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PART 3

CONFIDENTIAL FILING

Review of Rights of Entry
Implementation of the Keith Report
Crown Prosecution Service

HOME AFFAIRS

PT1: OCT 1979

PT3: MARCH 1986

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
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dti

the department for Enterprise

cc PS

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

.J M G Taylor Esq
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Chancellor of the Exchequer
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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

HOME AFFAIRS : Rights & Guem PT3

FILE KK

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

25 July 1988

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).

(PAUL GRAY)

Jonathan Taylor, Esq.,
HM Treasury.

PRIME MINISTER

IMPLEMENTATION OF THE KEITH REPORT

You agreed last week to let the Chancellor go ahead with publication of a consultative paper on residence and domicile.

I now attach a further tax consultation document the Chancellor wants to publish before the Recess. This covers those recommendations of the Keith Report which are still outstanding. The covering letter from the Chancellor's Office explains that the latest proposals have been substantially modified in response to earlier consultations; and indicates that the paper has been agreed by the Enterprise and Deregulation Unit.

Potentially the most sensitive area covered is that in section 5 (pages 42-45) concerning legal professional privilege. But this is the area where the Revenue have backed off most fully in response to the earlier consultations.

Content to let the Chancellor go ahead with the consultation document, while reserving your right - as with residence and domicile - to feed in your thoughts later?

PAUL GRAY

22 July 1988

Duty Clerk.

am very much against the proposed

override powers.

PM2ADC

mjd 2/4Jn

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

21 July 1988

Paul Gray, Esq
PS/Prime Minister
No.10 Downing Street
London SW1

Dear Paul

IMPLEMENTATION OF THE KEITH REPORT

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

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 commitments, 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 the month.

A copy of this letter goes to Jeremy Godfrey (DTI).

Yours ever

J M G TAYLOR
Private Secretary

KEITH: FURTHER PROPOSALS

Further proposals in response to the recommendations of the Keith Committee on income tax, capital gains tax and corporation tax.

A consultative paper.

Section 1: INTRODUCTION

Background

1.1 In July 1980, a committee was established under the chairmanship of Lord Keith of Kinkel to consider and make recommendations upon the enforcement powers of the Revenue Departments. The first two volumes of the report of the Keith Committee ("Keith") were published in March 1983 as Cmnd 8822. These made far-reaching proposals for modernising the administration of VAT, income tax, capital gains tax and corporation tax. After public consultation, proposals based on Keith's recommendations for the administration of VAT were enacted in the Finance Act 1985.

1.2 In December 1986, the Inland Revenue published a consultative document entitled "The Inland Revenue and the Taxpayer", making detailed proposals in response to Keith's recommendations for the administration of income tax, capital gains tax and corporation tax. Comments were invited by February 1987 on the priority proposals for streamlining the administration of corporation tax and for improving the effectiveness of the PAYE and subcontractors deduction schemes. These proposals, modified in the light of comments received, were enacted in the Finance No 2 Act 1987.

1.3 Comments on the remainder of the proposals in the 1986 consultative document were invited by October 1987. Some of

the proposals, including the modernisation of the obligation to notify the Revenue of liability to tax and amendments to the Revenue's information powers, modified in the light of comments received, were included in this year's Finance Bill.

1.4 This further consultative paper reviews the remaining draft clauses from the consultative document - that is those which have not been included in last year's Finance Act or this year's Finance Bill - and makes revised proposals, which take account of the earlier consultation. It also makes detailed proposals for the new interest arrangements for the corporation tax "Pay and File" system, introduced in last year's Act, and for PAYE, introduced in this year's Bill.

Draft clauses already legislated

1.5 The following clauses from the 1986 consultative document have already been given statutory effect and therefore do not appear further in this paper:

Clauses 4, 18, 30-33, 38-42 (which were enacted in Finance Act (No 2) 1987).

Clauses 1, 3, 5, 6, 29, 37 and part 1(9) of Schedule 1 (which are included in Finance Bill (No 2) 1988).

Draft clauses not dealt with in this paper

1.6 Draft clauses 9 and 44 from the consultative document are not dealt with in this consultative paper.

1.7 Clause 9 was designed to respond to Keith's recommendation that the basis on which the Inland Revenue may make discovery assessments (which the Committee broadly accepted, subject to the point covered in Clause 11) should be set out in statute rather than resting on the existing

combination of case law and administrative practice. The Clause accordingly proposed to introduce statutory rules based on the existing case law and practice, taking into account the decision in the case of Scorer v Olin Energy Systems Limited [1985] 2 WLR 668.

1.8 There has been little support for the approach in Clause 9. Many of those who responded felt the Clause would lead to greater uncertainty about whether tax liabilities had been finally determined. Some representative bodies questioned the need for legislation following the decision in the Olin case. Another suggestion was that a statement of the Inland Revenue's view of the law in this area would be helpful to taxpayers and their advisers.

1.9 Further consideration is needed of the issues before any firm decision can be taken. As a next step Ministers have asked the Inland Revenue to consider whether it might be possible to issue a Statement of Practice setting out the Revenue's view of the law and the circumstances in which Inspectors would normally seek to make discovery assessments.

1.10 Clause 44 would implement part of Keith recommendations 90 and 91 on the administration and conduct of appeals and the publication of Special Commissioners' cases in anonymised form. Proposals for legislation in this area are being considered by the Inalnd Revenue and the Lord Chancellor's Department and will be the subject of a separate consultative document or documents.

General approach of revised proposals

1.11 Keith made wide-ranging recommendations for the reform of the administration of income tax, capital gains tax and corporation tax. Many of these were widely welcomed as leading to a more modern and streamlined tax system, which would be both fairer and more efficient.

1.12 Of the recommendations that enjoyed widespread support, some have been legislated already. The remainder reappear in this paper, either with confirmation that the proposals in the 1986 consultative document remain unchanged, or with minor revisions to meet points raised during the subsequent consultations.

1.13 Amongst the remaining recommendations, however, are a number which have been less well received. For example, concern has been expressed that the introduction of too-rigid a compliance regime for individual taxpayers within the present complex framework of tax rules, and strict rules on the records businesses should keep for tax, could add unnecessarily to burdens on small businesses. There have been worries that proposals for making penalties for tax evasion automatic are too inflexible for the purposes of Inland Revenue taxes. The recommendation for introducing a new Inland Revenue general information power has drawn criticism as reducing the safeguards against unwarranted intrusion upon individuals' privacy. And the group of proposals on professional privilege has been criticised as extracting too high a price through the introduction of an override provision.

1.14 In these areas, many respondents saw the present administrative structure as providing a more satisfactory balance between taxpayers' rights and obligations, and between the powers of the Revenue and safeguards for taxpayers, than would be achieved under Keith's proposals. The revised proposals in this paper reflect many of these concerns. So while seeking to modernise the tax system in the main ways that Keith suggested, which have enjoyed general support, in some other respects they leave the existing structure broadly unaltered.

1.15 Sections 2 and 6 of this paper make proposals for further modernising the administration arrangements for corporation tax and for employers' PAYE deductions. In response to suggestions, these Sections include descriptions

of the frameworks already established in legislation for Corporation Tax Pay and File and for interest on PAYE, so as to make it easier to see how the further proposals fit into the overall picture.

Representations

1.16 Detailed comments on the revised proposals made in this paper, including, where appropriate, an indication of their effect on compliance costs, should be sent, to arrive by 30 September 1988, to:

Inland Revenue
Keith Committee Review
Room 15
New Wing
Somerset House
LONDON WC2R 1LB

SECTION 2: THE INTEREST REGIME FOR CORPORATION TAX PAY AND FILE

Background

2.1 Sections 82 to 91 Finance (No 2) Act 1987 introduced a new system, known as Pay and File, which will streamline and modernise the administration of corporation tax. Pay and File will not come into effect before 1992 at the earliest. This allows companies and their advisers time to prepare for the new system, so that they will be able to meet the time limits for estimating their tax liabilities and filing their tax returns. The exact starting date for Pay and File, which itself will be made possible by the new computer system which the Revenue is installing for its Collection system, will be announced nearer the time.

2.2 Under present law and practice, many companies' accounts and tax computations do not reach tax offices in time for Inspectors to make agreed corporation tax assessments by the date when the tax becomes due. In about two thirds of cases, the corporation tax profit figure has to be estimated and the company then enters a formal appeal to keep matters open until agreement can be reached. In the meantime, the company has to pay the full amount of the estimated tax shown by the assessment on the due date for payment, unless some smaller figure can be supported and is agreed to by the Inspector or the Appeal Commissioners. Complicated rules govern interest on tax unpaid when due; and conversely on tax ultimately found to have been overpaid. And, in addition, many cases have to be referred to the Appeal Commissioners to oblige companies to deliver their accounts and tax computations to the Revenue so that assessments can be revised. These procedure are cumbersome and time wasting.

2.3 Pay and File will be a much smoother and more efficient system. The company will make its own estimate of the tax due and pay this, without the need for an estimated assessment, on the normal due date 9 months after the end of its accounting period (Section 90).

2.4 The company will be allowed 12 months, from the end of the period to which it makes up its accounts, in which to supply its return and accounts (Section 82). If it fails to send the return and the accounts within 12 months, it will - unless it can show a reasonable excuse - incur an automatic penalty. The penalty will start at £100 and increase in steps for longer delays and for repeated offences up to £1,000 plus 20 per cent of the tax unpaid (Section 83).

2.5 Where the final liability agreed with the Revenue differs from the estimated payment made at the normal due date, interest will be charged by the Revenue on any additional liability, and paid by the Revenue on any repayment from the due date, until the additional liability is met or repayment is made (Sections 85 and 87).

2.6 This section looks at the further measures - the new tax return and the interest rate arrangements - which must be settled before Pay and File is introduced. Comments are particularly invited on the detailed proposals for the interest arrangements.

New corporation tax return

2.7 A new tax return will be introduced for Pay and File. This will be based on the corporation tax working sheet which was issued to companies with their tax returns on an experimental basis from October 1985 to March 1988. Modifications will take account of the results of that experiment and of recent changes in administration and legislation. The content and format of the new return are

presently being worked out in consultation with representatives of companies and professional practitioners. It is intended to consult publicly on a draft, before the return is finalised.

2.8 It is planned to introduce the new return before the start of Pay and File, to allow companies and their advisers a period during which they can familiarise themselves with it, without running a risk of automatic penalties for failing to complete it on time.

Interest arrangements

2.9 When the main statutory framework for Pay and File was introduced, the Government announced that there would be consultations on the appropriate structure of interest rates for Pay and File. The following proposals are based on discussions with representatives of the accountancy and legal professions and of business organisations.

Role of interest in Pay and File

2.10 Interest plays a central role in Pay and File. The payment which a company will make at the 9 month point will be based upon its own estimate of liability. The Revenue will have no means of checking whether or not it is approximately right until the return comes in. Since the return will not be due until 12 months after the end of the accounting period - that is 3 months after the payment date - it will be possible for a company deliberately to underpay or defer payment. Similarly, it will be possible for a company deliberately to overpay. And a company could defer repayment beyond 12 months by deferring claims to relief.

2.11 Under the present system, in which tax is assessed before it is due, steps can be taken to promote the payment of tax at the correct time. Under Pay and File these

measures will be replaced by the interest charge. It is therefore crucial to the success of Pay and File that interest encourages, and does not discourage, the correct payment of tax.

2.12 In order to encourage the correct payment, but without penalising companies, the rates of interest charged and paid by the Revenue need to be aligned as closely as possible to the rates charged and paid in the market. They should neither be more nor less favourable to companies than market rates.

2.13 However, the differing rates paid, and more especially charged, by the market make it impossible for the interest regime for Pay and File to fit every company exactly. So the interest regime that is proposed corresponds to the market regime for an average company - the average company being small (93 per cent of companies are small under the Companies Act definition) and paying corporation tax at the small companies rate (95 per cent of companies pay corporation tax wholly at this rate). It thus provides a fair and practicable solution, by achieving the best fit possible for the overwhelming majority of companies.

Simple interest

2.14 Market rates of interest are frequently compound, and there are obvious arguments in principle for adopting the same approach for tax. As against that, however, simple interest has the important advantage that it is easier to administer, both for the Revenue in computing it and for the company in checking the amount. On balance, the conclusion is that it is right at this stage to maintain a charge to simple interest, on the lines of the present arrangement for interest charged and paid by the Revenue.

2.15 However, it is for further consideration whether payments made to the Revenue should in consequence be allocated against interest first, in priority to unpaid tax.

Tax treatment of interest

2.16 It is proposed that interest under Pay and File should be paid without deduction of tax and left out of account for all tax purposes. This is consistent with the present rules for interest charged and paid by the Revenue.

2.17 The advantage of exempting interest from tax in this way is that it is very much easier for the company and for its advisers. If it were not tax exempt, interest paid by the Revenue would have to be paid under deduction of income tax. It would be taxable in the company's hands but have to be accounted for separately from its trading profits. Interest charged by the Revenue would have to be paid gross. It would not be allowable as a deduction in arriving at the company's trading profits, although it would, in most cases, be allowable as a charge.

2.18 Whether interest for Pay and File is exempted from tax or not, however, some differences are unavoidable in the effective after-tax rates of Revenue and market interest for different companies. This is a consequence of the interest being paid by or to the Crown, rather than by or to a commercial concern, and of it being for tax purposes rather than for trading purposes. For the overwhelming majority of companies, there is no particular case on grounds of neutrality for preferring one tax treatment rather than the other. For large companies, which could benfit from lower effective after-tax tates of interest on late payments if the tax treatment were altered, a substantial measure of protection from exposure to interest on late payments is built into the proposals (see paragraphs 2.26 to 2.29). And, given that there can be no single rate which can exactly match the post-tax rate of interest paid by, or received by, every single company,there are strong practical grounds, in the interests of both companies and the Department, for preferring the simplicity of tax exemption.

Interest on overdue tax

2.19 Consistent with the present practice for interest charged by the Revenue, the objective is that the interest on overdue tax should be kept in line with the cost of borrowing from the market for an average company.

2.20 The majority of companies can borrow at rates between base plus one and base plus five - although the very largest with the best credit ratings can shave the cost closer to base, whilst the very smallest or those with poor credit ratings can only borrow through their directors at personal loan, or even credit card, rates. In most cases the costs of borrowing are allowable for tax.

2.21 Interest on overdue tax is presently kept just below the mid point between these levels, at base plus 2.5, reduced by the basic rate of tax (ie the small companies rate) to reflect the tax treatment. This is, broadly speaking, the rate at which an average company can borrow.

2.22 Although there is evidence that this rate is, in some cases, too low to encourage companies to pay tax on time (substantial amounts of corporation tax remain unpaid for considerable periods) it could be seen to be unfair to some companies to charge interest at a higher rate under Pay and File than at present. **The proposal is, therefore, to continue to charge interest on late payments at base plus 2.5, reduced by the small companies rate.**

Interest on repayments

2.23 It is proposed that the interest on repayments should be kept in line with the return on deposit for an average company. This differs from the present practice under which the Revenue pays interest at a rate above the return on deposit but for part of the period only.

2.24 Companies can typically obtain a pre-tax return on deposit of up to base minus one. If the rate on repayments were higher than base minus one, reduced by the full rate of corporation tax to reflect the tax treatment, large companies would, through deliberate overpayment, be able to "bank" with the Exchequer at rates above the market. In some cases, companies would even be able to "round-trip", making a profit from deliberate overpayment financed by borrowing. Such a situation would clearly not be acceptable.

2.25 On the other hand, to pay interest at a rate lower than base minus one, reduced by the full rate of corporation tax, could be seen to be unfair to some companies. The proposal, therefore, is to pay interest on repayments at base minus one, reduced by the full rate of corporation tax.

Large Companies

2.26 For large companies, the rate of interest proposed for late payments is higher than they would expect to be charged on borrowings from the market, and this differential is widened by the tax treatment proposed in paragraph 2.17. This raises the question of whether the rate is appropriate and fair for large companies, especially when (because, for example, the final liability depends on the resolution of a technical argument about the tax computation) the tax may be paid late through no fault of their own.

2.27 For this reason, the new scheme has been designed to allow large companies a substantial measure of protection against exposure to interest at this rate.

2.28 First, where tax is in dispute, they can protect themselves either by the purchase of certificates of tax deposit or by making a payment on account - secure, in the latter case, in the knowledge that, if the tax turns out ultimately not to be due, it will be repaid with interest at a fair market rate (under the proposals in paragraph 2.25).

2.29 Second, the special arrangements proposed in paragraphs 2.30 to 2.33 allow corporation tax liabilities to be rearranged within a company or within a group of companies without exposing companies to interest at the higher rate charged on late payments.

Set-off of overpayments within a company

2.30 It is proposed that where an overpayment for one accounting period is set off against a liability for another accounting period, no interest would be charged or paid for the period for which interest would otherwise run both on the overpayment and on the liability.

2.31 This is to ensure that the company is not exposed to interest charges through the difference in interest rates where there is no net liability. Overpayments would be set-off automatically by the Revenue where it knew of a liability for another period. Companies would also be able to instruct the Revenue to set overpayments off in this way.

Set-off of overpayments within a group

2.32 It is proposed that companies should be able to surrender an overpayment to another company within a group to meet a liability for the same accounting period. The effect of the surrender would be to treat the payment as if it had been made by the receiving company in the first place, so that no interest was paid to the surrendering company and no interest was charged on the receiving company for the period of overpayment.

2.33 The purpose of this proposal is to allow groups to rearrange the individual tax liabilities for an accounting period within a group, without exposing the group to interest charges though the difference in interest rates. A company would not be able to make a surrender once it had received, and cashed, an overpayment. The surrendering and

receiving company would have to be in a 75 per cent group relationship throughout the accounting period (which would have to be identical for the two companies) and up to the time of surrender. The surrender, and any payment made in return, would be left out of account for tax purposes (except, possibly, for value shifting and depreciatory transactions).

Rate setting mechanism

2.34 Changes to Revenue interest rates are presently made by Statutory Instrument. This is a slow and cumbersome procedure which makes it impossible to keep the rates properly in line with the market. It currently takes up to one month to change the rates following a change in base rate. There is a strong case for a more streamlined procedure which would allow changes to be made within one day, for instance, in accordance with a formula approved by Parliament. Ways in which this might be achieved are being examined.

SECTION 3: INTEREST AND PENALTIES

Background

3.1 Keith made far-reaching recommendations for reforming the system of monetary penalties for tax offences. These included a number of relatively uncontroversial proposals for updating the present system by increasing penalties in line with inflation, abolishing obsolete penalties and limits and generally simplifying the system.

3.2 But Keith also suggested a radical change from fully-mitigable to automatic penalties.

3.3 At present, the Revenue have the power to charge penalties up to prescribed maxima. The penalties can be set aside, or varied within the same limits, by the Appeal Commissioners. These are normally described as fully-mitigable penalties.

3.4 Keith thought that it would be fairer and simpler, and would improve voluntary compliance, if penalties were charged automatically, in amounts determined according to prescribed formulae, whenever offences occurred. These penalties would be -

(a) time-geared to the length of any delay,

(b) tax-geared to the amount of tax at risk,

(c) increased for repeated offences,

(d) and, for culpable offences - that is offences which Keith described as being "subversive of the tax system" - increased in steps according to the seriousness of the deception.

These are described as automatic penalties in this paper.

3.5 The present fully-mitigable penalties for culpable offences can be set anywhere in the range of nil to 100 per cent of the tax lost. (The legislation provides a limit of 200 per cent in some cases, but in practice it is very rare for penalties to exceed 100 per cent). Keith proposed that the penalties should be set at nil, or 30 per cent, or between 50 per cent and 100 per cent of the tax lost, according to the seriousness of the offence. This was criticised as being too harsh, and too inflexible, for the range of offences that may occur. The consultative document therefore proposed a halfway house of partially-mitigable penalties which would be set at nil, between 20 per cent and 40 per cent, or between 50 per cent and 100 per cent, according to the seriousness of the offence. These are described as semi-automatic penalties in this paper.

Reactions to the consultative document

3.6 Comments on the consultative document revealed continuing concern, even over these modified proposals. The general view was that trying to fit culpable offences into bands of seriousness with a corresponding progression of penalties would be too inflexible to take account of all possible factors and would work unfairly. All of those consulted believed that the present system of fully-mitigable penalties, allowing the penalty to be set anywhere within the overall span, was fairer.

Revised proposals

3.7 It is not, therefore, now proposed to follow Keith's radical approach for culpable offences. Instead, it is proposed to update the penalties to remove obsolete limits, as Keith recommended, whilst leaving their overall structure unchanged.

3.8 The case for automatic penalties is more persuasive in the case of regulatory offences, where the penalty is intended to encourage compliance within prescribed time

limits. As the criteria for charging the penalty and the factors determining the seriousness of the offence - the length of delay and the tax at risk - are wholly objective, automatic penalties are likely to be both fairer and more effective. And, while automatic penalties have been criticised, chiefly by the bodies representing businesses and their legal and accountancy advisers, there has been general support for them in other quarters, on the grounds that they would help to streamline the tax system to the benefit of the general body of taxpayers.

Comprehensive Compliance regimes

3.9 Keith's general approach on the making of tax returns was to recommend moving towards more streamlined compliance arrangements, with more realistic time limits, less reliance on estimated assessments and more effective sanctions.

3.10 A modern compliance regime for corporation tax, known as Pay and File, was proposed in the consultative document and legislated for in 1987. It is described in Section 2 of this paper.

3.11 Proposals for a modern compliance regime for PAYE appear in Section 6 of this paper.

3.12 For the remainder of income tax, a modern compliance regime remains a long term objective. The present structure of income tax, with its differing bases and due dates, is however much more complicated than that of corporation tax, and its reform faces greater transitional problems. Moreover, important changes in the tax treatment of married couples, introduced in the recent Budget, need to be implemented beforehand. For these reasons, it would be imprudent to make fundamental changes to that compliance regime for the time being. The revised proposals for personal tax returns therefore merely update the present penalty levels in line with inflation, as Keith recommended, whilst leaving their overall structure largely unchanged.

3.13 The proposals which follow revise draft Clauses 10, 11, 15-28 and 43 and Schedule 2 from the consultative document. A summary is given at the end showing how each clause is affected under the revised proposals.

Assessments founded on fraudulent or negligent conduct

3.14 At present, the Inspector can go back, in some cases to 1936, and in some other cases indefinitely, to recover tax lost through a taxpayer's default. Clause 10 and Schedule 2 amended the period to 20 years in all cases. This would bring the position for the direct taxes into line with the position for VAT. These proposals have been generally welcomed, and remain unchanged.

Discovery Assessments

3.15 Clause 11 does two things. First, in subsection (1), in response to a specific Keith recommendation, it extends the provisions of Section 43(2) Taxes Management Act 1970 (TMA) to corporation tax. This broadly provides an extended time limit of one year for the making of claims for relief following the making of an assessment, in circumstances where the claims could only be made as a result of the assessment. Further consideration of this matter in the light of the proposals for corporation tax Pay and File has cast doubt on the need for a provision of this kind once Pay and File is fully in operation. It is, therefore, proposed not to proceed with this subsection, but - for the interim period before Pay and File comes fully into operation - to give relief by way of extra-statutory concession in those circumstances where Section 43(2), if it extended to corporation tax, would have applied.

3.16 Second, subsection (2) responds to another Keith recommendation by making provision for a taxpayer who has received a discovery assessment to make or vary etc any claims, elections etc if as a result he will reduce the

liability to tax resulting from the discovery assessment itself, or any other tax liability he has for the period to which the assessment relates, or for any other period which has earlier been settled. But any such reduction in total is not to exceed the amount of the additional tax payable on the discovery assessment. This proposal has been widely welcomed. Although there has been some criticism of the limitation on relief, it is considered that this is right in principle and should not be changed. The clause will, however, have to be revised in the light of what is proposed for Clause 9 (see paragraphs 1.7 to 1.9) and changes elsewhere. The revised clause will be made available to interested parties in draft for comments.

Interest on tax recovered to make good loss

3.17 Clause 15 extended the Revenue's power to charge default interest to tax recovered late as a result of an innocent error by the taxpayer. This removes the present anomaly, whereby a taxpayer who is not charged tax at the correct time because he completes his return incorrectly thereby gains an advantage over the taxpayer who completes his return correctly and pays his tax at the right time. There has been general support for this proposal, which remains unchanged.

Late returns for income tax and capital gains tax

3.18 The present 30 day time limit for filing personal tax returns is not in practice enforced, since it would be unreasonable to expect those persons whose tax affairs are more complex than the average to complete their returns within this time. The taxpayer is normally given a final warning before penalty proceedings have ultimately to be taken before the Appeal Commissioners. Where the return is still not made after this, the Commissioners can award initial and continuing penalties up to prescribed monetary limits. Where the delay is exceptionally long - beyond

between one and two years depending on when the return was sent to the taxpayer - he becomes liable to a fully-mitigable, tax-geared penalty of up to 100 per cent of the tax that is assessed late as a result of his delay.

3.19 Keith recommended that the time limit for filing personal tax returns should be three months, with a further three months extension available in more complex cases, and that this should be enforced strictly through automatic tax and time-geared penalties. This arrangement is not, however, practicable under the present tax system. Returns have to be examined by the Revenue, and assessments made, before the end of October if tax is to be due at the correct time. Under Keith's proposal, many returns would not reach the Revenue until the beginning of October, which would make it impossible to examine them all within the necessary timescale.

3.20 In principle, of course, it is desirable - as Keith said - to get to a position where people have reasonable time limits (which may in fact vary between taxpayers) for sending in returns, and these time limits are then effectively enforced. However, this turns on some wide-ranging and difficult reforms to modernise personal income tax generally. Meanwhile, the present system, despite its critics' objections, does work reasonably well in practice. It is not therefore proposed at this stage to change the 30 day time limit or to introduce automatic penalties for late returns.

3.21 Clause 16 proposed a halfway house between the present system and fully automatic penalties. The tax geared penalty for exceptional delay was to be fixed at 20 per cent of the tax paid late, in line with the corresponding penalty proposed for companies under CT Pay and File. The daily penalty could still be awarded only by Commissioners, but would then be fully automatic.

3.22 Making the tax-geared penalty for exceptional delay a fixed rate of 20 per cent attracted the same general criticism as other automatic penalties. It was widely agreed, however, that it was pitched at the right level and would be fairer to taxpayers than the present, fully-mitigable penalty of up to 100 per cent. This proposal is therefore retained unchanged.

3.23 The proposal for making the daily penalty automatic once it had been declared by the Commissioners attracted more fundamental criticism as being unfair, since the Commissioners would have no choice but to award it in the cases that the Revenue selected to put before them.

3.24 It is therefore proposed to leave unchanged the structure of fully mitigable initial and daily penalties, awarded by the Commissioners. But, in accordance with Keith's general recommendation that penalties unchanged since 1960 should be updated, it is proposed to increase the limits in line with inflation to £300 and £60 respectively, both fully-mitigable.

3.25 It is also proposed to streamline the procedure for charging daily penalties, after an initial penalty had been awarded by the Commissioners, by assessing them directly. In making an assessment, the Inspector will be able to mitigate the penalty according to the circumstances of the case. The taxpayer will be able to appeal to the Commissioners against the imposition of the penalty (and/or its level).

3.26 Commissioners are, at present, barred from awarding penalties if the return has been delivered before the proceedings are commenced - which is, in law, when information is laid before the Commissioners prior to the issue of a summons to the taxpayer to appear at the penalty hearing. A number of commentators suggested that the taxpayer should be allowed a final warning before a penalty is awarded. The case for this becomes stronger with the

revalorisation of the limits. It is therefore proposed to provide a final warning which would be combined with the notice of hearing. The Commissioners would not be allowed to award an initial penalty if the return had been delivered before the penalty hearing. Similarly, it is proposed to provide that daily penalties - which would always be assessed in arrear - may not be assessed once the return has been delivered.

3.27 Where the taxpayer shows that no income or gains were to be included in the return, the penalty for delay in completing the return has, since 1907, been limited to £5. Clause 16 proposed to increase this to £30, in line with inflation since 1960. It is now proposed to fix the limit at £100, which still falls far short of its real value when it was last set.

Incorrect returns for income tax and capital gains tax

3.28 Section 95 TMA provides a fully mitigable penalty for fraudulently or negligently incorrect returns or accounts for income tax and capital gains tax of up to £50 plus 100 per cent or, in the case of fraud, 200 per cent of the tax lost.

3.29 It is not proposed to proceed with Clause 17, which proposed to replace Section 95 with a semi-automatic penalty.

3.30 Instead, it is proposed to amend Section 95 to remove the obsolete penalty of £50 and the (virtually obsolete) limit of 200 per cent. The penalty thus becomes a fully mitigable penalty of up to 100 per cent of the tax lost.

3.31 Clause 17 provided that there would be no penalty for "simple" negligence, which was defined according to an arithmetic test. This statutory de minimis provision was necessary because the penalty was semi-automatic. Without a statutory de minimis limit, penalties would have been

charged for all omissions, however small. This is not necessary with a fully-mitigable penalty where the de minimis can be set administratively. And there is the further advantage that it will be easier to alter the de minimis, as appropriate, in the future.

Incorrect returns for corporation tax

3.32 Section 96 TMA provides, for corporation tax, a penalty for incorrect returns or accounts which is identical to that provided by Section 95 for income tax and capital gains tax.

3.33 It is not proposed to proceed with Clause 19, which proposed to revise Section 96 in the same way as Clause 17 proposed to revise Section 95.

3.34 Instead, it is proposed to amend Section 96, in the same way as is proposed for Section 95, by removing the obsolete penalty of £50 and the (virtually obsolete) limit of 200 per cent. The revised penalty would be a fully mitigable penalty of up to 100 per cent of the tax lost.

Special returns by companies

3.35 Clauses 20 and 21 proposed a new compliance regime, based on automatic penalties, for the returns required from companies under Schedules 13 and 16 Income and Corporation Taxes Act (ICTA) 1988 (advance corporation tax and income tax on company payments).

3.36 The general view in comments on the consultative document was that these proposals were unfair. These returns differ from personal and company tax returns in that no notice is given requiring them to be completed; furthermore, they differ from the PAYE end of year return that an employer is required to make every year in that a company's obligation to make a Schedule 13 and 16 return may arise only from time to time. This makes it difficult to

design automatic penalties which would work fairly. It is not, therefore, planned to proceed with these proposals.

3.37 Offences in relation to these special returns will therefore continue, as at present, to attract penalties under Section 98 TMA. Revised proposals for Section 98 penalties appear below.

Late and incorrect returns for information etc

3.38 Broadly speaking, Section 98 TMA is a sweep up penalty provision. It provides penalties for late and incorrect returns and notices where these are required under a wide range of different measures which do not have their own penalty provisions. Many of the circumstances involved occur only very rarely.

3.39 Section 98 also applies, however, to returns and notices required under the PAYE regulations. It is proposed to introduce a separate compliance regime for employers' end of year returns, which is described in Section 6 of this paper. Section 98 would continue to apply to other returns and notices required under the PAYE regulations.

3.40 Section 98(1) allows the Commissioners to award initial and continuing fully mitigable penalties for delay in making the returns or notices required. Clause 22 of the consultative document proposed to replace these with automatic penalties. This proposal has been criticised on the same grounds as explained at paragraph 3.36 above, and is not being proceeded with.

3.41 It is therefore proposed to leave the structure of Section 98(1) unchanged; to update the limits for initial and continuing penalties in line with inflation to £300 and £60 respectively, both fully mitigable; and to introduce further safeguards for the taxpayer and to streamline the continuing penalty on the lines proposed for Section 93(1) TMA at paragraphs 3.25 and 26 above.

3.42 Section 98(2) TMA provides a fully mitigable penalty for making an incorrect return or notice of up to £250 for negligence, or up to £500 for fraud. Clause 24(1) proposed to replace these with automatic penalties of £1,500 and £3,000 respectively. These are penalties for culpable offences and the proposal for making them automatic is accordingly not being proceeded with (see paragraph 3.7).

3.43 Instead, it is proposed to keep the penalty fully mitigable, to update it in line with inflation and to remove the distinction for fraud - making the penalty fully mitigable up to £3,000, in line with the proposals for minor penalties (see paragraph 3.45).

Increase in certain penalties

3.44 Clause 24 proposed a number of amendments to minor penalties, to increase them in line with inflation and to remove mitigation, making them automatic. The latter proposal is not being proceeded with.

3.45 Instead, it is proposed to amend these minor penalties by updating them in line with inflation, and by removing the distinction for fraud in Section 98(2) TMA and paragraph 13(6) Schedule 5 Finance Act 1983. The new penalties in Clause 24(1) become fully-mitigable penalties of up to £3,000 in all cases.

Assessment of default interest and penalties

3.46 The present procedures for recovery of default interest and penalties are unnecessarily complex. Keith recommended that they should be made simpler by allowing the Revenue to assess the interest and penalty as if they were tax. This would give the taxpayer a clear right of appeal to the Commissioners if he disputed either that interest or penalties were due, or the amount of them. And it would simplify the procedural arrangements.

3.47 Clauses 25, 26, 27 and 28 set out the system for assessing interest and penalties. They were generally welcomed as a sensible modernisation, and were legislated in a modified form for penalties for corporation tax Pay and File in Finance (No 2) Act 1987.

3.48 Some minor revisions will be needed to these proposals to exclude initial penalties under Sections 93(1) and 98(1) TMA, which will, under these revised proposals, be imposed by the Commissioners and not by way of Revenue assessment.

3.49 A problem with the assessment of default interest is that the precise amount cannot be finally calculated until all the relevant tax has been paid. A further simplification is therefore proposed whereby the Inspector could make a determination that default interest was due. The determination would either be combined with a notice of assessment or be given separately. It would say that the tax, or part of it, carried default interest from a specified date, or dates. The taxpayer would be able to appeal against the determination to the Commissioners in the usual way. It is for consideration whether an appeal against an assessment which is combined with a determination should be deemed to be an appeal against the determination as well, or whether a separate appeal should be required.

Automatic revalorisation of certain penalties and limits

3.50 Keith recommended that penalties should, in future, be revalorised automatically in line with inflation. Clause 43 made proposals which closely followed this recommendation. The Government's success in bringing inflation under control renders this provision largely unnecessary, and it is not being pursued. But the Government will, of course, continue to keep the limits under review so that they remain appropriate and effective.

Criminal tax offences

3.51 There are a limited number of specific Inland Revenue criminal offences. Apart from these, where the Revenue prosecutes taxpayers it does so for general law offences eg theft, cheating the public revenue, etc. Keith recommended the creation of further specific Revenue criminal offences for dishonesty, similar to those for VAT.

3.52 Paragraph 6.8.2 of the consultative document left this recommendation for further consideration and invited comments on the proposal. The 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. It is therefore not proposed to implement this recommendation.

Loss of tax through removal abroad and going unknown

3.53 The present assessment procedures and the territoriality of tax debts make it possible for persons deliberately to evade payment of their proper tax liabilities by (i) removing themselves or their assets abroad or (ii) by going unknown, so that the Revenue does not know their present whereabouts. The number of persons evading payment in this way has increased sharply in recent years, and in some of the cases the tax involved can be substantial.

3.54 The Revenue can, where a firm tax debt exists, secure assets to prevent their removal abroad, through the use of an injunction, known as a Mareva injunction, or, in Scotland, by means of arrestment. A person intent on evading payment can forestall such measures, however, by obstructing the determination of his liabilities or by removing his assets before the tax becomes due.

3.55 Keith recommended that the problem should be addressed by allowing the Revenue to make "jeopardy" assessments which would be immediately enforceable. Under Keith's proposal, the Inspector would first have to obtain leave from the Special Commissioners, who would need to be satisfied that there was reasonable cause to believe that tax might be lost due to the default of the taxpayer. The jeopardy assessment, which could be made before the tax would normally be due, would be immediately enforceable, though without prejudice to the commencement or continuation of appeal proceedings. The enforceable debt could then found the issue of a writ; and the normal interim relief, such as Mareva injunctions or arrestment, would be available from the Court. Since the purpose would be to secure assets, the hearing before the Commissioners and the application to the Court for interim relief would be ex-parte.

3.56 Keith's proposals have been criticised as going further than is needed to secure assets. The jeopardy assessment would create a collectible debt which would be immediately enforceable. Some have suggested that, even in these exceptional circumstances, it would be wrong to allow tax to be collected before it would normally be due. The consultative document therefore left the matter for further study.

3.57 The following proposals suggest a way in which the loss of tax due to the removal of the taxpayer or his assets abroad or his going unknown could be prevented, without collecting the tax before it would normally be due. The use of this procedure would, however, be appropriate only in those exceptional cases where substantial amounts of tax were at risk. Comments are particularly invited on these proposals.

3.58 The proposals are that where there is reasonable cause to believe that tax might be lost, either (i) through the taxpayer's absence or removal from the jurisdiction or (ii) through the removal of his assets from the jurisdiction, the

Revenue should be able to apply ex-parte to the High Court (or, in Scotland, the Court of Session) for an Order that the taxpayer gives such security as the Court may think fit. The Court would be given power to grant a restraint and/or charging order to secure assets until security was given.

3.59 It is for consideration whether the procedure should also be available where the Revenue is unable to establish the present whereabouts of the taxpayer, but does know the whereabouts of assets belonging to the taxpayer and located within the United Kingdom. Where the taxpayer's present whereabouts are unknown, the Revenue will, in most cases, have no knowledge as to whether the taxpayer is within the United Kingdom or of his possible intentions as to removal of assets abroad. There is a strong case, therefore, for allowing assets to be secured in these circumstances too. Such action would, however, be appropriate only where substantial amounts of tax were at risk and the whereabouts of assets of substantial value were known.

3.60 It would neither be necessary for the liability to be finally determined, nor for the earliest date that the liability may be due to have passed, for the remedy to be available. However, the Revenue would have to establish to the satisfaction of the Court (i) that it was likely that the liability for which remedy was sought would be due and (ii) the likely amount of that liability.

3.61 The taxpayer would be able to apply inter-partes to have the order etc set aside or varied. Moreover, provision could be made for the payment of compensation in appropriate cases where the final liability was for a sum less than that secured.

Summary of revised proposals for Clauses 10, 11, 15 to 28, 43 and Schedule 2 of the consultative document

10	No change.
11(1)	To be replaced by concession.
11(2)	To be revised
15	No change.
16(1)	Replaced by six-fold uprating of Section 93(1) limits
16(2)	No change.
16(3)(a)	Withdrawn.
16(3)(b)	Revised to update limit in Section 93(7) to £100.
17	Withdrawn. Fully mitigable penalty of 100 per cent of tax lost proposed.
18	Included, in revised form, in F(No 2)A 1987.
19	Withdrawn. Fully mitigable penalty of 100 per cent of tax lost proposed.
20	Withdrawn.
21	Withdrawn.
22	Withdrawn, except for subsection (4). Six-fold uprating of penalty in Section 98(1) proposed.
23	No change.
24(1)	All the new penalties revised to fully mitigable penalties of £3,000.
24(2)	Withdrawn.
24(3)	Revised to make new penalty of £300 fully mitigable.
24(4)-(5)	No change.
25-28	Minor amendments consequential upon other proposals.
43	Withdrawn.
Schedule 2	No change.

NB No change means no change in principle. Minor amendments will be needed in some cases consequent upon changes in other proposals and in other legislation.

SECTION 4: INFORMATION POWERS

Background

4.1 The Revenue has certain powers to obtain information about a person whose tax affairs are under enquiry. Under Section 20 TMA, the person, or a third party, can be required to produce relevant documents. Under Section 20C TMA, the Revenue can, where appropriate, obtain a warrant to search premises.

4.2 The power allowing the Revenue to require documents to be delivered is limited in its scope, and can be used by an Inspector only after an informal request for the information and with the permission of an independent Appeal Commissioner.

4.3 Keith thought that these conditions were too restrictive and could prevent, or unreasonably impede, the Revenue's enquiries. He recommended that (i) the power be made more general and (ii) the conditions prior to its use - the informal request and oversight by the Commissioner - be replaced by a right of appeal to the Commissioners after its use.

4.4 His recommendations were criticised, however, as providing inadequate safeguards for the citizen against unnecessary invasion of his privacy and the imposition of unreasonable costs of compliance.

4.5 The draft clauses in the consultative document tried to meet these concerns by proposing a general information power on the lines that Keith had suggested but with additional safeguards. Comments on the draft clauses, however, revealed continuing concern over these proposals. The general view was that the citizen is better safeguarded if the oversight by the Commissioners is exercised before the power can be used than if it is exercised after it has been used.

4.6 The revised proposals in this Section therefore do not pursue that aspect of Keith's approach. Instead, they update the existing arrangements, in ways which Keith suggested and which enjoyed general approval, whilst leaving their overall structure unchanged. They replace Schedule 1 to the draft clauses in the consultative document. A summary is given at the end of this section showing the fate of each subparagraph of Schedule 1 under the proposals.

Revenue's power to call for documents

4.7 At present, before an Inspector can make a formal order requiring a taxpayer or a third party to provide information, he must (i) make an informal request for the information to be provided and (ii) obtain the consent of a Commissioner for a formal order to be given. This ensures that there is, in every case, independent oversight before the power can be used.

4.8 The application to the Commissioner is ex parte. This is usual for such applications for judicial consent and is necessary since the Inspector must justify his application by showing why the taxpayer's affairs are under enquiry. It could prejudice his enquiries if the taxpayer were present, and would breach confidence if a third party were there. However, the informal request allows the taxpayer or third party to object if the request goes beyond the bounds of the power or is unreasonable. Any objections would be reported, by the Inspector, to the Commissioner, who would take them into account in deciding whether consent should be given.

4.9 As stated above, Keith thought that it would be better if the independent oversight over the use of the special information power was exercised after the notice was given rather than before. He recommended that the informal request for the information and the prior approval by a Commissioner should be dropped, and replaced by a right of appeal after the formal order had been given.

4.10 The appeal hearing would be inter partes but, for the reasons given in paragraph 4.8, its scope would necessarily be restricted. The consultative document proposed that the possible grounds for appeal should be that the information required was not in the person's possession; or could not be relevant to any of the taxpayer's tax liabilities; or that the time for production of the information was unreasonable; or that the information was protected from disclosure as relating to the conduct of an appeal, as part of an accountant's working papers or through legal professional privilege. (The appeal hearing would also have provided the route for deciding claims by the Revenue that legal professional privilege should be overridden, but this will not be necessary under the proposals in Section 5 of this paper.)

4.11 The criticism of Keith's proposals focused on concern that they would reduce the safeguards for the citizen against misuse of the information power by the Revenue. Most commentators have regarded the present system, with its informal request and prior review by an independent Commissioner, as providing greater protection than a restricted right of appeal after the event.

4.12 The general view has been that the existing arrangements should be retained. There have been some suggestions that a right of appeal after the event should be provided as well and the grounds for appeal widened to include questioning the grounds for the Inspector's enquiries. For the reasons given in paragraph 4.8, it is not possible to extend the grounds for appeal in this way. Furthermore, it would add unjustified administrative complications to the system.

4.13 Given the choice between the practical alternatives - either (i) to retain the present arrangements of an informal request and prior approval or (ii) to replace these with an

appeal after the event as Keith recommended - most of those consulted preferred to retain the present arrangements. It is therefore not proposed to make any change.

4.14 It will, of course, remain the position that a person required to provide information has a right to refuse to do so if he believes that the Revenue has overstepped its powers. And if the Revenue does not accept this, and institutes penalty proceedings, it is the Commissioners that will decide the issue. This provides a route whereby the person can appeal to the Commissioners against a notice which he believes to be invalid.

4.15 Moreover, there will be no change in the general provision under which the period for providing information may be extended, if it would not be reasonable to comply within the time given.

Extension to particulars

4.16 The information that the Revenue can insist on seeing is, at present, restricted to documents already in existence. Keith recommended that it should be extended to particulars - that is to allow the Revenue to require written answers to be given to written questions.

4.17 It is generally agreed that extending the information that can be required to include particulars is a sensible modernisation, where the information is to be provided by the taxpayer himself. Requests for answers to questions, rather than for access to a large number of documents which may contain that information, could in many cases reduce the compliance burden upon those involved. However, some commentators were concerned that an extension to particulars for third parties could, in some of those cases, impose excessive burdens.

4.18 It is proposed, therefore, to include "particulars" in the information that can be required, but only in relation to information from the person whose affairs are under enquiry. Information that can be required from third parties would continue to be restricted to the delivery of documents already in existence.

Reimbursement of costs

4.19 It is part of a citizen's duty to comply with his statutory obligations, and it is a general principle that the Exchequer does not reimburse the costs of so doing. The present information powers follow this general principle and provide no reimbursement for the costs of supplying information.

4.20 Keith recognised that, if the information that could be required were extended to particulars - that is from providing access to documents to providing answers to questions - the costs of compliance could, in some cases, be increased substantially. He therefore recommended, in this case, a limited breach of the general principle, so as to allow the costs of innocent third parties to be reimbursed. By "innocent", Keith meant third parties genuinely at arm's length from the person whose affairs were under enquiry.

4.21 Since, however, it is not proposed to extend the information that third parties can be required to provide to particulars as Keith suggested, the question of reimbursement of costs does not arise. Information from third parties will continue to be restricted to the delivery of documents already in existence and it is not proposed to introduce any reimbursement of their costs.

Definition of third party in Section 20 TMA

4.22 The Revenue can, at present, call for information from third parties only if they fall within certain categories, broadly covering businesses and relatives of the person

under enquiry. Keith thought that these restrictions were unnecessary and served to encourage taxpayers who wished to conceal information from the Revenue to seek out sanctuaries outside these categories. He therefore recommended that the restrictions should be lifted.

4.23 Some commentators have suggested that it is an invasion of privacy to ask for information about a taxpayer from any third party, including unrelated individuals. This argument is, however, less persuasive if, first, the information is limited to documents already in existence and, second, the consent of a Commissioner is required. There would be great difficulty in settling liabilities correctly if taxpayers could deny the Revenue access to relevant documents by finding an excluded third party to take charge of them. It is therefore proposed to remove the restrictions on the definition of third party, as Keith suggested.

Time limits for providing information under Section 20 TMA

4.24 There is, at present, no statutory time limit for providing information required under Section 20. Keith recommended that the Inspector should specify a time limit for providing the information in his formal notice and that this should in no circumstances be less than 21 days. This proposal was generally welcomed, though some respondents thought that the minimum period should be longer and suggested 30 days. This is accepted for notices given by an Inspector under Section 20(1) and (3) TMA.

4.25 There are, however, some serious cases where a shorter time limit would be appropriate. Under Keith's proposals, this would have been available to the Revenue under the new production order, which appeared as Section 20D in Schedule 1 to the draft clauses contained in the consultative document. It is proposed in paragraphs 4.35 to 4.37 that Section 20D should be dropped. Instead, it is proposed that there should be no statutory minimum limit for notices given by the Board under Section 20(2).

Copy of third party notice to taxpayer

4.26 Keith recommended that notices to third parties requiring information to be provided should be copied to the taxpayer except where there were grounds to suspect fraud. This proposal is accepted.

Accountants' working papers

4.27 Section 20B(9) excludes tax accountants' working papers from the ambit of the information power. Keith observed that this exclusion was too wide. In the case of many small businesses, the tax accountant's working papers are in effect the books of account and the Inspector should, where appropriate, be able to call for them. Keith therefore recommended that the exclusion be lifted, with the exception of audit papers and tax advice.

4.28 The proposals in the consultative document closely followed Keith's recommendations. The exclusion for accountants' working papers was to be lifted with the exception of audit papers, which would be defined in regulations. This was criticised by the accountancy bodies who did not consider that audit papers could be defined satisfactorily.

4.29 The consultative document left the protection for tax advice to be given under a general extension of privilege to accountants. As explained in paragraphs 5.13 to 5.16, it is no longer proposed to extend privilege in this way. Instead, it is now intended to provide this protection explicitly within an amended Section 20B(9).

4.30 It is proposed, therefore, to amend Section 20B(9) to make it clear that audit papers and tax advice are protected from disclosure by a tax accountant, but that papers showing the composition of any item in the taxpayer's accounts or return, or showing how the item was derived from the

taxpayer's accounting records or from information from other persons, are not. Where such papers are part of the accountant's audit papers or include tax advice, protection would be maintained by allowing the accountant to deliver, in place of those papers, such relevant extracts, or such new schedules prepared from his papers, as the Inspector may require to show the composition or derivation of any item.

4.31 By defining, in this way, the part of the accountant's papers that the Inspector may see and providing for extracts to be provided where necessary, the need to define audit papers in detail is avoided. There will be consultations with the accountancy profession on the wording of the revised Section 20B(9).

Working papers of tax accountants in default

4.32 Section 20A TMA allows the Revenue access to the working papers of a tax accountant who has been convicted of a tax offence or has had a penalty awarded against him for aiding and abetting in a false return or accounts. Paragraph 2 of Schedule 1 makes a series of amendments to Section 20A which are consequential on the proposals for assessing penalties. No substantive change to the law is involved. This proposal remains unchanged.

Search powers

4.33 In the most serious cases of suspected tax evasion, the Revenue can apply to a judge, or a sheriff, for a search warrant. Keith examined these search powers in considerable detail and made a number of very detailed proposals for improving the safeguards for the citizen. Paragraph 4 of Schedule 1 amends the search powers to provide the additional safeguards that Keith recommended and to bring the powers into line with the search powers for VAT and the provisions of the Police and Criminal Evidence Act 1984 (PCEA).

4.34 There is widespread support for Keith's recommendations and for the proposals in the consultative document. Some commentators suggested additional safeguards, but in each case these were safeguards which Keith examined in great detail and rejected as inappropriate. These proposals therefore remain unchanged.

Production order

4.35 Keith recommended a new procedure, as an alternative to a search warrant, under which the Revenue could ask the Courts to order a person to produce information where fraud was suspected. This was intended to deal with cases where information was required urgently, but use of the full search powers was not justified. This appeared as a new Section 20D in Part III of Schedule 1.

4.36 A number of respondents to the consultative document questioned whether this additional power was needed if the Revenue's powers under Section 20 TMA were strengthened in the ways that Keith suggested elsewhere.

4.37 This paper includes proposals for allowing access to accountants working papers (paragraphs 4.30 to 4.31), for no time limit on orders on taxpayers under a Board's notice (paragraph 4.25) and for effective sanctions against destruction of records (paragraphs 4.40 to 4.41). In these circumstances, it is not considered that the additional power that Section 20D would provide is required.

Procedure where documents etc are removed

4.38 Keith recommended that the Revenue should introduce formal procedures governing access to documents removed during a search. The proposed procedure was set out in new Section 20E in Part III of Schedule 1 in the consultative document. It followed closely the similar provisions in PCEA.

4.39 These proposals were generally well received. Some commentators suggested minor changes on points of detail, but these would be departures from the equivalent procedures in PCEA. It is not thought desirable that there should be unnecessary differences between these procedures. This proposal therefore remains unchanged.

Destruction of records

4.40 Keith recommended that there should be an appropriate criminal penalty for the export or destruction of documents following the receipt of an information notice requiring their delivery to the Revenue. He recommended a criminal penalty with a fine of up to £1000 on summary prosecution and, in indictable cases, a maximum of 2 years imprisonment and an unlimited fine.

4.41 It is generally accepted that there should be an appropriate sanction against the deliberate removal or destruction of documents in order to frustrate the Revenue's enquiries. It is therefore proposed to introduce penalties on the lines suggested by Keith. Comments are invited on the appropriateness of the level of penalty that he recommended.

4.42 Keith also recommended that there should be a penalty for destroying documents which were the subject of a Commissioner's notice under Section 51 TMA. This is accepted in principle, but the proper place for such a sanction would appear to be in the procedural rules for the Commissioners and not in the Finance Act. This will therefore be examined later together with the other proposals on procedural rules (see paragraph 1.10).

Summary of revised proposals from Schedule 1 of the consultative document

Part I

1.1 No change.
1.2 No change.
1.3 Restrict extension to Section 20(1) and (2).
1.4 No change.
1.5 No change.
1.6 Withdrawn.
1.7 Withdrawn.
1.8 Restrict time limit to Section 20(1) and (3).
1.9 Included in Finance (No 2) Bill 1988.
2 No change.
3.1 No change.
3.2 Withdrawn.
3.3 Withdrawn.
3.4 No change.
3.5 Withdrawn.
3.6 Revise to protect audit papers and tax advice.
3.7 Withdrawn.

Part II

4 No change.

Part III

New Section 20D withdrawn.
New Section 20E No change.
New Section 20F(1) No change.
New Section 20F(2) Withdrawn.
New Section 20F(3) No change.
New Section 20F(4) No change.

SECTION 5: LEGAL PROFESSIONAL PRIVILEGE

Background

5.1 Legal professional privilege has the effect, according to the law of England, that communications made between a professional legal adviser and client (i) for the purpose of legal proceedings (litigation privilege) or (ii) for the purpose of seeking or obtaining legal advice (advice privilege) may not be given in evidence in proceedings.

5.2 The Taxes Acts provide a form of protection for tax purposes which is broadly equivalent to litigation privilege. This protection, under Section 20B(2) TMA 1970, applies in precisely the same way to communications with both lawyers and accountants.

5.3 This section is concerned principally with forms of protection for tax purposes which are broadly equivalent to advice privilege.

The present role of legal professional privilege

5.4 There are a number of provisions in the Taxes Acts which deny the Revenue access to documents for which legal professional privilege could be claimed. These are, Keith suggested, designed not to preserve legal professional privilege as such, but to save legal advisers from being put in the position of having to breach the obligation of confidentiality incumbent upon them.

5.5 For instance, the Revenue has powers under Section 20 TMA 1970 to require, in certain circumstances, a person to provide access to documents in his possession. Section 20B(8) provides that the powers cannot be used to oblige a legal adviser to provide access to privileged documents. But there is no prohibition against the use of the powers to require a taxpayer or someone other than a legal adviser to provide access to privileged documents.

There should be.

5.6 Keith recommended a package of measures on legal professional privilege. He suggested that, if the package were implemented, it would achieve a satisfactory balance between the legitimate interests and aims of the Revenue and those of the legal profession and their taxpayer clients.

Keith's views

5.7 Keith was concerned that there were cases where the only source of facts required to determine a tax liability was in papers which were unavailable to the Revenue because of legal professional privilege. He gave as an example instances where, in order to prevent the Revenue from obtaining access to material facts, details of tax avoidance schemes had been fully committed to writing only in instructions to Counsel.

5.8 Keith therefore recommended that claims to legal professional privilege should be able to be overridden by the Courts or Appeal Commissioners, where this was needed to ascertain the facts necessary to the proper determination of a taxpayer's tax liabilities.

5.9 On the other hand, Keith received representations that the protection given to privileged documents in the hands of legal advisers should be extended to privileged documents in the hands of taxpayers and other third parties. While he regarded this extension as unacceptable on its own - since it could lead to the complete stultification of the procedures for making tax assessments - he saw the override as removing this obstacle. On that basis, he recommended that the protection given to privileged documents, subject to the limitations imposed by the override, should be available generally.

5.10 At present, disputes over claims by legal advisers to protection for privileged documents may be resolved by judicial review instituted by the adviser or by penalty

proceedings instituted by the Revenue. Keith recommended a further appeal procedure, to allow the Courts and Appeal Commissioners to resolve disputed claims to privilege by taxpayers and others and to decide whether in particular cases privilege should be overridden.

5.11 The proposals on privilege have provoked widespread discussion. There is some support for the proposal that the protection for privileged communications with lawyers on tax matters should be extended more widely. On the other hand, considerable concern has been expressed over the proposals for the override, which many see as an unacceptable erosion of the rights of the citizen.

5.12 This group of recommendations is very much a package. On the basis that, as Keith stated, it would be unacceptable to extend the protection for privilege more widely without introducing the balance of the override as well, the view of many people is that this would be too high a price to pay for the extension. The Government recognises the strength of feeling here, and is therefore not proposing to make any changes to the way in which protection for legal professional privilege operates at present, for tax purposes, in relation to communications with lawyers.

Extension of privilege to accountants

5.13 Keith recommended, by a majority, that the protection that would be given to privileged communications under his package of measures, including the override, should be extended to advice given to a taxpayer by his tax agent - that is the person appointed by the taxpayer and notified as such to the Revenue to act on his behalf in all or any of his tax affairs - provided that the agent was a member of an incorporated society of accountants or of the Institute of Taxation. All the Committee agreed that privilege should not extend to employed professionally qualified tax agents, as opposed to those in private practice.

5.14 Some commentators have suggested that this recommendation would constitute a restrictive practice, because it would discriminate in favour of the professional accountancy firms and against accountants employed in companies' own tax departments, against the growing diversity of tax advisers in the financial sector and against tax advisers who do not have professional accountancy qualifications.

5.15 Furthermore, as with Keith's recommendations for extending the protection of privilege with lawyers more widely, nearly all commentators saw the override as too high a price to pay for extending privilege to accountants.

5.16 As with the previous recommendations on privilege, the Government recognise the force of these arguments, and it is therefore not proposed to implement this recommendation either.

Respective interest of lawyers and tax accountants

5.17 It is intended, nevertheless, that tax advice given by tax accountants should enjoy broadly similar protection to that given to tax advice given by lawyers. To put this beyond doubt, it is proposed to make the point explicit in the amendments to Section 20B(9) (see paragraphs 4.30 to 4.31).

5.18 In this way, a broad balance will be achieved between the protection given for tax purposes to accountants and that given to lawyers - both for the equivalent of litigation privilege (in Section 20B(2)) and for the equivalent of advice privilege (in Sections 20B(8) and (9)).

SECTION 6: EMPLOYERS PAYE COMPLIANCE

Background

6.1 Keith made a number of recommendations to modernise and streamline the administrative arrangements under which employers pay to the Revenue the PAYE tax they have deducted from their employees. He recommended (i) that interest should be charged on all late payments (ii) that procedures for collecting tax where an employer is behind with his payments should be simplified and (iii) that automatic penalties should be charged where an employer's end of year returns were late. And the National Audit Office has, in recent reports expressed concern about the rise in recent years in the amounts of PAYE tax due but outstanding.

6.2 General interest charges and automatic penalties will be made possible by the new computer support which the Revenue is installing for its Collection system. Until this is available, and as a first step towards improving compliance by employers with their existing obligations, the consultative document proposed that interest should be charged on late payments in the exceptional cases where the Inspector has to make a formal determination of the amount that is due. This change was introduced in Finance (No 2) Act 1987 and came into effect from 19 April 1988.

6.3 The consultative document left for future study the recommendations for a general interest charge and automatic penalties. This section now makes detailed proposals. Comments are particularly invited on those in paragraphs 6.18 to 6.30 for a revised filing date for the end of year return and for penalties for late and incorrect returns.

6.4 It is an important element in any compliance regime for PAYE, that employers should have a clear explanation of how to operate PAYE, and that there should be advice an assistance available to both new and established employers where this is needed. The Revenue have given a high

priority to this; recent initiatives in this area have included the comprehensive, and much commended, rewrite of the Employer's Guide to PAYE and the new, greatly simplified, form P11D.

A general interest charge

6.5 There are strong practical arguments against charging interest during the tax year on late monthly remittances. To make such a charge it would be necessary to quantify the amount due month by month. This would make the administration of PAYE much more complicated. First, the work falling on employers would increase, because they would have to supply additional information each month so that the Revenue could determine whether interest was due. And, second, there would have to be detailed rules for computing the charge to cope with payments by the employer - eg PAYE rebates, statutory sick pay, statutory maternity pay - which he sets-off against deductions.

6.6 The idea of in-year interest is therefore not being pursued. Instead, Clause 120 Finance (No 2) Bill 1988 paves the way for the introduction of an interest charge on payments delayed beyond the end of the tax year. This charge will be made possible by the new computer system which the Revenue is installing for its Collection system, but this will not be available before 1992 at the earliest. It is planned, however, to publish the regulations, which will determine how the charge will work, before the end of 1989, so as to provide a firm base upon which both employers and the Revenue can make their future plans. Before that, the text will be made available to interested parties for comments.

Interest on late payments by employers

6.7 Clause 120 provides that interest may be charged on sums due to the Revenue which are not paid by the final due date for the tax year - that is 19 April. It

is proposed to charge simple interest, at the same rate as is charged under Section 86 TMA on late payments of tax, from 19 April to the date that the payment is made.

6.8 Where interest is charged on a sum which subsequently turns out not to be due, the interest would be repaid.

Interest on payments to employers

6.9 Clause 120 also provides for interest to be paid on sums due from the Revenue, but only from one year after the end of the tax year. This brings the rules for payment of interest to employers into line with the rules for payment of repayment supplement to employees.

6.10 It is proposed, therefore, to pay simple interest, at the same rate as is paid under Section 824 ICTA 1988 on repayments of tax, from the end of the following tax year to the date that the payable order is issued.

6.11 Finally, Clause 120 provides that interest charged or paid to employers is to be paid without deduction of tax and left out of account for all tax purposes.

Streamlining collection of overdue monthly remittances

6.12 Where an employer is behind with his monthly payments, the collector needs to establish the amount due and to take steps to ensure it is paid. Up to 1985, the collector normally had to visit the employer's premises and examine his records to find out how much was due. This added to the work of both the collector and the employer. An alternative procedure was introduced in 1985, known as regulation 27A, which allowed the collector to estimate the amount due from his record of past payments. This new procedure has proved to be a fair and efficient way of encouraging prompt payment.

6.13 There are, however, circumstances in which it would be inappropriate for him to make an estimate from past payments - for instance, where an employer has recently started in business but has made no monthly payments. In these cases the collector can, under Regulation 27, require the employer to provide all the details necessary for the collector to calculate the outstanding PAYE liability. This is another cumbersome procedure which puts considerable burdens on both the employer and the collector.

6.14 It is proposed, accordingly, to replace Regulation 27 by a more streamlined procedure which would act as a formal reminder to the employer to pay. Under the new procedure, which is intended to be more convenient for both the employer and the Revenue, the collector would require the employer to state within 14 days the amount of his outstanding PAYE liability. If this were not paid promptly, the collector would then be able to take appropriate steps to recover the amount due.

Automatic penalties for end of year returns

6.15 At the end of the tax year, the employer is required to make an end of year return providing details for employees on forms P14, P35 and P38/P38A. This serves two purposes. First, a check can be made that the employer has deducted PAYE correctly and paid it over. Second, the details of each employee's pay and tax can be linked up with his other tax affairs and a check made that he has paid the correct amount of tax for the year as a whole; and, if he has not, arrangements can be made to collect or repay the difference. In order to make all the checks that are needed, and to make any repayments and assessments in good time, it is essential that the Revenue receives the employer's return as soon as possible after the year end. (Forms P11D are considered separately at paragraph 6.31 below).

6.16 At present, this end of year return must be delivered to the Revenue by the final payment date for the tax year,

ie 19 April. There are no automatic penalties for late returns, but the Revenue can take proceedings before the Commissioners for penalties to be imposed. Proceedings are taken in selected cases only - normally, not until the return is at least three months overdue.

6.17 At present, this offence comes within the sweep up provision of Section 98 1970, which provides penalties for offences which do not have their own penalty provisions. Section 98 penalties are, however, not well suited to end of year returns. First, they are not automatic. Second, they are too crude properly to reflect the seriousness of the offence. In some cases, the potential penalty under Section 98 would be far too high, eg if an employer with a very large number of employees was late in filing his return or omitted a small amount, perhaps holiday pay, from each employee's pay. On the other hand, the potential penalty can be far too low, eg if an employer fails to operate PAYE for a small number of highly paid employees or directors. The revised Section 98 penalties, proposed in paragraphs 3.41 to 3.43, will be inappropriate for end of year returns for the same reasons. It is therefore proposed to introduce a separate penalty for failure to comply with end of year returns provisions.

6.18 Keith recommended that a more realistic filing date should be introduced for the end of year return, and suggested 5 May. Some of those consulted thought that even this was too early and suggested 19 May, or later. A filing date later than 19 May would delay both repayments to employees and the check that the employer has accounted for the deductions he has made. It would also make it more difficult for the Revenue to make the assessments that are needed on employees at the correct time. It is therefore proposed that the revised filing date should be 19 May. This would not affect the payment date which would remain at 19 April.

6.19 Keith recommended that compliance with the revised filing date should be encouraged through the imposition of automatic penalties for delay. The suggestion was that initially these should be at a daily rate of £10, increasing to £20 or £30 for repeated offences. Keith also recommended that the Revenue should examine penalties related to the tax at risk.

6.20 The purpose of a time-geared penalty would be to encourage employers to file their returns promptly. The penalty ought, therefore, to be automatic (see paragraph 3.8). As it stood, Keith's recommendation would have led to some disproportionately large penalties, eg at £30 per day the penalty would be £21,900 for two years' delay by a small employer. The proposals which follow modify this so that automatic penalties based on time gearing would run for 12 months only, and take account of the number of employees.

6.21 Automatic penalties would require computer support, which (as stated above), will not be available before 1992 at the earliest. In the interim, it is proposed to introduce a partially automatic penalty for delays of up to 12 months which would apply only where the penalty was declared by the Commissioners. It is proposed that this partially automatic penalty would be introduced gradually, so as to allow compliance levels to be improved before penalties become fully automatic.

6.22 For longer delays (i.e. more than 12 months) and for incorrect returns, it is proposed that the penalty should be tax-geared and fully mitigable. The penalty would be brought into line with the penalties introduced in Finance (No 2) Bill 1988 for failure to notify, as well as with those proposed in paragraphs 3.28 to 3.34 for incorrect returns. The reason for bringing the penalty for longer delay into line with penalties for failure to notify liability is that these can be equivalent offences for PAYE, since the employer is obliged to operate PAYE and to make an

end of year return. No interim arrangements are proposed for the tax-geared penalties which could take effect from the year after they were legislated.

Automatic penalties for shorter delays, not to be introduced before 1992

6.23 It is proposed that the penalty for delay in making an end of year return should be as follows:

- if there are 50 employees or less, an automatic (ie non mitigable) penalty of £100 for each month, or part of a month, of delay in filing the return for up to a maximum of 12 months;

- if there are more than 50 employees, the automatic penalty would be increased by £100 per month, or part of a month, for each additional 50 employees (ie penalty is £200 p.m. if between 51 and 100 employees, £300 p.m. if between 101 and 150 employees, etc.)

Partially automatic penalties for shorter delays, to be introduced in the interim

6.24 In the interim, it is proposed that:

- the filing date for returns should be extended to 19 May;

- penalties for delays of less than 12 months could, as now, be awarded only where proceedings are taken before Commissioners;

- the Commissioners would be able to award an initial penalty of between nil and £1,200 per 50 employees;

- if the failure continued after it had been declared before the Commissioners, automatic penalties of £100 per month per 50 employees would be charged for any further delay, but not beyond 12 months after the original filing date of 19 May;

- proceedings would, as now, be taken only in selected cases.

6.25 It is proposed that this interim compliance regime should be introduced gradually:

- in the first year of operation, proceedings would, as now, not be taken for returns that were less than three months overdue - that is that were made by 19 August;

- this would be reduced by one month in each successive year, thus allowing penalty proceedings to be taken for any late return in the fourth and subsequent years;

- penalty proceedings would, however, continue to be taken in selected cases only.

6.26 The switch from partially automatic penalties in selected cases only, to fully automatic penalties for all late returns, would not be made before the fourth year at the earliest.

Penalties for longer delays

6.27 Where the delay continues beyond 12 months after the filing date, it is proposed that a further penalty should be incurred. This penalty would be fully mitigable, and up to 100 per cent of the amount due for the tax year which remained unpaid at the end of the year - that is at the 19th April immediately following the end of the tax year.

Penalty for incorrect returns

6.28 It is proposed that where a person fraudulently or negligently delivers an incorrect end of year return, he should be liable to a fully mitigable penalty of up to 100 per cent of the shortfall, if any, between the amount which would be due to the Revenue if the return as made were correct, and the amount which is correctly due.

Penalty provisions

6.29 The detailed rules for the administration of PAYE are prescribed in regulations rather than in primary legislation. Some commentators have suggested that penalties for end of year returns should, nevertheless, be prescribed in primary legislation. It is accepted that the charge should be in primary legislation, although some details would be prescribed in regulations. For instance, it would be necessary to define the end of year return and the number of employees in regulations. (It is proposed that the number of employees would be the number for whom deductions working sheets were, or should have been, prepared during the tax year.)

Reasonable excuse and avoidance of double charges

6.30 As with other penalty provisions, there would be no penalty for delay where the employer could show a reasonable excuse; and where the employer incurred two tax-geared penalties to be computed by reference to the same amount, the total penalty could not exceed 100 per cent of that amount.

P11Ds and other PAYE returns and documents

6.31 Section 98 TMA 1970 would continue to apply to all other PAYE documents and returns, including forms P46 and P11D. It is, however, proposed that the time limit for submission of forms P11D should be extended to 19 May in line with the filing date for end of year returns.

NIC and subcontractors deductions

6.32 All the above proposals relating to PAYE deductions would apply equally to Class 1 National Insurance Contributions (NIC), which employers pay to the Revenue together with their PAYE deductions, and to deductions under the scheme for subcontractors in the construction industry.

Self-employed

6.33 The self employed pay their Class 4 NIC together with their Schedule D tax. At present, except where Section 88 interest is involved, no interest is charged on late payments of Class 4 NIC. Nor is it paid on repayments. It is proposed that, to preserve equality of treatment between employees, employers and the self employed, interest will be introduced on late payments, and repayments, of Class 4 NIC under the same rules as the accompanying Schedule D tax.

SECTION 7: MISCELLANEOUS

Background

7.1 This section deals with a miscellany of topics. It covers the draft clauses from the consultative document not dealt with in the previous sections - Clauses 1 to 9, 12 to 14, 34 to 36 and 44 to 45 - and some minor proposals for modernising the tax system.

7.2 A summary is given at the end showing the fate of each clause under the revised proposals.

Return of income chargeable under Schedule E

7.3 Clause 2 enables a return of income for a year to require the inclusion of Schedule E income to which a taxpayer became entitled or received during the year, but which is chargeable for an earlier year, provided that it has not been included on a return for an earlier year. This remains unchanged.

Obligation of persons making returns to inform persons affected

7.4 The Revenue has powers to require certain persons to provide particular categories of information. A bank, for instance, can be required to provide details of interest paid to depositors, an agent to provide details of income received on behalf of clients and a business to provide details of payments made for services. Information that the Revenue obtains under these powers is used to cross-check tax returns. The knowledge that this is done encourages taxpayers to complete their returns correctly. These powers are also used to help uncover underdeclarations of business profits, to track down so-called "ghosts" who are not on the Revenue's books but should be paying tax, and to identify moonlighters who are not paying tax on second jobs.

7.5 Keith recommended that any person who provides information about a taxpayer to the Revenue under one of these powers, should be required to tell the taxpayer that he has done so. The businesses that are regularly required to provide information about large numbers of taxpayers objected that this would impose upon them substantial costs of compliance.

7.6 Clause 8 proposed that any person who supplied information about a taxpayer to the Revenue should be obliged to tell the taxpayer that he had done so. But, regular providers of information were exempted from the obligation, if they had previously told the taxpayer affected that the information might be disclosed to the Revenue. A bank would, for instance, be exempted if it added a warning to each bank statement that any interest might be disclosed to the Revenue.

7.7 This clause was widely criticised, both as going too far and as not going far enough.

7.8 On the one hand, there were those who objected to the exemption. They insisted that every person who provides information to the Revenue should be required to tell each taxpayer affected what information had been given about him. As most of the information that the Revenue receives would come within the exemption, they thought the proposal virtually worthless.

7.9 On the other hand, there were those who believed that the proposal was wrong in principle, since it placed additional burdens - in some cases substantial - upon the information providers. Although the exemption might protect regular providers from heavy compliance burdens, it would provide no protection for persons receiving unexpected and sporadic requests for information. These would often be small businesses.

7.10 The bulk providers of information expressed concern lest the exemption were watered down in any way, because of the substantial compliance costs that they would then have to bear.

7.11 A number of commentators thought Keith's recommendation wholly misconceived. They suggested that the requirement would be likely to impede, rather than to assist, the Revenue's investigation of possible abuses. Some suggested that, far from encouraging taxpayers to complete their returns correctly, this proposal could encourage some taxpayers to omit from their returns income which they knew, through the absence of a notice from the payer, not to have been reported to the Revenue.

7.12 Furthermore, some suggested that the proposal was unworkable since it contained no sanction to enforce compliance and did not cover information supplied in response to an informal request.

7.13 The main proponents of making the requirement universal, without an exemption, argued that the information provided to the Revenue is sometimes incorrect and can then lead the Revenue to investigate an innocent taxpayer. They suggested that if the information is copied to the taxpayer in every case, these errors could be identified and corrected before investigations began.

7.14 Although such errors do occur, they are infrequent. Moreover, Keith recommended that an Inspector investigating a taxpayer's returns on the basis of information received should, wherever possible, indicate the nature of that information. This recommendation has already been implemented by administrative action by the Revenue, which should mean that such mistakes are, in future, put right without the kind of difficulty that has sometimes been experienced in the past.

7.15 In view of the comments received, and in particular because of the potential burden that would be placed upon businesses, it is not proposed to proceed with this recommendation.

Seizure of goods to meet tax debts

7.16 The Revenue has powers to seize goods, in order to meet tax debts. Clauses 12, 13 and 14 proposed various measures to improve the rights and safeguards of taxpayers and other creditors in relation to these powers. These proposals were widely welcomed and remain unchanged.

7.17 Clause 12 also proposed to introduce a penalty for a breach of walking possession agreement, as Keith recommended. Because it now appears doubtful that the penalty would be effective in preventing breaches or could be collected where this occurred, it is not proposed to proceed with this aspect.

Accounting records

7.18 There is at present no statutory requirement upon taxpayers to keep records for tax purposes. Keith recommended that all unincorporated traders and companies should be required (i) to keep such books and records as would enable accurate returns of income, gains and profits to be made and (ii) to retain them for six years.

7.19 At present an Inspector has no general power to enter business premises to inspect books and records. Keith recommended that there should be a power of entry to business premises to inspect the records being kept. The power would be used routinely as a means of policing the record keeping requirement and exceptionally in the course of an investigation.

7.20 Clauses 34, 35 and 36 made proposals which closely followed Keith's recommendations. Comments on these were generally in favour of the principle that there should be a statutory requirement that records should be kept, but registered disagreement over the means whereby this could be achieved.

7.21 Clauses 34, 35 and 36 put upon the Revenue the responsibility for laying down the guidelines on the records to be kept, and for checking that traders were complying with them. A number of representative bodies, including those for the accountancy profession, were unhappy with the proposal that the Revenue should lay down such guidelines. Some also criticised the proposals for the Revenue to visit traders' premises to inspect records, on the grounds that this would be an unacceptable invasion of privacy.

7.22 The main alternative approach, which has emerged from comments on the consultative document and subsequent discussions, is a solution based on that used in the Companies Act. This would put upon the accountancy profession the responsibility for laying down guidelines on the records to be kept for tax, and for ensuring that traders meet those obligations. That approach, however, suffers from the drawbacks that it would create a new restrictive practice and could add to the burdens of some small businesses.

7.23 Whilst the Government recognise that there are good commercial reasons for all traders to keep proper books and records, there are also problems in introducing a statutory obligation and specification designed for tax purposes. At this stage, therefore, and pending further study and consultation, it is not proposing to bring forward legislation on the lines of Clauses 34, 35 and 36.

Admissibility of evidence

7.24 Clause 45 proposed certain minor amendments consequential upon other proposals in the consultative

document. Some small revisions will be needed, to take account of other revised proposals. But these proposals are otherwise unchanged.

De minimis limits for interest provisions

7.25 Some of the present provisions for charging interest on overdue tax (Sections 86 and 87 TMA) and for paying supplement on repayments (Sections 47 and 48 F (No 2) A 1975) have statutory de minimis limits. The purpose of these is to avoid the administrative cost of computing small amounts of interest manually.

7.26 The Revenue is, at present, computerising its collection procedures. When this is complete, calculations of interest will be handled automatically, making it both unnecessary and unhelpful to have statutory de minimis limits.

7.27 It is therefore proposed to remove the de minimis limits when the computation of interest is transferred to the new computers. On the present, provisional timetable for computerisation this would not be before 1992. The legislation for Corporation Tax Pay and File in F (No 2) A 1987 anticipated this change and contained no de minimis limits for interest.

7.28 The effect of this change would be that supplement would be paid on all late repayments, without any de minimis limit. Interest would be charged on late payments, but subject to administrative de minimis limits which would ensure that demands were not made for small amounts of tax and interest.

Recovery of default interest

7.29 Where tax is recovered under a late assessment, either ordinary interest or default interest may be due. Ordinary interest, charged under Section 86 TMA, runs from the date

the tax is due under the late assessment. Default interest, under Section 88 TMA, runs from the earlier date the tax would have been due if it had been assessed at the proper time.

7.30 It is not always clear, when a late assessment is made, whether interest should be ordinary or default. The taxpayer may, for instance, dispute which it should be and the issue may not be resolved until much later. This can cause delays in charging interest.

7.31 It is proposed to streamline the arrangements for collecting interest, by charging ordinary interest where it is not clear whether interest should be ordinary or default. Where it was subsequently shown that default interest was due, the additional interest resulting would then be charged. Similarly, where default interest is charged and subsequently turns out not to be due, the charge would be reduced to the ordinary interest due and any overpayment would be repaid.

Summary of revised proposals for Clauses 1 to 9, 11 to 14, 34 to 36 and 44 to 45 of the consultative document

1	Included, in revised form, in Finance (No 2) Bill 1988.
2	No change.
3	Included, in revised form, in Finance (No 2) Bill 1988.
4	Included, in revised form, in F (No 2) A 1987.
5,6	Included, in revised form, in Finance (No 2) Bill 1988.
7	See revised proposals for Schedule 1 in Section 4.
8	Withdrawn.
9	See paragraphs 1.7 to 1.9.
12	Subsection (3) withdrawn, otherwise no change.
13	No change.
14	No change.
34	Withdrawn.
35	Withdrawn.
36	Withdrawn.
44	See paragraph 1.10.
45	Minor revisions consequential upon other proposals.

CCBG

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CABINET OFFICE,
WHITEHALL, LONDON SW1A 2AS

Chancellor of the Duchy of Lancaster

Tel No: 233 3299
7471

18 November 1986

Tony Kuczys Esq
Private Secretary to the
Chancellor of the Exchequer
H M Treasury
Parliament Street
LONDON
SW1

NBPT

Dear Tony,

IMPLEMENTATION OF THE KEITH REPORT

Thank you for the copy of your letter of 7 November to David Norgrove. The Chancellor of the Duchy is content with the proposals in that letter.

I am copying this letter to David Norgrove (No10) and Stephen Ratcliffe (DEmp).

Yours Sincerely,

A. Lansley

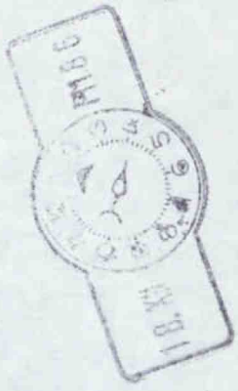
ANDREW LANSLEY
Private Secretary

4 AFFAIRS

RIGHTS

OF ENTRY

PT 3



Kill

OA

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

11 November 1986

IMPLEMENTATION OF THE KEITH REPORT

The Prime Minister has seen your letter to me of 7 November about the implementation of the Keith Report. She is content with the Chancellor's proposals, subject to the views of colleagues.

I am copying this letter to Stephen Ratcliffe (Department of Employment) and to Andrew Lansley (Chancellor of the Duchy of Lancaster's Office).

(David Norgrove)

Tony Kuczys, Esq.,
HM Treasury.

CAI

JA2AFO

PRIME MINISTER

IMPLEMENTATION OF THE KEITH REPORT

I am sorry to bother you with this now. However it is I think straightforward.

The Chancellor has been consulting confidentially with business and representative organisations about implementation of Keith.

Good progress is being made and he has decided to publish draft clauses on two matters for possible enactment in the 1987 Finance Bill. The rest of Keith would be left for later.

The first is a proposal for a new system for companies to make their tax returns and pay their tax. The present system of estimated assessments would be abandoned. In its place there would be a system under which companies made their own assessments, and symmetric interest penalties payable to the Revenue or interest payments by the Revenue would accrue. The Treasury claim it would bring benefits to companies, practitioners and the Revenue. The new system would not take effect for some years.

Secondly, there would be measures to secure prompter payment of PAYE from certain businesses, often Director controlled companies, which are at present able to delay payment frequently for long periods at a cost to their competitors and the Exchequer.

Lord Young and the Policy Unit are content with the proposed announcement. Most of those who have been consulted wish to see the draft clauses published, if only to allow the debate to be widened.

Content that the proposals should be published? Yes

DN

David Norgrove
10 November 1986

10 DOWNING STREET

Mr Norgrove

David,

Keith Report

I can see no harm in the consultation document being issued on the basis that only a "small package" will be implemented in 1987.

Those with points to make can do so on exposure; at least it seems that some of the more draconian suggestions have been dropped.

David Hunt
10/11/86

MR 2/52

Any PV comments by Monday night please
DRS

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

7 November 1986

David Norgrove Esq
10 Downing Street

Dear David

IMPLEMENTATION OF THE KEITH REPORT

Towards the end of last year the Prime Minister and the Chancellor discussed how to carry forward the report of the Keith Committee concerning the Inland Revenue's powers, individuals' rights and taxpayer obligations.

In his minute of 8 November 1985 the Chancellor proposed that, although good progress had been made in confidential discussions with a number of representative bodies, there should be a further period of consultation before moving forward to legislation. First, the draft clauses needed to be subjected to detailed analysis to ensure that they were on the right lines. Second, there was a strong case for giving the proposals a wider public exposure so as to reassure the ordinary man in the street that his interests would be safeguarded and clarified, and that conscientious taxpayers, including honest businessmen, had nothing to worry about.

The Prime Minister agreed, and the Economic Secretary accordingly announced on 11 December (Hansard extract attached) that the consultations would continue for a further period and that the Government hoped during 1986 to publish draft clauses, representing their conclusions, with a view to legislation in 1987.

These further confidential consultations, which have proved most constructive, have now been completed. The draft legislation has been given a rigorous examination, and the clauses have been modified to reflect points - both technical and of principle - which have been put by the outside experts, including representatives of a number of small firms bodies. While there inevitably remain a number of aspects of the proposals about which the outside bodies have reservations, the areas where there are major differences of view or of emphasis have been considerably narrowed down. Moreover, most of those who have been consulted now wish to see the draft clauses published, if only to allow the debate to extend to the majority of their ordinary members who have not been privy to the consultations so far.

The Chancellor therefore proposes that the promised consultative document, including the draft clauses and full explanatory notes, should now be published, as foreshadowed in the Economic Secretary's announcement. This will also allow those who are not represented by any of the formal bodies to have their say.

The greater part of the consultative document will consist of draft clauses and a technical commentary on them. There will, however, be a more general Introduction, explaining the broad thrust of the proposals, together with a summary designed for the layman. The drafting of both of these sections - copies of which are attached - has been closely supervised by Treasury Ministers. The Secretary of State for Employment has been consulted about, and agrees with, the terms of the Introduction.

The Chancellor wishes to leave open for the time being the question of the timing of legislation. The draft clauses are lengthy, and it is unrealistic - whatever the original arguments for implementing Keith as a single package - to expect there to be space in next year's Finance Bill for a complete package. Moreover, firm decisions on the content of the 1987 Bill cannot be taken until nearer the time, in the light of the Budget as a whole.

On the other hand, the Chancellor believes that there is a case for making a start on implementing Keith in 1987. It would demonstrate that the Government is prepared to act on recommendations made to it by an independent Committee of Enquiry. Perhaps more importantly, there are aspects of the proposals which would help carry forward the Government's policy of modernising and streamlining the administration of Inland Revenue taxes.

The Chancellor is therefore considering a small package for 1987 which would consist of two main elements.

First, there is the proposal for a new system for companies to make their tax returns and pay their tax, which has become known as "pay and file". It is described in paragraphs 17 to 25 of the Introduction. This system would bring practical benefits to companies, practitioners and the Revenue. In particular, it would begin to get rid of the antediluvian system of "estimated assessments", and establish a balanced system of reciprocal interest payments for tax overpaid as well as underpaid, for which there has long been support. As the Introduction makes clear, this new system would not take effect for some years, but the changes need to be known with certainty well in advance for planning purposes both within and outside Government. Nor would it extend, for the time being at least, to unincorporated businesses; reform, for them, is rather further down the road.

Second, there would be measures to secure prompter payment of PAYE tax from certain businesses - often director-controlled companies - which are at present able to delay payment, frequently for long periods, at a cost to their competitors and the Exchequer. This is covered in paragraphs 29 to 31 of the Introduction. The measures would deal with an area where Keith thought the present rules were open to undesirable manipulation. But his recommendations for a move towards a more general interest charge for late payment and automatic penalties for late returns would be left for further study and consultation over the longer term.

It will be difficult, on publication of the consultative document, to avoid answering questions about the Government's intentions on timing of implementation, if only because interested outsiders will need to be given guidance as to which parts of the document they should concentrate on immediately. The Chancellor's provisional view is that on publication he should make it clear that while there is no question of the whole of Keith being included in the 1987 Bill, he is minded, subject of course to reactions to the proposals, to make a start by implementing the two items described above.

There is clearly a strong case for publishing the consultative document as much in advance of Christmas as possible. It is expected that publication could take place about one month after the decision to publish is taken.

I am copying this letter to Stephen Ratcliffe (Employment) and Andrew Lansley (Chancellor of the Duchy's Office).

Yours ever,

Tony

A W KUCZYS

35 per [illegible] rate would apply to taxable income between the stated levels and the indexed 40 per cent. threshold of £17,100.

Drug Trafficking

Mr. Greg Knight asked the Chancellor of the Exchequer how many customs officers were employed in drug detection duties over the past 12 months; and what number he estimates will be so engaged over the forthcoming year.

Mr. Peter Brooke: I shall let my hon. Friend have a reply as soon as possible.

Mr. Greg Knight asked the Chancellor of the Exchequer what steps he is taking to see that customs officers have adequate capital equipment, such as X-ray machines, to assist in the detection of drug imports; and if he will make a statement.

Mr. Peter Brooke: I shall let my hon. Friend have a reply as soon as possible.

Departmental Staffs

Mr. Neil Hamilton asked the Chancellor of the Exchequer what was the number of staff-in-post in central Government Departments at 1 October.

Mr. John MacGregor: At 1 October 1985 there were 595,764 staff-in-post — 495,981 non-industrials and 99,783 industrials.

EC (Budget Contributions)

Mr. Gordon Brown asked the Chancellor of the Exchequer if he will publish a table showing the net contribution paid by Britain to the EEC in each year from 1979 to the latest date for which figures are available and if he will list the figures *(a)* in cash terms *(b)* in real terms at 1985 prices and *(c)* as a proportion of the total EEC budget.

Mr. Brooke [*pursuant to his reply*, 10 December 1985]: The figures requested are as follows:

Year	**Cash*	*Constant 1985 prices*	†*Per cent. of Community budget*
1979	947	1,571	10·2
1980	706	977	7·3
1981	397	491	4·0
1982	606	698	5·3
1983	647	711	4·5
1984	656	689	4·1
1985	1,212	1,212	7·2

* United Kingdom showing payments to the total Community budget on a cash flow basis. Budget refunds and abatements are credited to the year in which they are paid.

† Percentage of payments appropriations in Community budget for year in question. Figures for 1981-85 calculated from sterling figures in 1984 and 1985 statements on Community budget (Cmnds. 9174 and 9633). Figures for 1979 derived from budget figures converted at rate of £1=1·55 ecu, and those for 1980 from budget figures converted at £1=1·67 ecu.

Inland Revenue (Enforcement Powers)

Mr. Tim Smith asked the Chancellor of the Exchequer when he expects to publish his consultation document on the enforcement powers of the Inland Revenue; and if it remains his intention to include provisions on those matters in the Finance Bill 1986.

Mr. Ian Stewart [*pursuant to his reply*, 9 December 1985, c. *542*]: The Keith committee identified a need to modernise the powers and rights which regulate the day-to-day working relationship between the Inland Revenue, taxpayers and tax advisers. These matters have been the subject of detailed consultation with a number of interested parties over recent months. Although good progress has been made, there remain a number of points which require further examination and the Inland Revenue has therefore been authorised to continue its consultations for a further period. Accordingly, the Government now hope during 1986 to publish draft clauses, representing their conclusions, with a view to legislation in 1987.

The Inland Revenue will also be continuing, for a further period, its consultations on the proposals made in volume 3 of the report.

WALES

Capital Investment

Dr. Marek asked the Secretary of State for Wales (1) what was the gross capital investment in (i) schools and (ii) higher and further education in 1970-71, 1975-76, 1980-81, 1984-85, 1985-86 and planned for 1986-87 expressed in *(a)* cash terms and *(b)* 1984-85 prices;

(2) what was the gross capital investment in (i) trunk roads and (ii) local roads in 1970-71, 1975-76, 1980-81, 1984-85, 1985-86 and planned for 1986-87 expressed in *(a)* cash terms and *(b)* 1984-85 prices;

(3) what was the gross capital investment in (i) housing and (ii) the local environmental services in 1970-71, 1975-76, 1980-81, 1984-85, 1985-86 and planned for 1986-87 expressed in *(a)* cash terms and *(b)* 1984-85 prices;

(4) what was the gross capital investment in hospital services in 1970-71, 1975-76, 1980-81, 1984-85, 1985-86 and planned for 1986-87 expressed in *(a)* cash terms and *(b)* 1984-85 prices.

Mr. Nicholas Edwards: Gross public sector capital expenditure in Wales for the services requested is estimated to be as follows:

£ million

	1970-71	*1975-76*	*1980-81*	**1984-85*	†*1985-86*	‡*1986-87*
Trunk roads and motorways						
cash terms	15	45	89	93	89	105
1984-85 prices	71	114	114	93	85	95

SECTION 1

INTRODUCTION

1. In July 1980, a committee was established under the chairmanship of Lord Keith of Kinkel to consider and make recommendations upon the enforcement powers of the Revenue Departments. The first two volumes of the report of the Keith Committee ("Keith") were published in March 1983 as Cmmd 8822. This consultative document, and the draft clauses it contains, have been prepared in response to the recommendations in Volumes 1 and 2 relating to the administration of income tax, corporation tax and capital gains tax.

Overall Balance of the proposals

2. Keith sought in the Report to put together a balanced package of recommendations. It accepted that the Revenue Departments should have sufficient powers to encourage people to honour their tax liabilities at the right time, and to ensure that a small minority could not, by delay or outright evasion, count on gaining an unfair advantage over taxpayers generally. But Keith considered that those powers should be exercised within a framework which ensured that individual taxpayers were sufficiently protected against any undue or unnecessary intrusion into personal privacy, and generally against any abuse of powers. For this purpose it recommended that the Revenue Departments' use of their powers should be controlled within clear statutory rules, defining the rights as well as the obligations of taxpayers, incorporating clear rights of appeal, and subject always to judicial supervision by the independent Appeal Commissioners (Special and General) and the Courts.

3. The majority of those who submitted comments on the Report accepted that Keith had come close to achieving a fair balance in these difficult and sensitive matters. However, there was also a general feeling that, in certain respects, the balance of the arguments pointed to a rather more flexible system than Keith recommended, together with some additional strengthening of the safeguards for individual taxpayers. The draft clauses give effect to the main thrust of Keith's recommendations, but depart from them in some respects to reflect that general feeling.

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4. This section outlines the broad approach adopted on the more wide-ranging of Keith's recommendations. Section 2 is a summary of the proposals. Section 3 is a detailed commentary on the draft clauses which are found in Section 4. Section 5 deals with those recommendations which would not require legislation for their implementation; and Section 6 is concerned with those recommendations which are still under consideration or where the balance of argument is against implementation.

5. Keith's recommendations are listed in summary form in Appendix I. The Appendix also provides a general guide to the document, indicating the proposed response to each recommendation, the relevant draft clause number (where appropriate) and the reference to the paragraph number in Section 3, 5 or 6 at which detailed consideration of each recommendation is to be found.

6. Information on the background to, and work of, the Keith Committee, including its membership and terms of reference, is at Appendix II.

7. The approach set out in this paper has been developed with the benefit of detailed consultation with many representative bodies and others, whose assistance is gratefully acknowledged. A note on these consultations is at Appendix III.

Declaration of income

8. The starting point for taxation in the United Kingdom is for the Inland Revenue to have a record of everyone who is liable, or potentially liable, to tax. Thus taxpayers, at present, even when they are not asked to complete a tax return, have to tell the Revenue if they have income which is chargeable to tax. If they do not do so, they are liable to a penalty of up to £100.

9. Keith's view was that these rules did not make the taxpayer's obligation sufficiently clear. The draft clauses would therefore put a more specific obligation on everyone to declare each source of his income, although they would also provide for certain exemptions to be made covering, for instance, income already subject to PAYE deduction. The penalty for failing to notify sources of income would be altered to reflect the amount of tax evaded.

The filing of personal tax returns

10. At present, taxpayers are required to send back their completed tax returns to the Revenue within 30 days of issue. If they fail to do so, the Inspector can take proceedings before the Appeal Commissioners, who can impose an initial penalty of £50 and a daily penalty of up to £10 per day for continuing delay. In practice, the 30 day limit is widely disregarded, though the majority of taxpayers make their returns within 2 months. Penalty proceedings are taken only in the tiny percentage of cases in which the delay becomes flagrant.

11. Keith criticised this widespread use of administrative discretion, and recommended a more closely-defined system. On the one hand, taxpayers would be allowed a realistic period in which to complete their returns - that is, 3 months, which could be extended with the Inspector's approval to 6 months. On the other hand, however, a taxpayer who failed to meet the more generous deadline would automatically incur a penalty, unless he had a reasonable excuse for the delay.

12. Keith's recommendations would achieve greater clarity and efficiency in the arrangements for the submission of personal returns. They would, however, represent a radical departure from present practice and the following reasons suggest that their implementation would be better delayed:

a. taxpayers and their professional advisers would have time to prepare for the introduction of more strictly applied procedures.

b. allowance could be made for any change in the future shape of the personal tax system - and especially the treatment of husband and wife - following the Green Paper "The Reform of Personal Taxation".

c. the significant enhancements of the Inland Revenue's computer systems which will be needed to put the Revenue in a position to cope with the new time-limit and the extended imposition of penalties, would have been effected.

13. Implementation of revised arrangements of the kind envisaged by Keith would, therefore, be for the longer-term. For the present, the draft clauses accordingly provide only for minor amendments. These broadly harmonise the rates

of penalty for late filing of income tax returns with Keith's wider scheme of penalties although, exceptionally, there would be no change for the present in the way daily rate penalties are sought. No other substantial interim changes are proposed.

14. Keith considered the extent to which return forms are issued to taxpayers. At present, these are issued to PAYE taxpayers on a selective basis. An employee whose pay is below a certain level, and whose affairs are thought to be straightforward, is seldom asked to complete a return. Keith regarded this practice as a contributory factor in the growth of the black economy, and recommended that every taxpayer should receive a return every year - or, failing that, once every 3 years.

15. The cost of issuing returns on the scale favoured by Keith would, however, be considerable - particularly when, in due course, failure to complete them by a specified date would attract automatic penalties. But this does warrant further consideration. A pilot scheme is therefore to be run, involving the issue of a small number of extra tax returns, to test the effectiveness of this approach in bringing to light previously unreported sources of income. At the same time the Revenue are continuing to examine the scope for adopting simpler return forms and the possibility of other and more cost-effective ways of getting information about a taxpayer's income sources.

16. Keith proposed a statutory obligation upon taxpayers to disclose the full facts of transactions when they had doubts about whether an item of income was taxable or a relief due. This recommendation has been widely and vigorously criticised as impractical and it is not covered in the draft clauses. However, greater opportunity and encouragement could be provided for taxpayers to enter the full facts of transactions on their return forms, and this is being examined.

The submission of business accounts and returns

17. There is at present no statutory obligation on a business to send its accounts to the Revenue in support of its normal declarations of profits. In practice the vast majority of businesses do so. Keith recommended that the practice should be given the force of law and the draft clauses include a proposal to this effect, confined initially to companies only.

18. Keith was also concerned about the time allowed for sending accounts and recommended that accounts should be provided within a prescribed period from the end of the tax year. At present, estimated assessments are made in 2 million cases each year where accounts are not received in time to agree the liability before the normal date for payment of tax. In due course, the accounts are submitted in support of the taxpayer's appeal against the assessment, but often only after it has been listed for hearing by the Appeal Commissioners on one or more occasions. The Revenue then amend assessments in about 1.8 million instances each year.

19. Keith sought to avoid this costly rigmarole of estimated assessments, appeals, and amendments by recommending that the period within which business accounts must be sent to the Revenue should be reduced from an initial 12 months after the end of the trader's accounting year to 7 or, if possible, 6 months. At that point the large majority would be received in time to establish the agreed liability by the payment date.

20. In representations, objections have been lodged to this recommendation on the grounds that it would be unrealistic in the foreseeable future to impose a general requirement that business accounts and tax computations should be completed and provided in less than 12 months.

21. However for direct taxes Keith's aim of dispensing with the widespread need for estimated assessments might be better achieved by an alternative route. A different scheme is therefore proposed, initially for companies only. The requirement to supply accounts would form part of this scheme.

22. The essential features of the scheme for companies, which has been termed "Corporation Tax Pay and File", are as follows -

a. whether or not an assessment has been made a company would be required to pay corporation tax on a fixed date;

b. it would be allowed 12 months, from the end of the period to which it makes up its accounts, in which to supply its return and those accounts;

c. if it failed to send the return and accounts within 12 months, it would - unless it could show a reasonable excuse - incur an automatic daily penalty at a flat rate which would be subject to a ceiling;

d. if the return and accounts had not been supplied by the end of 2 years from the accounting date, the company would incur an additional automatic penalty of 20 per cent of the tax due, but unpaid, at that time;

e. when the accounts had been received and the agreed liability assessed, interest from the original payment date would be charged on tax underpaid, or be paid to the company on tax it had overpaid.

23. The scheme could not be implemented until the Revenue's computer systems for the assessment and collection of corporation tax had been improved. The new assessing

system is already being developed. The computerised collection system - which will link local collection offices with the main accounts offices and local tax offices - has been approved in principle. There is therefore a strong case for early legislation. First, this will allow the details of the scheme to be built into the computer design from the start, and avoid later delay and expense. Second, a substantial interval before implementation is equally important for accountants and companies who would need to adapt their systems and working practices to the new scheme.

24. A new Corporation Tax Working Sheet was introduced by the Revenue in autumn 1985 after extensive consultation with representatives of industry and the accountancy profession. One of the purposes of that form is to assist companies and their advisers to calculate the amount of tax due. This would be of increased importance under Pay and File. The early introduction of the working sheet as a non-statutory form also gave a lead to firms wishing to develop computer packages to process tax calculations. The essential features of the working sheet could with advantage be incorporated into a new statutory return form for companies shortly before the Corporation Tax Pay and File arrangements began to operate.

25. There is a strong case for saying that if Pay and File is appropriate for companies, a similar scheme is appropriate for unincorporated traders. However, a realistic timetable for implementation of that is too distant to justify early legislation. Unincorporated traders include their profits in their personal returns and supply accounts in support of the profit figure shown; so - as in the case of suggestions for changing the arrangements for requiring returns from individuals - it is advisable, before designing a detailed scheme, to take into account the impact of any forthcoming reforms of personal taxation. Moreover, the existing rules for allocating profits of

unincorporated traders to tax years are complex, and would fit uneasily within a Pay and File scheme of the sort described above. But symmetrical rules for charging or paying interest on underpayments or overpayments of tax, which is an essential feature of Pay and File for companies, would be likely to be a cornerstone of any eventual reform proposals for unincorporated traders.

Books and records

26. At present there is no statutory obligation on traders to maintain such books and records as are necessary to enable them to make an accurate return of the profits or gains of their trade.

27. Keith recommended that there should be such a requirement, that books and records should be retained for 6 years; and that the Revenue should be entitled to enter business premises to inspect them.

28. The draft clauses incorporate the recommended obligation to maintain books and records, which are to be kept for 6 years. However it is not proposed to implement the recommendation on the right of entry, checks would be carried out by means of a lesser entitlement, which would require only that the books and records were produced for inspection.

Payment by employers of PAYE tax deducted from employees

29. Keith reviewed the arrangements under which employers pay over PAYE tax monthly to the Revenue and make a return at the end of the year. There was concern that, although most employers paid the tax over at or near the date it was due, there was little in those arrangements to encourage the others to pay on time. In particular Keith criticised the fact that, unlike most other tax payments, there was no interest charge on any PAYE which an employer deducts from his employees and then either fails to pass over to the

Revenue or pays over late. Furthermore the procedures whereby the Revenue can collect that tax when it is not paid over, and obtain overdue returns, were seen by Keith as too cumbersome. Keith recommended some specific changes and also a more general move over a period, towards interest charges for late payment and automatic penalties for late returns.

30. The present arrangements have been improved to some extent since Keith reported, through the introduction of a new procedure under which the Revenue can take action to collect the tax based on an estimate of the PAYE overdue, instead of the Collector having to visit the premises to inspect the employer's records. However there is still an argument that, in fairness to employers who pay their PAYE promptly, there needs to be a shift towards a system of interest charges and more effective penalties for those who still do not pay or fail to make returns within a reasonable period.

31. At the same time, the smooth working of the PAYE system depends on the efforts and co-operation of employers. There is therefore a strong case for making changes only gradually over a period. Thus the draft clauses envisage that a new interest charge might apply only to the relatively small range of cases where it appears to the Revenue that the employer should have deducted and paid over tax but has not done so and as a result it has been necessary to make a formal assessment on the employer. This could be coupled with a clarification of the circumstances in which certain payments should be subject to PAYE deductions.

32. The question of a more general interest charge on late PAYE payments, and fixed penalties for late end-of-year returns, would be for study and consultation separately over the longer term.

33. Accounting for sums deducted under the construction industry tax deduction scheme has its own primary legislation and regulations. It is convenient for contractors that these should be broadly the same as those for PAYE, and it is proposed to preserve the present parallel when making changes for PAYE.

Information needed to establish tax liability

34. Before the Revenue are able to establish a person's tax liability they may need to get more information either from the taxpayer himself or from some other person (that is, a "third party"). There are restrictions on the sources open to the Revenue and the way they can go about getting information.

35. At present, the Revenue's ability to ask for information from third parties is largely limited to people in business. If the Inspector wishes to make a formal request to any person for information - whether about himself or some other person - he must ask an Appeal Commissioner for permission to do so. And before he seeks that permission he must first have given the person concerned a reasonable opportunity to provide the information voluntarily.

36. Keith was critical of these restrictions. It recommended that the Revenue should also be enabled to approach Government departments, public authorities and private individuals for information relevant to tax. It also sought to simplify procedures by permitting the Revenue to make a formal request for information without first having to make an informal approach and obtain the permission of an Appeal Commissioner.

37. At the same time, Keith recommended that taxpayers should be given additional safeguards, particularly by way of strengthened appeal rights. For example, unless there

was reason to suspect fraud, the Revenue should in future be required to notify a taxpayer when information about him was being sought from a third party; and the taxpayer himself, and third parties who received such enquiries, should have new rights of appeal, enabling them to challenge the Revenue's notice, for example on the grounds that the information requested was not reasonably needed for the purposes of tax.

38. The draft clauses would give effect to most of those recommendations. Some of Keith's recommendations for removing restrictions have, however, been modified. For example, it is proposed that the Revenue should continue to be required to seek the permission of an Appeal Commissioner before issuing any information-seeking notice to private individuals, other than members of the close family of the taxpayer involved.

39. Furthermore it is arguable that to enable the Revenue generally to obtain information held by Government departments and public authorities would be to extend the scope of the statutory provisions too widely. Discussions are still taking place on the precise scope of the arrangements, but a possibility would be to adopt a much more limited extension than that recommended by Keith, so that it applied only to specified information relevant to tax liabilities. More details of the type of information which could be covered is given in Section 6 and comments are invited on whether this more restrictive approach is preferable to that recommended by Keith.

40. Finally, it is proposed to follow Keith's recommendation that those asked to supply specific information about a taxpayer should in certain circumstances be allowed to claim reimbursement of the costs of providing it.

Privacy

41. More generally, it has been recognised that the present rules do not add up to a coherent protection of privacy for the citizen. In addition to the special procedure under which the Revenue have to obtain permission before giving notice to a private individual that they require information about a third party, there is a need to set out more clearly and improve the citizen's safeguards where premises have to be searched under warrant by the Revenue on suspicion of criminal tax fraud. Moreover, uncertainties about the availability of the protection of legal professional privilege in tax matters need to be removed.

42. If the Revenue suspect that they will find evidence of a suspected criminal tax fraud, they can at present carry out a search of premises provided they obtain a warrant issued by a Circuit Judge. It is now proposed, in line with Keith's recommendations, that the Circuit Judge would be able to place restrictions on the execution of the warrant, for example by limiting the number of Revenue officials who could take part in the search, or by specifying the time of day when it could begin. Furthermore, the Circuit Judge would have a new power to issue a production order instead of a search warrant where the information being sought was held by a third party. The effect of these changes would be that search powers would be limited to the cases where there was not only reason to suspect serious fraud but also a real risk of information needed by the Revenue being destroyed before it could be examined.

43. Keith's recommendation that legal privilege should be generally available for legal advice on tax matters is reflected in the draft clauses. But the recommendations for overriding the privilege and extending it to tax agents are

not included in the draft clauses. In these sensitive areas there is a need for further consideration.

44. A possible scheme to give effect to the Keith proposals has been drawn up and is set out in detail in Section 6. In outline, that scheme would provide for privilege to be overriden in part, subject to stringent conditions. This would ensure that privilege is not used to keep hidden from the Revenue facts which are essential to enable the Inspector to establish a person's tax liabilities. The Inspector's actions would at all times be subject to the external control of the Special Commissioners or the Courts. The person to whom the notice was given would have a full right of appeal against the notice before he handed over any information. The Commissioners and the Courts would have wide powers to decide whether, and to what extent, the privilege would be overriden; and, in doing so, they would be able to distinguish between factual and other information, even within a single document, thereby ensuring that any legal advice contained in it would continue to be given full protection.

45. Finally, as recommended by a majority decision of Keith, a protection equivalent to legal privilege would be available in respect of tax advice given to a taxpayer by a duly appointed tax agent who is a member of a chartered institute. Comments on the possible scheme set out in Section 6 are particularly invited.

Penalties for tax offences

46. The normal sanction imposed on a taxpayer who makes an incomplete tax return is a money penalty based on the amount of tax underpaid. The maximum penalties laid down in present legislation are one hundred per cent of the tax underpaid where the taxpayer has been negligent, or twice that amount in the case of fraud. In practice penalties of that size are not applied because large reductions are

allowed by the Revenue in arriving at a negotiated settlement with the taxpayer. The size of the reduction depends on whether the taxpayer comes forward voluntarily, on how far he cooperates in the investigation which is carried out and on the Inspector's judgment of the seriousness of the offence. Where the taxpayer and the Inspector are unable to reach agreement the Appeal Commissioners determine the size of the penalty.

47. Keith took the view that the present system for imposing penalties needed re-casting to make it fairer, clearer and less subject to administrative discretion. It recommended substantially reducing the maximum level of the tax-geared penalties for fraud and negligence. More radically, Keith proposed a system of penalties consisting of three categories of offence:

a. civil fraud,

b. gross negligence, and

c. simple negligence or innocent error.

48. In this system simple negligence below a certain threshold would not attract a penalty, although interest would be charged. Whether or not a taxpayer was guilty of negligent conduct, he would automatically become liable to a penalty for failure to declare income and gains above an arithmetic limit, broadly of £1,000 - unless the failure was fraudulent, in which case the fraud penalty would apply. The fraud penalty would be mitigable, down to 50 per cent of the tax underpaid, to reflect the cooperation of the taxpayer; but the gross negligence penalty would not.

49. In line with Keith's recommendations, the proposals in the draft clauses reflect the reduction in maximum penalties, the treatment of fraud and the division of

offences into three categories. On these the proposals broadly correspond to the penalty system already adopted for VAT purposes for underdeclarations or overclaims to repayment.

50. At the same time, representations were made that, for direct taxes, it would not be right to impose penalties for making an incorrect return where the taxpayer had not been negligent in some way, even though the amount of tax lost could be quite high. The strength of that argument has been recognised and, consequently, the draft clauses do not implement Keith's recommendation that a liability to a penalty should be triggered automatically whenever a minimum figure of income or gain has been exceeded. The difference in treatment in this area between the Inland Revenue taxes and VAT reflects the fact that the taxes are very different in nature, VAT being a self-assessed and transactions-based tax. Consequently the considerations and procedures for arriving at assessable profits for direct tax purposes are significantly different from those for arriving at the figures to which VAT is applied.

51. Another modification, following representations from a number of outside bodies, is that the draft clauses give a range, between 20 and 40 per cent of the tax underpaid, within which the penalty for negligence would be set, instead of the fixed percentage penalty of 30 per cent proposed by Keith. This would allow the Revenue or the Appeal Commissioners, in calculating the penalty, to take account of the degree of cooperation in the investigation shown by the taxpayer, just as would be done in cases of fraud.

52. It has been suggested that the range of adjustment in the negligence penalty should be greater still, so as to give an even bigger reduction in the amount of the penalty to someone who owned up before the Inspector began an

investigation. A balance needs to be struck here if the penalty is to retain its deterrent value and the system is to be fair to the majority of taxpayers who pay their liabilities in full. Comments are invited on whether a further reduction for disclosure should be allowed and, if so, what would be an appropriate amount.

53. Finally, the draft clauses would change the procedure by which penalties chargeable by law are actually imposed. Keith was critical of the cumbersome and old-fashioned procedures at present required for the recovery of penalties, which involve the laying of an information in writing before the Appeal Commissioners, and the Commissioners then issuing a summons. Under the draft clauses the Inspector would normally be able to assess penalties in the same way as he assesses tax. This procedure would apply to all kinds of penalties (other than, as already indicated, the daily rate penalty for failure to send in a non-company return) - for delay or failure to fulfil an obligation as well as for acting fraudulently or negligently. The taxpayer would be fully protected by a right of appeal, before paying any money, if he disagreed with the amount of penalty calculated by the Revenue; or if he believed that, because he had not in fact been fraudulent or negligent, he did not deserve to bear a penalty at all. The taxpayer would also be able to claim that, where the penalty was imposed because of his delay or failure, he had a reasonable excuse for not meeting his obligation.

The black economy

54. As already indicated, Keith's concern about the black economy was one reason for its recommending that there should be a wider issue of tax returns. Keith also recommended that the Revenue should seek out for prosecution suitable cases of unreported income from secondary employment or spare time self-employment. In its view such

a policy would have an exemplary effect, while helping to provide reassurance that the Revenue were being even-handed in their treatment of defaulting taxpayers. As the amounts of tax involved in cases of that type are individually relatively small, it might be thought that they would be more suitably dealt with in the Magistrates Courts alone. This is likely to be a simpler and less costly procedure. Comments are therefore invited on whether it would be appropriate to introduce a new revenue summary offence aimed primarily at those who seek to avoid payment of tax by knowingly failing to disclose their sources of income to the Revenue.

55. Keith also recommended that the Inland Revenue should publish each year a list of the names of tax evaders, subject to a discretion to omit those who had made a spontaneous full disclosure. Strong representations were made against this recommendation and, in the absence of clear evidence that adopting it would lead to any improvement in tax compliance, it is not proposed to give effect to it.

Reopening of assessments and claims for relief

56. Keith made recommendations relating to the Revenue's power to make a further assessment where it is discovered that a previous assessment was inadequate. These powers are, as Keith noted, cut down in part by case law (Cenlon Finance Co Ltd v Ellwood [1962] AC 782 is the main authority) and in part by departmental practice. Keith recommended that this mixture of case law and practice should be written into legislation. That recommendation now has to be considered in the light of the subsequent decision in the case of Scorer v Olin Energy Systems Limited [1985] 2 WLR 668.

57. Where an appeal has been determined by agreement between the taxpayer and the Inspector, it was previously the practice not to make a "discovery" assessment where the

point at issue had been the subject of explicit discussion leading to an agreement. The Olin case extends that limitation so that it applies to preclude a "discovery" assessment in relation to any particular point so fundamental to the consideration of the accounts and so clearly presented in the computation that the Inspector could not reasonably be regarded as having agreed the computation without considering it. In other words, where an appeal has been determined by agreement, the Revenue cannot reopen matters in cases where, even though the Inspector had not explicitly agreed the point at issue, the circumstances are such that he must be taken specifically to have done so. The draft clauses reflect this position and Keith's recommendations.

58. Keith made recommendations relating to a taxpayer's right to claim reliefs out of time following the making of a discovery assessment. These recommendations were that Section 43(2) of the Taxes Management Act 1970 should be extended to corporation tax, and that a taxpayer who has received a discovery assessment should have the right to make, revise or revoke decisions about claims and elections in the light of the new situation created by the making of the further assessment. The draft clauses would extend Section 43(2) to corporation tax; they would also allow a taxpayer to make, revise or revoke decisions about claims and elections for the period to which the discovery assessment relates. This new entitlement to reopen would be limited to the extent necessary to cover the revised liability to tax arising from the discovery assessment, so as not to favour unduly the taxpayer who received such an assessment as against one who did not and who could not therefore reopen his tax position with the benefit of hindsight.

Procedures for dealing with appeals

59. In addition to proposing new rights of appeal, Keith recommended a number of detailed changes in the procedures for dealing with appeals by the taxpayer against decisions by the Revenue. Some of these have already been adopted, while others are included in the draft clauses. A number require further consideration. The note on Clause 40 gives full details and draws attention to specific points on which comments are particularly sought.

Publicity

60. Keith stated that the working of the tax system should be open to public scrutiny, and that taxpayers should be better informed about their rights and obligations. The introduction of the Taxpayer's Charter, announced on 25 July 1986, is in keeping with these aims. A number of new explanatory leaflets are being prepared - covering such matters as PAYE inspections, the examination of business accounts and the conduct of investigations - which will be made widely available.

Other Taxes (Keith Volume 3)

61. In January 1984, Volume 3 of the Keith Committee's Report was published dealing with petroleum revenue tax, development land tax, capital transfer tax and stamp duty. Since then, the development land tax legislation has been repealed, inheritance tax has been introduced to replace capital transfer tax and major changes have been made to stamp duty. It is not therefore intended to deal generally with those taxes as part of this present exercise. The petroleum revenue tax proposals will be the subject of separate consultations. Consultations will also be held on the inheritance tax and stamp duty proposals at the appropriate time.

Representations

62. Detailed comments on the draft clauses and their effect on compliance costs should be sent to The Inland Revenue, Policy Division 2, Room 17 New Wing, Somerset House, London WC2R 1LB. [Comments on the "Pay and File" and PAYE proposals should be sent in by 31 January 1987.]

SECTION 2

SUMMARY OF 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 companies would pay their tax on a provisional basis on a fixed date, before filing their returns and accounts. Interest would be paid or charged to the company from that date, depending on whether the provisional payment proved in the event to be too much or too little.

- There should be a new form of penalty, related to the amount of tax unpaid, where a company has 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: Employer's Responsibilities

- Interest should be charged on PAYE tax underpaid in cases where the Inspector has to calculate the tax due because the employer has failed to apply PAYE properly.

- 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 arrangements for making deductions from payments to subcontractors working in the construction industry should be kept roadly 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 such information should have a right of appeal to the Appeal Commissioners against disclosure.

- Any taxpayer about whom such information is sought should have a right to appeal to the Appeal Commissioners against disclosure by the third party.

- 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.

Privacy

- A Circuit Judge, to whom the Inland Revenue must apply for a search warrant, should be able to specify the time during which 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.

- Procedures should be established for settling disputes arising as a result of 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 loss 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.

- When such an assessment has been received by a taxpayer, he should have the right to make or revise a claim for relief.

CONFIDENTIAL

file SUH (10)

10 DOWNING STREET

From the Principal Private Secretary 17 June 1986

Dear Michael,

The Prime Minister has seen the Attorney General's minute of 3 June in which he reports his conclusion that the added responsibilities of the Superintendent of the Crown Prosecution Service and the Serious Fraud Office do not call for the appointment of a Parliamentary Secretary in the Law Officers Department.

The Prime Minister has noted this conclusion.

I am sending a copy of this letter to Joan MacNaughton (Lord President's Office), John Mogg (Department of Trade and Industry), Jill Rutter (Chief Secretary's Office), Paul Thomas (Minister of State, Privy Council Office) and Michael Stark (Cabinet Office).

Yours ever,
Nigel Wicks

N L WICKS

Michael Saunders, Esq.,
Law Officers' Department

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PRIME MINISTER

SERIOUS FRAUD OFFICE

I asked Robert Armstrong to probe the Attorney's conclusion, in his minute at Flag A below, that his office's added responsibilities of the Superintendents of the Crown Prosecution Service and the Serious Fraud Office do not call for the appointment of a Parliamentary Secretary to the Law Officers Department.

Sir Robert Armstrong has now discussed this with Mr. Michael Saunders, the Legal Secretary to the Law Officers. He confirmed that the Attorney and the Solicitor were clearly against asking for a Parliamentary Secretary. The Solicitor General obviously felt that he had spare capacity to take on more work than at present and would be happy to do so. Experience under a previous Administration suggested that a Parliamentary Secretary in the Law Officers' Department tended very much to be the fifth wheel on the coach: it tended to add to the work without relieving the Attorney General of any significant part of the responsibility.

Robert also told Mr. Saunders that he was concerned about the additional burden upon the Attorney General, who seemed to be making rather slow progress in recovering from major heart surgery last year. Mr Saunders said that the Attorney General's health and vigour seemed to have improved markedly in the last six weeks. Though he still tended to tire, his enthusiasm for the work had revived. He really thought that the Attorney General was well on the mend and we need not worry about his capacity to take on the work.

The Attorney also raises in his minute the possibility of additional lawyers in the Department. No need for you to react to that.

Shall I simply reply that you have noted the Attorney's conclusion that he does not need a Parliamentary Secretary?

N.L.W.

N. L. Wicks
16 June 1986

Yes mf

CDP

MEA 13/6

FCS/86/160

SECRETARY OF STATE FOR THE HOME DEPARTMENT

CDP 13/6.

Review of Entry Clearance Policy

1. Thank you for your letter of 22 May.

2. I recognise there is some renewed pressure at the ports this year, not entirely offset by the drop in arrivals from the United States; and I am content that we should look again in October at how control in the ports has operated during the summer. Meanwhile, however, I stand by the conclusions of the Review and the views I expressed earlier. The extension of visa regimes would be a clumsy way of dealing with the problem at the ports: it is even more difficult to earmark, train and deploy necessary staff at short notice in posts abroad than it is to do this at home. We cannot accept long waits at posts for visitors' visas. All businessmen, for example, cannot be weeded out.

3. As you know, the manpower and financial resources needed to extend visa regimes would be considerable and could not be met within our existing provisions. For the three countries of the subcontinent approximately 94 extra staff and £6.6 million a year would be needed. In Dhaka, for example, we should not only need extra staff but a new office building. The Review explains why it is likely to be impossible to confine any new visa regime to one or two countries. Even a visa regime in Nigeria or Ghana would inevitably have implications for our bilateral and Commonwealth-wide relations, the latter at a sensitive time in view of South African issues - quite apart from the resource costs.

/4.

4. I am sending copies of this minute to the Prime Minister, the Lord President, the Lord Chancellor, the Lord Privy Seal, the Chancellor of the Exchequer, the Chancellor of the Duchy of Lancaster, the Secretaries of State for Employment, Transport, Social Services and the Environment, to the Chief Secretary and to Sir Robert Armstrong.

GEOFFREY HOWE

Foreign & Commonwealth Office
13 June 1986

HOME AFFAIRS

RIGHTS OF ENTRY

PT 3

c - Mr. Wicks (No. 10)

Ref. A086/1680

NOTE FOR RECORD

I had a brief meeting with Mr Michael Saunders, the Legal Secretary to the Law Officers on Wednesday 11 June 1986 about the implication for the Law Officers' Department of the increase in the burden placed upon the Law Officers by the Crown Prosecution Service and the new arrangements for dealing with fraud. In particular, I asked Mr Saunders about the possibility that there might be a case for a Parliamentary Secretary in the Law Officers' Department to help to deal with this load of work which would be management work as well as legal, and about the implication for the staff of the Law Officers' Department. Mr Saunders said that the Attorney General had discussed this matter with the Solicitor General and himself, particularly in relation to the possibility of appointing a Parliamentary Secretary. The decision had been clearly against asking for a Parliamentary Secretary. The Solicitor General obviously felt that he had spare capacity to take on more work than at present and would be happy to do so. Experience under a previous Administration suggested that a Parliamentary Secretary in the Law Officers' Department tended very much to be the fifth wheel on the coach: it tended to add to the work without relieving the Attorney General of any significant part of the responsibility.

2. I said that I was concerned about the additional burden upon the Attorney General, who seemed to be making rather slow progress in recovering from major heart surgery last year. Mr Saunders said that the Attorney General's health and vigour seemed to have improved markedly in the last six weeks. Though he still tended to tire, his enthusiasm for the work had

revived. He really thought that the Attorney General was well on the mend and we need not worry about his capacity to take on the work.

3. Turning to the office, Mr Saunders said that he thought that he would need additional support. He spoke in terms of two additional lawyers and one or two Executive Officers or HEOs. The main burden of administering the Crown Prosecution Service was likely to fall on the Director of Public Prosecutions and his staff. It was agreed that Mr Saunders would pursue his proposals for additional staff with the Treasury.

4. Mr Saunders confirmed that the Director of Public Prosecutions had informed the Attorney General that he would now like to retire from the public service in September 1987 and not (as originally planned) in April 1988. By that time the Crown Prosecution Service would have been going for a year and should be sufficiently on its feet to enable a new Director to take over. Mr Saunders said that the Attorney General would be content with that timing. He agreed that the only internal candidate was likely to be Mr James Nursaw, presently the Legal Adviser to the Home Office. It might well be necessary to look to the Bar for other candidates.

RA

ROBERT ARMSTRONG

12 June 1986

"A"

CC DT 1

CONFIDENTIAL

1. AW to see
2. Private Secretary. 4

PRIME MINISTER

SERIOUS FRAUD OFFICE

1. I have seen a copy of your minute to the Lord President in which you ask me to consider in more detail the administrative and management implications of giving me responsibility for the Serious Fraud Squad.

2. I have discussed the matter with the Solicitor General. We are agreed that the added responsibilities of the superintendence of the Crown Prosecution Service and the Serious Fruad Office do not call for the appointment of a Parliamentary Secretary to my Department. We do believe, however, that we will probably require at least one additional lawyer in the Department and that there will almost certainly be a need for structural changes in the organisation of the Department. I will examine this question, together with the question as to how we can best ensure adequate superintendence over the Crown Prosecution Service and Serious Fraud Office, with officials and will report to you my conclusions.

3. I am sending a copy of this minute to members of H Committee, and the Minister of State, Privy Council Office and to Sir Robert Armstrong.

M.H.

3 June 1986

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Gould
PT 3

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OUD

CCBG

HOME SECRETARY

QUEEN ANNE'S GATE LONDON SWIH 9AT

22 May 1986

1. MyA
2. GDP

Dear Geoffrey,

PRESSURES ON THE IMMIGRATION CONTROL
REVIEW OF ENTRY CLEARANCE POLICY

WILL REQUEST IF REQUIRED

Thank you for your minute of 14 May in reply to my letter of 16 April about the work which has been done by our officials in preparing the review of entry clearance policy. I fully appreciate the points you make and I welcome your readiness to consider the need for extending visa regimes if emergencies arise. My officials will keep in touch with yours: one point to be pursued is the possibility that in an emergency we could justify making visitors wait a little while for visas and that the staff required, and their cost, would thus be less than the figures quoted in the review.

The situation at the ports this year is already more serious than we had expected when I wrote to you a month ago or the Review had anticipated. The reduction in the number of American visitors coming here, though very unwelcome in all other respects, has been of some help to the operation of the control. This relief has however been more than offset by the increase in the amount of "difficult" casework of the sub-continent. There is a serious increase in passengers seeking to get in at the ports who do not qualify under the immigration rules. I enclose a summary table showing the picture over the first four months of this year compared with last. This brings out the new pressures very clearly.

We are taking all the action that is possible to try to hold the line both in terms of manageable queues and, of equal importance, of the effectiveness of the control in preventing abuse. A new system for handling representations from Members of Parliament in immigration cases which will we hope buttress the effectiveness of the control was as you know introduced on 1 May. We have yet to see how well it will work. Within the Home Office manpower ceiling I have diverted as many additional staff as we can afford both to handle "difficult" casework at the ports and to work on representations. (For this summer, even if it was possible to approve yet more staff on top of the extra 50 whom we are now recruiting, there would be insufficient time to train and recruit them.) My officials are considering urgently how to provide additional emergency detention accommodation to meet the rising numbers of those refused entry who cannot safely be granted temporary admission while arrangements are made for their return.

/These measures

The Rt Hon Sir Geoffrey Howe, QC, MP

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These measures, combined with the steps discussed by our officials for publicity which the High Commissions in Lagos or Accra may be able to issue to deter Nigerians and Ghanaians from "trying their luck" at the ports, may enable us to maintain the control at Heathrow without unacceptable inconvenience to bona fide travellers or undermining standards. But we have still not reached the peak summer period and some worrying delays have already occurred.

In the debate on MPs representations on 26 March I warned the House that we might have to change our system if the pressures on the control became too great. This year's developments have in my judgment already brought us nearer to the point where as a matter of general policy visas will have to be imposed on selected nationalities in order to protect the control. While there are clearly foreign policy and community relations implications to be weighed, the longer passengers from the sub-continent and West Africa are delayed at the ports, and the louder the resultant (and sometimes justified) complaints that they, their relatives here and their relatives' MPs make about the delays, the greater the damage such criticisms can do both to our external relations and to community relations here. There must come a point at which a system with visas that was seen to work tolerably well would be preferable to a system without one that did not. Many other countries do operate a general visa requirement perfectly satisfactorily.

In saying this I am not ignoring the arguments, not least those of cost, in favour of seeking to strengthen the present system. I would still hope, as I said in my earlier letter, that we could review the whole matter again in October having seen how the control operated this summer. But we could be forced to act more quickly and to consider, notwithstanding the reservations which your offials expressed during the joint review, the imposition of visas for one or two of the Indian sub-continent countries (rather than all three) and for Ghana and Nigeria (without also including South Africa). This more limited resort to visas would of course significantly reduce the cost.

A number of our colleagues have a keen interest in the way our immigration control operates at our major air and sea ports, and in particular in minimising inconvenience to businessmen and genuine tourists. The latter consideration is particularly relevant to attempts to woo back American tourists given the delays that some of them suffered during the difficulties the control experienced last summer. Our colleagues do, of course, know that Home Office and FCO officials have been studying the arguments for and against the greater use of visas. In order to give colleagues an opportunity to consider our officials' findings, against the new background described in this letter, and against the possibility that we might have to seek their concurrence in rapid decisions, I am circulating to them both the Summary of the Review completed in March and copies of our subsequent correspondence.

/Accordingly,

Accordingly, copies of this letter together with copies of the Summary section of the Review in which its conclusions are set out, and copies of my letter of 16 April and your minute of 14 May, are being sent to the Prime Minister, the Lord President, the Lord Chancellor, the Lord Privy Seal, the Chancellor of the Exchequer, the Chancellor of the Duchy of Lancaster, the Secretaries of State for Employment, Transport, Social Services and the Environment and the Chief Secretary to Sir Robert Armstrong.

Yours,

Douglas.

FCS/86/133

SECRETARY OF STATE FOR THE HOME DEPARTMENT

Review of Entry Clearance Policy

1. Thank you for your letter of 16 April. I have studied carefully the review of entry clearance policy prepared by our officials.

2. The main conclusion to be drawn seems to be that it would be expensive and wasteful to introduce new visa regimes now, even if this were to be done only in the Sub-Continent. The Report draws attention, rightly in my view, to the serious resource implications of further visa regimes in terms of finance and Civil Service manpower, as well as to the foreign policy disadvantages. The option of strengthening immigtation staff in the United Kingdom seems clearly preferable and I am glad that you are pressing on with putting in place the reinforcements mentioned in the Report, to help keep the queues at our points of entry to manageable proportions. I note your doubts about the present system of immigration control being able to maintain sufficiently firm control in the 1990s. But I was particularly struck by the argument that your staff at home are available to meet pressures from wherever they may arise, whereas the introduction of new visa regimes involves sending ECOs to Posts overseas where they are deployed in a much less flexible way. Such "locked in" resources can, of course, be used only to deal with local situations which can and sometimes do change rapidly.

3. This does not mean of course that we shall never have to extend our visa regimes if emergencies arise. We must certainly continue to keep the situation in review, particularly this

/year's

year's increase in the refusal rate of young Nigerians and Ghanaians although, as you point out, the costs of visa regimes in West Africa are considerable and the Nigerians are especially prone to take offence if they feel they are being singled out or discriminated against.

4. I sympathise with your wish that we should give further study to contingency plans for the rapid imposition of visas in certain countries. But it is not easy to do this usefully without resource implications. For example, ear-marking additional office and residential accommodation may require existing leases to be extended or new ones to be taken out if we are to keep options open. Much the same applies to manpower implications where further contingency planning would be even less useful as we simply could not meet the requirements from existing staff resources. To take Nigeria alone, we have established that an additional 20 full-time ECOs would be required with a further 30 for summer relief. We could hope to find no more than a fraction of these from existing resources and that only by stripping other Posts of experienced staff.

5. You suggest that we might look at the issue again in October in the light of developments at the ports during the summer and the new guidelines on MPs' representations. I agree.

6. Subject to my doubts about taking contingency planning any further, I am content that you should tell Cabinet colleagues that we will look at the whole issue again in the autumn after the busy season in the ports. When we have the comments of other interested Departments, we might then consider how we should report jointly to No 10.

(GEOFFREY HOWE)

Foreign and Commonwealth Office
14 May 1986

IV. CONCLUDING SUMMARY AND ANALYSIS

152. This section of the report summarises the main conclusions of the previous sections and seeks to analyse the main issues which we think Ministers now need to consider. We have not thought it would be useful to attempt to reach agreed recommendations but we are agreed on the analysis set out below.

153. The United Kingdom system of immigration control summarised in Section I of our report operates primarily at the port of entry, thus taking advantage of the fact that Great Britain is an island. Its primary sanction is the power of the immigration officer to refuse admission to persons who do not qualify for admission under the Immigration Rules. Since 1969, entry clearance requirements have been extended by successive changes in the Immigration Rules so that now all those coming to the United Kingdom for settlement, or for marriage leading to settlement must first apply for entry clearance* at a United Kingdom post abroad. (The latest change was the extension of this requirement to female fiancees in July 1985). But the United Kingdom applies a general visa requirement, under which all persons seeking admission, including visitors or students, must first obtain visas from posts abroad, only to the nationals of some foreign countries (broadly speaking those in Eastern Europe and the third world) and, in the Commonwealth, to Sri Lanka.

154. For periods during 1985 the operation of the immigration control at the ports came under very great strain. This resulted in delays, notably at Terminal 3 at Heathrow, to all incoming passengers particularly to those passengers who had to be set aside for further examination before a decision on admission could be taken. It also led, in the judgement of the Immigration Service, to a weakening of the effectiveness of the control exercised at the ports.

155. We analyse the separate factors which contributed to this increased strain on the control in Section II of our report and summarise them below. Their effect has been cumulative:

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* See paragraph 13 for an explanation of the terminology used in the Immigration Act 1971. A visa is one form of entry clearance.

a. The general increase in passenger traffic. The number of non-EC passengers subject to immigration control who arrived in the first half of 1985 was 15% higher than in the first half of 1984. The traffic projections of the British Airports Authority indicate that this trend is likely to continue in future years (see paragraph 55);

b. A similar, and in the case of some nationalities greater, increase in the number of passengers who do not qualify for admission and/or are judged to be seeking to evade the control*; (see paragraphs 35-37)

c. Increased difficulty in securing the rapid removal of those refused admission. Passengers refused admission, or their relatives or sponsors here, may seek to have removal delayed by invoking the help of an MP, by claiming asylum, or by applying to the courts for judidical review of the refusal decision. The number of port refusal cases in which Members of Parliament have made representations have increased fivefold in three years. As shown by the figures in paragraph 45 this unofficial appeal system is now used by a high proportion of passengers from the subcontinent refused admission but by a smaller proportion of other nationals so refused. It is the Home Office view that those who apply for asylum cannot, consistent with our international obligations, be removed from the country until the application has been considered. The courts have recently confirmed that passengers should not be removed while an application is pending before the courts although they also indicated that they will be unwilling to consider applications for judicial review save in exceptional cases and will then consider them without delay;

d. In a few days at the end of May 1985 over 1,000 Tamils from Sri Lanka arrived in this country and claimed asylum. This influx (see paragraph 40) led directly to the imposition, with the understanding of the Sri Lankan government, of a visa requirement on Sri Lanka, the first for a Commonwealth country;

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* In the first two months of 1986 there have been further substantial increases for some nationalities in the refusals at terminal 3 compared with the same period in 1985. For example the increase for Indians was 50%, Pakistanis 43%, Ghanaians 36% and Nigerians 85%.

e. From the middle of July 1985 to the end of October there was a dramatic increase in the number of passengers from Bangladesh, ostensibly visitors, who were found not to qualify under the Immigration Rules (see paragraphs 42 and 43). This may have been due to a misunderstanding about our immigration policy intentions, compounded by unscrupulous travel agents. Following efforts to explain the situation and of representations to the Bangladesh Government, the influx ceased and by the end of the year the numbers of refusals had returned to earlier levels.

156. We have not attempted to forecast whether, whence or when there might be a similar influx of inadmissible passengers from particular countries in response to unforeseen events. We merely note that the smaller the safety margin within which the port control is operating in dealing with predicted traffic, the more difficult it is to cope with an influx such as occurred in 1985 from Sri Lanka or Bangladesh. The main concern of our report has been to examine how the control might operate more effectively in 1986 and the following years, without the strains, delays and consequent complaints of 1985 and within the framework of the Government's existing immigration policy.

157. We have examined, and attempted to cost, two broad options; first, the strengthening of the Immigration Service to enable the present port control system to operate effectively. Second, the extension of visa regimes, whereby a greater proportion of the difficult case work would be transferred from the ports of entry to posts overseas.

158. In considering the first we have noted that the difficulties at Heathrow in 1985 were exacerbated by the inadequate accommodation available in the existing terminals. There will be some immediate relief from the opening of terminal 4 at Heathrow in April this year, though at the cost of providing additional immigration officers. The opening of the second terminal at Gatwick in 1987 will also provide increased accommodation and require additional staff.

159. In 1986/7 the Immigration and Nationality Department (IND) of the Home Office are aiming to provide about 50 additional immigration officers over their current PES provision at a cost of some £1.1m. This will provide the capacity for the port control to operate at about the same level of effectiveness as in 1984 provided there are no new significant influxes from

particular parts of the world. The cost should be partially offset by a saving of £0.7 million on public expense removals of passengers if the delays experienced last year in dealing with representations from MPs can be substantially reduced. The net cost in 1986/87 would therefore be £0.4 million. Assuming no major change in policy or practice, the Home Office estimate that an additional 20 staff will be needed each year to cope with the increase in difficult case work quite apart from increases required by the general volume of increased traffic or by the opening of new terminals (see paragraphs 63-67).

160. In considering the option of extending visa regimes we rejected the theoretical arguments for adopting the Australian and present US practice of requiring all passengers subject to immigration control (other than, in our case, those of EC countries) to obtain visas. There is no case for imposing visas on, say, Swedes or Australians, and the costs of trying to do so for United States' nationals, given that three million or so of them come here each year, would be prohibitive.

161. We noted (see paragraph 30) that the United Kingdom has agreed to discuss harmonisation of visa regimes within the EC. This could in due course require us to apply visa requirements to additional countries. We decided, however, to examine only the implications and costs of extending visa regimes to a specific list of countries. There are seven countries, India, Pakistan, Bangladesh, Nigeria, Ghana, Algeria and Morocco which have refusal rates well above the average and which account for more than half of all refusals and for over 70% of the case work at terminal 3. For the reasons explained in paragraphs 70 and 71 we added Sierra Leone, Tunisia and South Africa to this list.

162. We then considered whether it would be practicable to impose visa regimes on particular countries within these ten or whether we face an "all or nothing" choice. We concluded it would be possible to distinguish the three countries of the subcontinent from the rest. They provide the greatest problems for the immigration control and their nationals are at present more likely than the nationals of the African countries to invoke the aid of Members of Parliament. It was, however, the clear view of the FCO that it would not be feasible, save in a grave emergency, to impose a visa requirement on Bangladesh without imposing one at the same time on India and Pakistan. Similarly the FCO took the view that it would be very

difficult to impose a visa requirement on Ghana (the country with the highest proportional refusal rate) without also imposing one on Nigeria and Sierra Leone.

163. We therefore decided to examine the costs and implications of applying a visa requirement to all ten countries, or, alternatively, to the three countries of the subcontinent. The cost and manpower implications are set out in the summary tables at the end of this section and are summarised in the following paragraphs. (They are discussed in detail in paragraphs 82 to 119).

164. The FCO estimates that to operate a visa requirement in the ten countries in 1986/7 would require 136 extra permanent United Kingdom based staff and 253 extra locally engaged staff. To allow for projected increase in workload, this staff provision would need to be increased at a rate of 5% a year in later years. High season reinforcement of 132 United Kingdom based staff and 187 locally engaged staff would also be needed. There would be a start up cost of at least £6.2 million (plus further substantial capital costs in the longer term), and an annual cost in 1986/7 of £20.8 million, with additional costs for the Home Office and the appeals system of about £0.5 million a year.

165. Against the additional expenditure can be set £6.4 million in expected receipts from visa fees. The Immigration Service would have less difficult casework to deal with at the ports and would therefore need fewer staff. The difference between the number required if visas were introduced and the number required to enable the present system to work effectively (see paragraph 159 above) is 80 staff. The net saving on the current IND PES provision would therefore be 30 posts and the financial saving £0.7 million in 1986/87. There would also be a saving of about £0.7 million on public expense removals. Putting all this together, the net additional cost to public expenditure would be about £13.5 million a year at 1986/7 levels, plus the start up costs of £6.2 million.

166. On a similar basis the FCO estimates that the manpower requirements for extending a visa requirement to the three countries of the subcontinent in 1986/7 would be 61 permanent United Kingdom based and 131 permanent locally engaged staff reinforced in high season by 69 United Kingdom based and 104 locally engaged staff. Again, this provision would need to be increased by 5% a year in later years. There would be a start up cost of at

least £2.9 million (with further capital costs in the longer term) and an annual cost in 1986/7 of £7.4 million with additional costs for the Home Office and the appeals system of about £0.3 million.

167. Against these costs for imposing a visa requirement on India, Pakistan and Bangladesh can be set £2.8 million in expected receipts from visa fees. The difference between the number of immigration staff required if visas were introduced and the number required to enable the system to work effectively (see paragraph 159 above) is 55 staff. The net saving on the current IND PES provision would therefore be 5 posts and the financial saving £0.1 million in 1986/7. There would also be a saving of about £0.7 million on public expense removals. In addition to the start up costs of £2.9 million the net additional cost to public expenditure would be about £4.1 million in 1986/7. The difference between this cost and that of enabling the present system to work effectively would be about £3.7 million in 1986/7 and slightly less thereafter.

168. We have attempted to make our costings as precise and comprehensive as possible. They rest, inevitably, on a number of assumptions which events could prove wrong. Moreover they relate only to public expenditure and to civil service manpower. A number of unquantifiable costs are not included. We have not attempted to quantify the consequences of extending visa regimes from the point of view either of the travelling public or of the nationals of the countries concerned. Nor have we attempted to indicate where any extra resources for new visa regimes might come from. We believe that resources of the magnitude required, even if changes were limited to the subcontinent, could not be met within existing PES provisions for the Home Office or FCO. New money and manpower would be required.

169. An important argument in favour of extending visa regimes is that it should enable a higher proportion of immigration officers to be deployed in dealing with bona fide passengers at the ports, thus reducing congestion and delay and removing a source of irritation to both tourists and businessmen. Against that, substantial numbers of bona fide visitors and students overseas would be put to the time and expense of travelling to a British post in order to obtain a visa, involving extra form filling and delay. More generally, there could be damage to Britain's image abroad, to relations with the Commonwealth and to our bilateral relations with the

countries concerned, who might seek to retaliate even though some of them already impose a visa requirement on British visitors. See paragraph 80 and Annex D for the foreign policy implications for each candidate country.

170. A major increase in entry clearance work overseas would have serious consequences for the structure and balance of the posts concerned and for the staffing and structure of the Diplomatic Service as a whole. As explained in paragraph 96 of our report, the existing arrangements for granting entry clearance to those coming for settlement have already affected the character of FCO work, especially in the subcontinent.

171. We explain in section III D that it is not easy to judge the effect on community relations in this country of imposing visas on the candidate countries. The present delays at London Airport when passengers from the subcontinent have to be referred for further examination cause great inconvenience to relatives who have come to meet would-be visitors and themselves fuel allegations about the alleged bias in the immigration control. On the other hand, any change which appeared to tighten the present immigration controls and make visiting relatives here more difficult would arouse suspicion and resentment and would be exploited by the opponents of the Government's immigration policy. Immigrants' organisations are on record as opposing the extension of visa regimes.

172. In section IIIC of our report we discuss briefly certain other measures which have been considered in response to the problems caused at the ports in 1985, and in particular the difficulty of securing the speedy removal of passengers from certain countries who are refused admission. We explain (in paragraphs 126-129) the Home Secretary's present proposals for new arrangements for dealing with representations from MPs. It is hoped that these will alleviate the recent problems. We also outline in paragraphs 130-142 the possible advantages and disadvantages of:

a. attempting the immediate removal of passengers in respect of whom representations are made or where application is made for judicial review;

b. curtailing the use of temporary admission and holding refused passengers in detention; and

c. summary adjudication at the ports by way of appeals against immigration officers' decisions.

173. Such more drastic measures might have to be contemplated either temporarily in an emergency or if the changes in handling MPs' representations do not secure the desired result. We have not, however, attempted any detailed analysis of the costs, implications and practicalities of these measures. We do not regard them, at least in the immediate future, as providing Ministers with reasonable alternatives to the main options discussed in our report: those of strengthening the Immigration Service to maintain the effectiveness of the present control or extending the visa requirement.

174. In considering these options there are two further, more general arguments which should be borne in mind. The first concerns the thoroughness with which the Government's policy of firm immigration control can in practice be applied to all individuals wishing to come here. The decisions from 1969 onwards to require all those seeking settlement to obtain entry clearance rather than establish their claim on arrival at the port arose from the difficulty of dealing with settlement cases at the ports. A passenger who requires a visa is unlikely to be accepted by an airline unless he has one and cannot therefore try his luck at Heathrow. He first has to make an application to a post overseas. This gives the opportunity for a more thorough examination of a larger number of passengers than is possible at busy ports given present manpower levels and detention facilities. We indicate in paragraph 123 some of the implications of a comparable approach at the ports. An extension of visa regimes might therefore be a possible way of maintaining and to some extent strengthening the immigration control.

175. Against this it should be borne in mind that resources devoted to entry clearance work overseas can be used much less flexibly than resources at home. Overseas staff cannot easily be redeployed to cope with the pressures of the moment, whereas extra manpower and resources at the ports can be redeployed quickly to deal with crises from whatever country they originate. A visa regime is also a blunt instrument; it may catch doubtful visitors at an earlier stage but it also creates new bureaucratic obstacles for those who at present enter with a minimum of fuss.

M A N P O W E R

ENABLING THE PRESENT SYSTEM TO WORK EFFECTIVELY

	1986/87	1987/88	1988/89	1989/90
Immigration Service	50	70	90	110

Notes

The additional Immigration Service staff above IND PES provision. This assumes no enhancement of the control or changes in productivity and does not include the additional staff for new terminals.

EXTEND VISA REQUIREMENTS TO ALL CANDIDATE COUNTRIES

	1986/87	1987/88	1988/89	1989/90
FCO UK based staff increases				
- permanent	136	143	150	157
- summer extras	66	69	73	76
IND staff increases	5	5	5	5
	207	217	228	238
Immigration Service staff savings	(30)	(30)	(30)	(30)
TOTAL INCREASE UK based staff	177	187	198	208
FCO locally engaged staff increases				
- permanent	253	266	279	293
- temporary	93	98	103	108
	346	364	382	401

For 1986/7 this estimate of staff increases above PES provision includes 113 entry clearance, 11 admin., 5 communications, 2 MVD and 5 margin. There are 5% annual increases thereafter.
For 1986/7 the estimate is that 132 additional temporary staff are required, equivalent to 66 man years. There are 5% annual increases thereafter.
Additional EOs to deal with an increase in referred casework.

The difference between the saving in immigration staff from visa regimes and the increases necessary to enable the system to work effectively.

This is the number of man years, half the total number of temporary staff.

EXTEND VISA REQUIREMENT TO SUB CONTINENT

	1986/87	1987/88	1988/89	1989/90
FCO UK based staff increases				
- permanent	61	64	67	71
- summer extras	35	36	38	40
IND staff increases	3	3	3	3
	99	103	108	114
Immigration Service staff changes	(5)	1	7	13
TOTAL INCREASE UK based staff	94	104	115	127
FCO locally engaged staff increases				
- permanent	131	138	144	152
- temporary	52	55	57	60
	183	193	201	212

For 1986/7 this estimate of staff increases above PES provision includes 50 entry clearance, 6 admin., 3 communications and 2 margin. There are 5% annual increases thereafter.
For 1986/7 the estimate is that 69 additional temporary staff are required, equivalent to 35 man years. There are 5% annual increases thereafter.

Additional EOs to deal with an increase in referred casework.

The difference between the saving in immigration staff from visa regimes and the increases necessary to enable the system to work effectively.

This is the number of man years, half the total number of temporary staff.

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SUMMARY OF COSTS AND SAVINGS

1986/7 prices £M (rounded to nearest £.1M)

ENABLING THE PRESENT SYSTEM TO WORK EFFECTIVELY

	1986/87	1987/88	1988/89	1989/90
Cost Immigration Staff	1.1	1.6	2.0	2.5
Savings Public Expense Removals	(.7)	(.7)	(.7)	(.7)
NEW MONEY	.4	0.9	1.3	1.8

EXTENDED VISA REQUIREMENTS TO ALL CANDIDATE COUNTRIES

	1986/87	1987/88	1988/89	1989/90
FCO costs	20.8	21.8	22.9	24.1
Cost of immigration appeals	.4	.4	.4	.4
Cost B1 Division staff	.1	.1	.1	.1
	21.3	22.3	23.4	24.6
Estimated visa fees	(6.4)	(6.7)	(7.0)	(7.4)
Savings:				
Public Expense Removals	(.7)	(.7)	(.7)	(.7)
UK Immigration Staff	(.7)	(.7)	(.7)	(.7)
ANNUAL COST ABOVE PES PROVISION	13.5	14.2	15.0	15.8
SHORT-TERM SET UP COSTS	6.2	-	-	-
NEW MONEY	19.7	14.2	15.0	15.8
NET COST OVER ENABLING THE PRESENT SYSTEM TO WORK EFFECTIVELY	19.3	13.3	13.7	14.0

EXTEND VISA REQUIREMENT TO SUB-CONTINENT

	1986/87	1987/88	1988/89	1989/90
FCO costs	7.4	7.8	8.2	8.6
Cost of immigration appeals	.2	.2	.2	.2
Cost of B1 Division staff	.1	.1	.1	.1
	7.7	8.1	8.5	8.9
Estimated Visa Fees	(2.8)	(3.0)	(3.1)	(3.3)
Savings:				
Public Expense Removals	(.7)	(.7)	(.7)	(.7)
UK Immigration Staff	(.1)	0	.1	.2
ANNUAL COST ABOVE PES PROVISION	4.1	4.4	4.8	5.1
SHORT-TERM SET UP COSTS	2.9	-	-	-
NEW MONEY	7.0	4.4	4.8	5.1
NET COST OVER ENABLING THE PRESENT SYSTEM TO WORK EFFECTIVELY	6.6	3.5	3.5	3.3

Notes

The cost of the staff required above current IND PES provision. It assumes no enhancement of the control or changes in productivity and does not include the additional staff for new terminals.
The maximum saving possible if all passengers who are refused are removed at carriers' expense.

The cost of all additional full-time and seasonal UK based and locally engaged staff with accommodation and other directly attributable costs but not including the cost of the additional burden on senior staff, recruitment, training, bag services etc. Assumes the same standards of control as applied overseas at present and no changes in productivity.
The cost of an additional 8,300 appeals as a result of a higher refusal rate and greater propensity to appeal in entry clearance cases than in port cases.
5 additional EOs to deal with an increase in referred casework.

Assumes a fee of £12 for every application.

The maximum saving possible if all passengers who are refused are removed within 2 months.
The difference between the saving in immigration staff costs which arises with visa regimes and the additional staff costs to enable the control to work effectively.

No attempt has been made to estimate capital costs in later years when it could be necessary to acquire new accommodation.

The cost of all additional full-time and seasonal UK based and locally engaged staff with accommodation and other directly attributable costs but not including the cost of the additional burden on senior staff etc. Assumes no enhancement of control and no changes in productivity.
The cost of an additional 3,800 appeals as a result of a higher refusal rate and greater propensity to appeal in entry clearance cases compared with port cases.
2/3 EOs to deal with an increase in referred casework.

Assumes a fee of £12 for every application.

The maximum saving possible if all passengers who are refused are removed within 2 months.
The difference between the saving in immigration staff which arises with visa regimes and the additional staff to enable the control to operate effectively.

No attempt has been made to estimate capital costs in later years when it could be necessary to acquire new accommodation.

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HOME SECRETARY

QUEEN ANNE'S GATE LONDON SW1H 9AT

16 April 1986

Dear Geoffrey,

REVIEW OF ENTRY CLEARANCE POLICY

We have both received the joint report by our officials on their review of entry clearance policy. I am committed to letting David Young see the report, given his interest in tourism and the speedy clearance of passengers through the ports, and circulating it also to other colleagues who also have an interest. Before doing so, however, I would be glad to know your initial reaction to the analysis that officials have put before us.

So far as the rest of this year is concerned, it is now too late to contemplate the general extension of entry clearance requirements, even if we were persuaded that that was the right course to take and could persuade our Treasury colleagues to sanction the requisite increases in expenditure. I am asking officials to press on with the relatively modest increases in the size of the Immigration Service to which the report refers, and we shall do all we can to operate the new guidelines for representations from MPs as firmly as we can. It remains to be seen what effect the new guidelines will have. For this year therefore I see the imposition of visas as something to which we should turn only in response to an emergency resulting from a build up of pressure from one or two countries. But we cannot rule out that possibility if, for example, the recent striking increase in the numbers of inadmissible passengers from West Africa were to prove a harbinger of an influx analogous to that last year from Bangladesh. I hope you would agree that your officials, with mine, should give some further study to contingency plans for the rapid imposition of visas on Ghana and Nigeria, as well as on Bangladesh, should the need arise.

Looking further ahead I find it more difficult to make a judgment. Our supporters in Parliament and the country expect us to maintain a firm immigration control. The general pressure to emigrate from the Third World is not going to diminish, nor, so far as we can judge, is the pressure from relatives (genuine and otherwise) in Bangladesh, and the desire of people in West Africa to look for employment opportunities (legal or otherwise) in this country. I am by no means persuaded that the present system of immigration control, though it has served us pretty well in the past, and its cost is modest in financial terms, will enable us to maintain a sufficiently firm immigration control in the 1990s. We

/also have to

The Rt Hon Sir Geoffrey Howe, QC, MP

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also have to reckon with the continued pressure to simplify frontier formalities, and speed passengers on their way, eg through the Channel Fixed Link, and the Euroepan pressures for harmonisation of visa requirements. Nor am I persuaded that any of the other ways of reinforcing the effectiveness of the port control which are briefly discussed in the report by officials would in practice offer an alternative to the extension of visas. On the other hand, I quite see the foreign policy difficutlies, especially perhaps, despite their own visa requirement, in the case of India. On the assumptions made by your officials the costs of imposing visas on selected African countries are also a formidable obstacle to doing so, although for the countries of the sub-continent an increase of only £3-4 million a year in the net cost of the control would be seen by many of our supporters as a price well worth paying for the more thorough examination of more passengers.

I suggest, if you agree, that barring any unforeseen developments which might require us to contemplate visas for one or more particular countries before then, we should look at the whole issue again in October by which time we shall know how well, or badly, the port control has coped with this year's pressures, and what results the new guidelines on handling MPs representations have produced. We may also know a little more about the conflicting pressures from Europe.

Would you be content if I indicated to colleagues that that was the way our minds were moving? If you think a meeting would be helpful at this stage, and before the report is circulated more widely, please let me know.

Yours,

Douglas.

CC/BG

ROYAL COURTS OF JUSTICE
LONDON, WC2A 2LL

01-405 7641 Extn

16 April 1986

The Rt Hon John MacGregor MP
Chief Secretary of the Treasury
HM Treasury
Parliament Street
London
SW1P 3AG

JBM.

Dear John.

CROWN PROSECUTION SERVICE (CPS): 1986-87 MAIN ESTIMATES: CLASS XX, VOTE 26

Thank you for your letter of the 14th March 1986.

I accept the need to ensure that future returns by the CPS in the Public Expenditure Survey must be more accurate. I confirm the willingness of DPP officials to consult closely with their Treasury colleagues at all stages throughout the 1986 Survey.

It is fair, however, to remind you of the circumstances in which the DPP participated in the 1985 Public Expenditure Survey. Treasury officials had, understandably, declined to discuss the structure and staffing of the new Service until the report by management consultants was available and had been thoroughly evaluated. This related to both the headquarters and the "field" of the new Service. Two consequences followed. First, the structure of the organisation for which provision had to be estimated was not completely clear until very late in the day. Secondly, the task of strengthening the headquarters staff to establish that structure could not be carried out until very much later in the year. This includes posts with responsibilities in the field of budgets and costs.

You will recall that the more delicate negotiations concerning the grading and recruitment of the necessary personnel. I am satisfied that such shortcomings as we have to acknowledge arose despite the best endeavours of the limited manpower available to the Director at that stage. While it is always regrettable when an estimate proves to have been wide of the mark there were powerfully extenuating circumstances here.

I am sorry to note from the second paragraph of your letter that you have formed a firm view as to future provision for the Service even before it has begun to operate. Your officials are aware that the £7½ million shortfall on the net Vote provision was primarily intended to cover work known about at the time of the 1985 Survey, which either could not then be estimated accurately, or about which there was some doubt concerning Crown Prosecution Service responsibility. The work covered such things as advance disclosure and the payment of witnesses. Some of that doubt has now been clarified, but the work has not gone away. The Crown Prosecution Service has to do it, and at the moment has been given no funds for the purpose. I understand this is because the Treasury has judged it right that we wait just a little longer to see more precisely what resources will be required. That seems sensible, but we should be clear that both sides agree that some, as yet unspecified, further provision looks likely to be necessary.

You say that you will be looking for savings in the light of experience of how the new Service operates. I too look forward to that. I believe such savings should arise in two ways; first, our experience should show how to carry out our work more efficiently, and secondly, the presence of a unified Service will for the first time allow us the option of taking certain policy decisions about the criminal justice system which should show resource savings. However, we must recognise the pressures which

will be operating against us in these endeavours. For instance, it is clear from current data that since the compilation of the 1984 data on court sittings and defendant numbers, which were used to determine the Service's present complement, a substantial increase in the demands on the Service has taken place. If this trend continues and our complement is not changed to match it, these demands will have to be reflected in our private agents' costs in Vote 27. The other pressure which could prevent us achieving the savings you are looking for is that many of them will be found in budgets other than that of the Service. Local authorities and the police are obvious examples.

As regards the final paragraph of your letter, I of course see that the establishment of a complete new Government Department with some 4,000 staff is an exercise which might well repay some ex post facto scrutiny to identify lessons which might be learnt for the future. But I do not necessarily accept your criticisms of the information provided as a basis for the decision by Ministers. I had understood it to be common ground that the costs of the existing prosecution system are so distributed that nobody can provide any reliable figures for the actual cost to the public. We accordingly cannot conclude that £130 million is almost double, or any proportion of, the cost of prosecutions at present. Certainly your officials on the Steering Group did not suggest any inadequacies in the paper presented to H Committee. Savings will inevitably occur on other budgets, but until they have been ferreted out and quantified the sort of exercise you envisage would be of only limited value. My officials have already noted your observations for their input to the Working Group considering the establishment of a unified investigation and prosecution organisation for fraud cases.

Copies of this letter go to Douglas Hurd and Kenneth Baker as well as to the Prime Minister and other colleagues on H Committee who took the original policy decision.

Home Affairs: Rights of
Entry Pt 3

From: THE PRIVATE SECRETARY

FOR MEA

HOME OFFICE
QUEEN ANNE'S GATE
LONDON SWIH 9AT

16 April 1986

NBPA

Dear John.

CROWN PROSECUTION SERVICE

In your letter of 14 March to Patrick Mayhew, you invite me to consider taking the lead in an exercise to draw any lessons from the emerging costs of the Crown Prosecution Service.

I share your desire to learn from this experience.

I should be very happy for the Home Office to take the lead, in discussion at official level between the three Departments concerned, with the aim of assembling all the relevant information, agreeing on its validity, and attempting to reach agreed conclusions on what may be learned. A further report should then be made to Ministers. Picking up your reference to the scrutiny process, I suggest that we require the final report to be completed within three months.

If you agree, officials here will be in touch with yours, and those in the Law Officers' Department, as soon as possible.

As far as I can see, no-one predicted savings in public expenditure as a whole. The H Committee minutes (H(84)6th Meeting) show that when Ministers collectively decided to go ahead, they did so in full knowledge that the "overall public expenditure implications were uncertain". The H Committee papers, and the Explanatory and Financial Memorandum to the Bill, show that the estimated reduction of £3.2 million to which you refer related to the costs of prosecution alone, and not to total public expenditure.

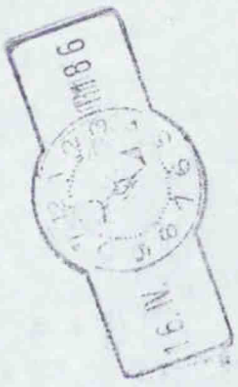
I am copying this letter to the Prime Minister, the Secretary of State for the Environment, other H Committee colleagues, and Sir Robert Armstrong.

Yours ever,

Douglas.

The Rt Hon John MacGregor, OBE., MP.

Home Affairs; Rights of Entry Pt 3



10 DOWNING STREET

Prime Minister

It would not help public expenditure control for you to write as suggested here.

Financial control in legal services is very poor, and the legal departments should be left to do the best they can with the Treasury.

DHW
19/3.

PRIME MINISTER 19 March 1986

CROWN PROSECUTION SERVICE (CPS)

The Government's initiative to launch the CPS is in danger of being attacked by both the lawyers employed in it and possibly the press. There are a number of complaints. The service is said to be underpaid for the boring work it does, it is demoralised (nearly a third of all new recruits employed during the last few months have resigned), and it is understaffed by about two-thirds of places in the London area alone. Old Scotland Yard hands have, in some cases, been downgraded and are querulous. London weighting is not thought sufficient to attract prosecutors from the provinces. And, importantly, it is suggested that the police are likely to be unhappy that all their work in ferreting out evidence may be wasted if the prosecutors employed are of a low calibre and fail to secure a conviction.

We believe that it is essential to keep the goal of considerable public sector savings, which could come from giving the Crown Prosecution Service the powers to decide who goes to Crown Court. This will depend upon the status and perceived professional competence of the new service.

For all these reasons, we strongly support the Solicitor General's request for more funds to be paid from the reserve.

HARTLEY BOOTH

cc BS

Treasury Chambers, Parliament Street, SW1P 3AG

Sir Patrick Mayhew QC MP
Solicitor General
Law Officers Department
Royal Courts of Justice
Strand
London
EC2A 2LL

14 March 1986

Dear Patrick,

CROWN PROSECUTION SERVICE (CPS):
1986-87 MAIN ESTIMATES: CLASS XX, VOTE 26

WILL REQUEST IF REQUIRED

In my letter to you of 20 January on extradition, I expressed concern that the main cash limited estimate for the CPS had come in not only one month late but also some 50 per cent above the provision agreed in the 1985 Public Expenditure Survey.

My officials are prepared to recommend to me a total net provision on this Vote of £64,714,000, which is £7,496,000 less than the Estimates provision sought and represents an increase in your running costs of £14,691,000 and a charge on the Reserve of £15,883,000. I am prepared to accept that this is necessary to achieve realistic provision, but only with the greatest reluctance. I must insist that my officials are closely consulted throughout the course of the 1986 Survey, so that the Estimate can follow from it in the normal way. I will also find it very hard indeed to contemplate any further real increase in provision particularly for running costs; indeed I will be looking for savings in the light of experience of how the new service operates.

I do not doubt that you share my concern that the 1985 Survey provision was so far out. But that is only the last chapter of a longer story. When the responsible Ministers agreed in 1984 that the CPS should be set up, it was on the basis that it was likely to result in net

HOME AFFAIRS RIGHT OF ENTRY PT 2

savings in public expenditure of £3.3 million a year. As you know, the Estimate provision above deals with only part of the total cost of the CPS - mainly the administrative costs. I now understand that the CPS will cost the taxpayer some £130 million, almost double the cost of prosecutions at present. There is no indication that the additional tasks falling on the CPS, such as the review of all prosecution cases coming forward, justify such an increase. But in any case our policy decisions need to be based on far better estimates of their cost than this one seems to have been and I should like to suggest that the Home Office, whose policy was concerned in this case, might take the lead now in an exercise (perhaps akin to an efficiency scrutiny) to establish the lessons for avoiding a similar tale in other cases.

I am copying this letter to Douglas Hurd and Kenneth Baker: and also to the Prime Minister and colleagues on H Committee which took the original policy decision.

Yours ever,

JOHN MacGREGOR

PART 2 ends:-

MGA to LAW OFFICERS DEPT 16/12/85

PART 3 begins:-

CST to SOL. GEN 14/3/86

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