

OPERATIONAL IMPACT ASSESSMENT

Board and Lodging Adjustment Agreements for Hotels and Guesthouses

Purpose and Intended Effect

The Policy Objective

1. To identify a fair and effective way for hoteliers to account for non-business expenditure for the purposes of income tax self assessment.
2. This objective seeks to:
 - enable hoteliers to complete their annual tax returns accurately without unnecessary administrative costs;
 - enable HMRC to deal with the tax affairs of hotel owners in an efficient manner; and
 - ensure that hoteliers are treated equitably and fairly in different parts of the country.

Background

3. Under section 34(1a) Income Tax (Trading and Other Income) Act 2005, a deduction from a person's taxable income may be made for expenditure incurred wholly and exclusively for business purposes.
4. Many guesthouse and hotel owners live on their business premises. There is therefore a need to adjust expenditure to reflect the private use of accommodation, facilities and food. A number of local HMRC offices entered into agreements with representatives of hoteliers and guesthouse owners in order to minimise the administrative costs of establishing an appropriate level of non-business expenditure. These agreements took the form of a flat rate which represented private use of board and lodgings.
5. The levels at which these agreements were set varied in different parts of the country, whilst other areas had no such agreement in place. In consequence, all local agreements were withdrawn on 21 April 2006 and reinstated temporarily, in response to concerns expressed by the industry, in order to seek and implement an administratively effective solution.

Rationale for HMRC Intervention

6. HMRC intervention is required to determine the most fair and effective long-term approach to accounting for hoteliers' private expenditure without

introducing additional administrative complexities for the department or for businesses.

7. The reason for variations in these agreements cannot be established without central intervention. A suitable way forward needs to be agreed and implemented in time for the start of the 2007-08 tax year.

Consultation

Within Government

8. The Small Business Service in the Department for Trade and Industry has been consulted regarding the impact of proposed options on small businesses.

Public Consultation

9. A public consultation was undertaken from 26 October 2006 to 18 January 2007 to inform decisions on the most appropriate method of accounting for non-business expenditure.

Options

Option 1: End all local agreements

To bring to an end all local agreements would require the owners of private hotels and guesthouses to keep detailed business records of each item of non-business expenditure. This would produce a significant increase in administrative burdens on taxpayers and their representatives whilst creating additional resource costs for HMRC. This option was therefore rejected.

Option 2: Introduce a new local system for non-business adjustment on a permanent basis

This would allow hoteliers to continue to account for non-business expenditure by using a flat-rate adjustment when completing their self-assessment tax returns, thereby keeping administrative burdens to a minimum. With the levels of individual agreements being set at a local level, it also has the flexibility necessary to reflect variations in costs in different geographical areas. A very clear preference was expressed for this option during public consultation.

Option 3: Replace local agreements with a single national regime

The introduction of a new system of agreements whose level was set nationally level would be relatively simple to administer, but the lack of flexibility to account for regional cost variations would mean that it would

create unfairness of treatment in practice. This option received little support during consultation.

Costs and Benefits

10. There are roughly 22,000 private hotel and guesthouse businesses in the UK. As was established during consultation, there is wide use of these agreements across the sector.

Option 1

Benefits

10. Under this option, all local agreements would cease at the end of the temporary reinstatement period. All owners of hotels and guest houses would be required to keep accurate and detailed records of non-business expenditure from the start of the next tax year onwards. This would lead to greater levels of accuracy in accounting for non-business expenditure on hoteliers' tax returns.

Costs

11. The requirement for hoteliers to keep detailed records of non-business expenditure would introduce additional compliance costs. They would be required to produce on request paper or electronic copies of receipts, invoices and payments for all non-business expenditure. The scale of these costs would depend on individual circumstances, such as the size of the hotel and the number of transactions involved in each case.

12. At the same time, there would be additional resource costs for HMRC, both in verifying the accuracy of records and in rectifying any errors made as a consequence of this approach.

Risks and Implementation Issues

13. The removal of all agreements would need to be clearly communicated to all stakeholders both within and outside the department. HMRC would need to issue new guidance both for their own staff and for hoteliers and their advisors.

Option 2

Benefits

14. A locally administered system for non-business adjustments would allow hoteliers to continue to account for private expenditure in a way with which

they are familiar and without any increase in the current level of compliance costs. There would also be no increase in the costs of administering the system by HMRC staff.

Costs

15. HMRC will need to research and establish the appropriate level at which to set the new local adjustments and communicate it clearly to hoteliers and other stakeholders within and outside the department.

Risks and Implementation Issues

16. The main risk in maintaining the existing local agreements is that variations in different parts of the country will give rise to unfairness of treatment of hoteliers.

Option 3

Benefits

17. The introduction of a national regime would provide a consistent approach and remove any geographical discrepancies. It would not lead to any increase in record-keeping requirements for hoteliers or to any additional administrative costs for HMRC.

Costs

18. This option would require HMRC to establish a fair level at which to set a national agreement. Whilst there would be no inequity of treatment across different parts of the country, there would inevitably be winners and losers where the new national agreement differs from the current local agreement.

Risks and Implementation Issues

19. Implementation of a national agreement would need to be clearly communicated to the hotel sector and to HMRC staff.
20. The level at which the national agreement is set, once agreed, would need to be reviewed on an annual or similar basis by HMRC.

Recommended Option and Way Forward

21. Based on the information provided by those who responded to the consultation, the recommended option is a system of local agreements which would provide a simple means of ensuring that hoteliers are treated

fairly in different parts of the country whilst keeping administrative burdens to a minimum.

Small Firms Impact Test

22. These agreements are targeted exclusively at small firms. The recommended way forward would effectively maintain the existing and well-established treatment and therefore would have no immediate impact on small firms.

Competition Assessment

23. All privately-owned hotels and guesthouses are affected by these agreements and the proposals are likely to have little or no effect on competition.

Enforcement, Sanctions and Monitoring

24. The recommended option will be monitored and enforced through HMRC's existing processes for administering the self assessment system, including the right to raise an enquiry into any tax return.

Contact point

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Declaration and publication

I have read the operational impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:

Dawn Primarolo MP
PAYMASTER GENERAL

8 February 2007