

HM Revenue and Customs and the Taxpayer: Modernising Powers, Deterrents and Safeguards



Introduction

The Paymaster General announced during Second Reading of the Commissioners for Revenue and Customs (CRC) Bill a major review, involving wide consultation, of the powers, deterrents and safeguards that will underpin the new revenue department, HM Revenue and Customs (HMRC). She set out its broad scope as including “the requirement to provide information, interest and surcharge regimes for late payment, penalties for non-compliance and rights of appeal, and the modern regulations and practices that HMRC will need to be a high-performing 21st-century tax administration.”

The existing powers and practices of the Inland Revenue and HM Customs and Excise have evolved over a considerable period and involve substantial differences between the two departments and between individual taxes. The CRC Bill transfers these powers unchanged to the new department.

The aim of the review will be to provide a framework of law and practice for HMRC that supports the Government’s objectives of a tax system that is fair and better adapted to the needs of customers. It will consider the scope for aligning and rationalising existing powers so as to make it easier for individuals and businesses to comply with their tax obligations and receive the tax credits to which they are entitled. It will also consider how best to obtain the information needed for better risk assessment and for better-targeted compliance activities.

The review and consultation will be an important element in creating a modern tax administration that is in tune with the needs of taxpayers and with a modern global and technology-based economy.

This document begins the consultation. It sets out the areas to be covered by the review, the form and broad timetable envisaged for the consultation process, the key objectives for the new framework and the principles that it is intended should inform its design. It also asks for comments on key strategic questions to open up a discussion on how best these objectives can be met.

The Consultation process

The review will be comprehensive and will involve wide consultation. It is concerned with what will be the full range of HMRC’s responsibilities including taxes, child benefit, tax credits and customs duties¹. However, work will initially focus mainly on the relationship between businesses and HMRC: the area of

¹ Where appropriate references to “tax” should be read as including national insurance contributions and “taxpayer” should be read as including those receiving tax credits or child benefit and those paying national insurance contributions.

greatest overlap between the existing departments. As business people self-assess their income tax liabilities this early work will also include considering the self-assessment regime.

Given the wide remit, some aspects will also fall within separate consultations, for example that on reducing the administrative burden of the tax system on small businesses which was launched at the Budget². Where that occurs relevant responses will be passed between the teams.

In particular consultation will cover the law and practice that governs:

- the information that is provided on a routine basis, for example in registering with HMRC or in tax returns, and is used to calculate the amount due or payable, to assess risks of non-compliance and for other purposes such as forecasting tax receipts or providing targeted support;
- the powers to obtain additional information and to make assessments in the course of enquiries and inspections into the amounts of tax due, to obtain evidence where an offence is suspected and to settle the tax and any interest and penalties which is ultimately due;
- the financial and other sanctions that can be applied in cases where complete and accurate information is not provided, the appropriate amount of tax is not paid at the right time, there is a need to deter non-compliance or to ensure that those who break the rules do not obtain an unfair benefit;
- the restrictions and appeal rights that apply to the use of these powers and provide an essential safeguard for taxpayers.

These are important issues that potentially affect all individuals and businesses, and the Government believes that everybody should have a chance to make their views known.

A key part of this consultation process will be the establishment of a Consultative Committee including tax experts, business representatives and a range of others who can reflect the views of the wider taxpaying community. This group will be chaired by Dave Hartnett, the Inland Revenue Board member currently responsible for tax policy, and will consider both the broad options for reform and detailed proposals for change, bringing in people with specific expertise where needed. Details of other Committee members will be published shortly.

In addition throughout the process there will be opportunities for others to contribute, starting with the present document. Details of responses to this

² *Working towards a new relationship: A consultation on priorities for reducing the administrative burdens of the tax system on small business*

consultation will be published before the end of July. Once Ministers have considered the Consultative Committee's suggested options HMRC will publish proposals for any legislative and non-legislative changes, supported by explanations of their purpose and rationale. The intention will be to do this in time to allow reflection before legislation is considered in detail by Parliament or non-legislative changes are introduced.

Objectives

The creation of HMRC provides the opportunity to achieve a step change in the approach to tax. The aim will be to introduce better customer focus, greater effectiveness and greater efficiency into the system, and as part of its Public Service Agreement it has already been set specific objectives for improvements in these areas.

Improved use of information will be central to achieving all of these (see Box³) and this needs to be underpinned by a legal framework with appropriate checks and balances.

The O'Donnell Report described the goals for HMRC

The new service must become something different from its predecessors, achieving a step change in the Government's approach to tax, providing benefits for companies, public services, and staff by:

- *using information provided by taxpayers to develop a better understanding of customer needs so that ... the burden for compliant taxpayers should be reduced by simplifying interactions with the new service;*
- *using information so that honest businesses in the UK are not subject to unfair competition from the non-compliant; and*
- *ensuring resources are allocated effectively so as to minimise tax losses to the Exchequer and so ensure public services are well financed.*

³ Financing Britain's Future: Review of the Revenue Departments – Gus O'Donnell report of March 2004 which recommended integration of the Inland Revenue and Customs and Excise.

Supporting taxpayers in complying with their obligations

A key objective of the new department will be to reduce the costs to taxpayers of meeting their obligations. This requires a simplification of the relationship between HMRC and taxpayers and support to encourage customers to comply voluntarily.

There are a number of areas where improvements will be sought:

- providing information only once;
- easier and quicker agreement and payment of tax bills;
- obtaining information and returns in ways that fit as closely as possible with taxpayers' existing systems, working lives and preferences;
- 'designing out' sources of error and difficulty in the system;
- as far as possible aligning powers and practices across different taxes;
- streamlining procedures for carrying out inspections, with no inspections without a reason; and
- using information gained to provide targeted support and education.

A fair and risk-based approach to compliance

But the Government also needs to protect the revenue base to provide the resources for funding public services. A key part of its approach is to encourage voluntary compliance. But it is also determined to take vigorous action against those who choose not to comply. HMRC will therefore need to have the powers and tools to enable it effectively to combat criminality, fraud and avoidance.

Central elements of HMRC's strategy will be

- developing further its risk-based approach to compliance work, through improving its understanding of the differences in risks of non-compliance

- between taxpayers and taxes;
- allocating its compliance efforts in line with these risks; and
- dealing swiftly and effectively with those who deliberately flout their obligations.

To be effective this will require:

- obtaining sufficient information from taxpayers on a routine basis to enable risks to be adequately assessed;
- tailoring the information required to match risks and sectoral differences within a broadly consistent format; and
- a penalty regime that reflects risks, has an effective deterrent effect and assures the compliant that those who break the rules do not benefit.

An efficient organisation in tune with modern technology and business practices

HMRC also has targets to improve the efficiency of its own operations, and key to this will be taking the opportunities presented by new technology and new forms of electronic data management and communications.

The number of returns currently issued and claims made each year give some indication of the possible scope for savings for both HMRC and taxpayers through greater efficiency:

In 2003/04 the Inland Revenue and Customs and Excise issued nearly 11 million Self Assessment tax returns, almost 7.5 million VAT returns and over 3 million employers' returns. In addition at the end of the year over 6 million families benefited from tax credits.

Much of the existing framework of information requirements and powers was designed for an economy in which paper-based transactions were the norm. Technological developments have accelerated in recent years bringing with them major changes to business, commerce and communications. The review will therefore also consider how HMRC can move to ways of doing business that will remain effective in a modern global economy.

Particular areas to be considered here include:

- designing information requirements to fit with the form in which it is held in a business's existing systems or in other ways convenient to the taxpayer so as to facilitate electronic transfer.
- Looking at ways in which technological change can enable the redesign of processes so that liabilities can be settled sooner thus giving earlier certainty to taxpayers and businesses.

The principles which should support taxpayers' relationship with HMRC

Requiring information about a person's business, private financial and other dealings is a sensitive issue. Concern for privacy and compliance costs has to be balanced against the need to be fair to everyone by ensuring the correct amount of tax or credit is paid. That is why reviewing the law and practice that HMRC will inherit and designing the changes that might be needed must be underpinned by a consistent set of principles.

The proposed principles, which are consistent with the recommendations of the Hampton Review⁴, are:

- HMRC must continue to deal with all information lawfully, including complying with the safeguards for taxpayer confidentiality, the Human Rights Act and the Data Protection Act.
- Legal requirements ought not to be imposed unless they are needed for HMRC to carry out its functions efficiently and effectively and wherever possible information should not be requested more than once from the same party.
- Requirements should be as straightforward as possible to understand and operate and should be clearly explained. Where appropriate and possible there should be an opportunity to comply voluntarily.
- Audits and inspections should have a reason, generally as the result of risk assessment or in a small number of cases the need to examine a random sample to ensure the integrity of the system and improve the understanding of risk.
- Fairness is only maintained for those who comply if there are appropriate and effective deterrents to non-compliance and tools to discover it. These should be visible and intelligible.
- Deterrent measures should adequately reflect the seriousness of any contravention, the risk to the Exchequer and the circumstances of those they penalise.
- Tools to obtain information or other material and their use in practice should balance the potential impact on the citizen, including the costs of compliance, against the risks they are intended to address.
- The most intrusive or extensive powers should only be used in cases where the circumstances make them appropriate and will generally justify greater degrees of control and regulation of their use.
- Except in the exercise of routine functions, such as the requirement to complete tax returns, the design of powers and requirements should include appropriate safeguards for the individual. These can be in the form of rights of appeal to an independent tribunal or independent scrutiny prior to the use of a power.
- Where any decision can be challenged the route should be clear, including the time limit and the person or body to whom any appeal should be sent.

⁴ *The Hampton Review on regulatory inspections and enforcement* published on Budget Day and available on HM Treasury Budget website

- Everyone should be in a position to understand his or her rights and responsibilities. The application of particular powers should be consistent and where possible powers used in similar situations should be consistent across all of HMRC's responsibilities.

Invitation for Comments

The Government believes it is important to take sufficient time to achieve the right balance within an overall package of measures. This document is a first step in a process that should realise that opportunity through legislation in the 2006 Finance Bill and beyond.

Within the broad context of the objectives for a fair tax system discussed above the Government would like to invite comments from interested parties. Particular issues that might be considered include:

- whether there are aspects of the existing system which do not support the government's objectives for the tax system;
- whether there are improvements that could be made to the existing system in order to provide better support for the government's objectives for the tax system;
- the proposed principles that should inform the design of powers;
- how best to build in safeguards;
- how best to harness the opportunities presented by new technology and electronic communications to re-think assumptions that relied on paper transactions and systems and thereby reduce compliance burdens, provide earlier closure of liabilities and enable the effective detection and deterrence of non-compliance;
- the appropriate balance between consistency of approach across taxes, duties and credits and the need to recognise the differences between particular groups or sectors.

Comments should be received by 13th June 2005. Relevant comments made in response to the document *Working towards a new relationship: A consultation on priorities for reducing the administrative burdens of the tax system on small business* will be taken into account as part of this consultation, and vice versa.

All comments received may be made public unless specifically requested otherwise. In the case of comments received electronically, general confidentiality disclaimers that often appear at the end of e-mails will be disregarded for the purposes of publishing comments unless an explicit request otherwise is made in the body of the comment.

Comments should be sent by e-mail to:

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