision made by itself. This runs contrary to normal principles of English law. A decision can generally be reviewed by a higher court, as is possible in this case by way of judicial review, but not by the court itself. A distinction should be drawn here between cases where there is an interlocutory hearing first followed by a full hearing later, as with an affidavit or as used to happen with leave to assess outside normal time limits, and cases where there is a substantive hearing even though the proceedings may be ex-parte, as with applications for a search warrant or consent to issue an information notice.

28. The appeal hearing might, or might not, be before the same Commissioners as gave consent. The amendment gives no guidance as to whether the Commissioners are meant to put the evidence given at the application for consent out of their mind; whether the evidence is to be reintroduced at the full hearing, and if so whether in full or whether evidence may be reintroduced in part; whether further evidence may be adduced; etc.

These are some of the practical difficulties which lead to the general rule that a court does not review a decision of itself. There is also the general principle that a court decision must stand unless it is overturned by a higher authority.

29. Although consent may be given by a General or a Special Commissioner, Sir William's amendment would require the appeal to be heard by a Special Commissioner only. This is probably a drafting error, but would introduce a new principle which would, in effect, make the Special Commissioners a court of appeal against decisions of the General Commissioners in this case. This would have implications for the relative status of the General and Special Commissioners, and for the number of tiers of appeal. These matters are the responsibility of the Lord Chancellor but would, we believe, run counter to present policy.

30. Sir William's amendment would allow an appeal on the grounds of onerousness. Again this is probably a drafting error, but this is the wrong test as it takes no account of the size, complexity or seriousness of the case. In effect, it would allow the Revenue access to information in small, minor cases, but not in large, major ones. A more appropriate test would be 'unduly onerous', which is already covered by the present longstop appeal procedures of judicial review and penalty proceedings.

Representative bodies

31. As far as we can establish, there has been no proposal to this effect during the many years of consultations on the recommendations of the Keith Committee. There has certainly been no such proposal from the main bodies that represent the persons that might normally receive third-party notices, banks and accountants.

32. Sir William Clark indicated in the Debate that his amendment had been inspired by the CBI. It had not, however, been suggested by them during consultations. I therefore spoke to the CBI to try to establish the reason for the amendment.

33. The CBI tell me that the amendment is not intended to address a known problem. They are not aware of any difficulties with third-party notices in practice. The amendment was inspired by their long standing concern, since the Keith Report was first published, that Keith's new general approach - which would have given the Revenue much wider powers to call for information from third-parties - would have allowed the Revenue to make excessive and unreasonable demands. The Government has, however, rejected the new general approach, and has left the power to call for information about a named taxpayer from a third-party unchanged, apart from closing some minor lacunae.

UNCLASSIFIED

FROM: J M G TAYLOR
DATE: 4 JULY 1989

MR GILHOOLY

cc PS/Financial Secretary
PS/Economic Secretary
Mr Scholar
Mr Culpin
Mr Michie
Miss Hay
Mrs Chaplin

Mr D L Shaw - IR
PS/IR

PS/C&E

Jonathan
Mr Gilhooly is awaiting comments from IR + C&E (expected today)
John then intends to get something to us by close on Friday

KEITH

The Chancellor understands that, once this year's Finance Bill has been enacted, there will be very little left amongst the Keith recommendations which will neither have been acted upon nor become defunct. He has asked when we can announce that Keith has been completed. I should be grateful for advice.

J M G TAYLOR

UNCLASSIFIED

fp.ac.jfg/352/KEITH

FROM: J F GILHOOLY (FP)
DATE: 20 July 1989
EXTN 4550

CHANCELLOR OF THE EXCHEQUER

cc PS/Financial Secretary
PS/Economic Secretary
Mr Scholar
Mr Culpin
Mr Michie
Miss Hay
Mrs Chaplin

Mr Bush IR
Mr D L Shaw IR
Mr J Willmer IR
PS/IR

Ms Seammen C&E
Mr C J Holloway C&E
Mr Walton C&E
PS/C&E

KEITH

You asked (Mr Taylor's minute of 4 July) when the completion of Keith could be announced. The following, based on advice from Customs and the Revenue, and agreed with them, confirms that the bulk of the work has been completed, including all the major changes: but various lesser items remain. Details are set out in the Annex.

2. So far as legislation is concerned, the outstanding items should probably be ready for the 1990 Finance Bill, except for the civil penalty regimes for customs and excise duties which will not be ready until the 1991 Finance Bill. Customs say that this longer timetable is because of the complexity there would be in running a new civil penalty regime (as recommended by Keith) in parallel with continuing criminal offence action in some cases. This will require extensive consultation and the legislation is likely to be tricky. It has been necessary to create a special implementation team which, because of staffing constraints, could not be set up before June 1989.

3. The latest statement on the progress of Keith was in the Budget Day Press Release, which announced that

> "These measures are based on recommendations of the Keith Committee for the reform of the compliance system for income tax, capital gains tax and corporation tax together with measures introduced in the last two Finance Acts, they substantially complete the Government's programme of reform in this area.
>
> Most of these measures will take effect immediately, although some will be introduced gradually over a lengthy transitional period".

4. As it stands, it looks as if it is not possible to go further than that until the remaining measures are legislated for in the 1990 Finance Bill, and even then there would have to be a caveat about the items which Customs have in mind for the 1991 Bill.

J F GILHOOLY

ANNEX : State of Play on Keith Recommendations

Volumes 1 & 2 (IT, CGT, CT & VAT)

The package in this year's Finance Bill largely completes the legislation on volumes 1 and 2. There are two relatively minor items where legislation would still be needed, where responsibility is shared between the Inland Revenue and the Lord Chancellor's Department.

- **Administration and conduct of appeals** - The Inland Revenue hope to publish a consultative paper in the autumn with a view to legislation next year.

- **Publication of Special Commissioner's cases** - The LCD have plans to publish a consultative paper, but they have not yet settled on a date for it.

2. Implementation is incomplete on **CT Pay and File** which will be implemented in 1993, and the measures to improve employer's compliance on **PAYE & NIC** will not be fully implemented until 1995, on present plans.

3. All the VAT recommendations have been completed although the trade is seeking further dialogue on professional privilege.

Volume 3 (DLT, PRT, CTT & Stamp duties)

4. **PRT** - The recommendations for PRT largely follow those for IT and CT. The Inland Revenue are presently working on the Keith proposals and certain related areas, and are likely to recommend consultation with the industry and legislative action on some of the proposals (a submission will be put forward shortly after the summer recess).

5. **Stamp Duty** - Although a good deal of preliminary work has been carried out on the recommendations, many of them will not be implemented for some time. The Inland Revenue will put forward a progress report on these recommendations in the autumn overview papers.

6. **CTT/IHT** - Should Ministers wish to proceed with these recommendations the Inland Revenue would need to consult representative bodies. Depending on the response, legislation in 1990 might be practicable.

Volume 4 Customs

7. The more pressing recommendations have been acted upon. Work is in hand on the raft of proposals for **civil penalties regimes (and subsequent consolidation of the criminal penalties structure) and revised appeals mechanisms.** It is hoped that proposals for these will be settled in time for the 1991 Finance Bill. There are a few other minor candidates for administrative or legal change in volume 4.

chex.jp/jmt2/4 **UNCLASSIFIED**

FROM: J M G TAYLOR
DATE: 21 JULY 1989

MR GILHOOLY (FP)

cc PS/Financial Secretary
PS/Economic Secretary
Mr Scholar
Mr Culpin
Mr Michie
Miss Hay
Mrs Chaplin

Mr Bush - IR
Mr D L Shaw - IR
Mr J Willmer - IR
PS/IR

Ms Seammen - C&E
Mr C J Holloway - C&E
Mr Walton - C&E
PS/C&E

KEITH

The Chancellor was most grateful for your note of 20 July.

J M G TAYLOR

UNCLASSIFIED

fp.ac.jfg/372/keith/dft

FROM: J F GILHOOLY (FP)
DATE: 1 August 1989

EXTN: 4550

PS/CHANCELLOR

cc PS/Financial Secretary
Mr Culpin
Miss Hay

PS/IR

KEITH

My submission of 20 July summarised the state of play on KEITH. It now needs two glosses:

(a) at the Chancellor's meeting of 25 July it was agreed that consultation on **stamp duty** appeals procedures should take place in 1990 - with legislation for a subsequent Finance Bill;

(b) on **PRT** and **CTT/IHT** appeals procedures, while the Revenue have not finally ruled out legislation in 1990, the work they now have in hand is suggesting that that timetable might leave an unacceptably short a time for consultation.

2. The Revenue will be covering timetables for consultation on (a) and (b) in submissions they plan for after the Recess. But it now looks as if there will be more legislation to come after the 1990 Finance Bill than we first thought.

J F GILHOOLY

DEFAULT SURCHARGE

REVIEW

REVIEW OF DEFAULT SURCHARGE

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5. Quarterly analysis of traders at third and subsequent default

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10. Summary of responses received not covered elsewhere

11. Associations, Firms and individuals from whom contributions have been received

REVIEW OF THE DEFAULT SURCHARGE

1. INTRODUCTION

The Keith Committee was concerned about, among other things, the widespread delays in paying VAT by more than three quarters of those required to make returns and payments. It considered that the sanction of prosecution in the courts for failure to furnish returns or pay tax was ineffective and no longer appropriate. In recommendation number 50 of its Report it proposed that "Customs and Excise should take further steps to enhance their VAT enforcement regime ... provision should be made for a system of automatic surcharge". This would be targeted at persistent offenders whose VAT returns and tax payments are regularly delayed beyond the statutory due date and who might otherwise look to delaying VAT payments as a relatively cheap and readily available source of finance. The objective of the surcharge was, therefore, to achieve a greater compliance with the legal requirement that VAT returns be furnished and tax paid within one month from the end of the accounting period to which they relate.

The default surcharge was introduced by Treasury Order (SI 968) on 1 October 1986 under the provisions of Finance Act 1985 Section 19. To counterbalance the surcharge system the Keith Committee considered that a form of compensatory supplement when the Department delayed repayment of a trader's tax claim was required; this was enacted as the repayment supplement in FA 85 Section 20.

Surcharge statistics for the tax period 09/88 were not available at the time of production of this review, so our conclusions and recommendations are based on experience of the system up to and including the issue of the first 30% surcharge assessments for the tax period 06/88.

A list of Associations, Firms and individuals from whom contributions have been received is at annex 11.

2. THE SURCHARGE SYSTEM EXPLAINED

A Surcharge Liability Notice (SLN) is issued to traders who are late in paying tax or sending in VAT returns on two occasions within a period of 12 months, with a warning that any delay in returns or payment within the next 12 months will cause a surcharge

to be added to the amount of tax delayed. A further default also causes the surcharge period to be extended so that it remains extant until 12 months free of default have elapsed. The surcharge rate starts at 5% and rises in 5% stages to a maximum of 30%. There is a minimum surcharge of £30.

A late return or payment does not count for surcharge purposes if the trader has a reasonable excuse or if it was despatched in good time but delayed. Although a trader is technically in default if return and tax are not received within one month of the end of the tax period (ie by the due date), in practice a few days' grace is allowed - but not publicised. This does not, however, relieve traders of the responsibility for getting the return to the VAT Central Unit by the due date. If it can be shown that the return and any tax were despatched by first class post at least one clear working day (including Saturdays) before the due date a default will not be recorded. Where the due date falls on a Saturday, Sunday or a Bank Holiday the first working day thereafter is regarded as an acceptable date of receipt.

3. VARIATIONS FROM ORIGINAL KEITH RECOMMENDATIONS

The Keith Committee recommended that if a trader defaulted twice in any two year period he should receive a Surcharge Liability Notice (SLN). A further default within the two years following the SLN would result in an assessment of surcharge. Ministers agreed to significant changes in the trader's favour during the passage of the 1985 Finance Act. These were the issue of an SLN after two defaults in one year and release from the surcharge regime after one year's compliance instead of two.

We have exercised our discretion under FA 85 S21 and apply the surcharge system only to those traders who normally pay tax to Customs. Surcharge is not applied to traders who normally make net tax claims (repayment traders). This has the effect of excluding traders such as exporters, farmers and local authorities.

In theory the default surcharge system applies to all VAT registered traders, but it would be a misuse of resources to include repayment traders. Surcharge is based on the amount of VAT owed for the period but unpaid at the due date. In effect for repayment traders this would amount to a zero charge subject to the £30 minimum surcharge. It would not be cost effective to apply this minimum charge to late repayment claims. Furthermore it would be a nonsense to apply the minimum when

returns from these traders would also be eligible for supplement if Customs delayed repayment. From a purely monetary standpoint, it is to the Crowns advantage if repayment claims are submitted late.

4. ALTERNATIVE PENALTY

Surcharge is the main sanction where there is a failure to submit returns or to pay tax. If, in the future, cases arise where surcharge is proved to be ineffective, for example when a trader restructures his business to avoid being surcharged, S17(5) FA 85 provides an alternative daily rate penalty. To date, there has been no need to make use of this alternative penalty. In any event, it would not normally be applied without prior written warning.

5. PUBLICITY

Before surcharge was implemented on 1 October 1986, all traders were encouraged to review their accounting procedures. Particular attention was paid to those who were persistently late with returns and payments. This very full publicity programme led to a reduction in the amount of tax outstanding of £300 - £400 million by 31 March 1987.

As an additional measure since April 1987 returns issued while an SLN is in force have been overprinted with the legend "If this return and any tax due are not received by the due date you will be liable to a surcharge". General information about surcharge was included in the revised edition of the VAT Guide issued in October 1987.

Details of the publicity programme are shown in Annex 9.

6. IMPACT OF SURCHARGE

6.1 Overall picture

After the first 21 tax periods with surcharge in operation 670,434 traders had no extant defaults; 152,756 traders had one extant default; 145,877 traders had two and 190,096 traders had three or more. Full details are shown at Annexes 4 and 5.

The value of surcharge assessments issued in the financial year ended 31 March 1988 was £74.6 million. Annex 2 refers.

In the same period, surcharge receipts totalled £25 million, 34% of the total value of surcharges assessed. The receipts figure reflects the time lag between assessment (at an increasing rate) and payment. Some £16.8M was assessed in the last 2 months of the financial year. Annex 2 refers.

6.2 Effect on VAT arrears

When the default surcharge was enacted in the 1985 Finance Act, it was estimated that the tax outstanding at any one time averaged £1200M. It was on this basis that we advised Ministers that a 50% reduction (£600M) would be achieved by 1989. The figure of £1200M was subsequently re-indexed to £1374M at 30 June 1985 (the last quarter before enactment of the legislation). The re-indexed average arrears represented 7.4% of the annual VAT liability. By 31 March 1988 we had reduced the arrears of the liability and are now well on the way to achieving the 50% target by 31 March 1989 - see Table at Annex 1. Expressed in financial terms it is estimated that by 31 March 1989 the average VAT arrears will be £1031M less than they would have been without the surcharge system. See Annex 1.

Surcharge has given the Treasury cash flow a tremendous boost and must be recorded as a major success.

7. OPERATIONAL DIFFICULTIES

7.1 Additional assessments of tax

If a trader assessed for tax and surcharge subsequently makes a VAT return for that period showing a greater amount of tax due, surcharge is automatically recalculated. If the trader does not make a return, but an officer issues an assessment for the additional tax there is no recalculation of the surcharge. When the timetable for the introduction of surcharge was drawn up it was recognised that because of computer and time limitations it would not be possible to apply surcharge to additional tax assessments until later. Although this was a situation that the astute trader might manipulate to his advantage, the risk was acceptable given the short gap of less than two years then anticipated before the introduction of the serious misdeclaration penalty and default interest provisions (Keith III).

Ministers agreed that the Keith III programme should be put back to late 1989, partly to accommodate the introduction of Cash and Annual Accounting. In last year's review of surcharge we proposed, subject to the availability of resources, to introduce a manual system of surcharging large additional tax assessments, ie where £2,000 or more additional tax is due in any quarter. A feasibility study had been made and such a system would not only eliminate the risk of manipulation, but would also bring in a worthwhile amount of revenue at very little cost. The estimated revenue gain is £600,000.

The proposed system was based on the manual identification and assessment of the additional surcharge but the recording and enforcement of non-payment was to be computer controlled. A change to the computer system was required for this purpose. We have so far been unable to divert hard pressed resources from other priorities, mainly the computerisation of Keith Phase III, to carry out the necessary work.

7.2 Enforcement of small surcharge debts

For reasons of cost effectiveness we do not normally enforce debts totalling less than £200. This led to a build-up of small debts, including unenforced surcharge

debts and we became increasingly concerned about the credibility of the surcharge in the eyes of the small trader. So for two months we temporarily lowered the enforcement threshold first to £140, then to £30, and demand notices for arrears were issued. In the interest of good house-keeping we did not divert already hard-pressed staff resources to follow up these demands if they remained unpaid.

The total number of demands issued in this special exercise was 28,377 with a total value of £3.1M. 15,149 payments were received (53.4%) totalling £1.6M, ie 51.6% of the total debt reported which was a satisfactory outcome at minimum cost. We propose to repeat the special exercise after a suitable interval.

FA 85 S19(4) provides for a £30 minimum surcharge. In practice if the surcharge, calculated as a percentage of the tax outstanding, is less than £1 we do not issue an assessment. For the future we consider it would be preferable to issue fewer small surcharge assessments than to leave them unenforced. As a first step we propose to increase the administrative £1 de minimis to £15. The percentage rates would continue to rise and surcharge periods would be extended, so the least compliant of the small traders would still be surcharged. Traders not surcharged because of the operation of the de minimis limit are notified that they are in default and the surcharge period is extended as a result. Annex 7 illustrates how the revised de minimis limit will be operated.

We can raise the £1 de minimis to £15, without additional legislation, under the provisions for the care and management of the tax. The effects are shown at Annex 7. We have notified the National Audit Office of our proposal.

7.3 Postal Strike

As a result of industrial action by Post Office workers it was necessary to totally suspend surcharge processing for the tax period ended 31 July 1988 (07/88) and partially for the tax period ended 31 August 1988 (08/88).

8. LEGAL DIFFICULTIES

8.1 SLN Deemed not to have been served - see Annex 8

Before a surcharge can be assessed a surcharge liability notice (SLN) must have been served. Service of this notice is dependent upon the trader having defaulted twice in a 12 month period. Should either of these defaults be cancelled - for example because reasonable excuse is accepted - then FA 1985 S.19(6) deems the SLN not to have been served. We are advised that in such circumstances all default surcharges dependent on the issue of the now non-existent SLN will be invalid.

Our difficulty is that where a reasonable excuse for first or second default is not proffered until after several surcharges have been assessed then all surcharges may fall. This is clearly not the intention of the legislation.

Although the time limit for appeal is limited the VAT Tribunal can exercise their power to extend this time indefinitely. Having done so they will insist on reviewing the operation of surcharge in any particular case from the trader's first default onwards.

Where the Tribunal has accepted reasonable excuse we have been required to adjust surcharges in light of the new default history rather than cancel them. However it is rare for an appellant to have the benefit of legal advice or representation and thus far this point about SLNs has not been argued. We are concerned that the matter is at least unclear and should now be put beyond doubt.

8.2 Proof of service of SLN

Medway Draughting and Technical Services Ltd appealed to the Tribunal against an assessment of surcharge on the grounds that the SLN had never been received, and therefore they could not be held liable for payment of the assessed surcharge. The SLN had not been returned to the Department through the dead letter service and it was therefore decided that in all probability the SLN had been posted to the Company. The question then posed was that of "was the SLN served on the Company?".

In considering these sections Judge Medd ruled that there was proof beyond reasonable doubt that the Company did not receive the SLN and held that this was sufficient to invalidate service.

In brief, if the SLN is not received, and therefore the trader has not been formally warned regarding future late returns and/or remittances, the surcharge period has not commenced. The Department is appealing against this decision in the High Court to establish a precise interpretation of the law, but in reality we must accept that a trader is entitled to be warned before being surcharged.

8.3 Legislative changes to enable an SLNE to be deemed an SLN

A surcharge liability notice extension (SLNE) is issued when a trader defaults during the 12 month period specified in the SLN. It always accompanies an assessment of surcharge but may be issued alone. We are seeking legislative change to enable the SLNE to be deemed to be an SLN, in the event that the preceding SLN has not been served (whether as a result of the removal of defaults or proof of non-receipt). The nett result will be that subsequent surcharges are reduced rather than eliminated. This change would give clear legal authority to current Tribunal practice.

9. COMPLAINTS ABOUT SURCHARGE

Between 1 May 1986 and 30 November 1988 723 written complaints were received about the surcharge system, directly from traders or via MPs. Our response has normally included an explanation that the due date for payment was not changed by the new legislation; the system allows for occasional difficulties; surcharge is never assessed without a written warning; and there is a right of appeal.

A significant majority of these complaints were from traders claiming that they had to pay tax before customers had settled accounts. The introduction of Cash Accounting in October 1987 provides a solution to this problem for small businesses. Cash Accounting allows traders to account for VAT on the basis of payments received and made, rather than tax invoices issued and received. Additionally those who undertake to pay by credit transfer are allowed a further seven days beyond the due date for returns and payments to be sent. Some traders who claim to have difficulty completing their

returns on time were helped by the introduction of Annual Accounting on 1 July 1988. Annual Accounting allows traders to account for VAT by making nine equal monthly payments by direct debit - based on an estimate of the amount of VAT due - and send in an annual return with a tenth payment at the end of the year to balance their account. For traders in the annual accounting scheme normal surcharge processing applies, except that failure to meet a direct debit does not count as a default.

10. APPEALS

10.1 Law

Appeal to a VAT Tribunal against liability to surcharge is provided for in Sections 19(6) and 24 of the Finance Act 1985. The grounds for appeal may be that the return and tax were despatched in time to arrive by the due date or that there was a reasonable excuse for the default. Insufficiency of funds and dilatoriness or inaccuracy on the part of any other person are statutorily excluded from being reasonable excuses (FA 85 S33).

10.2 Consideration of Excuses

Traders who believe they have a reasonable excuse for default are encouraged to submit their case for consideration by the local VAT office irrespective of whether a right of appeal exists at that time. Because a surcharge is not assessed in respect of the first two defaults this policy entails dealing with more excuses than may be necessary but allowing the trader to make a case based on contemporaneous facts has proved to be of advantage to both sides. Local offices have discretion as to whether an excuse is to be accepted, but, to ensure consistency, headquarters review all formal appeals to the VAT tribunal before the hearing.

Statistics of cases dealt with are at Annex 6. The majority of accepted excuses concerned illness, where small businesses are most vulnerable. Up to 30 November 1988, 18 surcharges were waived on compassionate grounds where there was otherwise not a reasonable excuse.

Traders' claims to have despatched return and/or tax in time for it to arrive by the due date have largely been accepted (73.4%). The recording of postmarks (where legible) by the VAT Central Unit has helped us to decide cases where a trader has no proof of posting.

10.3 Tribunal Appeals

Once he has received a surcharge assessment a trader may appeal to the VAT Tribunal against our refusal to accept that there was a reasonable excuse for default or that return and tax were despatched in time to arrive by the due date. Statistical details are at Annex 6.

It is recognised that tribunal appeals can be both expensive and inconvenient for traders but it is misleading to look at appeals in isolation. The low success rate can be taken as an endorsement of our treatment of cases. Those excuses which are reasonable will, in the main, have already been accepted.

We have been grateful for the guidance given by the tribunals in their examination of reasonable excuse. This will be incorporated in the leaflet to be published.

10.4 VAT Appeals to the High Court

We have only three such appeals so far. Two concern the service of an SLN which is examined in paragraph 8. The other concerns the statutory exclusion of insufficiency of funds.

10.5 Legal Costs

Surcharge has now been in operation for a sufficient period for traders to be fully aware of the appeal procedure, and in particular the need to present a

proper case to a tribunal. In future costs will be applied for in the following circumstances:

a. the appellant fails to appear at the hearing and has no good reason for this failure;

b. the appeal is either frivolous or vexatious. If traders persist in taking their grievance to a tribunal it is reasonable that they should pay for the privilege.

This brings default surcharge appeals into line with our normal policy on costs, details of which are reproduced as Appendix B to the Notice "VAT Appeals and Applications to the Tribunals" published by the President of the VAT Tribunals.

11. PRINCIPAL REPRESENTATIONS RECEIVED DURING THIS REVIEW

11.1 Mitigation

The demand for a general power of mitigation would, of course, extend to all the VAT penalties. There is no separate case for mitigation in respect of default surcharge.

Before being surcharged, traders will have defaulted twice and have been issued with a surcharge liability notice. If they persist in failing to account for and pay their tax by due date we see little or no justification for a power to mitigate the known and fixed surcharge amounts. Were such a power to be granted it could largely nullify the improvement in compliance already achieved through the operation of surcharge.

The introduction of a power of mitigation would encourage virtually every penalised trader to "try his luck" first with Customs and then on appeal to the tribunal since there could be nothing to lose by so doing. This would have significant implications for resources both in Customs and in the Lord Chancellor's Department at a time when the Government is seeking to reduce public expenditure costs. Mitigation would inevitably entail subjective tests in order

to determine the amount of a penalty. Such a system would be extremely difficult to operate equitably on a national basis and could fuel even more accusations of harsh treatment and injustice. Acceptance of the principle of mitigation would strike at the heart of the basic Keith philosophy that penalties should be assessed on objective, not subjective tests. The matter was debated fully during the passage of the act and we strongly **recommend** that the concept of fixed and certain penalty be maintained and that any pressure for mitigation be resisted.

Reasonable excuse is the means adopted by Parliament as the alternative to mitigation. It has, we believe, worked well and secured the objective, as stated by Sir Barney Hayhoe, "of removing the sharpest edges from the penalty system". It is, however, an all or nothing system; the business being liable to the full fixed penalty or no penalty at all. It is this feature which outside commentators dislike and why they continue to press for a general power of mitigation.

11.2 Surcharge is excessive

Another theme running through the complaints and representations is that the amount of the surcharge is excessive and destructive.

The main improvement in trader compliance is generated by the issue of an SLN. This warning of a liability to surcharge is sufficient to prompt the majority of traders to render subsequent returns and, more importantly, full payment on time.

Of those traders who do progress to a third default many find it difficult to escape the surcharge system. A large proportion of those tax payers who are surcharged at the higher rates are unable to pay the tax - irrespective of any penalty imposed. We consider that the maximum rate could be reduced to 20% without weakening surcharge as a deterrent. The cost of this change is estimated at £18M surcharge per annum.

11.3 Notification of first defaults

Since surcharge was introduced some trade bodies, particularly the National Federation Of The Self Employed, have asked us to notify traders of first defaults. However although 653,173 Surcharge Liability Notices had been issued up to 31 May 1988 we have received only a handful of complaints from individual traders. Our own evidence therefore does not support the views of the trade organisations on this matter.

Notification of first defaults goes beyond the Keith Report intention to take action against persistent defaulters and beyond the requirements of Parliament as expressed in FA 85 S19.. A first offender is not a persistent defaulter.

At 31 May 1988 152,756 traders had only one extant default. A key feature of the current surcharge regime is that the occasional delay by a trader does not invoke official action. The vast majority of defaulters receive an assessment for unpaid tax; this effectively advises them that they have defaulted and a further notification would be otiose.

Notification of first default - which in effect would be notification of intention to issue a warning (a Surcharge Liability Notice) for the next default - offends the principles of efficient and economical management required by the Government's Financial Management Initiative. Notification could also lead to requests for more information, requiring further resources with no certainty of improved tax yield or compliance.

The notification might also be seen as adding to the burdens of Government on business - particularly small traders. Many resent the sheer volume of Government communications and are likely to interpret this first notification as a threat, after only a single slip on their part, rather than a helpful reminder.

The main arguments in favour of notification of first defaults are that they might induce earlier compliance by some traders and would allow Local VAT Offices to consider "reasonable excuse" and "posted in time" applications at a stage when the supporting evidence is less affected by the passage of time.

For the purposes of this Review we have considered a computer system change which would modify enforcement processing so as to advise traders of first defaults, either combined with an ordinary tax assessment or independently. The cost of implementation is estimated at £30,000. Running costs would not exceed £50,000 per annum.

The cost seems high - but it is not significant in the context of surcharge processing as a whole. More significant is the computer resource required to facilitate the change and the consequent probable delay to Keith phase III. On these grounds we recommend no action.

11.4 Late repayment returns not to count as defaults

It has been suggested that repayment returns submitted late should not count as defaults.

As explained in paragraph 2, late submission of any return is a default, with a £30 minimum surcharge being assessed if appropriate. In paragraph 3 we have explained why we have chosen not to apply surcharge to late repayment returns.

Those traders who normally make payments of tax to Customs will be in default if they send their repayment returns late. This can cause the rate of surcharge to be higher on a subsequent assessment, but for this to be the case there must be a record of persistent default. The exclusion of defaults in respect of repayment returns in these circumstances increase administrative costs and is not justified.

11.5 Maximum default surcharge to be restricted to £100,000 in respect of any one default

It has been suggested that there should be an upper limit for any surcharge assessment of £100,000. This would require legislative change which cannot be justified, not least because few if any traders would benefit.

Only the very largest taxpayers could be surcharged more than £100,000 for one default. We already closely monitor compliance by these traders and defaults are rare.

11.6 Interest to replace surcharge

A number of traders have suggested that surcharges should be replaced by simple interest. This, however, ignores the underlying principle that the surcharge system is designed to encourage businesses to pay tax on time. If they need to borrow money they should look to the banks and not to the revenue. Surcharge is a deterrent whereas interest - unless set at a penal rate - is merely commercial restitution. An interest system on overdue VAT would be more complicated and costly to administer than the present surcharge system. For example the system would involve detailed monitoring of all part-payments. Furthermore, it would be confused with Default Interest, which is to be introduced under Keith phase III as commercial restitution for tax underdeclared. In comparison the surcharge system is simple, being geared solely to achieving prompt receipt of returns and tax.

11.7 Comments from President of VAT Tribunals

We sought comments from His Honour Judge Medd OBE QC, President of the Value Added Tax Tribunals. After consulting other Tribunal Chairmen he suggested the following would help traders.

a. Allow 2 months to render a return instead of one.

The existing arrangements already give the trader an average of $2\frac{1}{2}$ months in which to collect the tax due. A further 7 days is allowed if the trader consents to pay regularly and promptly by credit transfer and any further extensions would be very expensive.

b. Increase turnover threshold for cash accounting and annual accounting from £250,000 to £500,000.

Such considerations are not within the scope of this review. Cash accounting is currently the subject of a separate review and the suggestion will be borne in mind. Our choices are, however, restricted by European Commission Directives.

c. Introduce time - related surcharges.

We have received a number of representations about the surcharge operating on the same specified percentage of the tax regardless of the extent of the delay.

A system of time-related penalties could be introduced without undermining the Keith concepts of certainty and automaticity. There is a danger, however, that such a system would be seen as interest rather than penalties. The case against interest instead of surcharge has already been examined in paragraph 11.6.

The introduction of time related penalties would require major computer program changes which could not be effected without seriously delaying other very important work. Such a change would also lead to many more

representations from traders about the date of despatch of payments, with a consequent effect on resources.

We are aware that EC members generally operate a time-related system and we will look at this matter again after implementation of Keith phase III.

For the moment we recommend no change from the present system of a percentage rate tax geared surcharge.

d. Surcharge to be calculated as a percentage of the trader's average tax payable on, for example, the last four returns.

This suggestion conflicts with Keith's concept of a surcharge directly relating to the tax delayed. Such a method of calculation would add to administrative costs and would do little to encourage compliance by traders who make occasional large payments of tax.

11.8 Comments from the Enterprise and Deregulation Unit

The unit commented on interest, mitigation and notification of first defaults. We have already dealt in detail with these matters in paragraphs 11.6, 11.1 and 11.3 respectively.

12. CONCLUSION

The introduction of the default surcharge in 1986 was a radical change to our enforcement procedures. It was anticipated that the surcharge might provoke a strong reaction from traders but the number of complaints and criticisms received as a result of the review has been relatively small.

The improvement in compliance already achieved is encouraging and indicates that a 50% reduction in VAT arrears will be achieved by the target date of 31 March 1989.

Since the beginning of 1988 compliance has been steady at 80%, compared with 74% following the issue of the first surcharge assessments in May 1987. Annex 3 refers.

The number of traders at each stage of the surcharge system has remained fairly static, with a gradual chipping away at the hard core of non-compliance. Annexes 4 and 5 refer.

We do not recommend a further review of the surcharge system but it would be appropriate to include default surcharge in any major review of the Keith Penalty system undertaken following the implementation of Keith III.

13. RECOMMENDATIONS

The recommendations of this review are:

	Recommendation	Review reference
1.	The maximum specified surcharge percentage should be reduced from 30% to 20%. (FA 85 S19(5)(c)).	Para. 11.2
2.	A surcharge should not be assessed when, calculated as a percentage of the tax outstanding, it does not exceed £15.	Para. 7.2
3.	Legal provision should be made to enable the Commissioners to maintain, albeit at a lower rate, those surcharges which would otherwise be cancelled where an SLN is deemed not to have been served. (FA 85 S19(6)).	Para. 8.3

Annex 1
(Referred to in para 6.2)

ANALYSIS OF THE EFFECT OF SURCHARGE ON VAT ARREARS

1. ARREARS POSITION AT THE INTRODUCTION OF SURCHARGE

12 months VAT liability	£18610M	
Average arrears		£1374M
Arrears as a percentage of 12 months liability		7.4%

2. ESTIMATES FOR 1988/89 WITHOUT SURCHARGE

Estimated 12 months VAT liability	£27180M	
Projected average arrears on the assumption that the percentage of 12 months liability would have remained constant at 7.4%		£2011M

3. ACTUAL ESTIMATES FOR 1988/89

Estimated 12 months VAT liability	£27180M	
Estimated average arrears		£980M
Arrears as a percentage of 12 months liability		3.6%

The estimated arrears for 1988/89 are therefore £1031M less than they would have been without the surcharge. We are well on the way to achieving a result of this order by 31 March 1989.

Annex 1

(Referred to in para. 6.2)

SUMMARY

Quarter Ended	12 month's liability (£M)	Average Arrears (£M)	Arrears as a percentage of liability
30.6.85	18610	1374	7.4
Financial Year			
1985-86	20704	1352	6.5
1986-87	22435	1219	5.4
1987-88	25236	1060	4.2
1988-89 (est)	27180	980	3.6

Annex 2
(Referred to in para. 6.1)

SURCHARGE ASSESSED AND PAID 1987/88

MONTH	SURCHARGE ASSESSMENTS ISSUED £	SURCHARGE PAID £
April 1987	77,365	60
May 1987)	Figures not available	11,062
)	due to industrial action.	
June 1987)	Incorporated in the	
	July total.	
July 1987	7,277,879	225,912
August 1987	4,549,520	533,954
September 1987	13,831,361*	2,242,910
October 1987	5,968,643	2,392,969
November 1987	7,553,758	2,097,812
December 1987	9,102,320	2,109,563
January 1988	9,339,797	5,071,028
February 1988	9,280,154	4,250,890
March 1988	7,635,439	6,117,337
TOTALS	74,616,236	25,053,497

* Recovery period from industrial action

Annex 3
(Referred to in para. 6.1)

QUARTERLY ANALYSIS OF DEFAULTS

Tax Period	Number of Payment Traders	Quarterly Total	Number of Payment Traders in Default	Quarterly Total	Percentage of Payment Traders in Default	Quarterly Percentage
9/86	376348		82863		22	
10/86	361050		85239		24	
11/86	370946	1108344	86150	254252	23	23
12/86	373835		91270		24	
1/87	362030		93646		26	
2/87*	371000	1106865	103195	288111	28	26
3/87	372830		87605		23	
4/87	365329		101512		28	
5/87	378364	1116523	106332	295449	28	26
6/87	376740		84118		22	
7/87	369124		95675		26	
8/87	380325	1126189	86699	266492	23	24
9/87	374285		79038		21	
10/87	370891		68449		18	
11/87	384056	1129232	86954	234441	23	21
12/87	377884		72975		19	
1/88	373929		70706		19	
2/88	388296	1140109	68430	212111	18	19
3/88	381929		65159		17	
4/88	381620		76132		20	
5/88	395614	1159163	74742	216033	19	19
6/88	388697		69137		18	

Excluding: VAT Act 1983, Section 20 bodies, missing traders, insolvent traders, deregistered traders, and traders who have changed stagger code in the last twelve months.

*Estimated figures based on previous periods in stagger. Exact 02/87 figure not available because of industrial action.

DEFAULT SURCHARGE: QUARTERLY ANALYSIS OF TRADERS AT EACH STAGE OF SURCHARGE SYSTEM

QUARTERLY PERIOD (a)	NUMBER OF PAYMENT TRADERS (b)	TRADERS WITH ZERO DEFAULTS (c)	(c) AS PERCENTAGE OF (b) (d)	TRADERS AT FIRST DEFAULT STAGE (e)	(e) AS PERCENTAGE OF (b) (f)	TRADERS AT SLN STAGE (g)	(g) AS PERCENTAGE OF (b) (h)	TRADERS ON THIRD OR SUBSEQUENT DEFAULT (j)	(j) AS PERCENTAGE OF (b) (k)
11/86	1,108,344	854,092	77.1	254,252	22.9	0	0	0	0
02/87*	1,106,865	758,202	68.5	174,886	15.8	173,777	15.7	0	0
05/87	1,116,523	692,932	62.1	174,425	15.6	145,166	13.0	104,000	9.3
08/87	1,126,189	655,373	58.2	174,335	15.4	154,231	13.7	142,522	12.7
11/87	1,129,232	629,916	55.8	175,425	15.5	160,060	14.2	163,829	14.5
02/88	1,140,109	643,754	56.5	156,179	13.7	161,736	14.2	178,440	15.6
05/88	1,159,163	670,434	57.8	152,756	13.2	145,877	12.6	190,096	16.4

*Estimated. Exact 02/87 figure not available because of industrial action.

ANNEX 4

(Referred to in para 6.1

ANNEX 5

(Referred to in para 6.1

DEFAULT SURCHARGE : QUARTERLY ANALYSIS OF TRADERS AT THIRD AND SUBSEQUENT DEFAULT

PERIOD a	NUMBER OF PAYMENT TRADERS b	TRADERS AT 5% SURCHARGE c	c as a % of b d	TRADERS AT 10% SURCHARGE e	e as a % of b f	TRADERS AT 15% SURCHARGE g	g as a % of b h	TRADERS AT 20% SURCHARGE j	j as a % of b k	TRADERS AT 25% SURCHARGE l	l as a % of b m	TRADERS AT 30% SURCHARGE n	as a % of o
11/86	1,108,344	0	0	0	0	0	0	0	C	0	0	0	0
02/87	1,106,865	0	0	0	0	0	0	0	C	0	0	0	0
05/87	1,116,523	104,000	9.3	0	0	0	0	0	0	0	0	0	0
08/87	1,126,189	65.211	5.8	77,311	6.9	0	0	0	0	0	0	0	0
11/87	1,129,232	67,358	6	39,724	3.5	56,660	5	86	.01	0	0	0	0
02/88	1,140,109	63,976	5.6	44,329	3.9	29,036	2.5	41,043	3.6	67	.005	0	0
05/88	1,159,163	63,347	5.5	41,978	3.6	31,365	2.7	22,516	1.9	30,785	2.7	107	.01

Annex 6
(Referred to in paras. 10.2 and 10.3)

APPEALS AGAINST SURCHARGE : STATISTICS UP TO 30 NOVEMBER 1988

1. CASES REVIEWED BY LOCAL VAT OFFICES:

Total Considered	32618	
Reasonable excuse accepted	9239	(28.3%)
Excuse rejected	23379	(71.7%)
Total considered	5298	
Claim to despatch in time accepted	3889	(73.4%)
Claim to despatch in time rejected	1409	(26.6%)

2. APPEALS TO THE VAT TRIBUNAL

Appeals lodged	1255	
Appeals withdrawn	348	(27.7%)
Total decisions received	431	(100%)
Appeal upheld	73	(16.9%)
Appeal part upheld	8	(1.9%)
Appeal dismissed	350	(81.2%)

Annex 7

(Referred to in para. 7.2)

INCREASE OF ADMINISTRATIVE DE MINIMIS FROM £1 TO £15:

Surcharge would not be assessed where the following conditions apply to the percentage rate and to the tax.

Percentage Rate	Tax Less Than
5	£300
10	£150
15	£100
20	£ 75
25	£ 60
30	£ 50

REVENUE EFFECT

Average number of £30 de minimis surcharge assessments issued per tax period = 10,500.

Of which 50% (max) have surcharge calculated at £1-£15 = 5,250.

5,250
x 30

157,500 x 12 = £1.9M.

The cost of increasing the administrative de minimis to £15 is therefore estimated as a loss of £2M surcharge pa.

Annex 8

(Referred to in para. 8.1)

SLN DEEMED NOT TO HAVE BEEN SERVED

EXAMPLE

1. A trader has incurred 4 defaults:

period	09/87	1st default
	12/87	2nd default, SLN
	03/88	3rd default, SLNE/Surcharge 5%
	06/88	4th default, SLNE/Surcharge 10%

2. Trader successfully appeals against 2nd default (SLN).

3. 03/88 and 06/88 surcharges are now technically invalid, S19(6)FA 85 refers. Surcharges therefore cancelled.

4. With legal provision to maintain, albeit at a lower rate, those surcharges which would otherwise be cancelled the position would be:

period	09/87	1st default
	03/88	2nd default, SLN
	06/88	3rd default, SLNE/Surcharge 5%

Annex 9

(Referred to in para. 5)

PUBLICITY

PRE-SURCHARGE PUBLICITY

1.	February 1986	Information sheet issued to all enquirers and to traders receiving VAT enforcement and control visits.
2.	December 1985 - August 1986	Returns overprinted with a message drawing attention to the changes.
3.	March 1986 (VAT Notes 1. 1986/87) November 1986 (VAT Notes 2. 1986/87)	VAT notes issued with returns. They reminded traders of the scheme, urged them to check their accounting arrangements and told them where to find further information.
4.	July - September 1986	Insert slips reminding traders of the start date for surcharge included with assessments notified for periods 05/86 - 07/86.
5.	July - September 1986	Leaflet giving detailed information about the surcharge issued with all returns for periods 07/86 - 09/86.
6.	March - September 1986	Supplement warning traders about surcharge sent out with demand notices at the discretion of the local VAT Office.
7.	October 1986	Amendment to the VAT Guide published giving details of the surcharge system.

8.	March - September 1986	Individual warning letters sent to approximately 35,000 medium and large payers who would be likely to incur defaults.

CONTINUING PUBLICITY

1.	From September 1986	VAT return forms printed with a reminder of liability to financial penalties if received late.
2.	1 October 1987	Revised edition of the VAT Guide published giving general guidance on the surcharge system.
3.	By end 1988	A leaflet to be published giving guidance on reasonable excuse.

Annex 10
(Referred to in para. 13)

SUMMARY OF RESPONSES RECEIVED NOT COVERED ELSEWHERE

Many of the suggestions received were duplicated and have been grouped together in this summary.

Comment	Response	Action
Extend the one month limit for sending returns and paying tax.	The existing arrangements already allow the trader an average of $2\frac{1}{2}$ months in which to collect the tax due. A further 7 days is approved if paying by giro. Any extension would be very expensive.	Rejected.
Turnover thresholds for cash accounting and annual accounting should be increased.	The EC Directives restrict our choices. Matter not proper to this review.	Rejected.
There is a lack of current publicity about surcharge	Details are contained in VAT General Guide. Pre surcharge publicity was very successful.	Information leaflet will be provided for newly registered traders.
VAT forms relating to surcharge are unclear.	Constituent elements of forms require clearer definition, and those are continually being reviewed.	Accepted. Explanatory notes will be added to forms.

Comment	Response	Action
There is insufficient publicity about the cash accounting scheme.	A separate review of cash accounting will examine publicity of the scheme.	Not proper to this review.
Guidance should be issued about reasonable excuse.	A leaflet is to be issued early in 1989.	Accepted.
Insufficiency of funds should be a reasonable excuse.	This is a statutory exclusion. Inclusion would have very serious consequences on the revenue flow. Cash and Annual Accounting should assist in some respects.	Rejected.

ASSOCIATIONS, FIRMS AND INDIVIDUALS FROM WHOM CONTRIBUTIONS HAVE BEEN RECEIVED

Association of British Insurers
Barnsley Cannister Company
The Chartered Institute of Management Accountants
Confederation of British Industry
Council on Tribunals
Department of Employment
Department of Trade & Industry - Enterprise and Deregulation Unit
D H Bloom & Co
G B Techniques Ltd
Glasgow Chamber of Commerce
VB Goodman FCA
Ian Afflick FCA
The Institute of Chartered Accountants in England & Wales
The Institute of Chartered Accountants of Scotland
Institute of Directors
The Institute of Taxation
Jackson Son & Co
Matthew Hall PLC
President of the VAT Tribunals
The National Chamber of Trade
The Society of Motor Manufacturers & Traders Ltd
Wellington Nurseries

VCBRDS/P4