

**EXPLANATORY MEMORANDUM TO
THE VALUE ADDED TAX (AMENDMENT) REGULATIONS 2009**

2009 No. 586

1. This explanatory memorandum has been prepared by HM Revenue and Customs and is laid before the House of Commons by Command of Her Majesty. It contains information for the Select Committee on Statutory Instruments.

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2. **Purpose of the instrument**

Regulations 3 (time limits), 4, 8, 9 and 10

2.1 Time limits for assessments and claims are to be aligned across income tax (IT), capital gains tax (CGT), corporation tax (CT) and value added tax (VAT). This instrument makes the secondary law amendments which are required for VAT.

Regulations 3 (other than time limits) and 5

2.2 Regulation 3 makes amendments required following the decision of the European Court of Justice in the case of Terra Baubedarf-Handel GmbH (C-152/02) the effect of which was that time limits for the deduction of input tax must not start to run until the person seeking to deduct the input tax has not only incurred it but has also received the documentation required by article 178 of the Principal VAT Directive (2006/112/EC) (“PVD”).

2.3 Regulation 5 makes amendments required as a result of the fact that the current legislation has the effect of denying taxable persons their directly effective Community law rights to make an adjustment where the ‘price is reduced after the supply takes place’ under Article 90.1 of the PVD. Under Community law, a taxable person has the right to be taxed on the consideration received by him and no more and a time limit should not prevent adjustment before the first opportunity to make it arises.

Regulations 6 and 7

2.4 These amendments simplify the entry and leaving tests for the VAT Flat Rate Scheme (FRS). The eligibility entry test based on total business income is removed leaving a single turnover test. The leaving test is amended so that businesses will assess their continuing eligibility to use the scheme using the method used to calculate their VAT while on the scheme.

3. **Matters of special interest to the Select Committee on Statutory Instruments**

None

4. **Legislative Context**

This instrument amends the Value Added Tax Regulations 1995 S.I. 1995/2518 (“the Principal Regulations”). In relation to the time limit changes (part of regulation 3 and regulations 4, 8, 9 and 10), the related primary law provisions are contained in section 118 of and Schedule 39 to Finance Act 2008 (c.9) and will come into force subject to an appointed day order with effect from, in part, 1 April 2009 and, in part, 1 April 2010.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

Regulations 3 (time limits), 4, 8, 9 and 10

7.1 Following the formation of Her Majesty's Revenue and Customs (HMRC), a review was set up to align the rules across the taxes administered together by that Department where it is appropriate to do so. Having found that different time limits for assessments and taxpayers' claims for different taxes made a unified approach to compliance checking difficult and caused unnecessary complication for taxpayers, the decision was made to align time limits for assessments and for taxpayers' claims across IT, CGT, CT and VAT which, for VAT, results in an increase in the time limits for both assessments and claims from 3 years to 4 years.

7.2 The opportunity has also been taken to make it clear that errors of precisely £10,000 can be corrected by entering them on the next return after they are discovered.

Regulations 3 (other than time limits) and 5

7.3 Community law requires that time limits for the deduction of input tax must not start to run until the person seeking to deduct the input tax has not only incurred it but has also received the required documentation. This requires a change to the VAT claims time limit provisions to refer to the due date of the return for the first prescribed accounting period in which the claimant has both incurred the input tax and received the required documentation as opposed to the due date of the return for the prescribed accounting period in which the input tax first became chargeable as output tax.

7.4 The fact that Community law requires that adjustments can be made whenever there is a change in 'consideration' means that the capping provision in regulation 38 of the Principal Regulations has to be removed. In this context, "consideration" is to be understood as meaning the amount receivable for the supply net of VAT. Should a business fail to make the regulation 38 adjustment in the accounting period prescribed in regulation 38(5), any subsequent adjustment would be made under regulation 34 or regulation 35 (the error correction regulations) which do contain a specified limitation period.

7.5 The opportunity has also been taken to make it clear that adjustments must be made to the VAT account of the both the supplier and the recipient of the supply.

Regulations 6 and 7

7.6 The FRS was introduced in 2002 to simplify VAT for businesses with turnover up to £150,000. It allows businesses to pay VAT as a flat percentage of turnover, with rates set according to business sector and at a level intended to reflect the effective rates of VAT across that sector.

7.7 There are currently two entry tests to determine whether a business may use the FRS, a turnover test and an income test, both of which have to be met for a business to

be eligible to join. The income test is being removed so that businesses will only to have to satisfy the turnover test to be eligible to use the FRS.

7.8 Businesses must monitor their income each year to determine if they are eligible to remain in the FRS. If annual income exceeds £225,000, a business must leave the scheme. However, “income” for this purpose is not defined in VAT legislation and the legislation will now make it clear that a business must use the method used to calculate its VAT whilst on the scheme (for example cash received or invoices issued) to calculate the leaving test.

- ***Consolidation***

7.9 There are no projects presently on hand to consolidate the Principal Regulations.

8. Consultation outcome

Regulations 3 (time limits), 4, 8, 9 and 10

8.1 Proposals for aligning time limits across taxes were discussed in consultation documents published in May 2007 and January 2008. Responses to both consultations generally welcomed this alignment with 22 positive responses out of a total of 25.

Regulations 3 (other than time limits) and 5

8.2 The changes effected by these regulations are administrative in nature and are being made to ensure UK law properly implements Community law. As such, they have not been subject to consultation.

Regulations 6 and 7

8.3 The changes effected by these regulations are minor administrative easements. They have not been specifically exposed but arose out of a consultation on business priorities for simplification which was launched in 2007. The intention to regulate for these changes was announced at the time of the Pre Budget Report in 2008 and has been the subject of technical discussion with interested tax practitioners outside HMRC.

9. Guidance

Regulations 3 (time limits), 4, 8, 9 and 10

9.1 HMRC will shortly publish guidance on how the new time limits work within the new guidance for compliance checks, which will be available on HMRC’s website at www.hmrc.gov.uk/about/new-compliance-checks.htm.

Regulations 3 (other than time limits) and 5

9.2 HMRC publishes guidance on the operation of regulations 29 and 38 in Notice 700/45 and in V1-24A and V1-33 (HMRC Internal Guidance). These will be amended in due course to reflect the changes effected by this instrument.

Regulations 6 and 7

9.3 HMRC publishes guidance on the FRS in Notice 733: VAT Flat Rate Scheme. This Notice will be amended in due course to reflect the changes effected by this instrument.

10. Impact

10.1 The changes effected by this instrument should benefit business, charities and voluntary bodies by clarifying and simplifying the law and bringing increased certainty.

10.2 The impact on the public sector is nil.

10.3 An Impact Assessment covering the changes effected by regulations 3 (time limits), 4, 8, 9 and 10 (time limits) is attached to this memorandum. This Impact Assessment was published alongside the Finance Bill 2008 and can be found at www.hmrc.gov.uk/ria/compliance-checks.pdf. No Impact Assessment has been prepared for the other amendments effected by this instrument.

11. Regulating small business

The legislation does apply to small businesses and should benefit them by reducing administrative burdens and compliance costs as well as by simplification, clarification and increased certainty. .

12. Monitoring & review

Regulations 3 (time limits), 4, 8, 9 and 10

12.1 Post implementation review will take place within 3 years of implementation. Compliance checking powers will be reviewed continuously to ensure that they continue to be capable of addressing new forms of non-compliance. An Implementation Oversight Forum made up from external stakeholders and relevant HMRC directors will report to Ministers.

Regulations 3 (other than time limits), 5, 6 and 7

12.2 The changes are administrative with negligible cost and no formal monitoring is planned. HMRC will monitor any feedback by way of technical commentary or casework.

13. Contact

Regulations 3 (time limits), 4, 8, 9 and 10

13.1 Maria Richards at HMRC Tel: 020 7147 3223 or email: powers.review-of-hmrc@hmrc.gsi.gov.uk can answer any queries relating to the changes effected by these regulations.

Regulation 3 (other than time limits)

13.2 Marco Criscuolo at HMRC Tel: 0151 703 8622 or email: marco.criscuolo@hmrc.gsi.gov.uk can answer any queries regarding the relating to the changes effected by this regulation.

Regulation 5

13.3 Mark Crawford at HMRC Tel: 0151 703 8628 or email: mark.crawford@hmrc.gsi.gov.uk can answer any queries regarding the changes effected by this regulation.

Regulations 6 and 7

13.4 Stephen Davies at HMRC Tel: 0151 703 8653 or email:
stephen.c.davies@hmrc.gsi.gov.uk can answer any queries regarding the changes
effected by these regulations.

Summary: Intervention & Options

Department /Agency: HMRC	Title: Impact Assessment of A New Approach to Compliance Checks.	
Stage: Final	Version: 1.0	Date: 27 March 2008
Related Publications: Consultation document "A new approach to compliance checks", Draft Legislation and Commentary (both 10 January 2008); Responses to Consultation and Proposals (27 March 2008).		

Available to view or download at: <http://www.hmrc.gov.uk/better-regulation/ia.htm>

Contact for enquiries: powers.review-of-hmrc@hmrc.gsi.gov.uk

Telephone: 020 7147 3223

What is the problem under consideration? Why is government intervention necessary?

HMRC inherited tax-specific powers which stop it from taking a whole taxpayer view when checking tax liabilities. Non-compliance is a serious problem for both the government and those who correctly meet their tax obligations. HMRC must have a framework of checks to police the tax system and address risks. An aligned, flexible compliance checking framework will minimise the impact of these checks on the compliant and enhance HMRC's effectiveness to address non-compliance.

What are the policy objectives and the intended effects?

To develop effective compliance activities which tackle the full range of non-compliance across taxes, beginning here with CT, IT, VAT, PAYE and NICs. Compliance checks will be flexible and proportionate to risks and taxpayer behaviours. There will be a common approach to information gathering powers and time limits, where appropriate, balanced by safeguards to protect taxpayers' rights. The ability to check risks common to more than one tax and take a whole taxpayer view will reduce taxpayer burdens.

What policy is being taken forward?

Aligned record keeping requirements, information powers and assessing time limits for compliance checking.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? Post implementation review will take place within 3 years of implementation.

Compliance checking powers will be reviewed continuously to ensure they continue to be capable of addressing new forms of non-compliance.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.

Signed by the responsible Minister:

Jane Kennedy

Date: 27 March 2008

Summary: Analysis & Evidence

Policy	Description: Aligned powers for record-keeping requirements, compliance checks and assessment time limits.
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' Costs for HMRC to train staff and write guidance are estimated to be £1.5 million. For agents and taxpayers there will be costs of familiarisation with the new powers arrangements.
	One-off (Transition) Yrs	
	£ 1.5 million	
	Average Annual Cost (excluding one-off)	
	£ Negligible	Total Cost (PV) £ 1.5 million
Other key non-monetised costs by 'main affected groups' As with any change in policy there will be initial lack of knowledge about the new compliance checking framework, but published Codes of Practice will give guidance to the taxpayer on how the framework works and the safeguards available.		

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' Benefits from quicker checks have not been measured at this stage as it is difficult to compare existing checks to those which may be possible under the proposed framework.
	One-off Yrs	
	£ Not quantified	
	Average Annual Benefit (excluding one-off)	
	£ Not quantified	Total Benefit (PV) £ Not quantified
Other key non-monetised benefits by 'main affected groups' Compliant taxpayers and those who make mistakes will spend less time being checked than with the current checking framework. There will be greater safeguards against the use of information and inspection powers.		

Key Assumptions/Sensitivities/Risks It has not been possible to precisely quantify these benefits, but HMRC has gained a picture of the high level benefits from research, responses to its consultation and feedback from frontline staff. We expect to quantify these benefits as part of the Post implementation Review. There will be a net gain to the exchequer of about £10m a year from the new limits.

Price Base Year	Time Period Years	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £
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What is the geographic coverage of the policy/option?	Nationwide
On what date will the policy be implemented?	Not before April 2009
Which organisation(s) will enforce the policy?	HMRC
What is the total annual cost of enforcement for these organisations?	£ n/a
Does enforcement comply with Hampton principles?	Yes
Will implementation go beyond minimum EU requirements?	No
What is the value of the proposed offsetting measure per year?	£ n/a
What is the value of changes in greenhouse gas emissions?	£ n/a
Will the proposal have a significant impact on competition?	No
Annual cost (£-£) per organisation (excluding one-off)	Micro Small Medium Large
Are any of these organisations exempt?	No No N/A N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)	
Increase of	£ Nil	Decrease of	£ Negligible
		Net Impact	£ Negligible

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

Background

On 10 January 2008 HMRC published a consultation document, "Modernising Powers, Deterrents & Safeguards: A New Approach to Compliance Checks". This was the culmination of an extensive consultation (going back to March 2005) on options for improving compliance checks applied to income tax (IT), corporation tax (CT), capital gains tax (CGT), Pay As You Earn (PAYE) and value added tax (VAT). The term "compliance check" covers the activities HMRC undertakes to ensure that taxpayers declare the right amount of tax, whether they are individuals, partnerships, companies, trusts, employers or any other entity. These activities range from assistance and education through to full-scale civil tax investigations. Current compliance checks include Self Assessment (SA) Enquiries, Employer Compliance reviews, VAT assurance visits and informal checks. They are needed to:

- reassure the compliant that the system is fair;
- ensure that taxpayers are aware of and have understood their obligations to register for tax;
- establish whether taxpayers understand what records are needed to correctly calculate the tax due;
- identify and correct misinterpretations of the law;
- identify weaknesses in taxpayers' systems and processes;
- find and help to correct mistakes which have led to underpaid or overpaid tax;
- deter those with the opportunity to become non-compliant from doing so; and
- uncover deliberate understatements of tax.

The last consultation document considered options for aligning record-keeping requirements, information powers and assessing time limits. Evidence and views were sought during the consultation on the potential impacts of the proposals on taxpayers, including quantifying the following areas:

- one-off training costs for agents and taxpayers to learn about the new framework;
- benefits to the taxpayer of quicker checks;
- the benefits and costs of aligning information powers;
- the cost of extending inspection powers to IT and CT checks on businesses.

Evidence has been received to inform training costs for agents and this is discussed below. Evidence on the other areas has not been received to date, but HMRC will continue to seek this evidence and develop measures, following implementation of the framework.

The consultation period finished on 6 March and a full summary of responses has also been published on the 27 March 2008. In general responses applauded efforts to design an aligned framework. Most appreciated the difficulty of the task. Aligned time limits were particularly welcomed. Most wanted more special rules for IT and CT. Significant concerns were raised by external stakeholders about two areas. The first is a view that there should be a right for taxpayers to appeal against HMRC inspecting premises and tax records. However, HMRC believes that such an appeal right is inappropriate, and this policy is in line with current VAT and PAYE rules, other UK regulators and tax authorities. The second was a view that HMRC should not use information powers in IT and CT cases where the information relates to a period for which no return has yet been received. HMRC has looked at this again, but has concluded that it is important to have a pre-return power for IT and CT if we are to work effectively as a fully

integrated tax authority. A single set of rules is crucial for ease of understanding by both taxpayers and HMRC's staff. Most concerns centred on the way in which powers would be used operationally. While it is not appropriate to put such detail into primary legislation, HMRC will work with taxpayer representatives to ensure that these concerns are addressed through guidance for staff and taxpayers. This guidance will be subject to full consultation before the legislation is implemented in 2009.

The new powers will underpin the modernisation programme, started when HMRC was formed, with the objective of creating a customer focused organisation. The powers will enable HMRC to develop more flexible compliance checks which will be proportionate to risks and taxpayer behaviours. It is anticipated that there will be benefits for both taxpayers and HMRC, though it is too early in the development of the programme to measure these benefits and to determine how often they will be used. This will be done as part of a post implementation review, to be carried out two years after the legislation takes effect.

Aligned information powers

This policy will be applied initially to IT, CT, CGT, PAYE, and VAT and, if successful, might be extended later to other taxes. It will provide a single framework in which HMRC can carry out its responsibilities for checking the accuracy of returns and liabilities, and confirming whether every person or business who ought to be subject to tax is indeed so. While the basic compliance checking process will be the same whatever tax is involved, there will be variations to address intrinsic differences between taxes. The framework reflects responses to the consultation favouring more flexible and quicker checks, but with clear statutory framework operating outside of the existing Self Assessment (SA) enquiry framework and tax-specific interventions. These new approaches will work across the taxes using different methods of communication (e.g. phone and letter), so that in future a taxpayer's tax position can be checked more quickly and with fewer contacts, thereby reducing administration burdens and costs for taxpayers.

HMRC wants to be able to carry out more checks across the range of taxpayers using different methods of communication, instead of relying only on traditional face-to-face interventions for all tax risks. HMRC recognises that simple risks should be addressed with simpler checks not only to reduce costs, but also to benefit any compliant taxpayer who is inadvertently the subject of a check. With these new approaches a check can be cut short once it is clear that their tax position is accurate.

In 2006 there were six "new interventions" piloted using different approaches and involving 9,000 taxpayers who participated voluntarily in the absence of statutory powers. The evaluation of the results was published in April 2007 and can be found at: www.hmrc.gov.uk/new-interventions/index.htm. These pilots demonstrated the potential for improving the taxpayer's experience where mistakes had been made in tax returns. Research carried out by Ipsos MORI showed an overall positive response to these interventions being used to check for mistakes, as an alternative to a SA enquiry or VAT visit. Respondents felt that the traditional interventions were still the best way to tackle those who deliberately understate their tax liability. In future HMRC is looking to focus its technical resources on the highest risk taxpayers while increasing the coverage of those who make mistakes, or fail to take reasonable care, and need guidance to get things right in future. To be effective these checks must be supported by statutory information and inspection powers. Likewise, those who are subject to these checks need the assurance that they are protected by safeguards and treated the same as other taxpayers.

Currently SA enquiries take a long time, despite efforts to complete them more quickly. On average it takes HMRC 86 days to obtain a reply to the first information request in a SA enquiry. This can cause additional expense to the taxpayer and increased uncertainty while the enquiry is open. The following table sets out average elapsed time for HMRC's business compliance checks:

Type of check	Average elapsed months
Corporation Tax (CT) Full	23.8
CT Aspect	16.5
Income Tax (IT) Full	18.3
IT Aspect	14.5
Employer Compliance	11.0
VAT	2.7

Source: HMRC management information systems. This excludes the Large Business Service and Special Civil Investigations.

Although this table covers different types of approach, taxes and taxpayers it gives a useful comparison of the different approaches, with those using written enquiry powers taking considerably longer.

The new intervention pilots did measure and report on elapsed timescales for closed cases. The pilot interventions were voluntary for taxpayers and so could not be targeted at the seriously non-compliant. The results were weighted towards straightforward cases, so comparing them to the results of traditional interventions is problematic. However, they do show potential for saving time and costs, with letter-based interventions taking four weeks on average to complete and telephone contact cases taking two weeks on average. Currently simple risks and mistakes in SA returns are usually addressed with an aspect enquiry, taking up to sixteen months on average to complete (see above table). The new interventions results show these timescales could be reduced to weeks rather than months; cutting costs for those taxpayers who try to declare the right tax, but makes mistakes.

When it is implemented the proposed framework will enable shorter and flexible checks to be made on a wider range of risks and non-compliant taxpayers. It will also provide detailed information to more accurately assess the impact of these checks on taxpayers.

Benefits from aligned information powers

Benefits will arise from:

- aligned record keeping requirements;
- aligned checks, working across taxes;
- quicker checks from visits and pre-return work;
- better compliance resulting from pre-return checking;
- a framework for non-SA taxpayers;
- a framework for hidden economy traders; and
- simplification of CTSA enquiry closure.

Aligned checks, working across taxes

The O'Donnell Report suggested that alignment across taxes was necessary to deliver the new Department's potential. In particular an integrated approach to taxpayers' affairs will:

- permit more flexible deployment of resources between direct and indirect taxes; and
- enable more effective customer-focused activity by supporting checks which are flexible, proportionate to risk and tailored to the taxpayer group.

HMRC has already restructured its compliance operations, so that teams focus on taxpayer groups rather than specific taxes. This structure is still developing with nearly 5,000 staff now

trained in cross tax awareness and a “general practitioner” role currently being trialled. However, more effective cross-tax working is needed and this must be supported by powers which allow an officer to address IT or CT, VAT and PAYE issues in the same way and at the same time.

Currently HMRC carries out about 20,000 VAT checks in a year, addressing risk areas that can also apply to CT or IT. A number of these taxpayers may have had a separate CT or IT enquiry. Where there is an issue affecting two or more taxes, one officer will be able to work a case instead of two officers with separate cases. For example, entertainment expenses are subject to different rules according to the tax, but the source and value of those expenses can be examined in one go by a “general practitioner”, who can then check to see if the differing tax rules have been applied correctly and take immediate action to correct any errors. This will mean a reduced burden for taxpayers, who will be subject to one check instead of two in relation to this aspect of their tax affairs. There are other tax risks which are best addressed through a cross-tax approach, such as poor record-keeping, understating sales, overstating expenses and the hidden economy. These are examined in more detail below.

A cross-tax approach has received support from business representatives. For example, research done by the Forum of Private Businesses showed that 55% of respondents see combining VAT and CT checks as priority action for cutting out red tape.

Quicker checks from visits to business premises and pre-return checks

A power to see business premises and assets should lead to a compliance check being completed more quickly. Being able to see the business and ask simple questions of the taxpayer will allow the HMRC officer to narrow down what needs to be checked. If something in a document does give rise to a query, this can be addressed in minutes rather than through a lengthy exchange of correspondence. The proposals will allow HMRC to look at records which have not yet led to a return. This will mean that instead of working through past records to see how a particular, regular transaction had been treated, the officer can see how it is done in real time, thereby saving time and the cost of retrieving old records.

The benefit of extending to IT and CT the power to visit business premises and carry out pre-return checks will be shorter, more risk-focused checking, saving time for HMRC and taxpayers. This is evident in the shorter length of time a VAT or PAYE check takes (see above table). For example, where current checks for these regimes have found the predominant error to be in arithmetic, entertainment expenses and understated sales the elapsed time for a VAT visit is up to 90% quicker than an SA enquiry for IT and CT.

The benefits of working across taxes are mentioned above and are applicable to visits. For example, common checks made during a PAYE review are on directors’ private expenses and company cars. These are areas where errors are often made for VAT and CT purposes and an aligned information power will make it possible for the officer to check, quantify and agree any errors on one occasion, without disproportionate cost to the taxpayer.

Inspection powers will also allow HMRC to quickly check whether taxpayers whose penalties had been suspended, following introduction of the new penalties legislation in FA 2007, had improved their records and behaviours.

Supporting compliance with pre-return checks

For IT and CT, HMRC can currently only check records when it is too late to prevent submission of an incorrect return. For VAT and PAYE, the taxpayer is responsible for managing a number of processes on behalf of HMRC, who can in turn check those processes for accuracy. Extending pre-return checks to IT and CT means this assurance activity can be done across all the taxes, where appropriate, thereby minimising the number of contacts the taxpayer has with HMRC and correcting errors before the submission of an incorrect return. This will reduce the number of cases which are normally subject to the formal (and longer) process of post-return

enquiries and enable HMRC to focus post-return checks on different areas of non-compliance. A pre-return check examines current records with the aim of putting things right for the future. If no errors are found the check ends and the likelihood of the taxpayer receiving a post return check is reduced. It is expected that this approach will, over time, reduce the burden on compliant taxpayers.

About 40 per cent of errors found are due to inadequate record-keeping. This is a problem needing to be addressed early on, and the ability to check records before a return is submitted will mean that HMRC can examine new businesses' record keeping and systems to ensure the first return is more likely to be correct. The benefit for the taxpayer will be that they can take action needed to submit an accurate return, and there will be less likelihood of a penalty for getting it wrong. This is especially important where the taxpayer does not have an agent to advise them about appropriate record keeping. Currently, about a quarter of businesses are known to be unrepresented. The benefit for HMRC will be that the taxpayer will be more likely to get things right in the future. The taxpayers will also see HMRC in a supporting role rather than a penalising one and will be more likely to approach the Department for help in future.

For large and more complex businesses pre-return checks facilitate the recommendations made by HMRC's review of Links with Large Business (chaired by Sir David Varney and published November 2006). One of the themes arising from this review was the need for taxpayers to have certainty in their dealings with HMRC. The ability to check risk areas sooner and examine transactions while they are still fresh in the mind will speed up the resolution of issues. It will also minimise the cost of retrieving archived records, which inevitably happens when a transaction is examined well after the event and accounts have been closed. This approach is taken with many groups on a voluntary basis at present, but those groups have concerns that they will inappropriately breach confidentiality agreements by sharing certain documents unless HMRC has appropriate powers to require those documents.

A framework for non-SA taxpayers

The vast majority of taxpayers are employees or pensioners. The UK system issues tax returns on a selective basis that excludes the majority of these people in the expectation that PAYE and other deduction at source schemes get their tax right. Issuing tax returns to all income tax payers would create unnecessary burdens and significantly increase the cost of tax administration in the UK.

The new framework includes the ability to see tax records where no return has been submitted. Currently where there is a risk that a non-SA taxpayer has untaxed income, HMRC can only ask questions by statute through a written information notice pre-authorized by an Appeal Commissioner or by requiring a taxpayer to first complete a tax return. This can be disproportionate where the query is a simple one and can be intimidating for the taxpayer. There is benefit for both taxpayers and HMRC in being able to ask a question in a less confrontational dialogue, with clear statutory rights and safeguards.

A framework for hidden economy traders

The ability to see taxpayer records where no tax return has been submitted will have a clear benefit to HMRC in tackling the hidden economy. This poses a serious problem for legitimate businesses who inevitably suffer a competitive disadvantage. It is also an ongoing risk to the UK tax base, costing several billions of pounds in tax receipts each year. HMRC is working to establish a measure for this population and is reviewing how it tackles this large area of non-compliance, which ranges from one-man cash-based businesses to wealthy "ghosts".

A joined-up approach across taxes has proved successful in tackling the hidden economy. Joint operational teams, comprising VAT and IT staff, were set up in the 1990s to visit businesses suspected of failing to notify and pay their tax liabilities. This approach continues and in 2006-07 they successfully targeted 35,000 ghosts and moonlighters securing over 4,000

new VAT registrations, about £37 million in additional VAT and £53 million in IT. These results have in turn improved the competitive environment by helping to restore equitable trading conditions, reducing the opportunity for non-compliant business to undercut legitimate taxpaying rivals, and reducing the tax burden on compliant businesses by making the previously non-compliant contribute their fair share.

VAT and PAYE officers can already visit businesses, backed by their powers to inspect records, to check whether tax is being evaded. IT and CT officers have no statutory backing to call on businesses and to enquire must wait for a taxpayer to complete (or fail to complete) a SA return, before putting information requests to the business in writing. Extending inspection powers to IT and CT will speed up the work of these teams and free up time for more checks and greater coverage across the hidden economy population. It will allow one officer trained in both taxes to look at a business's records and come to a view across its tax liabilities. Where a non-compliant business wishes to become compliant, the position can be settled in one go, rather than settling the position for VAT and PAYE immediately but having to wait some months to settle the IT position. Where a compliant business is checked, it will be possible to establish its tax position with minimum delay and without the taxpayer needlessly having to complete a SA return before questions can be asked.

CTSA closing simplification

One part of this package simplifies the closure of CT enquiries. This proposal follows existing practice for IT and CGT enquiries. The result will be to shorten CT enquiries, by up to 30 days, and reduce the amount of work that needs to be done by taxpayers and HMRC.

Quantification of benefits

It has not been possible to precisely quantify these benefits, although HMRC has gained a picture of the high level benefits from taxpayer research, responses to its consultation and feedback from frontline staff.

The impact on HMRC costs and yield from checking depends on a large number of factors, including how many checks are carried out, how well they are targeted, and the extent and nature of non-compliance in the UK in future years. This will in turn be affected to some degree by reforms to penalties for the non-compliant, taking effect from 2008.

Key benefits for taxpayers stem from checks being quicker and more risk based. Given the variety of taxpayers in the UK, HMRC is not able to reliably quantify the financial impact of a shorter compliance check. Different taxpayers need to do different things to respond to different types of check. For some the cost will be the taxpayer's own time, for some it will be that of employees, for others that of a professional agent.

Costs

There could be a risk that checking at business premises will impose a new cost upon businesses. In practice this cost should not be greater than that of checking by correspondence, which can be protracted. Staff training and guidance will ensure that the powers are used reasonably and correctly, that visits to premises cause as little inconvenience as possible and that checking is conducted by letter or telephone where it is appropriate and less burdensome. The Code of Practice will give an agreed position on this for taxpayers and HMRC.

It is anticipated that the Post Implementation Review will provide evidence on the impact of the policy, based on the experience of the first two years of operation.

Aligned time limits for compliance checking

This part of the policy will align and modernise time limits for making tax assessments and claims. This will be achieved through a number of changes:

- to set the normal VAT assessing period at 4 years (increased from the current three);
- to reduce the period for IT (including PAYE and Construction Industry Scheme), CGT and CT during which tax can be brought into charge under a discovery assessment to 4 years instead of the present 6;
- to set the period for claims for IT, CGT and CT, and the period for VAT claims, at 4 years to retain symmetry, except where Parliament has set a different time limit for a particular claim;
- to set the period for tax lost as the result of a careless inaccuracy (failure to take reasonable care) at 6 years for IT, CGT and CT. This will be a reduction from 20 years for neglect;
- to align the period within which tax lost as a result of a deliberate inaccuracy (deliberate understatement) or failure to notify liability can be brought into charge at 20 years; and
- to set the period for charging tax lost as the result of an undisclosed avoidance scheme covered by the disclosure requirements at 20 years.

Benefits

The current timing provisions make a unified approach to compliance checking difficult. A VAT quarter's return is normally filed within a month, but a CT return covering the year in which the quarter falls is not required until a year after the end of the CT accounting period. A simultaneous compliance check for CT and VAT cannot start until the CT return is available. But the VAT assessing window closes three years after the end of the relevant VAT accounting period. A CT enquiry may bring to light an inaccuracy for CT and VAT purposes in (say) the fourth year after the taxable period. At present the VAT cannot be assessed or repaid, even if the understatement were due to a failure to take reasonable care. It can only be recovered if the understatement were deliberate. This position can be worse where IT is involved and the accounting period ends early in the tax year. Extending the assessing period for VAT by one year should address most problems and bring parity with IT and CT.

At present it is not possible to accurately quantify this benefit. The current time limit structures mean that HMRC does not look at the VAT consequences when looking at IT and CT, as HMRC will be too late to make a correction. It is expected that extending the assessment time limit for VAT will result in extra revenue for the exchequer and this is estimated to be in the region of £100 million a year.

There are other benefits which cannot be measured, such as the effects of behavioural changes arising from HMRC devoting IT, CGT and CT resources to more recent years rather than the more distant past.

Ipsos Mori's research for the new intervention pilots showed that taxpayers' anxiety levels are increased by trying to understand the interaction between tax regimes. A key benefit of aligned time limits will be to give the taxpayer greater certainty when dealing with SA and VAT. Reducing time limits for discovery assessments from 6 to 4 years will give taxpayers certainty that (except for careless and deliberate failure) they will not be faced with unexpected tax bills for closed years. It is not possible to quantify the benefit of greater taxpayer certainty, but consultation has shown that such certainty is very much valued.

Costs

Decreasing IT, CGT and CT assessing time limits, in order to give taxpayers greater certainty, is not without cost for the exchequer. HMRC estimate these costs to be around £90 million a year.

Where a compliance check does find an ongoing mistake or careless inaccuracy, HMRC will be correcting fewer past years. Instead the focus will be on improving compliance for the future.

There will also be an impact from the corresponding extension of VAT claim time limits where HMRC is unsuccessful in litigation. It is not possible to give an average yearly figure for this cost, as future litigation and the results of such litigation cannot be forecast.

Training costs for aligned information powers and assessing time limits.

There will be the cost of training frontline and policy staff involved in VAT, IT, CT and Employer Compliance. The type and intensity of that training will vary according to their roles. The cost of training existing staff following legislation is estimated to be around £1.5 million. This will be a one-off cost as training programmes will incorporate the changes for new staff.

Drafting new guidance, Codes of Practice and revising existing guidance will be carried out by existing staff dedicated to these tasks. Therefore these costs will be included in normal business activity.

There will be one-off implementation costs for agents and some taxpayers. Agents will need to learn about the new framework. The total cost will depend on the number of agents directly affected by the measures and the costs to them of attending training, and this will vary substantially depending on the type and size of agent. HMRC will aim to minimise these costs by publishing its guidance, Codes of Practice and training material.

Specific Impact Tests

Full details of the specific impact tests are listed at:

http://bre.berr.gov.uk/regulation/ria/toolkit/specific_impact_tests.asp. These have been applied to the new compliance checking powers and timing provisions.

The competition filter has been applied at this stage, and the policy found to have little or no competitive impact. However, HMRC will be better able to tackle the hidden economy with the powers proposed in this policy. This will help provide a level playing field for legitimate business and reduce unfair competition.

HMRC has consulted on information powers and timing as part of Review of Powers, Deterrents and Safeguards with a Consultative Committee which consists of representatives of the wider taxpaying community including small businesses. This committee has considered the measures in the policy. Compliant businesses will generally not face increased costs under the policy. HMRC has sought views on the impact on small businesses during its consultation.

Concerns have been raised in some responses to the consultation that the policy will impact on disabled people. The Low Incomes Reform Group has said that “any exercise that involves meetings, visits, rights of appeal etc and the provision of information to customers does need to be accessible and available to disabled people and appropriately accessed.” HMRC takes the impact of its activities on disabled people very seriously. The compliance activities included in this policy are already undertaken, but it is recognised that they may well impact on different taxpayer groups in future. HMRC will aim to minimise the impact of these activities on these groups by adopting good practice and standards and consulting with representative bodies on guidance and procedures.

These proposals are compatible with the Human Rights Act.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

Where to find this document.

This document can also be accessed from the HMRC internet site:

<http://www.hmrc.gov.uk/better-regulation/ia.htm>

Hard copies are available from HMRC Review of Powers: Compliance Checks, Room 1/72, 100 Parliament Street, London SW1A 2BQ.

The Review team can be contacted by telephone on: 020 7147 3223.

Confidentiality

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).

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, among other things, with 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 the Department.

The Department 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.

Any FOIA queries should be directed to the Review team, using the contact details above.