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Prime Minister²

To note.

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KEITH COMMITTEE

1. In 1980 we set up a committee under Lord Keith of Kinkel to review the enforcement powers of the Revenue Departments. It has recently completed the first part of its work, dealing with income tax and VAT powers. This is to be published on 23 March, as announced.

Background

2. The Committee was set up in fulfilment of a Manifesto pledge. That in turn was prompted by concern, especially amongst small traders, about the powers associated with VAT; about the more recent Inland Revenue powers to search premises; and about the Revenue's new techniques of "in depth" investigation of business accounts. On the other side, there was also anxiety - subsequently reinforced by the PAC - about the loss of revenue in the black economy.

Recommendations of the Report

3. Lord Keith has produced a massive first part of his report with a long list of recommendations - over 150 of them. He says that his central theme is "balance". He is seeking to safeguard the taxpayer's reasonable right to privacy and to conduct his affairs without unreasonable intrusion, while giving the Revenue Departments the power which he considers they need to do their job. A secondary /theme is to align



theme is to align the powers and safeguards of the two Revenue Departments.

.... 4. There are widely differing views about the correct balance. A number of Lord Keith's recommendations, summarised in the attached note, are likely to be contentious, and some highly controversial.

- legal powers

5. There is no doubt that the report will disappoint a number of people - including quite a few of our supporters - who have argued that the Departments' powers are too great and have been used with too little discretion. The Committee concludes that the search powers of the two Departments are necessary, have been operated responsibly, and should be retained. It endorses the Customs and Excise view that visits to traders' premises are essential to the control of VAT. It proposes new obligations on trading taxpayers.

6. The recommendations likely to be controversial include a new right for an Inspector of Taxes to examine traders' records at the business premises, and a new general information power for the Revenue and an extension of the exchange of information between the two Departments at local level (hitherto restricted to a small experiment at Leeds).

7. The report also recommends automatic penalties for the under-declaration of income or VAT and for the late filing of accounts and returns. This may well be a necessary condition here - as in other countries - for any move towards self-assessment. If it achieves the

/intended effect of

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highlight the Report and its contents. We shall attempt to secure the lowest key presentation and avoid any suggestion that we have accepted the Report's contents.

16. Copies of this minute go to the Home Secretary, the Lord Chancellor, the Secretary of State for Trade, the Attorney-General and Sir Robert Armstrong.

GEOFFREY HOWE

17 March 1983

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MAIN RECOMMENDATIONS

Inland Revenue1. Information

- (i) There should be a simpler statutory return for PAYE taxpayers which ideally should be sent annually, but failing that every 3 years. The taxpayer should have to state positively whether he has more than one employment.
- (ii) The normal time limit for making a return should be three months (it is 30 days at present). Trading taxpayers should be obliged to submit accounts; initially within 12 months of the end of the accounting year but eventually within 6 or 7 months.
- (iii) Failure to render a return or accounts within the new time limits should attract an automatic penalty of 5% of the tax at stake for each month or part of a month, up to a maximum of 30%.
- (iv) Traders should be obliged to keep records for direct tax purposes (they already have to keep them for VAT) and to retain them for 6 years.
- (v) The Revenue should have a new general information power that would enable the Inspector to require production of any information which in his reasonable opinion is relevant for any tax purpose. The recipient of the notice should have a right of appeal. The power would run against central and local government departments, and replace the present various powers in anti-avoidance provisions.

- (vi) The taxpayer should be told when an information notice is served on a third party for information in respect of the taxpayer: certain third parties should be able to recover their costs of compliance.
- (vii) Third parties (eg banks) who notify the Revenue of payments to taxpayers should let the taxpayer know they have done so.

2. Checks at business premises

- (i) Tax inspectors should have a new power of entry to business premises, on notice, to require production of business records so as to check the accuracy of trading profits. (The Revenue at present can only so inspect wages records.)
- (ii) A "code of conduct" governing visits to premises should be prepared, setting out the safeguards available to the taxpayer and published in the form of a leaflet. (Other leaflets should explain taxpayers' rights in an investigation and penalty negotiations. Increased publicity should be given to the taxpayers' rights of access to the Appeal Commissioners.)

3. Subcontractors, agency workers, casuals

- (i) There should be the right of appeal against the cancellation of a sub-contractor's certificate.
- (ii) The rate of withholding tax for subcontractors (currently 30%) should be reduced to one half of basic rate.
- (iii) Tax should be deducted at half the basic rate from payments to agency-worker companies. (We proposed a 30% deduction in the 1981 Finance Bill but withdrew it following criticism.)

- (iv) Employers should deduct tax at half the basic rate from payments to casual workers (this would affect up to one million employees - many of whom would be entitled to repayments).

4. Search warrants

- (i) The power to search for evidence under warrant should be retained but be restricted to serious cases of suspected tax fraud.
- (ii) A production order of the Court should be available to obtain information as an alternative to the search of an unsuspected third party's premises.
- (iii) The judicial authority issuing the warrant should be able to impose conditions, as safeguards for the citizen, about the size of the search party, the time the search can start and the presence of police officers. The warrant should contain as much detail of the suspected offence as is practicable and a copy be provided for the occupier of the premises.
- (iv) The safeguards for access to seized documents should be enhanced and a grievance procedure established whereby the owner of the documents may appeal to the judicial authority.

NB These recommendations on searches also apply to Customs and Excise.

5. Underdeclarations or omissions : Penalties and interest

- (i) The present penalty and interest system, which incorporates a considerable measure of Revenue discretion, should be replaced by an automatic system: interest would be charged in every case

and there would be a fixed 30% penalty whenever the omission exceeded a given level. Omissions below that level would no longer attract a penalty. Where the omission was made with the intention of deceiving to evade tax the penalty should be 100% (but mitigable to 50%). In the meantime the present penalties should be revalorised.

- (ii) Both Departments should be required to publish the names of serious defrauders unless there had been a full spontaneous voluntary disclosure.
- (iii) Revenue should consider possibility of an interest charge in respect of PAYE tax paid late. Interest and penalties should run in respect of tax on directors' remuneration paid late.

6. Co-operation between Revenue and Customs

- (i) The exchange of information between local Revenue and Customs offices should apply nationwide (there is currently an experiment in Leeds).
- (ii) A pilot scheme should be established for joint visits to traders and joint local investigations, to cut down the number of tax officials dealing with traders.

7. Black economy

- (i) The Revenue should seek out suitable cases of "moonlighting" for prosecution: there should be a set of specific criminal Revenue offences, providing for imprisonment of up to 7 years.

Customs and Excise

8. Control

- (i) Control visits should continue but with additional safeguards and minor enhancement of certain powers.
- (ii) Appropriate publicity should be given to the powers and safeguards applicable to VAT control visiting in the form of a leaflet setting out a "code of conduct".
- (iii) The present separate powers in respect of goods and services should be assimilated, subject to certain safeguards.

9. Search warrants

- (i) The judicial authority for issuing VAT search warrants should be raised to a Circuit Judge in England and Wales, to a County Court Judge in Northern Ireland and be maintained at Sheriff level in Scotland.
- (ii) All the additional safeguards referred to under paragraph 4 above apply also in respect of VAT searches.

10. Regulatory offences and compliance

- (i) Criminal regulatory sanctions in VAT should be abolished and civil penalties introduced for offences such as failure to keep or produce records and failure to furnish returns and pay VAT. A new tariff should provide for higher penalties for persistent offenders.

- (ii) Higher assessments should be issued where there is a repeated failure to furnish a VAT return but previous assessments have been paid; and a VAT Tribunal should be empowered to increase assessments on appeal.
- (iii) The Department should consider the wider use of early collection visits and the more effective use of enforcement sanctions, including the assessment of civil penalties. If significant non-compliance persists, provision should be made for a system of automatic tax-gearred surcharges.

11. The Civil Code

- (i) All understatements or overclaims of VAT should bear default interest.
- (ii) A civil default of gross negligence attracting a non-mitigable penalty of 30% of the VAT understated or overclaimed together with default interest should be introduced and include the unauthorised issue of tax invoices and failure to notify liability to be registered. Gross negligence should be defined by objective tests.

12. Fraud and Criminal Investigation

- (i) A civil default of "civil fraud" defined as an act or omission intended to deceive and attracting a penalty of 100% of VAT evaded, mitigable to 50%, together with default interest, should be introduced but criminal prosecution should remain available at the option of the Department (see also paragraph 5ii above).
- (ii) The criminal offence code should be redefined to include input tax offences, the maximum penalty of imprisonment for VAT criminal frauds should be increased from 2 to 7 years and there should be extended time limits for prosecutions.

- (iii) The code of questioning applying to the Department as respects the provision of legal advice to suspects in custody and future arrangements for tape recording interviews in custody should follow that applying to the police as eventually enacted as a result of the Police and Criminal Evidence Bill.
- (iv) A power of arrest should be conferred on Customs and Excise officers in respect of serious offences of suspected VAT fraud.