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PRIME MINISTER

**IMPLEMENTATION OF THE KEITH REPORT**

I have been thinking hard about the next steps in respect of the report of the Keith Committee.

We have long recognised the need to modernise and streamline the way in which taxes are administered. This involves two main tasks. The first is to computerise the Inland Revenue's network of local tax and collection offices. That we already have well in hand. The second is to overhaul what Keith described as the antediluvian system of Revenue powers, individuals' rights and taxpayer obligations which regulate the day to day working relationship between the Revenue, taxpayers and tax advisers.

The Keith Committee was set up by Geoffrey Howe in 1980 to review the enforcement powers of the Revenue Departments. The first two volumes of the Report were published in March 1983 and covered income tax, corporation tax, capital gains tax and VAT. We implemented the VAT recommendations, with some modifications, in this year's Finance Act.

On the Inland Revenue taxes, the Committee pointed towards a rather more wide-ranging modernisation of the system, including some substantial adjustments in working procedures. I have been concerned, so far as possible, to carry forward these reforms on the basis of a general consensus. We have deliberately allowed ourselves a lengthy period of consultation with the various representative bodies. Last year I announced that, in the light of the discussions, I hoped that during 1985 it would be possible to bring forward draft clauses representing the Government's conclusions, with a view to legislation in the 1986 Finance Bill.

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The Keith Committee's recommendations for the Inland Revenue were accepted by the professionals and the representative bodies as providing a convincing case for reform and achieving a fair balance, in these sensitive matters, between the tax authorities and taxpayers in general. That is not perhaps surprising, since the Committee had the benefit, not only of Lord Keith's experience as a Lord of Appeal, but also the expertise of Brian Crack and John Avery Jones; both of them are widely respected within their professions.

- On the one hand, the Committee took the view that the Revenue should have sufficient powers to ensure that people meet their tax liabilities in full and at the right time. In particular, it was felt that the Inland Revenue should have access to a wider range of information, that time limits for submitting returns and accounts should be more reasonable but more strictly enforced, and that there should be some strengthening of the penalties and interest charges where tax is paid late or not at all.
  
- On the other hand, the Committee recommended measures to ensure that the rules for making returns and paying tax were fair and realistic; and that individual taxpayers were sufficiently protected against undue or unnecessary intrusion into personal privacy, and generally against any abuse of official power. For this purpose the Revenue's use of its powers was to 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 and the Courts.



- the Committee was at the same time concerned to streamline and modernise the system, so that, in the normal case, tax could be assessed and collected with more certainty and less administrative burden for both the taxpayer and the Revenue.

The consultations which have subsequently taken place have been constructive and helpful. A general feeling has emerged during these discussions that in certain respects the balance of the arguments point to a rather more flexible system than Keith recommended, together with some additional strengthening of the safeguards for taxpayers. A synopsis of the proposals, incorporating our modifications to reflect this feeling, is attached as an Annex.

However, in spite of the progress we have made, I am not satisfied that, even if we published draft clauses as soon as possible, there would be sufficient time between now and the 1986 Budget for the provisions - which will be lengthy and complicated - to be given the detailed analysis they require if we are to be sure of getting them right.

Furthermore, I am not sure that we have yet adequately consulted small businessmen and the main body of individual taxpayers who are members of no representative body or, if they are, may not be aware of these developments or of how they would be affected by them. There is no escaping the fact that a minority of people who now deliberately delay payment of tax, or seek to evade it outright, would under the Keith proposals when fully implemented have to pay more promptly than they do now. There would be a small net addition to the tax yield, and complaints accordingly. It is all the more important to satisfy the great majority of taxpayers that their interests would be safeguarded, and clarified. It will therefore be important to underline the message - emphasised by Keith and by many of these who gave evidence to him - that it is the law-abiding



majority, and in particular honest businessmen, who suffer when others steal an unfair advantage by escaping tax. And we shall need to reassure people that the conscientious taxpayer, who takes reasonable care, has nothing to worry about.

I have concluded that both these factors point to a rather longer period of consultation on the draft legislation than would be possible if we were to include it in the next Finance Bill. My proposal therefore is that we should now complete the preparation of the draft clauses and discuss them on a confidential basis with the representative bodies. Provided that this further period of consultation proved satisfactory, the clauses could be published as part of a consultative document during the summer, once the Finance Bill is out of the way. That would allow a further 6 months or so of open consultation during which we would hear the views of ordinary taxpayers, including in particular small businessmen, before proceeding to legislate in 1987.

Even with legislation in 1987, we could, if we wished, delay the coming into effect of the new provisions until the next Parliament. A period of notice would probably be welcome to businessmen and accountants, and would be consistent with the gradualist approach which will be necessary in relation to a number of the more important aspects of the package. Some of these could in any case come fully into force only around the end of the decade.

The English and Welsh Institute of Chartered Accountants has recently written to me about their concern at the delay in issuing a consultative document; and other bodies have expressed similar worries. We ought not to let this uncertainty continue longer than necessary. Provided, therefore, that you agree to the revised timetable, I propose to make an early announcement to the effect that the 1986 Finance Bill will not contain any action on the Inland Revenue aspects of Keith and that further consultations are to take place with a view to legislating in 1987.

CONFIDENTIAL



I am copying this minute to the Chancellor of the Duchy of Lancaster and the Secretary of State for Employment.

*N.L.*

N.L.

8 November 1985

*I apologise for the moderate length of this  
minute + attachments. But it is a complete  
subject on which I know you are interested.  
N.L.*

KEITH PACKAGE

THEME	BRIEF DESCRIPTION OF PROPOSALS	TAXPAYERS AFFECTED	STRUCTURAL OR DETAIL	HOW NEAR TO KEITH'S RECOMMENDATIONS	LIKELY RECEPTION	REVENUE EFFECT
VERIFYING TAX RETURNS AND ACCOUNTS	<p><u>A simpler way for the Inland Revenue to ask for information about tax matters from anyone who has it.</u> There will be a new right of appeal for those who are asked to provide information; the reimbursement of some costs of complying; statutory safeguards on use by the Inland Revenue; and - subject to a High Court override - protection for privileged documents.</p>	<p>Anyone having information about a person's tax affairs: individuals, companies, and public authorities (including government departments).</p>	<p>Limited but important reform.</p>	<p>Fulfils Keith.</p>	<p>Some misgivings likely about extending coverage particularly to government departments.</p>	<p>Unquantifiable increased yield from investigations in longer term.</p>
	<p><u>Individual taxpayers to tell the Revenue of each source of income.</u></p>	<p>Individual taxpayers.</p>	<p>Remedies a weakness.</p>	<p>Fulfils Keith.</p>	<p>Unlikely to be opposed.</p>	<p>Unquantifiable increase in revenue.</p>
	<p><u>Tax related penalty for failure to tell the Revenue about a source of income or gains (to replace present flat rate penalty).</u></p>	<p>Individuals and companies.</p>	<p>Limited change</p>	<p>Fulfils Keith.</p>	<p>Unlikely to be opposed.</p>	<p>Unquantifiable increase in penalties.</p>
	<p><u>Freer exchange of information between local Revenue and Customs and Excise offices; and a pilot scheme for joint inspection visits.</u></p>	<p>Businesses above VAT threshold.</p>	<p>Wider use of existing 1972 legislation.</p>	<p>Follows closely.</p>	<p>Likely to be opposed by small business organisations.</p>	<p>Small increase in yield from investigations.</p>

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VERIFYING TAX RETURNS AND ACCOUNTS (Contd)	<u>Construction Industry</u> - modification to special tax deduction scheme; and new right of appeal for taxpayer.	Businesses within the construction industry.	Detailed minor changes.	Proposal to reduce rate of tax deduction dropped (opposed by some in industry).	Fully discussed with the industry who broadly accept.	Unquantifiable improvement in yield.
	<u>Creation of a summary offence</u> to simplify and make more effective the investigation of criminal offences in smaller cases.	Individuals, particularly "moonlighters", "ghosts" and "earners and drawers".	Structural.	Narrower in scope than original recommendations. (Awaiting the outcome of the Law Commission's review of the law of fraud).	Uncontroversial.	Small.
	<u>Business books and records</u> to be maintained and kept for 6 years.	Businesses.	Structural.	Fulfils Keith.	Acceptable in principle, but some misgivings among traders about the sort of records to be kept and the length of retention period.	Unquantifiable increase in revenue.
	<u>Revenue to be able to inspect business records.</u>	Businesses.	Structural.	Modified to exclude power to enter business premises.	Unwelcome to small business organisations and to some accountants.	Unquantifiable increase in revenue.
FAIR AND CLEAR SYSTEM OF PENALTIES	<p><u>Simplification</u>, including:</p> <ul style="list-style-type: none"> <li>- <u>reduction of maximum civil penalties</u> for fraud and negligence</li> <li>- <u>small omissions exonerated</u></li> <li>- <u>streamlined procedures for imposing penalties</u></li> <li>- <u>right of appeal</u></li> </ul>	Any taxpayer who commits a tax offence (company, unincorporated business or individual).	Structural reform, but with many detailed changes.	Significantly modified in response to representations: an arbitrary arithmetical test for determining liability to penalty has been dropped.	Generally acceptable as modified.	Streamlined procedures could have full year effect up to +£5m in interest charges and an unquantifiable amount in penalties. (Very tentative, since highly sensitive to taxpayer behaviour.)

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PROTECTING CITIZEN'S RIGHTS	- <u>New statutory safeguards for the taxpayer in relation to the Revenue's power to search for evidence under warrant in serious tax offence cases.</u>	Only those suspected of criminal fraud or holding evidence of criminal fraud.	Detail.	Small modification in further favour of taxpayer.	Expected and generally welcomed.	NIL
	<u>Courts to be able to order production of information as less intrusive alternative to search warrant procedure.</u>	Only those suspected of criminal fraud or holding evidence of criminal fraud.	Structural.	Fulfils Keith.	New power will reduce need for searches.	NIL
	- <u>New grievance procedures for taxpayers in respect of both powers.</u>	As above.	Detail.	Fulfils Keith.	Welcome.	NIL
	<u>Improvements to General and Special Commissioners' appeal procedures.</u>	Individuals and companies.	Detail.	Broadly as Keith (some points still under discussion with Lord Chancellor's Department).	Generally welcomed.	NIL
	Circumstances in which Revenue may make <u>further assessment</u> where no taxpayer default.	All classes of taxpayer.	Detail	Mainly fulfills Keith; but modified to put some limit on reopening claims to relief. A later Court decision has complicated this issue since Keith reported.	Some professional concern likely to be expressed.	Impact of Court decision potentially very damaging.
	<u>Inland Revenue investigation practice to be publicised.</u>	Mainly business taxpayers.	Detail.	Fulfils Keith.	Likely to be welcomed.	NIL





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MODERNISING ADMINISTRATION (Contd)	<u>Realistic time limit for sending in personal returns with strictly enforced penalties for delay. More widespread returns issue with simplified form.</u>	Employees and pensioners.	Structural.	Follows in principle but penalty scheme modified.	Acceptability depends on presentation. Will not take effect until early 1990's.	Some tax and penalty yield. Staff cost involved in increased returns issue.
	<u>Improvement and clarification of procedures for collecting overdue tax.</u>	Individuals and Companies	Detail, including codification.	Fulfils Keith.	Minor and uncontroversial.	Negligible.
	<u>Existing access to records extended to cover those on computer files.</u>	Businesses.	Moving with the times: mirrors 1985 Customs & Excise measure.	Fulfils Keith.	Neutral.	Possible small improvement in revenue.

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ENCOURAGING PAYMENT ON TIME	<u>Interest charge on late payments of PAYE</u> where delay in sending returns is such that the Revenue have been forced to issue regulatory notices. Also clarification of what is "payment" for PAYE purposes.	Mainly certain directors not deducting PAYE properly from their own fees etc.	Structural	Fulfils Keith.	Possible complaints from some directors. Otherwise should be accepted as right and fair.	Improved Exchequer cash flow once-and-for-all £80m brought forward in two years following implementation. Probable smaller bringing forward in later years.
	<u>New system of penalties for late end of year returns</u> (but not for immediate implementation).	Employers and Contractors.	Structural innovation.	Fulfils Keith.	May be controversial and will need careful presentation.	Advancing the receipt of PAYE tax by 4-6 weeks.
	<u>Furthur consideration of proposals for interest charges on late paid PAYE generally</u> , including failure to make monthly remittances on time.	Employers and Contractors.	Structural.	Fulfils Keith.	Non-commitment to this proposal will be welcomed.	Could potentially be very large revenue accelerator.
	<u>New form of streamlined penalty for delayed returns of dividends and other taxed payments.</u>	Companies making such payments.	Structural.	Follows Keith with minor modification.	Generally acceptable.	Significantly improved cash flow.

HOME AFFAIRS . Rights of Entry . Pt 2