

Delivering a new relationship with business

Progress towards reducing the administrative burden on business

March 2007

Chapter 1: Overview

- 1.1 HM Revenue and Customs (HMRC) is committed to improving its relationship with business. This paper reports progress towards a key element of this work - the delivery of HMRC's two administrative burden reduction targets, announced by the Chancellor at Budget 2006.

Background

- 1.2 Since its formation in April 2005, HMRC has consulted¹ widely with the business community on where the department should concentrate its efforts to improve its relationship with them. This led to HMRC developing a long term vision, where businesses will:

- provide information only once;
- benefit from a range of flexible payment options;
- spend less time dealing with inspections;
- enjoy a single point of contact with HMRC; and
- benefit from clear and targeted support, education and guidance at the time they need it most.

- 1.3 The information from these consultations was supplemented in 2006 by KPMG research² that modelled the administrative burden imposed by the UK tax system on business. The burden was calculated using the Standard Cost Methodology, originally developed in the Netherlands and since used more widely by other UK Government departments and a number of other countries across Europe.

- 1.4 The KPMG research found that the total administrative burden placed on business by the UK tax system is approximately **£5.1 billion** a year, which equates to **0.41 per cent** of GDP or **1.1 per cent** of the tax take³. This compares favourably with other countries which had undertaken similar research at the time (the Netherlands and Denmark).

The reduction targets

- 1.5 Using this research, at Budget 2006, the Chancellor announced administrative burden reduction targets for HMRC to achieve by 2010-11.

HMRC's administrative burden reduction targets

Target 1: to reduce the administrative burden on business of dealing with HMRC's **forms and returns** by at least 10 per cent over 5 years (equivalent to a total reduction of **£337 million**).

Target 2: to reduce the administrative burden on compliant business of dealing with HMRC's **audits and inspections** by 10 per cent over 3 years, and at least 15 per cent over 5 years (equivalent to reductions of **£14 million** and **£21 million** respectively).

¹ Documents relating to the new relationship with business are available online at: <http://www.hmrc.gov.uk/newrelationship/new-relationship.htm> and <http://www.hmrc.gov.uk/pbr2005/medium-business-links.pdf>.

² KPMG's report on the measurement of the administrative burdens and details of the standard cost model is available at: <http://www.hmrc.gov.uk/better-regulation/kpmg.htm>.

³ Figures relate to the tax system, GDP and tax take at the time of measurement in May 2005.

- 1.6 HMRC also recognises the importance of working to make improvements in those areas which, although only a small part of the total burden identified in the research, are particularly irritating to business.

Administrative Burden Advisory Board

- 1.7 To ensure HMRC takes action in the areas that matter most to business, HMRC works with the externally chaired Administrative Burden Advisory Board⁴. The Board comprises members from business organisations as well as people with hands-on experience of running businesses in the UK. The Advisory Board's business perspective is particularly valuable in helping HMRC to identify areas of work that will make a real difference to businesses, either by contributing towards the targets or by tackling those burdens that cause business most concern.

Progress towards the targets

- 1.8 HMRC has made good progress towards delivery against the targets.

Target 1: Forms and Returns

- By April 2007 HMRC will have delivered net annual **administrative burden reductions of an estimated £130 million**⁵ towards its target to reduce the burden of forms and returns. This puts HMRC on track to deliver its target of total reductions of at least **£337 million** by 2010-11. The package of measures leading to these net reductions, and the benefits they have for business, are discussed in Chapter 2.

Target 2: Audits and Inspections

- By April 2007 HMRC will have delivered net annual **administrative burden reductions of an estimated £43 million**⁶ towards its target to reduce the burden of audits and inspections. This is due to the reformed Construction Industry Scheme, which means subcontractors no longer have to travel to present payment vouchers to contractors for inspection.

- 1.9 Although some 20 per cent of all small and medium businesses operate in the construction industry⁷, HMRC is committed to making a difference that will be felt by a broader range of business sectors. HMRC's work will continue to focus on reducing the burden of audits and inspections on the vast majority of businesses that want to pay the right amount of tax, across all industry sectors. HMRC is currently developing further measures to demonstrate success. This is explained further in Chapter 3.

Further work towards burden reductions

- 1.10 As well as working towards its administrative burden reduction targets, HMRC is looking for opportunities to reduce the wider administrative burden of the tax system on business. These improvements are discussed in detail in Chapter 4. By April 2007 HMRC will have delivered wider annual administrative burden reductions of an estimated **£134 million** net, including:

⁴ More information is available at: <http://www.hmrc.gov.uk/better-regulation/ab-terms.htm>.

⁵ This target is net and therefore progress reflects any changes that necessarily increase burdens such the introduction of UK-REITS discussed in chapter 2.

⁶ As above, this figure reflects estimated net burden reductions.

⁷ Research and statistics on small and medium business is available from the Small Business Service website at www.sbs.gov.uk.

- the **simplified pensions tax regime** which was introduced in April 2006. Although this saw the introduction of a new form, meaning it added to the burden of HMRC's forms and returns, overall the new scheme has been welcomed by business, and provides **total savings of approximately £43 million overall**; and
- the new **Construction Industry Scheme** which will come into effect in April 2007. This will not only deliver administrative burden savings that contribute to both of HMRC's targets, but will also yield wider administrative burden reductions of around a further **£55 million**, making the **estimated total savings from the new scheme £202 million**, once the transition to the new scheme has been completed.

1.11 In addition, the Budget today announces a range of reforms that will impact on the administrative burdens placed on businesses. Overall, these will be deregulatory for business, complementing the package of changes discussed in this document. Further details of these reforms will be published once implementation plans have been finalised.

What next?

- 1.12 HMRC will continue to work closely with the Advisory Board, business and its representatives to identify new areas for action that tackle those burdens of most concern to business. In support of this work, HMRC has introduced an internal process to challenge existing methods and to stimulate new ideas and engagement across the organisation.
- 1.13 In its November 2006 paper *Delivering a new relationship with business: HMRC's plans to deliver a better service for business by 2010-11*⁸ HMRC set out initial milestones for a programme to deliver its long term vision of improving its relationship with business. HMRC continues to develop these plans and, following the completion of the Government's Comprehensive Spending Review, will provide an update later this year.

⁸ Available online at: <http://www.hmrc.gov.uk/better-regulation/new-relationship.pdf>

Chapter 2: Reducing the burden of forms and returns

Scope of the Target

- 2.1 The total annual administrative burden of HMRC's forms and returns was **£3.37 billion** in May 2005. HMRC is on track to deliver a reduction of at least **£337 million** by 2010-11. But the Department is conscious that it wants not only to meet the target, but also to make a noticeable difference to businesses' experience of the tax system.

Means of delivery

- 2.2 Consistent with the principles of the Hampton Review¹, HMRC is critically examining all of its major business forms to establish whether they, and the information requested on them, are absolutely necessary. HMRC is looking for opportunities to:
- reduce the number of forms that businesses have to complete;
 - simplify those that are crucial for an efficient tax system; and
 - eliminate duplicate or unnecessary information requests.

Progress to date

- 2.3 The reforms delivered since May 2005 in relation to Target 1 have reduced the net administrative burden to business by an estimated **£130 million (39 per cent** of the target total). This is made up of the range of changes outlined below, all of which will be in place by April 2007. They have made a real difference to the businesses directly affected and HMRC is committed to maintaining this momentum toward delivering further improvements.

Benefits to small and new business

- 2.4 HMRC has implemented a range of developments to reduce the burden of forms and returns which will save small and new businesses an estimated **£3 million** in reduced administrative burdens:
- **VAT 1 — VAT registration application** — a redesigned form, coupled with improved guidance, was released in December 2006. Together they benefit the almost 280,000 businesses registering for VAT each year, reducing errors which cause delays in VAT registration;
 - **VAT annual accounting scheme** — the upper threshold for the scheme for paying VAT in instalments was doubled in April 2006 to £1.35 million, making more than 1.1 million businesses eligible for the less burdensome scheme;
 - **abolition of the zero per cent and non-corporate distribution rates of corporation tax** — by removing these rates from April 2006, small companies' accounting and reporting requirements were simplified; and
 - **Intrastat** — while this form remains one of the more burdensome to complete, the threshold was increased in January 2007, as a result of which 2,300 small businesses are no longer required to submit detailed monthly statistical returns.

¹ Available online at: http://www.hm-treasury.gov.uk/consultations_and_legislation/hampton/consult_hampton_index.cfm.

Benefits to employers

- 2.5 In addition to the benefits to small and new businesses, there are positive savings of around **£46.5 million** for employers through a series of improvements introduced in April 2006:
- **Form 42 — employee share schemes** — the most significant of these savings came when improved HMRC risk assessment completely removed the need for 90 per cent of new companies to complete this form. This offers benefits to around 300,000 companies every year. Those businesses still required to complete the form can access it electronically;
 - **ending payment of Working Tax Credits via employers** — the responsibility for paying Working Tax Credits was transferred from employers to HMRC, removing a burden that businesses had found particularly onerous;
 - **new Form P46 and coding improvements** — together these mean one million more new employees, unable to provide their latest pay and tax details, now receive the correct initial tax code. This has reduced the number of queries to employers; and
 - **improved statutory payment calculators and interactive P11 working sheet** — together, these provide help to those employers who undertake complex allocations and calculations, and help avoid common errors, which take time to put right.

Regime changes

- 2.6 There have also been other significant changes to existing regimes, as well as the introduction of new requirements. Reforms in this area will have contributed an estimated net **£80 million** towards the target by April 2007:
- **new Construction Industry Scheme** — the new scheme, which will apply from April 2007, provides an electronic alternative to paper processes; replaces individual vouchers with a contractor's monthly return; and removes the need for the contractor's end of year return;
 - **simplified pensions tax regime** — HMRC delivered a simplified pensions tax regime in April 2006. This regime is expected to significantly reduce the administration burden on business, even though the new form adds to the burden of HMRC's forms and returns;
 - **deregulation of the alcohol and tobacco industry** — following a wide review of legislation and consultation with the industry, many provisions were removed or simplified in 2006; and
 - **Real Estate Investment Trusts** — this new scheme was developed in response to strong demand from business. Effective consultation has meant that the new scheme created minimal burden when introduced in January 2007.

What next?

- 2.7 Looking forward, there is a good deal more for HMRC to do to deliver the forms and returns burden reduction target by 2010-11. HMRC needs to identify and develop changes very soon in order to deliver them in time to meet the target, because of the long lead times before changes can be implemented. These lead times are necessary because of the importance of prior consultation, the potential need for legislative change and changes to complex IT systems. Businesses also need advance warning of changes, wherever possible, to allow

necessary adjustments to their systems to be made.

- 2.8 Over the coming year, HMRC will work very closely with the Administrative Burden Advisory Board, businesses and their representatives, to identify further changes that will contribute to the targets and also make a real improvement to the business experience of the tax regime. For example, research with business to better understand the difficulties small partnerships face in dealing with the partnership self assessment return has already started, and further work is underway to examine the scope for reducing the burden of the main business tax returns.

Chapter 3: Reducing the burden of audits and inspections

Scope of the Target

- 3.1 The total annual administrative burden of HMRC's audits and inspections was **£0.14 billion** in May 2005. HMRC therefore needed to reduce this burden on compliant businesses by at least **£14 million** by 2008-09 and by at least **£21 million** by 2010-11.

Progress to date

- 3.2 By April 2007 HMRC will have reduced the net administrative burden of audits and inspections by an estimated **£43 million**. This is due to the introduction of the **reformed Construction Industry Scheme**¹. This new scheme provides an electronic alternative to paper processes, replaces individual vouchers with a contractor's monthly return and removes the need for the contractor's end of year return. It also means that contractors no longer have to obtain payment vouchers from subcontractors and subcontractors do not have to travel to present their documentation in person.

What next?

- 3.3 Twenty per cent of small and medium businesses operate in the construction industry. These changes will therefore deliver a major improvement in the administrative requirements of a large sector of the UK economy. HMRC is committed to improving its audits and inspections regime for the vast majority of businesses that want to pay the right amount of tax. HMRC will therefore continue to work to reduce the burden of audits and inspections across all industry sectors.
- 3.4 HMRC is examining its procedures and processes, so that compliant businesses will spend less time and fewer resources dealing with audits and inspections, with a view to:
- rationalisation, making them more customer focussed;
 - making them more flexible and responsive to risk; and
 - improving HMRC's ability to identify risk.
- 3.5 Building on the lessons learned from the 2006 trial of new methods of intervention, HMRC is working collaboratively with business and agents to improve and modernise its approach to audits and inspections. In particular to:
- modernise practises and develop a suite of interventions that match the degree of risk and allow a **'lighter touch' to post return assurance** where simple mistakes have been made, while ensuring that wilful non-compliance is actively tackled;
 - share, where appropriate, the identity of common errors and risk assessments with agents and businesses to help reduce errors made with returns, and improve HMRC's understanding of the **pre-return processes** agents carry out. It may be possible to build assurance from such processes into HMRC's risk process to reduce the likelihood of an audit or inspection for compliant businesses; and

¹ KPMG categorised a large part of the old scheme regime under audits and inspections in their research and it is therefore included in the target 2 baseline.

- achieve more alignment between the compliance checks for different taxes and provide the statutory basis for more flexible approaches. A consultation paper on this will be published shortly.

How will success be measured going forward?

- 3.6 The administrative burden on business from HMRC's audits and inspections is a comparatively small part of the total administrative burden of the tax system because relatively few businesses experience an audit or inspection in any one year. In addition to this the administrative burden, as measured using the Standard Cost Methodology, does not take direct account of either the total length of an audit and inspection, or the psychological impact they can have on a business. It is clear from listening to business that the current audits and inspection target does not fully capture the aspects of audits and inspections that cause businesses most concern. Over the coming months HMRC will work with the Administrative Burden Advisory Board, as well as businesses and agents, to develop supplementary ways of measuring its success at reducing the burden from audits and inspections. These may, for example, include adopting a measure of the duration of an enquiry, to better capture the uncertainty a business faces whilst it remains open.
- 3.7 HMRC plans to announce these new measurements later in the year and use them to drive and monitor continued, significant and noticeable improvements of its audits and inspections regime across all business sectors.

Chapter 4: Other administrative burden reductions

- 4.1 As explained in Chapter 1, not only is HMRC working towards the delivery of administrative burden reductions in the targeted areas, but also wider reductions that benefit business. Reforms delivered by April 2007 will have reduced the wider net administrative burden to business by an estimated **£133 million**. These reductions are outlined below.

Benefits to employers

- 4.2 The **simplified pensions tax regime** and the **ending of payment of Working Tax Credits via employers** have already been mentioned in the context of the targets. These two reforms also deliver substantial wider benefits to employers, for example by removing obligations to retain records or supply information to third parties. Combined, these are estimated to have delivered administrative burden benefits of **£78 million** outside of the two target areas.

Regimes changes

- 4.3 The **reformed Construction Industry Scheme**, the removal of the **zero per cent rate of corporation tax** for small companies, and **deregulation of the alcohol and tobacco industry**, discussed previously, also deliver administrative burden reductions outside of the two target areas. The combined savings are estimated to be worth **£53.5 million**, taking account of the additional burden created by the introduction of **stamps on spirits bottles** in October 2006, to help legitimate businesses and combat the significant problem of spirits fraud.

VAT reforms

- 4.4 Changes in this area will have generated benefits to business of an estimated **£1 million**, delivered through:
- changes to speed up and streamline the **VAT partial exemption special method** approval process will come into effect from April 2007. These will clarify and simplify the legislation around special methods used by about 20,000 of the largest and most complex businesses; and
 - bringing the VAT record keeping requirements for some 50,000 businesses involved in the **transfers of a going concern** each year into line with the rest of the tax system from September 2007, simplifying the process and removing uncertainty and complexity.