



House of Commons  
Treasury Committee

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**Government Response  
to the Committee's  
Seventh Report: The  
Administrative Costs of  
Tax Compliance  
(HC 269)**

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**Seventh Special Report  
of Session 2003–04**

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## The 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

Rt Hon John McFall MP (*Labour, Dumbarton*) (Chairman)  
Mr Nigel Beard MP (*Labour, Bexleyheath and Crayford*)  
Mr Jim Cousins MP (*Labour, Newcastle upon Tyne Central*)  
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Mr James Plaskitt MP (*Labour, Warwick and Leamington*)  
Mr Robert Walter MP (*Conservative, North Dorset*)

The following Member was also a member of the Committee during part of this inquiry:

Mr David Ruffley MP (*Conservative, Bury St Edmunds*)

### 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](http://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/parliamentary\\_committees/treasury\\_committee/treasury\\_committee\\_reports.cfm](http://www.parliament.uk/parliamentary_committees/treasury_committee/treasury_committee_reports.cfm).

### Contacts

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# Seventh Special Report

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On 4 June 2004, we published our Seventh Report, *The Administrative Costs of Tax Compliance*, as House of Commons paper No. 269. We have now received a response from the Government (dated 21 July 2004) which is appended below.

## **APPENDIX: MEMORANDUM FROM HM TREASURY**

The Government welcomes the publication of the Committee's Report and notes its conclusions.

### **Detailed suggestions for reducing compliance costs**

- 1. The terms of reference of this inquiry were widely drawn, encompassing all taxes administered by Customs and Excise and the Inland Revenue. We have concentrated on the general issues and main areas of concern identified during the course of our work. A number of witnesses supplied detailed information on particular areas of concern suggesting specific measures for reducing the administrative cost of tax compliance in respect of individual taxes. We have not sought to investigate the merits of these, but we expect the Revenue Departments to give due consideration to all the detailed suggestions for reducing compliance costs that have been made to us. (Paragraph 5)**

The Revenue Departments will certainly give consideration to the detailed suggestions made during the course of the Committee's inquiry.

### **Relative priority of objectives**

- 2. We recognise the conflict between producing a tax system that is simple to understand and operate, and the need for checks and safeguards to bear down on tax avoidance. We also note that the Government has a number of other objectives for the tax system, such as promoting fairness and delivering social or environmental objectives, which can add to the administrative costs of tax compliance. As a result, the Government's objective of reducing compliance costs is only one of a number of objectives for the tax system. We recommend that the Government sets out more clearly the relative priority it attaches to each of these objectives. (Paragraph 10)**

The Government welcomes the Committee's recognition that there can be several conflicting drivers which affect tax compliance costs. The Government's central aim, as it set out in its evidence to the Committee, is to strike the right balance between these, making compliance easier and less costly for those who want or are trying to comply, with better targeted assurance activity aimed at the non-compliant.

The relative priority to be accorded to different objectives for the tax system will depend on the particular decision which is being considered. The Government remains committed to reducing tax compliance costs where this can be done consistently with its other objectives.

## PSA targets

- 3. The Revenue Departments' current PSA targets for reducing tax compliance costs can be met by any reduction in compliance costs, however small, and are not rigorous enough. We note and endorse the recommendation in the O'Donnell review of the Revenue Departments that the new merged revenue department should develop a better focussed PSA target on compliance costs supported by work to develop a better understanding of compliance costs. (Paragraph 13)**

The Government is in the process of setting Departments' Public Service Agreement targets as part of the 2004 Spending Review. It will take account of the Committee's comments in this process.

## Measuring Compliance Costs

- 4. Although measuring the administrative costs of tax compliance is difficult, comparative analyses confirm that the UK has lower administrative costs and fewer regulations than most EU countries. Nevertheless, we would like to see a determined effort to achieve a more accurate calculation of compliance costs. We believe a baseline figure would provide a greater impetus to the Government's objective of reducing compliance costs and inform decisions when the objectives of the tax system conflict. We recommend the Treasury consider the work done on this in the Netherlands. (Paragraph 21)**

In relation to the tax system, the Government believes (and some outside witnesses to the Committee's inquiry acknowledged) that there are significant difficulties in making a reliable overall measurement of compliance costs, and of achieving a meaningful baseline figure. The Government notes the Committee's comments about work done on compliance costs in the Netherlands. It will certainly consider this work to see what lessons can be learned from it, though transplanting processes and experience from one country to another can sometimes be problematic.

- 5. In the absence of firm data it is not possible to determine conclusively how the administrative costs of tax compliance have changed over time. Most business witnesses believed that tax compliance costs, particularly payroll-related costs, have increased. The Revenue Departments considered that compliance costs have been broadly neutral since April 2001. But the Inland Revenue accepted that a number of new payroll requirements had been placed on employers before this, such as the introduction of tax credits, that added significantly to compliance costs. We also note that in reaching its view on compliance costs Customs and Excise specifically excluded measures introduced to combat fraud. We note some evidence which suggested that the administrative costs of tax compliance have risen. But the absence of any reliable method of measurement makes it difficult to adjudicate between these claims. In the absence of any agreed method of measurement these ambiguities will remain. (Paragraph 28)**

The Government notes the Committee's conclusion.

## Compliance costs of employer taxes

6. **Witnesses agreed that employer (or payroll) taxes generate the highest compliance costs for business and that these can fall disproportionately on small businesses. The Bath study published in 1998 by the Inland Revenue examined the compliance costs of PAYE and NICs and identified how these costs had changed between 1981–82 and 1995–96. It made a number of recommendations for reducing these costs on which action is being taken by the Inland Revenue. We note that there are no plans to update this work despite the significant changes that have been made subsequently to the tax system, such as the introduction of self assessment and the introduction of tax credits. We welcome the announcement in Budget 2004 of the Government’s intention to remove the responsibility for the payment of working tax credits from employers. We recommend the Bath study be updated to determine what changes there have been in compliance costs. (Paragraph 32)**

The Government does not currently have any plans to update the Bath study. A number of important changes are in hand in relation to payroll, particularly following the report by the then Mr Patrick Carter, “Review of Payroll Services”, which the Government commissioned in 2001, and the Government’s recent proposal to consult on removing from employers the obligation to pay tax credits through the payroll. In these circumstances, a further study of tax administration costs in relation to payroll could be overtaken and outdated very quickly. The Government recognises the very valuable function which employers perform in the tax system. It remains strongly committed to a programme of further improvements and assistance in this area, but it believes that it has the basis for this without a further updating of the Bath study in the short term.

## Regulatory Impact Assessments

7. **The Revenue Departments use Regulatory Impact Assessments to assess and quantify the impact of policy decisions on the administrative costs of tax compliance. We note the concerns expressed by the CBI and others about the accuracy of the figures used for tax compliance costs and savings in these assessments. We endorse the introduction of post-implementation reviews of these assessments to provide assurance that the figures used were reasonable and we consider that the results of such reviews should be made available to business and tax practitioners for comment. We therefore recommend each individual review be published. (Paragraph 38)**

The Government agrees with the Committee that post-implementation reviews are an important part of the Regulatory Impact Assessment process. It notes the Committee’s recommendation and will be considering how best to publish the results of post-implementation reviews.

8. **The Regulatory Impact Assessment process does not apply to operational changes. Such changes can have a significant impact on tax compliance costs. We note the initiative by Customs and Excise to apply the process internally to major operational changes that have no legislative dimension. Given that such an assessment seeks to measure the impact of a major operational change on business, it is not clear why this process should be confined to the department. We therefore**

**recommend that the full Regulatory Impact Assessment process be applied by the Revenue Departments to all major operational changes that are proposed. (Paragraph 39)**

The Government agrees with the Committee's conclusion that operational changes can have significant impacts on tax compliance costs. Both Revenue Departments are now developing arrangements to assess the impact on tax compliance costs of major operational changes.

## **PAYE, National Insurance Contributions and Statutory Sick Pay**

**9. We note the complications that have arisen from definitions used in PAYE calculations differing from those used in calculating National Insurance Contributions and from Statutory Sick Pay being the responsibility of another Government Department. We recommend that a deliberate effort should be made to rectify and eliminate such unnecessary complexity by harmonising definitions, accounting principles, administration arrangements etc. (Paragraph 44)**

As regards PAYE and National Insurance Contributions (NIC), the Government introduced significant changes aimed at aligning income tax and NIC in 2000, removing the "entry fee" payable when an employee earned more than the Lower Earnings Limit and abolishing the multiple rates of employer contributions.

Complete structural alignment of income tax and NIC is difficult because of the different purpose that they serve. Income Tax is designed to raise revenue for public spending from all sorts of people according to their total income and personal circumstances, but NIC are directly linked to entitlement to contributory benefits such as retirement pensions and the structure of contributions reflects this link.

The Government has focused on the practical assistance to employers in operating their payroll recommended in Mr Patrick Carter's review of Payroll Services. The Inland Revenue continue to work with employer representatives and others to look for opportunities to align the tax and NIC rules at a practical level, while having regard to individuals' benefit entitlements.

As regards Statutory Sick Pay, the Committee is aware that the policy on SSP is the responsibility of the Secretary of State for Work and Pensions. This is because there are close connections in policy terms between SSP and Incapacity Benefit, and the Government believes that the balance of advantage lies in the policy for both being the responsibility of one Department. Operational responsibility rests with the Inland Revenue. It was transferred from the DWP to the Revenue in April 1999 in order to modernise the administrative process and went hand in hand with the similar transfer of NICs. The Inland Revenue provide a more stream-lined and efficient service for employers who administer the scheme. They also provide a single focal point for employees engaged in any dispute about entitlement to SSP.

A number of measures have been taken to assist employers in their duty to provide for employees during short-term sickness. Most notable was the extensive consultation and examination of SSP rules by a group comprising employers, payroll providers and officials

which led, in 1997, to the majority of employers being given the freedom not to operate the SSP scheme, except in the need to maintain basic records. The Inland Revenue have also done much recently to improve the assistance and guidance for employers who continue to operate the scheme.

The Government also welcomes and will consider suggestions for further changes to the SSP scheme from employers and their representative bodies.

## Common commencement dates

**10. We note the DTI's announcement that changes in employment regulations will only be implemented on two set days each year which should reduce costs and make it easier for businesses to implement and respond to changes made. We hope that other departments will follow this lead. In particular, we would welcome a statement from the Revenue Departments setting out how they intend to respond to this initiative. (Paragraph 46)**

The feasibility of extending common commencement dates to other areas of regulation and tax is currently subject to public consultation, following the announcement by the Chancellor of the Exchequer in Budget 2004. The consultation period is due to finish in September. The Government recognises the value of greater certainty about changes to the regulatory environment. It has noted the Committee's views and will be taking account of all responses to the consultation paper.

## Strategy for compliance costs

**11. With the reorganisation proposed for the Treasury and the amalgamation of the Inland Revenue and the Customs and Excise, it is an appropriate time to establish a deliberate strategy for reducing or, at least, containing tax gathering and benefit paying compliance costs. (Paragraph 47)**

The Government's strategy for reducing the administrative costs of tax compliance was set out in written and oral evidence to the Committee's inquiry, but it will, as the Committee suggests, be reviewing and developing the strategy in the context of the implementation of the recommendations in the Review of the Revenue Departments published in March 2004.

**HM Treasury  
21 July 2004**

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\* Government Responses are usually received in the same session as the Report was published. Accordingly, the HC number refers to that session unless otherwise indicated.