House of Commons

Treasury Committee

INLAND REVENUE: SELF ASSESSMENT SYSTEMS

Eighth Report of Session 2001–02

HC 681

House of Commons

Treasury Committee

INLAND REVENUE: SELF ASSESSMENT SYSTEMS

Eighth Report of Session 2001–02

Report, together with Proceedings of the Committee, Minutes of Evidence and Appendices

Ordered by The House of Commons *to be printed 23 July 2002*

HC 681
Published on 25th July 2002 by authority of the House of Commons
London : The Stationery Office Limited
£14.50

TREASURY COMMITTEE

The Treasury Committee is appointed by the House of Commons to examine the expenditure, administration and policy of the HM Treasury and its associated public bodies.

Current membership
Mr John McFall (*Labour, Dumbarton*) (Chairman)
Mr Nigel Beard MP (*Labour, Bexleyheath and Crayford*)
Mr Jim Cousins MP (*Labour, Newcastle upon Tyne Central*)
Mr Michael Fallon MP (*Conservative, Sevenoaks*)
Mr David Laws MP (*Liberal Democrat, Yeovil*)
Kali Mountford MP (*Labour, Colne Valley*)
Mr George Mudie MP (*Labour, Leeds East*)
Dr Nick Palmer MP (*Labour, Broxtowe*)
Mr James Plaskitt MP (*Labour, Warwick and Leamington*)
Mr David Ruffley MP (*Conservative, Bury St Edmunds*)
Mr Andrew Tyrie MP (*Conservative, Chichester*)

Powers
The Committee is one of the departmental select committees, the powers of which are set out in the House of Commons Standing Orders, principally in SO No. 152. These are available on the Internet via www.parliament.uk The Committee has power to appoint a Sub-Committee, which has similar powers to the main Committee, except that it reports to the main Committee, which then reports to the House. All members of the Committee are members of the Sub-Committee, and its Chairman is Mr Michael Fallon.

Publications
The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) from Session 1997-98 onwards are available on the Internet at www.parliament.uk/commons/selcom/treashome.htm. A list of Reports of the Committee published in the present parliament is at the back of this volume.

Contacts
All correspondence for the Treasury Committee should be addressed to the Clerk of the Treasury Committee, 7 Millbank, House of Commons, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5769. The Committee's email address is: treascom@parliament.uk.

Footnotes
In the footnotes of this Report, references to oral evidence are indicated by 'Q' followed by the question number. References to written evidence are indicated by the page number as in 'Ev 12'.

TABLE OF CONTENTS

EIGHTH REPORT

The Treasury Committee has agreed to the following Report:

INLAND REVENUE: SELF ASSESSMENT SYSTEMS

INTRODUCTION

1. The Treasury Committee established a Sub-committee in July 2001 to scrutinise the work of the various bodies for which Treasury Ministers are accountable. The Sub-committee announced, in January 2002, an inquiry into the Inland Revenue's Self Assessment systems for individuals and companies. We heard oral evidence from the Inland Revenue on 6 March 2002, from the Chartered Institute of Taxation and the Institute of Chartered Accountants in England and Wales on 13 March 2002, from TaxAid, the Low Incomes Tax Reform Group, and the Federation of Small Businesses on 20 March 2002, and from Dawn Primarolo MP, the Paymaster General, on 22 May 2002.

2. We visited Dublin on 15 and 16 May 2002 to be briefed by the Revenue Commissioners, tax practitioners and others on the operation of Self Assessment in Ireland. We also received a number of written submissions, most of which we have published with this volume. We are grateful for all the evidence we received, written and oral, and for the help given by those who briefed us.

INCOME TAX SELF ASSESSMENT

3. Self Assessment for Income Tax and Capital Gains Tax was introduced on 6 April 1996. It was the biggest change in tax administration since the introduction of Pay As You Earn (PAYE) over 50 years earlier, but it did not introduce any new liability to tax.[1] The key objectives of Income Tax Self Assessment are "to:

- give taxpayers greater responsibility for their tax affairs;
- establish a fixed timetable for returns and payment; and to
- bring in a new inquiry process with clear procedures setting out the rights and responsibilities of taxpayers and the Revenue."[2]

The Income Tax Self Assessment Population

4. Around 9 million people out of approximately 26 million taxpayers are required to fill in a tax return each year. These include the self employed; business partners; company directors; and others from whom the Inland Revenue needs additional information to collect the right amount of tax, typically PAYE higher rate taxpayers and some pensioners.[3]

---

[1] Ev 1, paras 3, 4
[2] Ev 1, para 6
[3] Ev 1, para 3

Who receives a tax return?

5. The Inland Revenue keeps the Income Tax Self Assessment population under regular review to make sure that only those people who in its opinion need to complete a tax return get one, and "the people who don't need one can have their tax affairs processed each year with the minimum amount of contact with [the Revenue] ...."[4] TaxAid, a charity working with unrepresented taxpayers, told us that "we find that some people are sent Self Assessment returns when there is no need for them to do one. Often clients have needed a Self Assessment return at some stage, for example when they were self-employed, but this income source has now ceased. ...Such taxpayers do not realise they could come out of Self Assessment, and because the system is automated, the Revenue do not necessarily review the need for a return before sending it out. One difficulty for the unrepresented taxpayer who thinks he does not need to do a Self Assessment return is that the return form does not explain why it has been sent. We would like to see a clear explanation, on the form itself or prominent in the notes, of the circumstances and individuals to which Self Assessment applies. Taxpayers would then understand why they have to fill in the return, or could challenge its issue and return it uncompleted ..."[5]

6. The Revenue told us that the legal position is that a taxpayer who is issued with a tax return must complete it and send it back. But where a return is issued in error, the taxpayer should contact the Revenue and discuss the position.[6] The Revenue also told us that it does not publish the criteria for issuing a Self Assessment tax return "because of the enormous number of situations which could, or not, bring people into Self Assessment, but we are looking at how we can provide greater transparency so that people have a clearer idea of whether they are in or not."[7] This is part of a review the Revenue is undertaking of ways of improving Self Assessment, which is examining, as one of its priorities, the types of people covered by the system with a view to removing from taxpayers wherever possible the obligation of Self Assessment.[8]

7. **People receiving Self Assessment tax returns are not told why they are issued, even though once received they are obliged by law to complete and return them. The Inland Revenue does not publish the criteria for issuing Self Assessment tax returns because of the enormous number of situations in which a return is issued. We believe this to be an unsatisfactory state of affairs, which stems from the complexity of the tax system. We note that the Inland Revenue is examining how it can provide greater transparency so that people have a clearer idea of whether they are covered by Self Assessment or not. We wish to see the criteria for issuing Self Assessment returns published in the interests of fairness to taxpayers.**

8. TaxAid noted that where the system has identified that someone is inappropriately within Self Assessment, and rectified it by ceasing to send them returns, the taxpayer is not routinely informed of this. "So one year they will get a return, and the next year not; but they do not realise that this is because they do not need to make a return. They then see the publicity about the obligation to make a return, and associated penalties [for failing to do so], and worry that they should be doing one. This is particularly true of older, poorer pensioners. If the Revenue decide not to issue a return because the taxpayer is outside the criteria for being in Self Assessment, they should inform the taxpayer and not simply stop sending returns without any explanation."[9]

---

[4] Ev 2, para 8
[5] Ev 51, para 5.2
[6] Q315
[7] Q29
[8] QQ2, 310, 311
[9] Ev 51, para 5.3

9. We put this point to the Paymaster General who told us that "what is very important is that where somebody has been in the system and they are out of the system, we should be absolutely clear at that point with them - and we do not always manage that - that they will not get the form again and they should not get it ..."[10] The Paymaster General agreed that, as a minimum, when the Revenue identified people who should not be in Self Assessment, it should write to them thanking them for the returns they had completed and informing them that the Revenue would not be sending any more.[11]

10. **We are concerned at the Revenue's failure to inform taxpayers who need no longer submit Self Assessment tax returns of this fact, causing unnecessary worry to taxpayers waiting for tax returns that will not arrive. We therefore welcome the Paymaster General's undertaking to the Committee that the Inland Revenue will now write to taxpayers when they are no longer required to submit a return to inform them of this fact.**

Pensioners

11. The Inland Revenue estimates that some 1.2 million of the 9 million people required to fill in a Self Assessment tax return each year are pensioners.[12] The Low Incomes Tax Reform Group, which seeks to represent people on low incomes who cannot afford to pay for tax advice, noted that the Self Assessment system included pensioners who, by reference to some Government measures, would be described as being 'in poverty'.[13] The Group provided three examples of pensioners with incomes ranging from £6,048 to £8,250 who would receive Self Assessment returns and noted that "prior to the introduction of Self Assessment all three of these pensioners would have had a relatively straightforward time with their tax affairs and simple forms would have been used in conjunction with a simple assessing procedure. The computer generated letters and forms used by Self Assessment are not sympathetic to the needs of this group of Inland Revenue customers and generate unnecessary paperwork and worry."[14]

12. Both the Low Incomes Tax Reform Group and TaxAid suggested that one way of removing the burden of Self Assessment for many people, particularly pensioners, could be by raising the limit for coding out untaxed income from its current level of £2,500 to perhaps £5,000.[15] The Inland Revenue told us that "we are aware that there are groups of low income people, pensioners particularly, who at the moment are in Self Assessment. We very much want to help them, and other people with low income, either by taking them out of Self Assessment altogether or finding a way of making it much easier for them to assess. So we are working with the Low Income Tax Reform Group, and, through them, with Age Concern and Help the Aged and TaxAid, to see how we can do this. I have to tell you ... it is not easy, but I would want you to know that we do genuinely want to find a way forward."[16]

13. **The Inland Revenue recognises that there are too many people with low incomes, particularly pensioners, in Self Assessment and is looking at ways of taking them out of the system altogether or of making it easier for them to assess. We support these aims and expect the Revenue to make real progress towards achieving them over the next year.**

---

[10] Q315
[11] Q316
[12] Q27
[13] Ev 57, paras 2-4
[14] Ev 58, paras 9, 10
[15] Ev 52, para 5.4, Ev 58, para 12
[16] Q34

Complexity

14. The Inland Revenue accepts that it is its job to make Self Assessment as easy and as straightforward to use as possible. It said that it tried to do this in two ways, by producing products and forms that people found easy to use, and by backing that up with help and guidance where they needed it. The Revenue told us that "we have ... a substantial number of customers who find Self Assessment relatively straightforward, but there are parts of the system which some people find difficult to use. The main areas of concern, for some people, are the return itself, the statement and the calculation guide; most problems are with the statement and the calculation guide. ..."[17]

15. Many of the submissions we received referred to the complexity of Self Assessment. The Institute of Chartered Accountants in Scotland noted that "the Tax Calculation Guide (even in its simplified version) is a confusing document that can baffle the most experienced professional tax specialists. The plethora of tax rates applied to different types of income makes the computations incomprehensible to most taxpayers. To make Self Assessment more acceptable, the number of rates should be reduced and the calculation procedures generally simplified."[18] A tax practitioner commented that "the tax calculation could be used as the entrance exam for Mensa. The main reason for its difficulty is the illogicality of having different tax rates for certain types of income like interest and dividends. ... I would suggest there is something fundamentally flawed with a system that even well educated taxpayers find too difficult to follow."[19] The Institute of Chartered Accountants in England and Wales commented "Self Assessment made the administration of the tax system easier to understand than the previous system of meaningless estimated assessments. However, change in the administration of the system cannot of itself make the system more comprehensible. The tax system is as complex as ever, although certain administrative procedures are now easier to follow. ..."[20] The Institute also noted that "having a tax system which is understandable to the intelligent layman should have been regarded as a pre-requisite for introducing Self Assessment. Taxpayers are more likely to file their tax returns and make tax payments on time if they can easily complete the forms and understand the basis for the tax that they have to pay."[21]

Tax simplification

16. The Chartered Institute of Taxation referred in their evidence to a paper they had submitted to the Revenue on tax simplification setting out personal tax 'Quick Wins' designed to challenge the Government and the tax authorities to acknowledge the problem of complexity by committing to make annual changes to the tax system aimed solely at simplification.[22] Mr Whiting, the President of the Institute, told us that they had submitted three papers on simplification "one aimed at personal tax which we submitted last summer, one on Corporation Tax which went in the autumn [and] one on VAT which went in in January ... we have been pleased at the reception of them; we have had constructive discussions on all three with the Treasury, with the Inland Revenue and Customs as appropriate, and we await results ..."[23] However, Mr Whiting also noted that not many previous suggestions for tax simplification had been accepted, as "all too often it is a case of there not being space in the Finance Bill for a measure which is just simplification, or it would cost too much money ..."[24]

---

[17] Q2
[18] Ev 98, para 5.8.1
[19] Ev 87, para 4
[20] Ev 40, para 10
[21] Ev 40, para 14
[22] Paper by the Chartered Institute of Taxation entitled "*Attacking Complexity: Quick Wins for Tax Simplification Personal Tax Quick Wins*", page 2
[23] Q133
[24] Q135

17. Subsequently, when the Committee took evidence on the 2002 Budget, Treasury officials acknowledged that the Budget contained no measures specifically on Self Assessment simplification. Mr Gibbs, Head of Tax Policy, said that "there are a lot of measures in the Budget which will, I think, quite significantly simplify the tax system, but primarily on the corporate side. ... we have regular meetings with the Chartered Institute of Taxation, both in the Treasury and jointly with the Inland Revenue. I have to say that none of the specific proposals we have had have been terribly useful or of the sort that we have felt able to implement through the system in a way that is consistent with its underlying objectives ..."[25]

18. We put this point to the Paymaster General who told us that "there were several changes in the Budget which assisted taxpayers in their returns, particularly the self-employed and in the area of company taxation. I would freely admit to the Committee that it is proving very difficult, for instance in the priority of wanting to remove taxpayers wherever possible from the obligation of Self Assessment, to settle on a clear system which does not end up making it more complicated for them. I would share the views of the Committee that I would have hoped to have been further on, but we are not and we need to press forward as quickly as we can. ..."[26]

19. **We are disappointed that the Budget contained no measures specifically designed to simplify Income Tax Self Assessment. Given the existing level of complexity, we support the proposition that there should be annual changes to the tax system aimed solely at simplification. We therefore recommend that this be included as one of the Inland Revenue's key performance targets against which the Revenue should report progress annually.**

The tax forms

20. The Inland Revenue told us that the Income Tax Self Assessment tax return had been developed with customer input and testing. It comprises a core of questions appropriate to most people and sets of additional questions (for example, relating to self employment) that do not apply to all. The computer system automatically selects the additional sets of questions to accompany the core tax return based on the taxpayer's last completed tax return. For people with new sources to be taxed, for example capital gains, the Revenue gives advice which explains that they need to ask for the appropriate additional set of questions.[27] The Revenue also noted that "we have ongoing consultation with accountants and taxpayers to identify ways that we can improve Income Tax Self Assessment forms. Most recent changes have been the improvements to the statement of account and the shorter six-step tax calculation guide."[28]

21. We received evidence on the need for a simpler tax return form from several witnesses. TaxAid noted that "the Revenue have made a commendable effort to produce a form which caters for all aspects of the tax legislation that might affect a taxpayer. For many TaxAid clients, the majority of sections on the form do not apply and they have to fill in just a few boxes, but they are daunted by the eight page form and the questions on page two, which employ technical terms which the average taxpayer may not understand. ...the Self-Employed pages of the return could be made simpler. ...[The] supplementary pages [for Land and Property, or Foreign, or Non-residence, or Capital Gains] are not user-friendly for the unrepresented individual. We realise that this is because they are attempting to cover some complex areas of tax. But more could be done to guide such

---

25 *The 2002 Budget*, Second Report, Session 2001-02, Volume II, HC 780-II, Qq160, 162
26 Q311
27 Ev 2, para 9
28 Ev 6, para 39

taxpayers through the sections they are likely to need. The issues likely to crop up are limited in range and could be predicted and identified."[29]

22. The Institute of Chartered Accountants in England and Wales believed that many of the forms had been designed to support the computer system rather than to make the form readily understandable. "As a result, the forms continue to cause widespread confusion and waste considerable time for taxpayers, agents and Inland Revenue staff. ...For example, the tax return form requires dividends received to be split into five or six categories. ..."[30] The Chartered Institute of Taxation considered that "there is a good deal of scope for looking hard at who gets tax returns, accepting that some people who get the returns necessarily have got quite simple tax affairs and, therefore, it would be possible to give them a much simpler tax return. The existing tax return goes part way towards that in the basic eight pages plus the supplementary pages, but there is a step further that could be done to get to the two or four page return for ... pensioners with very simple affairs who necessarily get dragged into the system."[31] The possibility of a shorter tax return for certain categories of taxpayers was supported by the Low Incomes Tax Reform Group who noted that such a system was operated in other jurisdictions such as Canada, where there is a two page form for over 65s under a certain income limit.[32]

23. The Paymaster General told us that the Revenue's first priority was to get everybody out of the Self Assessment system who does not need to be there and then focus on what information is required from the taxpayers who remain. The Paymaster General thought that if the Revenue could reduce the tax return to four pages it would be doing extremely well. While the idea would be to reduce the amount of information requested, it would be counter-productive not to seek sufficient information on the form and have to go back to the taxpayer for more.[33] The Paymaster General also told us that "it would be completely wrong of me to say that our first objective is simplicity. Our first objective is fairness, supported by simplicity and compliance."[34]

24. **We recognise that the tax return reflects the complexity of the tax regime and the need to obtain sufficient information to calculate their tax liability from taxpayers with different circumstances. But we consider there is scope for a shorter and simpler tax return, particularly for those with relatively straightforward affairs. We therefore recommend that the Revenue continues its efforts to develop a suitable form.**

---

[29] Ev 52, paras 6.1, 6.2, and 6.3
[30] Ev 42, para 31
[31] Q124
[32] Q232
[33] Qq315-319, 321
[34] Q330

Filing

25. Self Assessment introduced a timetable for submitting tax returns and making tax payments. The filing date of 31 January after the end of the tax year gives taxpayers some 10 months to assemble information and submit their returns. If a tax return is sent in by 30 September, the Revenue will calculate the tax due in order for payment to be made on 31 January. After 30 September the Revenue will still calculate tax, but it does not guarantee to do it in time for a calculation to go out to the taxpayer for the payment date of 31 January.[35] As the table below shows, since the introduction of Self Assessment taxpayers have consistently sent in around 90 per cent of tax returns by the 31 January deadline.

Table 1: Self Assessment tax returns filed by the deadline

Year to which returns relate	Number of returns issued (million)	Number of returns received at 30 September (million)	Per cent received	Number of returns received at 31 January (million)	Per cent received
1996-97	8.540	4.422	51.8	7.874	92.2
1997-98	9.018	4.433	49.1	8.198	90.9
1998-99	9.088	4.511	49.6	8.211	90.3
1999-2000	9.080	4.400	48.6	8.131	89.5
2000-01	9.171	4.278	46.6	8.253	90.0

Source: Inland Revenue (Ev 11)

Late filing

26. In March 2001, in the light of the slight but persistent reduction in the percentage of returns filed before 31 January each year, the Inland Revenue introduced an initiative to establish which groups of people were prone to late filing and to carry out a programme of initiatives to try to encourage them to file sooner. The Revenue told us that late filers are generally people who have just started in business; people who have ceased in business the previous year; and people with substantial income for the year before. As a result of the review of late filers, the Revenue took a number of measures aimed at the groups it thought were at risk including retargeting its advertising; adding reminders to mailshots and making 200,000 telephone reminders to people to file on time; and working with agents to encourage their clients to file on time. The Revenue attributed the small upturn in the percentage of returns for 2000-01 filed by 31 January 2002, which reversed a four-year downward trend in the figures, to these efforts.[36]

27. We asked the Inland Revenue about peaks in filing and what incentives there were for taxpayers to file on time. The Revenue told us that the experience of Self Assessment filing dates around the world was that there is a big peak before whatever deadline was set. The Revenue noted that "what we have been able to do, with our 30 September date [for those wishing the Revenue to calculate their tax liability], is pretty nearly split [the peak] in two and bring in about a half of the Self Assessment returns four months forward."[37] Although the Revenue said it did not have a closed mind to incentives, it considered that

---

[35] Ev 3, para 15, Ev5, para 31
[36] Qq35, 104
[37] Q37

the difficulty with a cash incentive to file was that you would have to pay it to the overwhelming majority of people who already do file on time.[38]

28. The Chartered Institute of Taxation told us that if a tax practitioner is asked by a client whether it makes sense to file earlier than the filing date they may draw attention to various disincentives that are perceived to exist. Prime among these is the perception that earlier filing gives the Inland Revenue a longer period of time (the 'enquiry window') in which to open an enquiry into the accuracy and veracity of the return and indeed that it increases the chances of the return being selected for enquiry. Despite Inland Revenue assurances that this is not the case, many practitioners simply decide not to take the risk - or in many cases their clients insist they do not.[39] One suggestion put to us by witnesses to help address this problem was to change the enquiry window to run for 12 months from the date the return was filed rather than as at present the 12 months from the filing date of 31 January.[40]

29. The Revenue accepted that there was a common misconception that by filing early people had a greater chance of being selected for enquiry. The Revenue told us that it had put out a note through the professional associations and would do so again, confirming that this was not the case. In fact, the Revenue's risk analysis shows that people who file late have a greater chance of filing inaccurately, and the Revenue has reflected this in the risk score it uses in selecting cases for enquiry.

30. **We are concerned that, despite the marginal improvement in the number of taxpayers that filed their tax return on time last year, one in ten taxpayers had not filed by 31 January, the due date. We expect the Revenue to monitor this position closely and review what further steps it can take to encourage people to file on time.**

31. **There is a misconception, which the Revenue needs to address, that filing early increases the chance of being selected for enquiry. In fact the reverse is the case. We recommend that the Revenue takes steps to make this clear to agents and taxpayers in its publicity. We also recommend, to encourage early filing and spread filing peaks, that the Revenue considers the possibility of changing the enquiry window to run for twelve months from the date the tax return is received, rather than twelve months from 31 January.**

Penalties

32. There are automatic penalties on those who do not file their returns on time. The first penalty takes effect after the 31 January filing deadline and the second penalty takes effect six months later. Each penalty is £100, but they are capped at the amount of tax ultimately due if that figure is less. About 90 per cent of people file at 31 January and another 5 per cent file after the issue of the first automatic penalty before the issue of the second penalty on 31 July. Late payments of tax incur interest and surcharge. The Revenue charges interest on all Self Assessment liabilities (except on interest itself) from the date on which the liability should be paid until the liability is paid. Surcharge is imposed in two stages: an initial surcharge on any tax unpaid more than 29 days after it is due, and an additional surcharge on any tax still unpaid more than six months after the due date. Both initial and additional surcharges are for 5% of the tax due. The Revenue sends taxpayers a formal notice of surcharge against which they have 30 days to appeal.[41]

---

[38] Q38
[39] Ev 29, para 4.4
[40] Ev 86, para 1.1
[41] Qq80,81, Ev 2, paras 11, 13, 14

33. If the Revenue does not receive a return it can issue a 'determination' of the amount of tax due. Taxpayers must pay the amount determined or send in their return. If taxpayers do not make a Self Assessment return to overturn the determination the Revenue can use enforcement procedures, such as court action, to collect the tax due as determined.[42]

34. Since the start of Self Assessment, the Revenue has issued 210,000 determinations of which 105,000 (50%) have resulted in the submission of the return. The Revenue told us that it recognised a need to step up the use of its powers, such as the imposition of daily penalties, in appropriate cases to get in outstanding returns and admitted that it had "a decreasing number [of tax returns not sent in] for each of the years of Self Assessment. We have a very few cases from 1996-97. We have a target at the moment to get in 40 per cent of all the old returns this year, and we are looking to see whether we can get most of the remaining ones in next year. I think it is fair to say, ... that this is an area where we think we can do better, and we have reviewed the processes and we are using our penalty regime more effectively now..."[43]

35. **We were very surprised to learn that there are tax returns outstanding from the start of Self Assessment in 1996-97 and for each of the following years. We are concerned that the Revenue has not actioned these cases in a timely manner and recommend urgent action now be taken to resolve this matter.**

Electronic filing

36. The facility to file Income Tax Self Assessment tax returns over the Internet was introduced on 3 July 2000. It allows most individual taxpayers to send their own tax return to the Revenue over the Internet. Electronic filing offers a number of advantages over the traditional paper tax return:

- taxpayers get an on-line acknowledgement when their return is received;
- there is automatic calculation of the tax as the return is completed so that taxpayers do not have to self calculate;
- repayments of tax to taxpayers are dealt with more quickly; and
- Internet returns are processed faster and there is no keying of data by staff, eliminating the scope for keying errors.[44]

37. The Revenue's Internet service has evolved in the light of experience and technology developments. In the first year of the service (2000-01) it required the issue of a CD-Rom which presented some problems: any 'bugs' in the product could only be addressed by sending updated CD-Roms, and some computers, for example Apple Macs, could not be used. In the second year (2001-02) the service was founded on an Internet-based form on-line, but restricted to the three main schedules. It was extended in August 2001 so that agents could file individual clients' returns on their behalf.[45]

38. The service this year (2002-03) encompasses the main schedules covering some 90 per cent of the Self Assessment population not represented by agents. The service now includes:

- a question and answer approach so that only relevant questions are displayed;
- a facility to store a part-completed return;
- on-line help including, for example, pop-up tables to record interest from different accounts;
- automatic calculation; and

---

[42] Ev 4, para 20
[43] Qq89-91, Ev 4, para 22
[44] Ev 5, paras 26, 27
[45] Ev 5, para 26, Ev 100, para 3

- item by item validation so that incorrect entries can be flagged back to the taxpayer.[46]

39. The Revenue informed us that 38,981 individuals filed their tax returns over the Internet in the first filing period to 31 January 2001, and that this number increased by 94 per cent to 75,449 for the equivalent filing period to 31 January 2002.[47] This compared to projections of 315,000 and 200,000 respectively for these periods.[48] The Revenue recognised that this was a slow start but considered that "customer inertia is a phenomenon experienced by many organisations in the early years of persuading customers to move to conducting transactions electronically."[49] The Revenue told us that the take-up of Internet services was notoriously difficult to predict and its projections of take-up had been the best it could make. While a target for the next year had not been finalised, the Revenue considered that a conservative target would be some 150,000, double the existing take-up.[50] The Revenue also told us that it has a target of 50 per cent take-up of its electronic services by 2005, which if achieved, would result in savings of some 1,300 staff.[51]

40. In the first year of Internet filing the Revenue gave individuals a £10 incentive to use the Internet service. However, the Revenue's customer research of users indicated that "their priority was not for an incentive, they wanted a system that was easier to use, and we have put our effort into doing that."[52] The Paymaster General noted that the Internet service was improving. In the peak period of January 2002, around 80 per cent of attempts to file on-line had succeeded.[53]

41. **The potential benefits from Internet filing to both taxpayers and the Revenue are considerable. But take-up of the service in the first two years has been very disappointing and much lower than the Revenue had anticipated. The Revenue will only achieve its ambitious target of 50 per cent take-up by 2005 if it offers a reliable service that meets users' expectations. In this context we are concerned that one in five attempts to file on-line fail and we recommend a review to identify the causes of these failures and remedies for those within the Revenue's control. We also recommend that the Revenue examines what further steps it can take to make its on-line service more attractive to potential users.**

42. The Revenue's on-line service was withdrawn at the end of May 2002 following a security incident when four people contacted the Revenue to report seeing information on another person's tax return while using the on-line Self Assessment service. People could also add to or overwrite information on that other person's return. Subsequently a further nine contacts were received from people, making 13 in total. The Revenue told us that it "takes taxpayer confidentiality very seriously and once the service was withdrawn an immediate investigation was started, involving the department's strategic partners EDS, the e-Envoy's Office, and an independent specialist Internet company. It was quickly established that the systems were not 'hacked' into."[54]

43. The Revenue told us that the reason for the problem turned out to be "very complex."[55] The investigation found that the Revenue's system had been vulnerable to someone outside its control storing information which should not have been stored. This had resulted in a situation whereby two different people could share an on-line 'session'

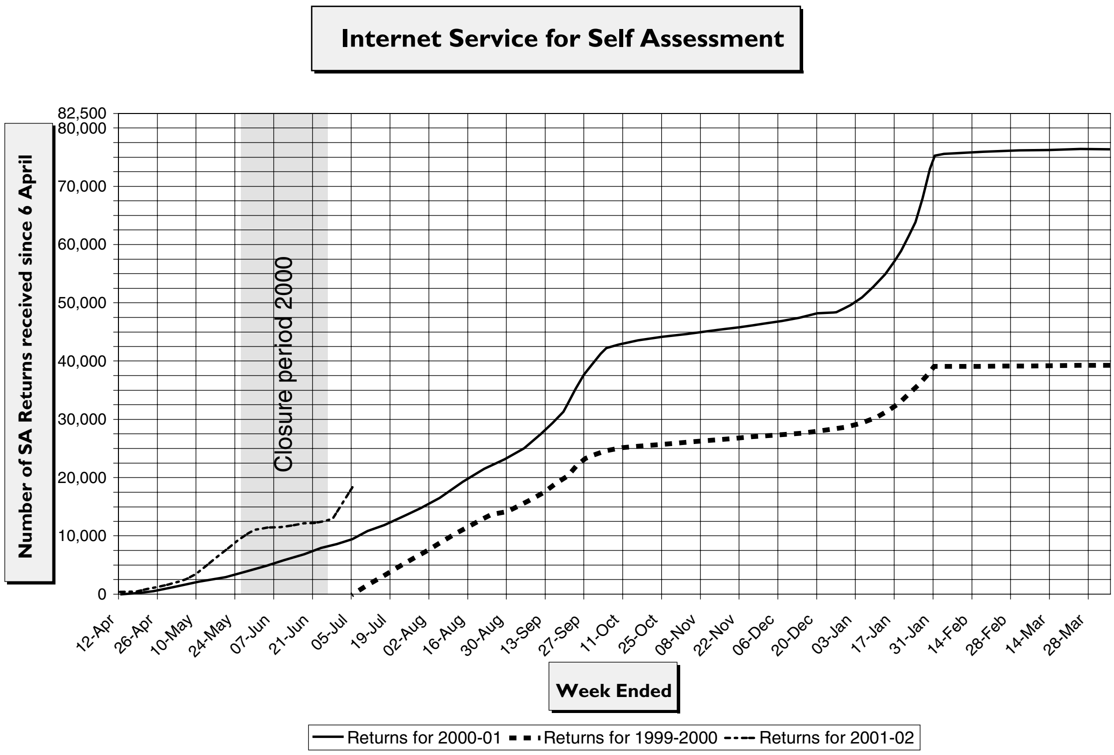
[46] Ev 100, para 3
[47] Ev 5, para 26
[48] *E-Revenue*, Report by the Comptroller and Auditor General, HC 492, Session 2001-2002, para 2.6
[49] Ev 5, para 26
[50] Qq 53-55, 63, 64
[51] Qq61, 69
[52] Q62
[53] Q372
[54] Ev 101, paras 5, 6
[55] Ev 101, para 7

because the system thought they were the same person, and as a result of this, some people had been able to see another's information. In nearly all cases, the problem had manifested itself through customers of one Internet Service Provider. But as Internet Service Providers out-source or subcontract many of their services including information, the Revenue considered it would be unfair to single out one for blame. Following a number of changes to the system designed to ensure that this would not happen again, the Revenue's on-line system was restored on 28 June 2002.[56] We intend to visit the Revenue to see the system in operation.

44. The Revenue took steps to establish how many people might have had their details seen by someone else. According to the Revenue, 27,967 taxpayers had used the system without their details being seen by anyone else. There were 47 cases where the tax returns could have been seen by someone else, and a further 665 cases where the Revenue could not be certain that someone's tax return had not been seen by another person, but there was no reason to believe that it had been. The Revenue told us that it had written to all the taxpayers who were or could have been affected, or their representatives, and that the response from them had been "remarkably positive."[57]

45. The Revenue noted that there were lessons to be drawn from this incident, including wider issues of Internet security, and that it was working with the e-Envoy's office to ensure that these were shared more widely.[58] The Revenue also told us that since the service had been restored, take-up volumes, shown in the figure below, were approaching the peak levels experienced last September. The Revenue considered that this was "an encouraging sign that the speed with which the department reacted to the problem and the thoroughness of its examination has paid dividends."[59]

Figure 1: Take-up of the Internet filing for Self Assessment



Source: Inland Revenue (Ev 101)

[56] Ev 101, paras 7, 8
[57] Ev 101, paras 9, 10
[58] Ev 102, para 11
[59] Ev 102, para 12

46. **We are very concerned that failings in the Revenue's Internet filing service allowed taxpayer confidentiality to be breached and that the service had to be withdrawn for more than a month while remedial action was taken. We note the Revenue's admission that there are lessons to be drawn from this extremely serious incident, including wider issues of Internet security, and that it is working with the e-Envoy's office to ensure that these are shared more widely. We expect the Revenue and the e-Envoy to include in their work a review of the procedures used to test the Revenue's system before it was implemented, and to report on the outcome of their deliberations on the lessons to be shared.**

47. **It is too soon to determine what impact this incident has had on the level of Internet filing. We expect the Revenue to monitor this closely, and to examine what additional steps it can take to restore taxpayer confidence in the security of the system should this be necessary.**

Payment

48. TaxAid told us that "a substantial part of our advice work is in relation to tax debt. Small self-employed businesses struggle to keep money aside to pay their Self Assessment liabilities. Often they have tried to save, and want to pay their tax in full at the due date, but some more pressing need means that they cannot do so. Currently, payments on account are required only six-monthly, and the smallest businesses do not make them. A scheme for those within Self Assessment to make more frequent and regular payments on account throughout the year has been proposed in the past, and is periodically revisited in discussions with the Revenue. Little progress has been made in translating it into practice. ... The facility to make regular payments on a monthly or weekly basis to the Revenue could enable many small self-employed taxpayers to keep abreast of their tax liabilities."[60]

49. Similarly, the Federation of Small Businesses told us that "a major problem for business taxpayers is that at the second 31 January after commencement of business they have to find the first year's tax in full plus the first instalment of the second year, so paying 150 per cent of a year's tax all at once .. this problem could be tempered by a facility to pay income tax by direct debit in monthly instalments."[61] The Federation noted that "it would also be useful to have alternative methods of payment, such as by credit card. This method is not currently available even when paying over the Internet. Given the Inland Revenue's enthusiasm for e-commerce one would have expected them to look to the greater use of plastic."[62]

50. The Inland Revenue told us that it had introduced a small scale Budget Payment Plan three years ago to test whether Self Assessment taxpayers found paying by direct debit attractive. A sample of taxpayers around the Revenue's Newcastle office were contacted and offered the choice of paying monthly instalments towards their Self Assessment liability providing they had no previous unpaid liabilities. More than 400 people joined the scheme, paying nearly £100,000 each month.[63] The Revenue also told us that it was now taking forward recommendations made in two reviews of payment methods "by establishing the convenience and cost of the payment channels and payment methods people use to pay us ... to identify preferred combinations that are convenient for people in different circumstances to use and are cost effective for us. Those are the combinations that we will develop and promote."[64]

---

[60] Ev 54, para 8.5
[61] Ev 66, paras 3.2, 3.3
[62] Ev 66, para 3.4
[63] Ev 98, para 2
[64] Ev 98, para 3

51. The Revenue has a national facility for accepting Self Assessment payments by debit card by telephone to its Debit Card Line, which is charged at local rates.[65] The Paymaster General told us that the Revenue needed to ensure that people can pay rapidly and conveniently in various ways.[66] The use of credit cards had not been ruled out, but "we need to look very carefully at whether the extra cost is justified in providing that facility .."[67]

52. **We note that the Revenue has been testing a scheme to allow taxpayers to pay monthly instalments by direct debit towards their Self Assessment liability. We believe that many taxpayers, particularly the self-employed and those starting a new business, would find such a facility useful. We are therefore concerned that this trial appears to have reached no conclusions after three years. We recommend that the Revenue evaluates and reports on the results of this trial as a matter of urgency.**

53. **We agree with the Paymaster General that people should be able to pay tax rapidly and conveniently in various ways, but introducing new payment methods does not appear to be a matter of priority to the Revenue. We recommend that the Revenue pursues this matter with more urgency than hitherto displayed. We also recommend that the cost to the Revenue of providing a facility to pay by credit card be evaluated.**

CORPORATION TAX SELF ASSESSMENT

54. The introduction of Self Assessment for companies extended the principles of Income Tax Self Assessment to company tax returns. Corporation Tax is levied by reference to a company's accounting period, which can vary in length and end on any day of the year. Corporation Tax Self Assessment applies to accounting periods ending on or after 1 July 1999. Companies normally have to file their returns 12 months after the end of an accounting period. But unlike Income Tax Self Assessment, the date when tax has to be paid is not the same as the date for filing. For most companies, Corporation Tax has to be paid 9 months after the end of the accounting period. So a company which has not filed its return by the due date for payment of tax will have to pay an estimate of its tax liability. Companies paying very large amounts of tax have to make quarterly payments of their estimated tax liability, with the first payment due half way through the taxable period and based on a projection of the current period's profits.[68]

55. The Revenue told us that the introduction of Corporation Tax Self Assessment had been a less radical change for companies than Income Tax Self Assessment had been for individuals. Company taxation had, since 1993, been governed by Pay and File rules, which introduced many of the planks of Self Assessment such as a computational style return form requiring the company to work out its own tax bill, and the requirement to pay on a current year basis before the tax liability is established by self assessment.[69]

56. The evidence we received confirmed this view. The Chartered Institute of Taxation noted that "the vast majority of companies are small or medium sized companies. For them, the transition from the Pay and File system to Corporation Tax Self Assessment involved very little change. No significant problems were experienced."[70] The Institute of Chartered Accountants in England and Wales noted that because Corporation Tax Self

---

65 Ev 99, para 7
66 Q376
67 Q378
68 Ev 8, paras 53-56
69 Ev 8, para57
70 Ev 27, para 3.2

Assessment had been built on the back of Pay and File it had been "relatively painless" for companies.[71] However, both Institutes called for a change to the system for large companies which are required to pay their Corporation Tax in quarterly instalments, the first two of which are based on estimates.[72] According to the Institute of Chartered Accountants in England and Wales "this is an unnecessary complication, which could be avoided if instalments were based on, for example, the previous year's figures with a balancing payment at the end to reflect the final liability for the year."[73]

57. **It appears from the evidence we have received that Corporation Tax Self Assessment has been introduced without any significant problems. We note the suggestion that the quarterly instalments large companies are required to pay should be based on prior year figures, rather than on estimates as at present, with a final adjustment based on outturn when known. We recommend that the Revenue examine and report on the costs and benefits of such a change.**

LIST OF CONCLUSIONS AND RECOMMENDATIONS

(a) **People receiving Self Assessment tax returns are not told why they are issued, even though once received they are obliged by law to complete and return them. The Inland Revenue do not publish the criteria for issuing Self Assessment tax returns because of the enormous number of situations in which a return is issued. We believe this to be an unsatisfactory state of affairs, which stems from the complexity of the tax system. We note that the Inland Revenue is examining how it can provide greater transparency so that people have a clearer idea of whether they are covered by Self Assessment or not. We wish to see the criteria for issuing Self Assessment returns published in the interests of fairness to taxpayers. (paragraph 7).**

(b) **We are concerned at the Revenue's failure to inform taxpayers who need no longer submit Self Assessment tax returns of this fact, causing unnecessary worry to taxpayers waiting for tax returns that will not arrive. We therefore welcome the Paymaster General's undertaking to the Committee that the Inland Revenue will now write to taxpayers when they are no longer required to submit a return to inform them of this fact (paragraph 10).**

(c) **The Inland Revenue recognises that there are too many people with low incomes, particularly pensioners, in Self Assessment and is looking at ways of taking them out of the system altogether or of making it easier for them to assess. We support these aims and expect the Revenue to make real progress towards achieving them over the next year (paragraph 13).**

(d) **We are disappointed that the Budget contained no measures specifically designed to simplify Income Tax Self Assessment. Given the existing level of complexity, we support the proposition that there should be annual changes to the tax system aimed solely at simplification. We therefore recommend that this be included as one of the Inland Revenue's key performance targets against which the Revenue should report progress annually (paragraph 19).**

---

[71] Ev44, para 41
[72] Qq159-162, 209
[73] Ev 44, para 45

(e) **We recognise that the tax return reflects the complexity of the tax regime and the need to obtain sufficient information to calculate their tax liability from taxpayers with different circumstances. But we consider there is scope for a shorter and simpler tax return, particularly for those with relatively straightforward affairs. We therefore recommend that the Revenue continues its efforts to develop a suitable form (paragraph 24).**

(f) **We are concerned that, despite the marginal improvement in the number of taxpayers that filed their tax return on time last year, one in ten taxpayers had not filed by 31 January, the due date. We expect the Revenue to monitor this position closely and review what further steps it can take to encourage people to file on time (paragraph 30).**

(g) **There is a misconception, which the Revenue needs to address, that filing early increases the chance of being selected for enquiry. In fact the reverse is the case. We recommend that the Revenue takes steps to make this clear to agents and taxpayers in its publicity. We also recommend, to encourage early filing and spread filing peaks, that the Revenue considers the possibility of changing the enquiry window to run for twelve months from the date the tax return is received, rather than twelve months from 31 January (paragraph 31).**

(h) **We were very surprised to learn that there are tax returns outstanding from the start of Self Assessment in 1996-97 and for each of the following years. We are concerned that the Revenue has not actioned these cases in a timely manner and recommend urgent action now be taken to resolve this matter (paragraph 35).**

(i) **The potential benefits from Internet filing to both taxpayers and the Revenue are considerable. But take-up of the service in the first two years has been very disappointing and much lower than the Revenue had anticipated. The Revenue will only achieve its ambitious target of 50 per cent take-up by 2005 if it offers a reliable service that meets users' expectations. In this context we are concerned that one in five attempts to file on-line fail and we recommend a review to identify the causes of these failures and remedies for those within the Revenue's control. We also recommend that the Revenue examines what further steps it can take to make its on-line service more attractive to potential users (paragraph 41).**

(j) **We are very concerned that failings in the Revenue's Internet filing service allowed taxpayer confidentiality to be breached and that the service had to be withdrawn for more than a month while remedial action was taken. We note the Revenue's admission that there are lessons to be drawn from this extremely serious incident, including wider issues of Internet security, and that it is working with the e-Envoy's office to ensure that these are shared more widely. We expect the Revenue and the e-Envoy to include in their work a review of the procedures used to test the Revenue's system before it was implemented, and to report on the outcome of their deliberations on the lessons to be shared (paragraph 46).**

(k) **It is too soon to determine what impact this incident has had on the level of Internet filing. We expect the Revenue to monitor this closely, and to examine what additional steps it can take to restore taxpayer confidence in the security of the system should this be necessary (paragraph 47).**

(l) **We note that the Revenue has been testing a scheme to allow taxpayers to pay monthly instalments by direct debit towards their Self Assessment liability. We believe that many taxpayers, particularly the self-employed and those starting a new business, would find such a facility useful. We are therefore concerned that this trial appears to have reached no conclusions after three years. We recommend that the Revenue evaluates and reports on the results of this trial as a matter of urgency (paragraph 52).**

(m) **We agree with the Paymaster General that people should be able to pay tax rapidly and conveniently in various ways, but introducing new payment methods does not appear to be a matter of priority to the Revenue. We recommend that the Revenue pursues this matter with more urgency than hitherto displayed. We also recommend that the cost to the Revenue of providing a facility to pay by credit card be evaluated (paragraph 53).**

(n) **It appears from the evidence we have received that Corporation Tax Self Assessment has been introduced without any significant problems. We note the suggestion that the quarterly instalments large companies are required to pay should be based on prior year figures, rather than on estimates as at present, with a final adjustment based on outturn when known. We recommend that the Revenue examine and report on the costs and benefits of such a change (paragraph 57).**

PROCEEDINGS OF THE COMMITTEE AND THE SUB-COMMITTEE RELATING TO THE REPORT

Main Committee

TUESDAY 23 JULY 2002

Members present:

Mr John McFall, in the Chair

Mr Jim Cousins	Dr Nick Palmer
Mr Michael Fallon	Mr James Plaskitt

* * * * *

The Committee deliberated.

Draft Report from the Sub-committee (Inland Revenue: Self Assessment Systems) brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 57 read and agreed to.

List of conclusions and recommendations read and agreed to.

Resolved, That the Report be the Eighth Report of the Committee to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the Appendices to the Minutes of Evidence taken before the Sub-committee be reported to the House.—(*The Chairman.*)

[Adjourned till Tuesday 15 October at Ten o'clock.

Sub-committee

TUESDAY 23 JULY 2002

Members present:

Mr Michael Fallon, in the Chair

Mr Jim Cousins
Mr John McFall
Dr Nick Palmer
Mr James Plaskitt

The Sub-committee deliberated.

Draft Report (Inland Revenue: Self Assessment Systems) proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 57 read and agreed to.

List of conclusions and recommendations read and agreed to.

Resolved, That the Report be the Third Report of the Sub-committee to the Committee.

Ordered, That the Chairman do make the Report to the Committee.

Several Papers were ordered to be appended to the Minutes of Evidence.

Ordered, That the Appendices to the Minutes of Evidence taken before the Sub-committee be reported to the Committee.—(*The Chairman.*)

[Adjourned till Wednesday 16 October at a quarter to Five o'clock.

LIST OF WITNESSES

LIST OF DOCUMENTS INCLUDED IN THE MINUTES OF EVIDENCE

LIST OF APPENDICES TO THE MINUTES OF EVIDENCE

Distributed by The Stationery Office Limited and available from:

The Stationery Office
(mail, telephone and fax orders only)
PO Box 29, Norwich NR3 1GN
General enquiries 0870 600 5522
Order through the Parliamentary Hotline *Lo-call* 0845 7 023474
Fax orders 0870 600 5533

You can now order books online at **www.tso.co.uk**

The Stationery Office Bookshops
123 Kingsway, London WC2B 6PQ
020 7242 6393 Fax 020 7242 6394
68–69 Bull Street, Birmingham B4 6AD
0121 236 9696 Fax 0121 236 9699
9–21 Princess Street, Manchester M60 8AS
0161 834 7201 Fax 0161 833 0634
16 Arthur Street, Belfast BT1 4GD
028 9023 8451 Fax 028 9023 5401
The Stationery Office Oriel Bookshop
18–19 High Street, Cardiff CF1 2BZ
029 2039 5548 Fax 029 2038 4347
71 Lothian Road, Edinburgh EH3 9AZ
0870 606 5566 Fax 0870 606 5588

The Parliamentary Bookshop
12 Bridge Street, Parliament Square
London SW1A 2JX
Telephone orders 020 7219 3890
General enquiries 020 7219 3890
Fax orders 020 7219 3866

The Stationery Office's Accredited Agents
(see Yellow Pages)

and through good booksellers

ISBN 0 215 00476 0