
HM Revenue and Customs

Interest – Working Towards a Harmonised Regime

Summary of Responses and Proposals

**Consultation Document
November 2008**



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Consultation Summary Table

Subject of this consultation:	The harmonisation of interest charged on late payments of tax and interest paid on overpayments.
Scope of this consultation:	This consultation document looks at specific proposals for harmonising the interest regime and seeks feedback from taxpayers on each proposal.
Impact Assessment:	An impact assessment is published as a separate document alongside this consultation.
Who should read this:	The consultation is open to all taxpayers who wish to respond. We would particularly like to hear from businesses, tax professionals and those bodies representing both personal and business taxpayers.
Duration:	From Pre Budget Report 2008 to 13 February 2009.
How to respond:	Comments should be sent by 13 February 2009 <ul style="list-style-type: none"> • by e-mail to: Katie.lunt@hmrc.gsi.gov.uk • or by post to: Katie Lunt, HMRC, Tax Administration Advice team, 4SW, Queens Dock, Liverpool, L74 4AA • or by fax to: 0151 703 8452 (please mark these for the attention of 'Katie Lunt')
Additional ways to become involved:	HMRC will be inviting taxpayer representatives for all taxes to meet with the Review team and discuss the issues raised in the consultation document.
After the consultation:	Responses to the consultation will be published around Budget 2009. Subject to consultation, the new interest harmonisation framework would be applied through legislation in the 2009 Finance Bill. The date or dates from which the provisions can take effect will be subject to further work.
Getting to this stage:	Following the creation of HM Revenue and Customs (HMRC) from the merger of the Inland Revenue and HM Customs and Excise, HMRC has been taking forward consultation on a programme of legislative changes to provide a modern and effective framework of law and practice for the new Department. The changes resulting from this work will help HMRC deliver the O'Donnell Review aims of better customer service, greater effectiveness and improved efficiency. This consultation seeks views on a number of areas where greater alignment of the interest charging and paying rules could bring benefits to taxpayers, their advisers and HMRC.

Previous engagement:	<p>As part of HMRC's drive to modernise the tax administration, we published an earlier consultation document on 19 June 2008 entitled "<i>Interest - Working Toward a Harmonised Regime</i>". That consultation set out the high-level principles that should underpin a modern interest regime and sought comments on the measures that might deliver a more consistent and fairer approach. It focussed on simplifying and harmonising how interest is charged and paid across tax regimes, rather than on making any changes to how the underlying tax regimes operate.</p> <p>As part of the consultation exercise, we received 26 written responses to the June consultation document and conducted 16 one to one discussions and two workshops involving taxpayers, representative bodies and tax professionals. The results of the feedback received have enabled the review to develop key proposals set out in this consultation document.</p>
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Chapter 1: Introduction

- 1.1 Following the creation of HM Revenue and Customs (HMRC) from the merger of the Inland Revenue and HM Customs and Excise, HMRC has been taking forward consultation on a programme of legislative changes to provide a modern and effective framework of law and practice for the new Department. The changes resulting from this work will help HMRC deliver the O'Donnell Review aims of better customer service, greater effectiveness and improved efficiency. This strand of consultation seeks views on a number of areas where greater alignment of the interest charging and paying rules could bring benefits to taxpayers, their advisors and HMRC.
- 1.2 HMRC inherited the legal framework governing the interest that HMRC charges on late payments and pays out on overpayments¹ from the Inland Revenue and HM Customs and Excise. There are a number of differences across the range of taxes² administered by HMRC. Taxpayers interact with HMRC across a range of taxes, and differences are increasingly seen as adding unnecessary complexity and administrative burdens for taxpayers, their advisors and HMRC.
- 1.3 On 19 June 2008, HMRC published two consultation documents as part of its drive to modernise the tax administration:
- “Interest - Working Toward a Harmonised Regime”, and
 - “Meeting the obligations to file returns and pay tax on time”

These consultations covered two interrelated but separate topics, interest on late payments and overpayments, and penalties for late and non filing and late and non payments of tax. Consideration of both topics is proceeding alongside HMRC’s ongoing consultation on a balanced package of proposals to improve its payment services and debt management operations, originally published in June 2007³.

- 1.4 The June consultation document on interest consulted on a number of proposals designed to remove inconsistencies in the way that interest is charged and paid, underpinned by three key principles:

¹ ‘Overpayments’ should be taken in this document as meaning repayments of tax accounted for in excess of the amount due and includes a refund arising from a tax or VAT return or other claim

² With the exception of Customs Duties “taxes” should be taken in this document to include all the taxes, duties and National Insurance contributions for which HMRC is responsible. Taxpayer should be taken to include anyone paying such taxes as well as those paying tax on behalf of another person. Customs duties are subject to recently agreed EU regulation and as such are outside the scope of this work. With this one exception the work focuses on taxes. Although administered by HMRC, Tax Credits and Child Benefits are not taxes and as such are not covered by this work.

³ Payments, Repayments and Debt: The Developing Programme of Work June 2007

Recompense

- Interest should provide recompense for loss of use of money
- Recompense both ways: for HMRC and for taxpayers
- Responsive to changes in market rates

Fairness

- Reassures those who pay on time or overpay that they are not disadvantaged
- Removes financial advantages of paying late
- Prevents incentives for delaying payment

Simplicity

- Harmonised regime where this is sensible
- Clear, transparent, easily understood and accessible to all
- Cost effective to administer

Progress since June

- 1.5 Since publishing the June consultation document HMRC have undertaken a number of activities to support this work, including commissioning independent research and engaging in a series of consultation meetings with taxpayers and representative bodies. These meetings, together with the results of the research and responses to the June consultation document have helped to develop and identify further work on the proposals and we are grateful to all those who participated.
- 1.6 Ipsos MORI was commissioned this year by HMRC to undertake research with customers who had been in tax debt during the past two years. The aim of the project was to develop a better understanding of late paying customers and the effect of different enforcement and support regimes.
- 1.7 Full details of the key findings of this research can be found in Chapter 2 of the consultation document, “Meeting the Obligations to File Returns and Pay Tax on Time: Consultation Responses and Refined Models”, published alongside this consultation.

The consultation package

1.8 This package comprises of two elements:

- a Summary of responses to the June consultation document which contains our response to comments on the June consultation document, and draft proposals informed by the feedback received, and
- the Impact Assessment.

Draft legislation will be published separately.

1.9 This second consultation will enable us to gain further insight into the possible shape of a harmonised regime. However, although we have put forward proposals, no fixed conclusions have been reached. We have not put forward hypothetical rates for calculating interest or suggested the size of any differential between rates charged and paid as these would depend on the detailed shape of the regime.

1.10 We welcome views on the measures contained within this consultation package.

Other consultations

1.11 This consultation is linked to two further strands of work being taken forward by HMRC.

1.12 Firstly, HMRC is exploring the circumstances in which taxpayers should become liable to civil penalties when they do not meet their obligations to submit returns and pay the tax they owe on time. The consultation on penalties published alongside this consultation is the third stage of a programme of reform of civil penalties and focuses on deterrents and the associated safeguards.

1.13 Secondly, HMRC is consulting on the next stage of a programme of consultation and legislative change on payments, repayments and debt. This includes examining the case for Payment Instalment Schemes to help taxpayers manage their cash flow. It also includes examining the case for a range of measures to enable HMRC to better manage tax debts.

1.14 These three strands of work are supported by improvements in the way HMRC engages with those who want to pay or those who have difficulty paying. Taken together they provide a framework designed to influence taxpayer behaviour so that more taxpayers than now file their returns and

pay what they owe on time, and to recompense the taxpayer and HMRC for loss of use of money. Collectively they would make it easier for taxpayers to pay what they owe on time, to understand their obligations, and the consequences of failure. They should also reduce the number of times HMRC needs to use its more invasive enforcement powers to collect debt, bringing benefits to taxpayers and HMRC.

How to comment

- 1.15 Your comments are welcomed on any aspect of this consultation document. Comments should be sent by 13 February 2009;
- by e-mail to: Katie.lunt@hmrc.gsi.gov.uk
 - or by post to: Katie Lunt, HMRC, Tax Administration Advice team, 4SW, Queens Dock, Liverpool, L74 4AA
 - or by fax to: 0151 703 8452 (please mark these for the attention of 'Katie Lunt')

This document, and the other consultations mentioned above, can also be accessed from the HMRC internet site:

www.hmrc.gov.uk/consultations/index.htm

Confidentiality

- 1.16 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.
- 1.17 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

- 1.18 HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Codes of Practice

- 1.19 This consultation is being conducted in accordance with the Government's Consultation Code of Practice. A copy of the Code of Practice criteria and a contact for any comments on the consultation process can be found in Annex C.

Chapter 2: The existing regime

- 2.1 An effective interest regime should be based on the principle of recompense. It should be fair to those who pay on time by removing the benefit of delaying payment to those who pay late and by providing reasonable recompense for those who overpay. It should have clear, simple and consistent rules. There are tensions between these principles, not least how to ensure that a simple framework provides effective recompense and is fair across a wide range of taxpayer groups.
- 2.2 The current rules on interest have evolved over time with additions and adaptations applied as each major tax has been reviewed or each new tax or duty has been introduced. As such there are a number of different rules applying for interest across the taxes which when taken together are complex, inconsistent, and difficult for taxpayers to understand.
- 2.3 For some taxes, interest is charged as soon as payment is late; for others it is only charged where underdeclarations are assessed, and for some liabilities there is no late payment interest charged at all. In addition, where repayment interest currently applies it may be called a supplement, credit interest or statutory interest, and it applies at a number of different rates depending on the tax to which it relates. This variance in applying and calculating interest, coupled with the differences in language, adds unnecessary complexity which is at odds with an effective modernised tax system.
- 2.4 Many business taxpayers have VAT, income tax or corporation tax and PAYE bills to pay and each with different rules. The different rules, when considered together across taxes, fail the desired principles for a harmonised regime in a number of ways. This is because interest:
 - is not always charged,
 - is not paid consistently,
 - where charged, is not always imposed automatically,
 - the date from which interest runs is not set consistently,
 - is calculated by reference to different formulae,
 - is charged at different rates for different taxes,
 - rates change irregularly and unpredictably,
 - may be charged and paid at the same rate or at different rates,
 - is not always tax deductible, and
 - uses inconsistent language between taxes.

2.5 This current consultation process builds on the responses to the June written consultation, the subsequent workshops and one to one discussions. It seeks to move away from the current inconsistencies towards a more aligned and transparent approach across all taxes to the charging and paying of interest in line with the three principles of recompense, fairness and simplicity.

Chapter 3: Harmonising interest: the next phase

- 3.1 Responses to both the June consultation document and subsequent workshops and bilateral meetings favoured the proposal to harmonise the interest paid and charged across all taxes. It was accepted by respondents as a reasonable way forward that fitted with the core principles of recompense, fairness and simplicity. A summary of the responses to the consultation is shown at Appendix A.
- 3.2 In the light of these responses, this document includes proposals developed by HMRC for further consultation. Draft legislation will be published separately.

The basis for charging interest

- 3.3 The current differences in the application of interest generate complexity and so fail to provide a simple system. Taxpayers are not treated equally across all taxes; the differences in the rules are difficult for taxpayers to understand and the system does not always deliver a degree of recompense as described in paragraph 1.4. An effective interest regime should be based on the principle of recompense. It should be fair to those who pay on time and have consistent, clear and simple rules.
- 3.4 In the June consultation document, HMRC proposed harmonising both the rate and application of interest across all taxes. Responses to these proposals were generally supportive of the need for change provided that appropriate safeguards and careful consideration was given to the potential impact of any change on current systems which were felt to be working well.
- 3.5 HMRC will be publishing draft legislation to charge simple interest on late payments and pay simple interest on overpayments across all taxes.

HMRC welcomes views on the proposal to charge and pay simple interest across all taxes.

The starting point for the interest rate formulae & frequency of changes

- 3.6 In the June consultation document, HMRC sought views on the best rate on which to base interest, those being:
- the Reference Rate (as used now),⁴

⁴ This is an average of the basic lending rates used by Barclays Bank plc, Lloyds TSB Bank plc, Bank of Scotland, National Westminster Bank plc and HSBC Bank plc and the Royal Bank of Scotland plc

- the Bank of England ‘bank’ rate (also known as ‘the base rate’)⁵,
- the London Inter-Bank Offered Rate (LIBOR), and
- the Government bond rate.

- 3.7 Whilst some respondents suggested that LIBOR could be an option, the vast majority recommended the Bank of England base rate.
- 3.8 The LIBOR for some was seen as offering the most commercially sensitive option; however LIBOR can change frequently adding the complexity of deciding when to review the rate. In addition, unlike the Bank of England Base Rate, most taxpayers are not generally aware of what the LIBOR is. The Bank of England base rate, on the other hand was seen as offering the most favourable option as it is widely communicated to the public at large and easy for people to understand.
- 3.9 When it came to the frequency of rate change, there were mixed views between the need for stability and what was the most practical. Whilst some felt that a quarterly, six monthly or even annual change was an option, the majority felt that the most logical and transparent option was for HMRC to track the Bank of England base rate. The Bank of England base rate is usually reviewed on a monthly basis; this would mean that HMRC would change rates in line with changes made by the Bank of England.
- 3.10 In light of the responses in favour of the Bank of England base rate and the evidence on transparency and stability, this document proposes adopting this as the rate on which to base interest, and tracking the changes in the Bank of England base rate as outlined in paragraph 3.9. This is consistent with the principles of fairness and simplicity and offers recompense that is responsive to market rates.

HMRC welcomes views on the proposal to adopt the Bank of England base rate as the starting point for calculating interest and on the proposal that changes to the HMRC interest rates are timed to follow any changes to the Bank of England base rate.

Differential between late payment rates and overpayment rates

- 3.11 Currently, for most taxes, there are different rates for the interest charged on late payments and interest paid on overpayments. This is in line with

⁵ In this document referred to as the Bank of England base rate.

commercial practice and is the policy adopted by other comparable tax authorities internationally.

- 3.12 In response to the June consultation document, most respondents understood and accepted the need for a differential, although some argued strongly for mirrored rates and felt that differential rates did not meet the principle of fairness. A number of those who did accept a case for a differential felt that the gap between the rates charged by HMRC and paid out by HMRC should be as narrow as possible.
- 3.13 Some respondents also felt that special consideration should also be given to paying compensation in cases where delays were caused by HMRC errors. Customers can in fact already ask HMRC to consider reimbursing them for an actual financial loss arising directly from HMRC error or unreasonable delay.
- 3.14 Those that expressed views against a differential felt that a Government department should not operate in a commercial way and should rather promote fairness by using a mirrored rate for paying and charging interest.
- 3.15 Not having a differential but a single rate for interest charged and paid would make it difficult to set that rate at a level which would meet policy objectives. Aligning at a lower rate would make the interest charge less effective in encouraging payment on time, cancelling the disadvantage of late payment. Aligning at a higher rate would arguably overcompensate those who had overpaid. A mid point mirrored rate would be a compromise which would be unsatisfactory for both late payments and underpayments and achieve neither fairness nor recompense.
- 3.16 Having differential rates for all taxes would reflect commercial practice for borrowing and lending and discourage arbitrage between tax and non-tax debts, and in turn would provide fairer levels of recompense in a clear and simple way as opposed to the inconsistencies within the current regime. One way to balance the concept of a differential with the principle of simplicity would be to have just one rate for late payment interest and one for repayment interest.
- 3.17 Removing the differential would not be fair, particularly for those who pay on time in that they would see late payers gaining an unfair financial advantage. Being seen to address this type of arbitrage reassures the compliant taxpayer that others are not gaining an unfair advantage.
- 3.18 Feedback from those interviewed as part of the Ipsos MORI research supported the view that interest rates should be comparable with bank rates to discourage late payment of taxes to gain a financial advantage.
- 3.19 It is recognised that the extent of the differential between the interest rate charged and paid will be important in ensuring overall fairness and that

this needs to be considered in the light of proposals for late payment penalties also being consulted on in parallel.

- 3.20 Draft legislation will be produced to take forward the proposal of one rate for late payment interest and a different rate for repayment interest.

HMRC welcomes views on the proposal to have differential rates for charging and paying interest

Pay As You Earn (PAYE)

- 3.21 Interest on late paid Pay As You Earn (PAYE), NICs and other payments by employers is currently charged only after the end of the year on any amounts outstanding for that year. Currently there is no interest charge on late payments of in year PAYE. As a result less of the tax due is paid on time than for other taxes and duties. As interest is not charged on in year PAYE paid late, there is an unfair advantage to non compliant employers. This absence of interest was commented upon by the Public Accounts Committee in a recent report. They stated, "Nearly 50% of businesses do not pay PAYE/NICs on time. The Department cannot impose a penalty or interest for late monthly payments of PAYE/NICs during the year. It can do so only on balances due at the end of the tax year.....It should seek to remedy this situation."
- 3.22 The lack of interest on in year PAYE paid late means that the Government receives no recompense for those payments made late and the system does not provide fairness between taxpayers. It is difficult to put a cost on the impact of these late payments but if the Government had to borrow funds to cover the tax that had not been paid on time, the cost of that borrowing would ultimately be borne by the whole taxpaying population.
- 3.23 The consultation document on penalties, "Meeting the obligations to file returns and pay tax on time"⁶ put forward a number of options to try and redress the balance including:
- asking employers for monthly statements;
 - applying a surcharge based on the number of missed payments in year and calculating in year interest for late payment based on a percentage of the amount submitted; and
 - assessments of what was due when a payment was not received.

⁶*Meeting the obligations to file returns and pay tax on time, (19th June2008), Paragraphs 8.28 to 8.37*

- 3.24 The June consultation document on interest considered how interest might be charged on late payments using the same approaches. Respondents generally favoured action designed to address late payment throughout the year. They perceived problems with all three options (which were acknowledged in the consultation document). Another option emerged from the consultation process. This was to require employers to report some additional information either on or alongside the end of year P35 return. This would be the amount due to be remitted to HMRC for each month of the year. The monthly figures would be an aggregate for each month, covering, but not itemising, PAYE, NICs, Student loans, Statutory Payments or Construction Industry Scheme payments and listed as a total figure for all employees. This would enable HMRC to see how much should have been paid in any given month and where payments were missed or underpaid, interest could be accurately calculated from the monthly due dates and charged at the end of the year.
- 3.25 During the workshops in September 2008, some very useful suggestions were made to minimise the administrative burden and to improve the design. These are outlined at consultation on late filing and late payment penalties.
- 3.26 There was strong support for charging interest on late payments of in year PAYE, given the unfair advantage afforded to the non-compliant without such interest. In looking at how and when interest would be charged, some participants suggested that interest on late payments of in year PAYE should be charged in year rather than at the year end. HMRC has looked at the possibility of charging interest in year and early indications are that this could be complex, both for HMRC and the taxpayer.
- 3.27 This document proposes charging interest on late payments of in year PAYE and exploring the potential for extending the P35 annual return as a way of achieving this. Reflecting feedback from taxpayers, we feel that this option balances the needs of HMRC to know what is due on any given month against the need to keep the administrative burden as low as possible. Given the concern raised about the possible impact on small and medium sized businesses, we will explore this option alongside the proposal for a de minimis limit and for smaller businesses to submit monthly records of calculated PAYE.

HMRC welcomes views on the proposal for charging interest on late payments of in year PAYE based on an extended P35 and the potential for a de minimis limit.

Special circumstances

- 3.28 In addition to consideration as to how a new interest regime could be harmonised across all taxes, the June consultation document on interest also asked whether any conditions that are specific to any of the taxes create a case for different treatment.
- 3.29 The current payment of interest on corporation tax payments back to the date paid reflects the fact that corporation tax payments fall due before the known liability is brought into charge. In particular, under the quarterly instalment payments (QIPs) regime the first two instalment payments are required before the accounting period has finished, and the third falls due just two weeks after the accounting date, by which time only initial accounts are available. This means that many payments are estimated and subsequent adjustments have to be made. Where companies inadvertently overpay as a result of these requirements, interest provides a level of recompense that ensures these taxpayers are no worse off than those that pay taxes based on known liabilities.
- 3.30 Feedback from the consultation suggested that paying interest on corporation tax back to the date paid continues to be justified. Those responding suggested that this treatment was needed to reflect the special conditions under which businesses are required to estimate corporation tax which leads to a high probability of under or over estimating their corporation tax liability. This consultation document proposes maintaining this treatment.
- 3.31 In the June consultation document we also acknowledged the dynamics behind the interest rates under current QIPs regime. The views expressed by respondents suggest that those factors support the case for maintaining the current interest regime for QIPs. Having considered those responses, this document proposes maintaining the current interest regime for QIPs.

HMRC welcomes views on the suggestion to maintain the current interest regime for QIPs

- 3.32 In certain circumstances taxpayers are able to carry back of losses from the current year to previous years and this can create a tax repayment. There are no plans to change the way that interest is paid in these circumstances as this already provides a level of recompense.
- 3.33 Interest charged on late paid corporation tax is an allowable deduction under the CT loan relationships law of the last decade, while interest received on overpayment or early payment of corporation tax is

chargeable to CT. This approach delivers both simplicity and consistency to corporations, treating interest paid by and payable to HMRC in the same way as other commercial interest and avoiding the need for a separate computational adjustment to reach the taxable profit.

HMRC welcomes views on maintaining the special arrangements for carry back of losses and the tax treatment of CT interest.

Summary

3.34 This consultation document sets out a number of proposals designed to take forward interest harmonisation. It seeks views on the proposed regime and on the draft clauses to give effect to it. Key proposals are :

- A single rate paid by HMRC on ‘overpayments’ across all taxes, duties, and penalties, other than QIPs
- A single rate charged by HMRC across all taxes, duties, and penalties etc that a taxpayer pays late to HMRC, other than QIPs
- Companies paying under the QIPs regime to have different rates
- Interest to be paid and charged as simple interest.
- A set of aligned rules, including for QIPS, with rates that;
 - are calculated by reference to the Bank of England base rate
 - track any changes in that rate

HMRC welcomes views on whether these proposals meet the principles of recompense, fairness, and simplicity

Annex A: Summary of responses to June consultation

Introduction

This annex summarises the responses received to the consultation document *Interest – Working Towards a harmonised regime*. This was published on 19 June 2008 and invited responses by 11 September 2008.

Responses were received from large corporate organisations and a number of representative bodies. Overall there were 26 written responses to the document, categorised as:

Small Professionals	0
Medium Professionals	1
Large Professionals	3
Large Corporates	2
Representative Bodies	16
Others	4

Both the June consultation on interest and the consultation document on penalties – *Meeting the obligations to file returns and pay tax on time* were released on the same day in June so that taxpayers could better understand the relationship between interest and penalties. This approach was also subsequently adopted during face to face meetings. HMRC held a series of bilateral meetings with representative bodies and interested parties as well as two joint workshops, exploring in detail some of the suggestions in the is consultation document. The workshops were attended by delegates representing businesses and their advisors.

Summary of Questions & Answers

Question one – Which of the options for a starting point for the interest rate formula best fits with the design principles of recompense, fairness and simplicity for the majority of taxpayers?

There was widespread support for adopting the Bank of England base rate. Most saw this as an opportunity to make the interest regime simpler and more transparent, thus making the system fairer. The Bank of England base rate is widely recognised, communicated to the public and large and used in the context of commercial lending and saving.

A few felt that the LIBOR offered a more commercially aligned solution which offered a truer reflection of the principle of recompense; however respondents acknowledged that with daily changes, some form of smoothing would be required to add stability. Given the current uncertainty in the banking community some of those favouring the LIBOR considered that even though the LIBOR

offered commercially realistic recompense, the current instability probably meant that the Bank of England base rate offered the best compromise. In addition, in comparison to the Bank of England base rate, the LIBOR is not widely known to the public at large.

Question two – How far should the difference between the rate of interest charged by HMRC and paid by HMRC reflect the difference between the borrowing and lending interest rates used commercially?

Whilst many respondents to the June consultation document accepted a differential, some respondents were not persuaded by the arguments for relating interest on tax paid late and tax overpaid to borrowing and lending rates. There was concern that in the interest of fairness, the rate should be the same in both cases.

However of those accepting the rationale for a differential, the view was that having this in place would deter people from deliberately paying early in an attempt to benefit from preferential interest rates on repayments which would not reflect commercial reality. In striking a balance of meeting the three principles of fairness, recompense and simplicity, respondents felt that HMRC should keep a differential as narrow as possible.

Question three – What do you consider is the best way to strike a balance between delivering simplicity through stability and achieving recompense in setting the rates of interest charged and paid by HMRC?

The vast majority of respondents felt that the Bank of England base rate offered the best option on which to base rates for interest charged and paid by HMRC, and favoured tracking the Bank of England base rate, i.e. changing the rates in line with any changes announced by the Bank of England. This was supported in the workshops with representatives of both large and small and medium sized businesses agreeing that this offered the simplest and most transparent approach and the one which was easiest for taxpayers to understand.

Some respondents felt that the overriding consideration was stability and recommended quarterly, six monthly or even annual reviews of the Bank of England base rate changes with possible rounding of rates by 0.5%. Of those opting for tracking of the Bank of England base rate, some did consider periodic reviews but felt that this could lead to uncertainty and over complication.

Question four – Which of these approaches for charging interest on late payments of in-year PAYE do you feel best deliver the design principles of recompense, fairness, and simplicity? And,

Question five – Are there other approaches that could be taken for charging interest on late payments of in-year PAYE that would fit with the design principles of recompense, fairness, and simplicity?

Whilst the responses to the June consultation document showed greatest support for monthly returns, this was by no means overwhelming with 40% supporting this option. Two respondents offered an alternative solution which involved adding an additional 12 boxes to the annual P35 to show the amount paid each month. That way HMRC would be able to reconcile these amounts against receipts and charge any interest due.

This option gathered momentum in the workshops and bilateral consultations where respondents felt that this option offered the most practical solution. Concern was however raised that whilst this offered a good solution for those with electronic payroll systems, there could be a disproportionate administrative burden for smaller employers operating manual systems.

Some representatives of small and medium sized businesses acknowledged that their members did still have to calculate their PAYE liability on a monthly basis and so would have the information to hand. They felt that for those businesses, some form of monthly return would be the best option as the employer could make both payment and return together.

Given the difference in systems operated by large and small businesses, some participants at the workshops recommended that there should be a de minimis limit for the smallest employers where their liability would be very low. This could be based on the number of employees or the total tax liability.

Question six – This chapter has considered the possible features of a new interest regime. Your views are invited on how the options discussed meet the principles of recompense, fairness, and simplicity.

Respondents to this question felt that the legislation should encompass the three principles and that interest should be seen as a mechanism for recompense and not as a penalty. They therefore recommended that the differential be as narrow as possible. Having a differential was for some difficult to reconcile with fairness, particularly if the delay in repaying a taxpayer was due to HMRC error with some arguing for higher interest along the lines of compensation in such cases.

On the debate between compound and simple interest, whilst many recognised that compound interest better reflected the commercial reality of recompense, simple interest was easier to understand and better met the principle of simplicity.

During the workshops, participants generally accepted the role of interest but were keen to ensure that sufficient safeguards were in place, particularly for those facing financial difficulty. The issue of financial difficulty and time to pay arrangements is an important one and is considered in the separate consultation document published alongside this consultation entitled “*Meeting the obligations to file returns and pay tax on time*”

Question seven – This chapter has considered how a new interest regime could be harmonised across all taxes - are there any conditions that are specific to any of the taxes that create a case for different treatment?

In feedback from both the written responses, workshops and bilateral discussions arguments were advanced for keeping separate the current system of interest for corporation tax Quarterly Instalment payments, (QIPs).

This was to reflect the special conditions under which the largest businesses are required to estimate corporation tax which leads to a high probability of under or over paying their corporation tax liability.

Question eight – What other factors should be taken into account in setting the formula to determine the interest rates HMRC charge and pay?

Respondents to this question expressed the view that any interest rate set should be there to encourage prompt payment and follow the principles of recompense, fairness and simplicity. Having too large a differential or setting the rate too high would be seen as punitive.

Annex B

List of respondents to written consultation

Association of Accounting Technicians
Association of International Accountants
Astra Zeneca
British Banking Association
Chartered Institute of Taxation
Chartered Institute of Taxation – Low Income Tax Reforms Group
CBI
Creaseys Chartered Accountants
Deloitte & Touche LLP
Federation of Small Businesses
Institute of Chartered Accountants for England & Wales
The Institute of Chartered Accountants of Scotland
Institute of Directors
The Institute of Payroll Professionals
KPMG LLP
London Society of Chartered Accountants
Pricewaterhouse Coopers LLP
Professional Contractors Group
Schroder Investment Management Ltd
The Society of Professional Accountants
UK Oil Industry Taxation Committee – Indirect Taxes Committee
VAT Practitioners Group

Organisations which attended consultation meetings or workshops with HMRC

Association of Chartered Certified Accountants
Association of Taxation Technicians
British Bankers' Association
British Computer Society
Chartered institute of Taxation
Confederation of British Industry
Deloitte
Ernst and Young
Federation of Small Businesses
Forum of Private Businesses
Institute of Chartered Accountants in England and Wales
Institute of Chartered Accountants of Scotland
Institute of Directors
Institute of Indirect Taxation
Institute of Payroll Professionals
KPMG
Law Society

Law Society of Scotland
Low Incomes Tax Reform Group
TaxAid
PriceWaterhouseCoopers
Professional Contractors Group
Tenon Group
VAT Practitioners Group

Annex C: The Government's Consultation Code of Practice

About the consultation process

This consultation is being conducted in accordance with the Government's Consultation Code of Practice. If you wish to access the full version of the Code, you can obtain it online at:

<http://www.berr.gov.uk/files/file47158.pdf>

THE CONSULTATION CRITERIA

1. **When to consult** - Formal consultation should take place at a stage when there is scope to influence the policy outcome.
2. **Duration of consultation exercises** - Consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
3. **Clarity of scope and impact** - Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
4. **Accessibility of consultation exercise** - Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
5. **The burden of consultation** - Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
6. **Responsiveness of consultation exercises** - Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
7. **Capacity to consult** - Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

If you feel that this consultation does not satisfy these criteria, or if you have any complaints about the process, please contact:

Richard Bowyer, Better Regulation Unit
020 7147 0062 or richard.bowyer@hmrc.gsi.gov.uk