National Audit Office

Corporation Tax: companies managed by HM Revenue and Customs' Area offices

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 678 Session 2005-2006 | 13 January 2006

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3 January 2006

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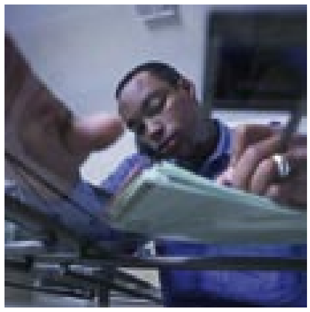

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EXECUTIVE SUMMARY

1 Corporation Tax is charged on the profits of around a million companies conducting business in the UK. The tax is levied at a rate of 30 per cent for companies making profits above £1.5 million, with lower rates for smaller profits. There is currently a nil-rate for profits below £10,000, but this is planned to be removed from 2006-07.[1] Corporation Tax is charged after certain adjustments to profits presented in a company's accounts, and various reliefs applied. Once registered with Companies House, companies become liable for Corporation Tax when they begin business. In 2004-05 HM Revenue and Customs (the Department) collected from them £33 billion in Corporation Tax.

2 Companies submit company tax returns[2] to the Department, which processes and checks them and collects the tax. It undertakes detailed enquiries on some returns, resulting in further tax revenue where taxpayers have not complied with their obligations. Such non-compliance might involve submitting a return with genuine errors or with inaccuracies aimed at paying less tax than is legally due. Companies may also seek to organise their affairs in ways that reduce their tax liability legally. The legality of different avoidance practices is often a matter of interpretation which ultimately may only be determined by the courts.

3 The Department manages Corporation Tax payers in two groups:

- A Large Business Service dealing with the direct and indirect tax affairs of the largest businesses, comprising some 900 groups of companies, who paid £18 billion in Corporation Tax in 2004-05. The Large Business Service also carries out audits of the compliance by larger businesses with their tax obligations as employers.
- A network of 68 Areas, which deals with around 1.1 million returns from the majority of companies, who paid £15 billion in Corporation Tax in 2004-05. The Areas also deal with Income Tax, PAYE and National Insurance contributions.

4 With the merger of the Inland Revenue and HM Customs & Excise in April 2005, their functions and organisations were combined, and are being restructured:

- Corporation Tax compliance work will continue to be managed in two groups. For those taxpayers dealt with locally, a new Local Compliance business unit will combine the local office networks of the two former departments. A new Strategic Zone structure is also being considered to allow some work to be concentrated in particular locations.
- Some risk-assessment work previously undertaken by Inland Revenue and Customs & Excise local areas is being brought together and centralised within a new Risk division. Company tax returns processing may also be centralised.
- The Department has created new business units to give a stronger focus on taxpayer customers and the design of tax processes; so that new customer units are managing the needs of small and medium enterprises and employers and of large enterprises and employers, and a new product and process unit is managing Corporation Tax and VAT systems.

1 In the 2005 Pre-Budget Report, the Government announced its decision to remove the nil rate band, and an associated ‘non-corporate distribution rate’, from 2006-07 onwards, and replace it by extending the current 19 per cent band to cover profits from zero to £300,000.

2 Company tax returns cover not just Corporation Tax but other taxes which affect companies such as tax on loans to directors and owners (‘Section 419 tax’).

5 The NAO examined the management of Corporation Tax for those businesses dealt with by local Areas. The examination centred on how the Department ensures that companies comply with Corporation Tax obligations and helps them to do so, and its efficiency in administering the tax, highlighting lessons and good practice to help the Department improve performance and achieve its efficiency targets. Appendix 1 provides details of our methodology.

Tackling non-compliance

6 Detailed enquiries by Areas on some taxpayers' returns have secured significant additional Corporation Tax that would otherwise have been lost, and increasingly so in recent years. Areas concluded 43,700 enquiries on 4 per cent of active companies in 2004-05. From these, they secured £602 million of additional yield (tax, interest and penalties); four per cent of the tax paid by companies dealt with by Areas. Since 1999-00, when the Department introduced self-assessment for Corporation Tax, it has almost halved the number of enquiries as it has sought to focus on higher risk cases while increasing the total additional tax yield by 42 per cent in real terms. [paragraph 2.7]

7 Aspect enquiries on average produce about half the yield of full enquiries, but they give a better pay-back because they need less staff input. The proportion of enquiries that change the tax or profit assessment has increased since 2002-03. Nevertheless, across the network 40 per cent of all Corporation Tax enquiries produced no additional tax yield or taxable profit adjustment, which we estimate cost £9 million in staff time. 'Aspect enquiries' concentrate on one or more element of the return where there are questions around the tax treatment of particular transactions. 'Full enquiries' tend to be undertaken on less complex companies where the focus may be on the disclosure and accounting for the entire income and assets of a business and its owners. Some 39,000 aspect enquiries secured yields of £12,000 on average – nearly 23 times their cost. 4,500 full enquiries, on the other hand, secured on average £27,000, five times their cost. Aspect enquiries had a higher no-change rate than for full enquiries. [paragraph 2.8]

8 Areas use penalties to help tackle non-compliance, mainly on full enquiries. Areas applied £11 million in penalties for negligently or fraudulently inaccurate returns in 13 per cent of the enquiries that resulted in an increased tax assessment in 2004-05: 51 per cent of full enquiries, but only 5 per cent of aspect enquiries. On aspect enquiries an important constraint in applying penalties against companies is that they often indicate they have relied in good faith on advice from external accountants or agents, and in such cases neither the company nor the agent can be penalised. The Department does not centrally collect details on the type of cases that are penalised or the extent to which penalties are abated to reflect the company's voluntary disclosure and cooperation, or the gravity of the offence. Fixed-penalties for failure to supply requested information are small when compared to business incomes – £50 plus daily penalties of up to £30. [paragraphs 2.9-2.10]

9 The extent of non-compliance identified and rectified through enquiries has to be set within the wider context of the 'tax gap' for Corporation Tax – the difference between the total tax that is theoretically payable and what is actually paid. The Department's random enquiry programme is now beginning to provide information on the extent and nature of that gap. The random enquiry programme for company tax was started in 2001. It has detected errors by companies in around 40 per cent of company tax returns dealt with by Areas, and identified common types of error, but the Department needs more time to produce sufficient data for it to draw robust conclusions on the likely amount of the tax being lost. [paragraphs 2.11-2.12]

10 The Department has performance indicators and targets for Corporation Tax which focus on Areas' enquiry work. It has developed these to provide a closer link with the Department's new Public Service Agreement target for reducing the level of underpaid tax. In 2002-03 the Department expanded the range of performance indicators and targets used for monitoring performance on Corporation Tax, having previously concentrated only on the numbers of enquiries completed. In 2004-05 it outperformed all of its Corporation Tax targets except for the yield:cost ratio on its full enquiries and the length of time its aspect enquiries are open. The Department has introduced new targets for 2005-06 which focus on total yield across the tax-streams. Areas are expected to contribute to meeting these Department-wide targets, which could encourage them to consider risks across the various taxes they manage. The main drawback of targets based on yield is that it could prompt Areas to concentrate on enquiries with firmer prospects of an immediate pay back at the expense of preventive work, including enquiries on loss-making companies which secure tax yields if subsequently a company moves into profit. [paragraphs 2.3-2.6]

11 There are variations in enquiry coverage so that companies of a similar size and compliance risk are more likely to be the subject of an enquiry in some Areas than in others. This uneven coverage stems from imbalances across Areas in the number and experience of tax inspectors compared to the number and complexity of the companies dealt with by each Area. The number of companies subjected to Corporation Tax enquiry ranged from 2 per cent of returns in one Area to 9 per cent in another. The number and type of enquiries is largely determined by the number and experience of staff in each Area. To achieve a better balance between caseloads and staff resources, the Department has moved some cases between Areas. [paragraphs 2.14-2.16]

12 There are also large variations across Areas in the additional tax yield they secure from their Corporation Tax enquiries. Overall, the average yield from full enquiries was £27,000, but ranged from an average of £13,000 in one Area to £60,000 in another. Yields on aspect enquiries were £12,000 on average, and Area averages ranged from £4,000 to £36,000. There was significant variation even when yields were weighted to reflect the size and complexity of the company caseload dealt with by each Area. The variations in the staffing, risk assessment, coverage and results of enquiry work suggest there is scope to achieve higher yields overall. An illustration of the broad order of magnitude of these variations is if Areas with below average yields in 2004-05 (weighted for each Area's company tax base) could have secured the network average yield, the total yield might have been around £60-100 million more. [paragraphs 2.13-2.15, 2.23]

13 The Department has over the last four years encouraged Areas to take a more structured approach in risk assessing returns to select cases for enquiry. This has involved making greater use of databases and a central catalogue of risk-profiling projects alongside the traditional technique of manually screening the returns and supporting documents. Higher performing Areas tended to make more extensive use of these techniques. Returns and their supplementary documents can run to many pages, and 'screening' them for non-compliance depends heavily on the skill and experience of staff. Some Areas continued to review all returns from companies above a particular level of turnover. Most, however, used a system for scoring the complexity of companies, a range of the databases available and risk-profiling 'projects' to select cases for enquiry or to reduce the pool of cases requiring screening or review. Some Areas considered they were unable to take full advantage of such techniques because of a lack of staff trained in the use of available databases. [paragraphs 2.18-2.22]

14 Areas have made increasing use of risk profiling projects, but as yet these do not appear to be significantly increasing the yields on full enquiries. Evaluating the results of project work will help in refining their design or improving the way they are applied. Since 2002-03, the Department has required Areas to use its catalogue of centrally defined risk-profiling 'projects' to generate at least 40 per cent of their full enquiries. Our survey of Areas found that such projects, along with projects devised locally, had helped to generate two-thirds of full enquiries in 2004-05. Areas which were making greater use of projects have not all recorded higher additional tax yields from their full enquiries. Some Areas using projects to select all of their full enquiries had recorded the lowest yield rates, although this might in part be because the project cases so far completed may be simpler than those still underway, involving lower potential yields. The Department's requirement for Areas to collect data on the results of projects should in time provide a means of evaluating which are the most worthwhile. [paragraph 2.21]

15 In setting targets for the number of Corporation Tax enquiries, the Department expects a minimum level of coverage of smaller companies. The Department plans to carry out further research on the deterrent effect of this coverage and the compliance risks associated with different sizes of companies to establish a baseline. The tax yields from small or less complex cases are low and under a risk based approach such cases might warrant little attention. The main purpose of setting a minimum level of coverage is to deter non-compliance amongst this group. The Department currently sets the minimum level of coverage without a detailed assessment of the relative compliance risk of different sizes of business. [paragraph 2.20]

16 The Department is examining how it can follow a more joined up approach for its compliance work on the different business taxes, which could bring benefits for both the Department and business taxpayers. The Department has initiated an analysis of the causes of non-compliance and errors that feature most commonly in company tax returns to inform its overarching risk strategy for direct taxes. The risks posed by a particular company on Corporation Tax may also be indicative of risks in other taxes such as PAYE. Our survey of Areas found that for full Corporation Tax enquiries, which could be most suitable for joint review, nine per cent also covered other taxes paid by the companies. The Department is undertaking pilot projects in four Areas to examine how enquiry teams can focus more on the business rather than each tax. [paragraphs 2.24-2.25]

17 Planned improvements in the databases available and further development of the company tax returns online filing system should help the Department enhance its risk assessments. Online filing enhancements should also contribute to more efficient processing of returns and greater convenience for many businesses. The 'Better Data for Corporation Tax' initiative, which is combining existing databases and making them more readily accessible, should help Areas to strengthen their risk assessments. In time, the Department expects to be able to process and analyse data in the accounts and tax computations filed electronically, and this should improve the availability and utility of data for risk assessments. [paragraphs 2.26-2.27, 3.9]

Enabling companies to comply with their Corporation Tax obligations

18 There is relatively little research on the administrative burden and costs for businesses in meeting their Corporation Tax obligations, although some studies suggest that these might be less in the UK than in some other countries. The level of errors in tax returns suggests that the complexity of the tax may be contributing to the difficulties some companies appear to face in complying with the regulations. Research suggests that Corporation Tax has the least compliance burden of the three main types of business taxes. Nevertheless, the business community and representative tax bodies have raised concerns over the compliance burden of Corporation Tax as well as of other business taxes. Academic and other research indicates that the burden arises principally from the complexity of the Tax structure, which requires various adjustments to the way in which assets, income and expenditure are presented in company accounts to arrive at taxable profit, and a growing volume of frequent legislative change. [paragraphs 3.2-3.3, 3.10]

19 The Department has introduced new measures to help Corporation Tax payers to submit compliant returns. Companies may use an electronic return which has in-built checks and provides an automatic acknowledgment of its receipt. The Department has also introduced a shorter paper form for those companies with simpler financial affairs. In recent years Areas have negotiated 'enabling' relationships with some of their largest companies, to deal with tax issues and to review companies' working papers before they submit their tax return. The benefits are convenience for companies in arranging their dealings with the Department and simple points can be clarified without the need for a formal enquiry. [paragraphs 3.7-3.9]

20 Enquiries are being carried out more quickly but they still take many months to complete. A Department trial of new methods for sharing data and communicating with companies suggests that the elapsed times for enquiries could be significantly reduced. Aspect enquiries which resulted in no additional tax yield or profit adjustment take on average 33 weeks to complete, and full enquiries 71 weeks. Enquiries in some Areas take much longer than this. The time taken to complete enquiries is affected by the time needed to check aspects of the return as well as the time taken by companies or their agents to respond to inspectors' questions. A trial in one Area using web-based technology to communicate and work with agents more effectively has indicated that elapsed times might be reduced by up to 20 per cent. [paragraphs 3.11-3.13]

21 The Department is taking steps which could reduce the obligations on companies and make it easier for them to meet their Corporation Tax obligations. The Department has been consulting on ways for smaller companies to file less data on a range of taxes less often and more easily. It outlined responses to the consultation in November 2005. In parallel with the Hampton initiative on reducing the impact of government regulation, it is mapping Corporation Tax and other tax requirements placed on companies to set a baseline for tracking and reducing the costs of compliance. As part of its restructuring, the Department has set up a business unit for small and medium enterprises and employers to focus more clearly on the needs of this taxpayer customer group. [paragraphs 3.4-3.5, 3.14]

Efficiency in managing Corporation Tax

22 The Department spent £320 million on Corporation Tax work in 2004-05, including central overheads, two-thirds of which related to Areas' work. Around 1,900 of some 39,000 staff in Areas work on Corporation Tax. About 800 staff processed company tax returns and other administrative and compliance tasks and another 1,100 undertook Corporation Tax enquiries. [paragraph 4.1]

23 **There were wide variations in Areas' efficiency in processing company tax returns, indicating scope for efficiency savings.** Areas have coped with a major surge in new incorporations over the last three years. Nevertheless, some Areas had six times the ratio of processing staff to returns processed as other Areas, although the range of tasks undertaken by these staff varied between offices. Our analysis of the Department's data indicated that if all Areas had undertaken tasks they recorded as processing work at the average rate nationally, staff costs might have been up to £2.2 million (13 per cent) lower. Because some Areas include some compliance activities in their 'processing' figures, however, any such improvement in processing rates might involve increased off-setting costs for enquiry work. The Department's plans to develop e-filing should reduce the cost of processing returns, and potentially greater savings might be possible if that allowed the Department to no longer have to process returns at the same locations as those undertaking enquiries. [paragraphs 4.2-4.3]

24 **There were also wide variations in Areas' efficiency in undertaking enquiries, again indicating potential for greater efficiency.** Average enquiry costs were twice as high in some Areas as in others, although this reflected in part the additional tax yields achieved. Broadly speaking £13 of yield required £1 of enquiry staff cost. Yields to some extent reflect the size of the companies each Area deals with. Taking this into account, some Areas were more efficient than others in terms of achieving their potential yield, with some incurring costs two or three times higher than others to secure similar weighted yields. [paragraphs 4.5-4.6]

25 **An important factor in the variations in enquiry efficiency appears to be differences in enquiry coverage, noted above, which causes Areas to cover their higher-risk companies to different degrees. But other factors are also involved. The Department has initiatives underway to improve the efficiency of enquiry work, and is currently reviewing the number and location of local offices as part of its restructuring.** The Department's trial on electronic communications with companies during enquiries (paragraph 20) could reduce enquiry costs. It has also developed a 'team working' system to allocate enquiry tasks more closely to staff with the appropriate level of experience, and a new planning system to balance local workloads and resources more closely across tax-streams. Further improvements could also be made from wider use of working practices that only some Areas use at present. [paragraphs 4.7-4.10]

Overall conclusions

26 **The management of Corporation Tax in the network has improved in recent years with the introduction of a more structured approach to risk assessment, better management information, and a new framework of performance indicators. Over the last five years the Department has significantly increased the additional Corporation Tax yield that Areas secure while carrying out fewer enquiries which take less time to complete.**

27 **Significant variations in performance remain across the 68 Areas, however, providing scope for savings in the cost of Corporation Tax processing and enquiry work, together with still higher yields. Much of the variation arises because resources are not matched to risks sufficiently closely throughout the network.**

28 **The Department's plans for reorganising local compliance work into fewer but larger offices, on which it is consulting staff, provides an opportunity to improve the effectiveness and efficiency of its work. Thus, it should be possible for the Department to match staffing levels and experience more closely to local compliance risks and workloads. It should also be easier to provide staff skilled in using risk-assessment databases across all new local offices. And best practices and experience of new techniques ought to be more easily shared if staff work together in bigger units.**

29 **At a more fundamental level, the scope for compliance improvements hinges not just on the way enquiries are managed but on being able to tackle some of the underlying reasons for non-compliance. The Department is taking steps to address some of those factors. Its random enquiry programme should help it identify the nature and risks of non-compliance. The Department's stronger focus on taxpayers' needs, together with any tax simplification from the current consultations and initiatives to reduce compliance burdens, should help to increase levels of compliance. These should make it easier for companies to understand and meet their requirements, and enable the Department to concentrate its work on those that seek to evade the tax.**

RECOMMENDATIONS

On tackling non-compliance

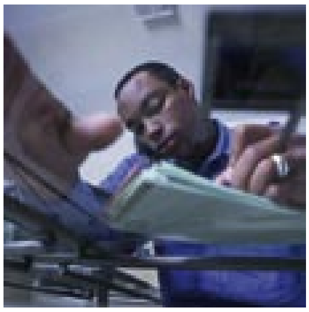
a Given the lower yields generally achieved from enquiries on small companies, and the time and cost these impose on the companies themselves, the Department should establish the extent and nature of non-compliance risks in this sector to formulate a reasonable minimum 'policing' coverage.

b Risk-profiling projects have the potential to help the Department to target quickly and effectively higher risk Corporation Tax cases for possible enquiry. To realise their full benefits, and to eliminate less productive work, the Department should analyse the results of centrally-defined projects to identify the most promising for further development and wider use. For risk assessing returns more generally, the Department should also use the results of the NAO's survey of Areas to target efforts to expand the use of available databases.

c In devising its new local office structure, the Department should aim to provide the skills needed to develop project work in local offices, and that each office has access to sufficient expertise in using databases and other analytical tools for risk assessment. It should also consider the benefits and costs of building up specialist knowledge on different business sectors to help improve its risk assessments and targeting of enquiries.

d Electronic filing of company tax returns should bring various benefits to the Department including opportunities for more effective risk-assessment. With further development, the Department will be able to process and analyse the data in the accounts and tax computations filed electronically, and should then encourage companies and their agents to file their tax returns and accounts online, and set targets for increasing take-up.

e Penalties applied should be sufficient to encourage companies to comply and to obtain appropriate advice from any third-party agents. But the Department first needs to improve its understanding of how it applies penalties in practice by analysing its use of negligence penalties and the abatements it makes.



On enabling compliance

f The Department should publicise the main types of non-compliance it rectifies, particularly for newly incorporated businesses.

g To encourage Areas to carry out preventive work that helps companies to comply, the Department should extend its current range of performance indicators to recognise the benefits also of this work, and consider how it might quantify the revenue benefits achieved from this type of work. It should also take account of the less-immediate benefits for tax yields from enquiries on loss-making companies which later become profit-making, to ensure this type of enquiry is accorded appropriate priority.

h The Department should reduce the time taken to complete enquiries, building on the encouraging results of its trial of an electronic 'shared workspace' in one Area, and the practices of those Areas with the lowest average elapsed times.

i In developing the role of its new customer business units, the Department should explore ways of obtaining more direct feedback on businesses' tax compliance burdens and possible improvements through the appointment of 'business ambassadors' from the business community.

On the efficiency of managing Corporation Tax

j As it seeks to reorganise local office structures, and in anticipation of greater use of electronic filing of company tax returns, the Department should explore the costs and benefits of concentrating returns processing in fewer locations.

k The Department should redistribute Corporation Tax enquiry workloads across Areas to even out the way risk is covered through its enquiries, building on existing local work-sharing arrangements. In reorganising the local office structure, it should build a sufficient critical mass of work for all offices to allow it to balance resources with risk more closely. This is also likely to require a fundamental reassessment of the workload norms and the way staff resources are allocated to enquiry work to improve productivity. It might also include widening the approach of enquiry work, by embracing more cross tax-stream enquiries.

l The Department should track the efficiency of Areas' enquiry and other compliance work, not just of the work actually undertaken but also in terms of Areas' relative efficiency in securing additional tax yield compared with the size of their local company caseload.

PART ONE
Introduction




1.1 Corporation Tax is charged on the profits of companies and clubs resident or conducting business in the United Kingdom. The tax is levied at different rates – 30 per cent for companies making profits above £1.5 million, 19 per cent for profits of between £50,000 and £300,000, and (until 2006-07[3]) a nil rate on profits below £10,000 – with a tapering scale of rates applied between the three bands. Taxable profits are derived from accounting profits after a range of adjustments and allowances. In total there are 2.3 million companies and 64,000 clubs and societies. Of these, however, around 500,000 are dormant and 700,000 have not been operating long enough to have to submit tax returns. A further 600,000 do not have to pay tax because they are in the nil rate band or are making losses. As a result, about 500,000 have a Tax liability. In 2004-05 Her Majesty's Revenue and Customs (the Department) collected £33 billion in Corporation Tax.

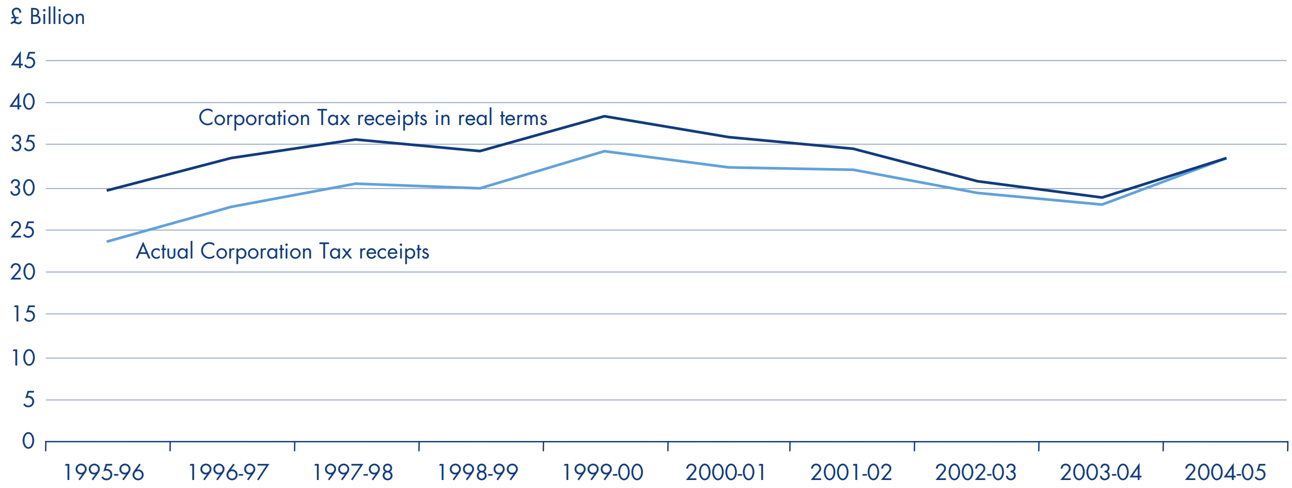
Trends in Corporation Tax revenues

1.2 Revenue from Corporation Tax fell from a peak of £34.3 billion in 1999-2000 to £28.1 billion in 2003-04 before rising again in 2004-05 **(Figure 1 overleaf)**. The 1999-2000 peak was due partly to rising stock markets and company profitability and partly to the introduction of quarterly in-year instalment payments for large companies, which brought forward the timing of Corporation Tax payments. Receipts have fallen since 1999-2000 because of lower profits in many businesses, reductions in Corporation Tax rates and changes to allowances. Corporation Tax receipts have generally been below government forecasts since 2000-01. The Department attributes this mainly to difficulties of relating forecast economic activity to tax receipts. For the majority of companies which do not pay tax in instalments, there is also a time lag of 12-24 months before changes in profitability are reflected in tax receipts. After 2002-03, company profits rose and were reflected in higher tax receipts in 2004-05.

1.3 The number of companies has grown in recent years, particularly following the introduction in 2002 of a nil tax rate of Corporation Tax for companies with profits below £10,000. This helped stimulate over 330,000 new incorporations in each of the last three tax years, peaking in 2003-04 at over 450,000. The Department estimates that there are 820,000 companies with profits below £50,000 a year; the point at which the 19 per cent rate is applied. To ensure that the benefits of the nil rate of Corporation Tax were directed towards those companies seeking to retain and re-invest their profits, the Government introduced a new 'non-corporate distribution rate' in 2004 to tax companies on certain dividends paid to individuals, and in December 2005 decided to replace both the nil rate band and the non-corporate distribution rate with an extended 19 per cent band, effective from April 2006.

3 In the 2005 Pre-Budget Report, the Government announced its decision to remove the nil rate band and the 'non-corporate distribution rate' (paragrah 1.3) from 2006-07 onwards, and replace it by extending the current 19 per cent band to cover profits from zero to £300,000.

1 Receipts from Corporation Tax 1995-96 – 2004-05



Source: National Audit Office analysis of HMRC data

NOTE

Real terms data, in 2004-05 terms, is derived from Treasury GDP deflators.

1.4 Individual companies' profits vary widely. Three-quarters of Corporation Tax receipts come from half of one per cent of companies, and two-thirds of companies have tax liabilities of less than £1,000 a year. Profits also fluctuate considerably from year to year. For example, 173,000 companies with no tax liability in 2002-03 had a liability in the following year. For more than 4,000 of them the liability was over £100,000. Conversely, 189,000 companies with a tax liability in 2002-03 had no liability in the following year.

Corporation Tax administration

1.5 Since the introduction of self assessment in 1999-2000 all companies are required to assess their own tax liability, pay any tax due, and file a return with the Department within twelve months of their accounting year-end. The Department carries out initial checks on the return and that the tax has been paid. Following risk assessment it also undertakes detailed enquiries on some returns, resulting in further tax revenue. Appendix 2 shows the stages of the process. The Department manages Corporation Tax payers in two groups:

- A **Large Business Service** dealing with the direct and indirect tax affairs of the largest 900 groups of companies who paid £18 billion in Corporation Tax in 2004-05. It also deals with PAYE and National Insurance contributions of the largest employers.
- A **network of 68 Areas**, organised until recently into seven Regions, which deals with the 1.1 million returns from other companies, who paid £15 billion in 2004-05. Each Area is responsible for processing and checking the tax returns of the companies based in its geographical area.

1.6 With the creation of HM Revenue and Customs in April 2005, the functions and organisation of the Inland Revenue and HM Customs & Excise were combined and are being restructured. The Department aims to increase the payment of tax that is due, whilst improving the service to taxpayers and making administrative efficiency savings. Checking companies' compliance with their Corporation Tax obligations will continue to be managed in two groups: the Large Business Service and a new Local Compliance business unit. The latter will combine and rationalise the local office networks of the two former departments within a new 'Strategic Zone' structure aimed at concentrating some activities in particular locations. The Department is consulting staff on these changes. Some risk assessment work previously undertaken by Areas will be brought together within a new Risk Division. The Department has created new business units to give a stronger focus on taxpaying customers' needs and behaviour and on the design of tax processes. One unit is looking at the needs of small and medium size enterprises and employers, another at the needs of large enterprises and employers, and another is looking at the structures and processes of Corporation Tax and Value Added Tax.

The scope of our study

1.7 The National Audit Office examined the management of Corporation Tax for those businesses dealt with by Areas (our recent Report on the 2004-05 Accounts of the former Inland Revenue covered aspects of the work of the Large Business Service[4]). Our examination centred on how the Department ensures companies comply with Corporation Tax obligations and helps them to do so, and its efficiency in administering the tax, highlighting lessons and good practice to help the Department improve performance. We did not examine the Department's arrangements for obtaining completed tax returns from companies or securing payment of tax due. We reported on the Department's collection of tax debt in 2004.[5]

1.8 Appendix 1 details our methodology. We examined the Department's performance data, supplemented by our own survey of Areas to obtain information on workloads and approaches to risk assessment. We interviewed Departmental staff, ran a focus group of Area and Regional staff, and visited three Areas. We consulted business, tax and professional accountancy representative bodies, and visited the United States and Sweden to gain international perspectives on the way corporate taxes are managed.

4 *C&AG's Standard Report on the Accounts of the Inland Revenue 2004-05*, HC 446, Session 2005-06, Part 3.
5 *Recovery of Debt by the Inland Revenue*, HC 363, Session 2003-04.

PART TWO
Tackling non-compliance





Main risks of non-compliance

2.1 Companies are required to notify the Department when they begin business and thereafter to file a tax return each year within twelve months of their accounting year-end. Companies House notifies the Department when a new company registers with it, which enables the Department to remind the company to complete a return and to check that it files a return in due course. Areas assess the returns for possible risks of non-compliance and select some cases for more detailed enquiries. Non-compliant tax returns might involve genuine mistakes, negligent errors or omissions, or deliberate errors aimed at evading tax. Companies may also seek to organise their affairs in ways that reduce their tax liability. The legality of different tax avoidance practices is often a matter of interpretation, which ultimately may only be resolved in the courts.

2.2 The calculation of a company's Corporation Tax liability starts with its accounting profits, but includes a range of adjustments. These include for example replacing depreciation in the accounts with the tax's capital allowances, and removing accounting expenditures that are not tax deductible such as on entertaining clients. Companies can also claim research and development and other tax credits, and they can offset against their taxable profits losses from other years and losses in other companies within the same group. The tax rate itself is affected by the number of companies in a group or otherwise associated with each other.[6]

Departmental targets and performance on enquiries

2.3 The Department's general aim for Corporation Tax, as for all direct taxes, is to reduce the loss of tax due to non-compliance using fewer resources, while at the same time minimising the burden on business. For 2005-2008 it has a new Public Service Agreement target to reduce the under-payment of direct tax and National Insurance contributions by £3.5 billion a year. In terms of the work of Areas, the Department has set performance indicators and targets for Corporation Tax, and for other taxes, that focus on their enquiry work. These cover the two types of enquiry: 'Full' enquiries and 'aspect' enquiries. Full enquiries attempt to validate the accuracy and completeness of a return, and the Department tends to undertake these on less complex companies where the focus is on the disclosure and accounting for the entire income and assets of a business and its owners. 'Aspect' enquiries examine the accuracy and tax treatment of one or more particular features of a return, and tend to be used for larger, more complex companies.

6 An associated company either controls another company or both are under common control by another person or persons.

2.4 Until 2001-02, the main performance indicators and targets for Areas were the number of enquiries begun, for each tax-stream, compared with the numbers planned. In 2002-03 the Department extended the range of indicators to include also the median additional yields (tax, interest and penalties) generated by enquiries, the quality standards achieved and the time taken to complete enquiries. The Department did this to reduce the incentive to open up new enquiries at the year-end to meet the targets, and to encourage Areas to select cases that might be more complex but offer the potential of higher yield, and to have regard to the need to complete enquiries quickly.

2.5 The Department agrees targets with each Region, who in turn agree targets with their Areas. By monitoring results, the Department together with some Regions sought to improve the standard of compliance work by developing training programmes to encourage local adherence to systems for managing enquiries. In 2004-05 the Department exceeded all of its overall targets except for the yield:cost ratio from its full enquiries and the length of time aspect enquiries have been open **(Figure 2)**.

2.6 The Department has retained these indicators as a means of assessing Area performance for 2005-06, and although there is no set target for Areas they are expected to contribute to meeting the Department's target of £1.5 billion additional direct tax yield. This revised target provides a closer link with the Public Service Agreement target of reducing tax under-payments, and could encourage Areas to consider risks across the various taxes they manage and to undertake more joint enquiries. The main drawback of performance indicators or targets based solely on additional yield is that they could prompt Areas to concentrate on enquiries with firmer prospects of an immediate pay back at the expense of preventive work which might lead to more significant additional yield in the longer term, but may be difficult to quantify. For example, enquiries on loss-making companies may now be seen as a lower priority even though the tax at risk could be significant because such losses can be offset later on if a company moves into profit. The Department is considering the scope for quantifying and scoring the potential future tax yields from enquiries which produce profit adjustments.

2 The Department's performance against targets set for Corporation Tax work by Areas in 2004-05

	Full enquiries		Aspect enquiries	
	Targets	Actual performance	Targets	Actual performance
Overall yield:cost ratio	5.6	4.8	19.4	22.6
Median additional tax-yield on full enquiries	£6,000	£7,200		
Median increased profit-adjustments on aspect enquiries			£24,000	£28,900
Number of enquiries	5,300	5,400	38,200	38,900
Average age of enquiries still open	73 weeks	66 weeks	49 weeks	51 weeks
Average elapsed time of completed enquiries with no change in tax assessment	73 weeks	71 weeks	38 weeks	33 weeks
Average quality score of the management of enquiry cases	Score of 90	Score of 96	Score of 90	Score of 94

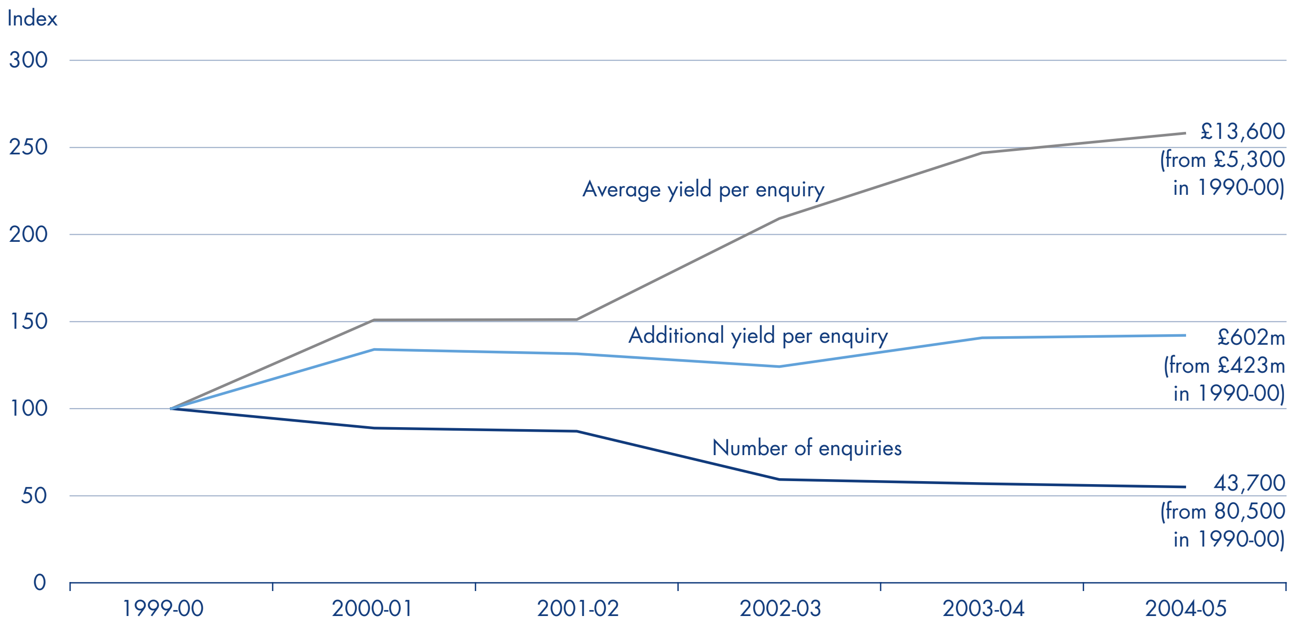
Source: National Audit Office analysis of HMRC data

The results of enquiries

2.7 In 2004-05 the Department generated £602 million in additional yield (tax, interest and penalties) as a result of Area enquiries on selected company tax returns[7], equivalent to 4 per cent of the tax paid by companies dealt with by Areas. Areas concluded 43,700 enquiries, around 4 per cent of the total number of returns. Since 1999-2000 the Department has reduced the number of enquiries by almost half as it has improved its targeting of enquiries on higher risk returns. As a result, additional tax generated increased by 42 per cent in real terms, and the average yield per enquiry by two-and-a-half times **(Figure 3)**.

2.8 Within each Area, separate Corporation Tax teams undertake full and aspect enquiries. In 2004-05, from 4,500 full enquiries they secured on average additional tax of £27,000, five times their average cost; and from some 39,200 aspect enquiries yields of £12,000 on average, nearly 23 times their cost. Many enquiries, however, do not generate additional tax or result in adjusted taxable profits.[8] The proportion of enquiries that change the tax or profit assessment has increased since 2002-03 **(Figure 4 overleaf)**. Nevertheless, across the network 40 per cent of enquiries produce no change, and we estimate that overall these cases cost £9 million in staff time. The proportion of enquiries with a nil result was much higher for aspect enquiries than for full enquiries or for business Income Tax enquiries **(Figure 5 overleaf)**. The proportion of enquiries which secure additional tax or profit adjustments could reflect a number of factors, including: the effectiveness of enquiry work; the difficulty in identifying non-compliant cases from initial risk-assessments; the need to seek additional information to test potential risks and the number of enquiries undertaken, where a greater company tax-base might increase the number of enquiries on relatively lower-risk returns. The Department does not set a target for an acceptable success rate for its enquiries.

3 Relative trends in the number of enquiries and the additional tax yields they achieved, in real terms (indexed-values; 1990-2000 = 100)



Source: National Audit Office analysis of HMRC data

NOTE
Additional yields and average yields are in real (2004-05) terms, derived from Treasury GDP deflators.

7 Company tax returns cover not just Corporation Tax but other taxes which affect companies such as tax on loans to directors and owners ('Section 419 tax').
8 A change in tax profit might not necessarily mean a change in tax liability, if for example the company or another in the same group is making losses.

4 Proportion of Corporation Tax enquiries which increased the tax or profit assessment, 2002-03 to 2004-05

	2002-03 %	2003-04 %	2004-05 %	Improvement (percentage points)
Full enquiries	77	79	81	4
Aspect enquiries	56	57	58	2

Source: National Audit Office analysis of HMRC data

5 Proportion of enquiries with no change in outcome, 2004-05

	Corporation Tax (%)	Business Income Tax returns (%)
Full enquiries	19	21
Aspect enquiries	42	29
Overall	40	25

Source: National Audit Office analysis of HMRC data

Penalties for inaccurate returns

2.9 When the Department identifies a negligently or fraudulently inaccurate return, it requires payment of the additional tax due and can impose an additional penalty of up to the same amount. The actual penalty depends on the level of abatement it applies after considering three possible mitigating factors: the extent of voluntary disclosure of the error by the company; the seriousness of the offence; and the co-operation the company gives the Department in the enquiry. The Department can also impose a fixed penalty of £50 plus daily penalties of up to £30 if a company fails to provide information requested in the course of an enquiry.

2.10 The Areas applied nearly 2,600 penalties for negligently or fraudulently inaccurate returns in 2004-05 totalling £11.1 million, net of abatements, or £4,300 each on average. 500 larger penalty cases were dealt with by the Department centrally as serious cases. Of the 19,000 enquiries that resulted in an increased tax assessment, the Department applied penalties in 13 per cent: in 51 per cent of full enquiries and in 5 per cent of aspect enquiries. An important constraint in applying penalties against companies on aspect enquiries is that these often involve questions of interpretation of accounting and tax rules where companies often rely in good faith on advice from external accountants or agents. In such cases companies and agents cannot be penalised under the existing legislation. The Department does not record centrally the types of cases that are penalised and those which are not, or the scale of the abatements applied, to assess whether penalties are being used effectively to deter non-compliant behaviour.

The Corporation Tax 'tax gap'

2.11 The extent of non-compliance rectified through enquiries has to be seen in the wider context of the overall 'tax gap' – the difference between the total tax that is theoretically payable and what is actually paid. For Corporation Tax and other direct taxes, it is inherently difficult to estimate the size of the tax gap from available macro-economic data, but the Department is seeking to estimate the overall level of error in tax returns from a programme of random enquiries. Company tax random enquiries were started in 2001 and the Department completed the first review of these cases in 2005, examining 400 returns covering a three year period. From this it has concluded that it does not yet have sufficient data to draw robust conclusions on the likely amount of tax being lost overall, but has been able to establish more reliable data on the types of errors in returns.

2.12 The company tax random enquiries detected errors by companies in around 40 per cent of returns, with under-assessments of tax of around £2,700 on average. The Department identified around 60 different main types of error, although eight accounted for half of all of the errors recorded. The most common were business receipts being understated, owners' personal expenses being included in the company's accounts and loans made to directors without being taxed.

Area performance on enquiry work

2.13 The contribution that each Area makes to tackling non-compliance through their enquiries varies significantly **(Figure 6)**. The proportion of enquiries that resulted in a tax yield or taxable profits adjustment (the 'strike rate') ranged from 44 per cent in one Area to 80 per cent in another. An Area's average yield in a particular year can be influenced by when larger individual enquiries are settled and their yield scored. Nevertheless, the range of Areas' average yields was wide – from £13,000 for one Area's full enquiries to £60,000 in another, and from £4,000 to £36,000 for aspect enquiries.

2.14 The way cases are risk assessed to select enquiries plays a part in that variable performance, as discussed at paragraphs 2.17 to 2.22. Another factor is differences in the level of enquiry coverage, which can result in companies of a particular size and risk being subject to enquiry in one Area but not in another. About 4 per cent of returns overall were the subject of enquiry in 2004-05, but this ranged from 9 per cent in one Area to 2 per cent in another. The uneven coverage stems in part from the distribution of enquiry staff between Areas and grade-mixes which did not closely reflect the risk-profile of the local tax-base.

2.15 The Department plans the number of enquiries according to the number of companies and a scoring of their size and complexity, as an indicator of their possible risk. But in allocating enquiry targets for each Area, it takes account of the number and grade-mix of local staff complements, which reflect the actual distribution of staff across the network. In most Areas these staffing complements differ significantly from the number indicated by the Department's planning norms for the number and complexity of the companies **(Figure 7 overleaf)**. Some Areas had enquiry staff complements nearly twice that warranted by the relative size of their tax base, for example, while others had only half. As a result, in 2004-05 a third of Areas had an enquiry target that differed from the number indicated by their local company tax-base by more than 25 per cent, although the Department adjusted Areas' enquiry targets to reduce some of the greatest disparities. To some extent these relative differences in staffing levels reflect the difficulty in refining complements when small teams are involved. Most Areas have between five and 30 enquiry staff.

6 The range in performance of Areas: additional yield and enquiry 'strike rates'

Type	National average	Highest Area Average	Lowest Area Average
Yields generated:			
Full enquiries	£27,000	£60,000	£13,000
Aspect enquiries	£12,000	£36,000	£4,000
Proportion of enquiries resulting in additional tax yield or profit adjustment ('strike rates'):			
Full enquiries	81%	100%	59%
Aspect enquiries	58%	78%	40%

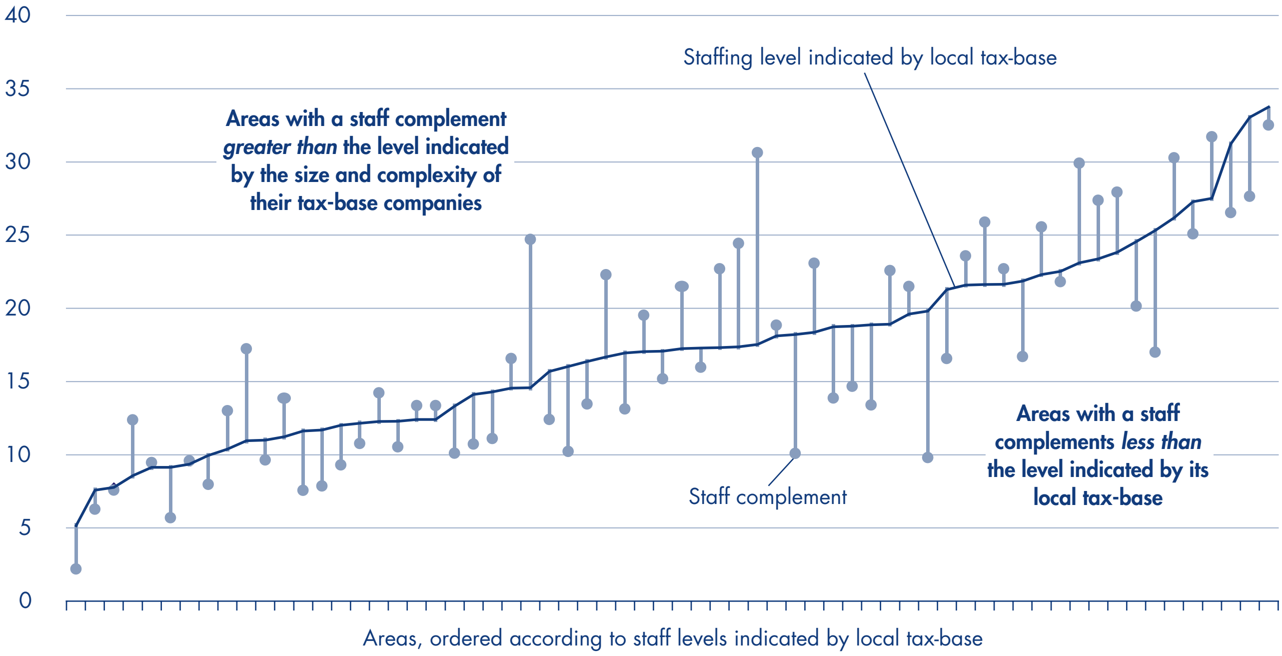
Source: National Audit Office analysis of HMRC data

2.16 These imbalances were compounded by a mismatch between the actual grade mix of staff compared to that indicated by the Department's planning norms **(Figure 8 overleaf)**. In 2002 the Department noted that in some London Areas, where the number of larger companies was not matched by the required number of senior staff, these companies were less likely to be subject to enquiry as similar-sized companies located elsewhere. The Department reduced that unevenness by moving some London cases elsewhere and it is now less significant. Nevertheless, the complements for qualified inspector grades nationally is 10 per cent below the level normally planned for dealing with the number and size of companies (Figure 8). Conversely, the relatively greater availability of some junior grade staff caused some Areas to do more enquiries of lower-risk returns than warranted. For example, one of the three Areas we visited judged it should undertake aspect enquiries on 30 of its smaller companies in 2004-05 but undertook 100 to load its junior staff fully. To help counter workload variations, and even out inconsistent risk coverage, some Areas have made informal arrangements to share their workloads. An Area we visited, for example, was part of a group of five intending to start reallocating cases from Autumn 2005.

7 Corporation Tax enquiry staff in Areas – comparison between complement and staffing levels indicated by the Area company caseload for 2004-05

This figure shows that most Areas had either significantly too many or too few staff for the scale of their respective company tax-base.

Staff in each Area; complements and level indicated by local tax-base (whole time equivalent)



Source: National Audit Office analysis of HMRC data

8 Comparison between Corporation Tax enquiry staff complements and numbers indicated by the tax-base, 2004-05

	Qualified Inspector grade-B1	Qualified Inspector grade-B2	Trainee Inspector	Inspector grade-C1	Inspector grade-C2	Caseworker grade-D	Caseworker grade-E1	Caseworker grade-E2	Totals
Staff level indicated by tax-base	147	310	10	240	243	120	73	67	1,209
Surplus/(deficiency) of complements against	(19)	(27)	5	(33)	28	10	(27)	(20)	(83)
that norm	(13%)	(9%)	56%	(14%)	11%	8%	(37%)	(30%)	(7%)

Source: National Audit Office analysis of HMRC data

Risk assessing cases to select enquiries

2.17 Selecting companies for enquiry that are most likely to identify an additional tax liability, and doing this efficiently, depends largely on good risk assessment. Before the introduction of self-assessment for Corporation Tax in 1999-2000, inspectors had to make a formal assessment of tax due which involved some degree of checking all returns received. With self-assessment, Areas retained much autonomy in deciding which returns they selected for enquiry and many continued the practice of manually 'screening' the returns of all companies achieving a particular level of turnover and reviewing them for non-compliance. Such screening could be time-consuming when it involved staff looking through a return with many pages of accounts and other supporting documents. The independent audit of accounts under the Companies Act, required for a little over half of companies' accounts, provides assurance about the content of the accounts. However, because company accounts have to be adjusted for a number of different tax rules to arrive at the taxable profits, inspectors focus on these adjustments and their relationship to the underlying accounts.

2.18 In recent years the Department has introduced methods to make the risk assessment process more efficient. These enable Areas to identify those returns which are likely to be higher risk and thereby reduce the pool of returns that need to be screened and reviewed:

- It introduced guidance in 2003 on a catalogue of databases which Areas could use to help identify companies with non-compliance risks. For example, data from commercially available databases of company accounts could be added to the Department's data from the tax return to help identify risks which would not be apparent from just one or the other source.
- It developed a system of scoring each company's size and financial complexity, using data derived from its own system and from the company's registration with Companies House. The Department has since 2003-04 required Areas to review all of the highest scoring companies and undertake a detailed check.
- Since 2002-03 it has produced a central catalogue of risk-profiling 'projects' to identify cases presenting particular tax risks related, for example, to particular trades and business activities. In addition, the Department set up Risk Intelligence & Analysis Teams in each Area to allow specialist database and accounting staff to identify higher risk cases for potential enquiry. The Department is encouraging Areas to use projects increasingly to target cases for review.

2.19 As a result, while Areas might typically receive between 10,000 and 40,000 returns each year, they are able to confine screening and reviews to a much smaller subset to select the 50-100 full enquiries and 500 or so aspect enquiries each is required to undertake. A typical scenario, from our survey of Areas, involves a range of approaches being used. Returns were usually grouped according to their complexity score (and sometimes also according to turnover) and allocated to staff of different grades to be screened for potential aspect enquiries. Other returns were also short-listed by using risk-profile projects (many using the various databases available) to select full enquiries. Nearly all Areas used the complexity scoring system to divide returns between potential full and aspect enquiries. The Department required Areas to select 40 per cent of their full enquiries in 2004-05 from its central list of potential projects. We found that overall Areas were using these projects, along with others that were devised locally, to help identify two-thirds of full enquiries. Screening returns that had previously been grouped according to complexity scores was used for identifying most aspect enquiries, although about 10 per cent were chosen as a result of project risk-profiles. At different ends of the spectrum, some Areas used projects to help select all of their enquiries, while others screened and reviewed every return from companies having a particular level of turnover.

2.20 In setting targets for the number of Corporation Tax enquiries, the Department expects a minimum level of coverage of smaller companies. The aim is to deter non-compliance amongst this group, while recognising that the yields from small or less complex cases are relatively low, and under a risk-based approach such cases might warrant less attention. The Department currently sets the minimum level of coverage without a detailed assessment of the relative compliance risk of different sizes of business. It plans to carry out further research on this and the deterrent effect to help establish a baseline for coverage.

2.21 Similarly, the effectiveness of projects, which tend to focus on identifying full enquiries on smaller companies, depends on how well the parameters used genuinely reflect risks of non-compliance. The Department has not so far evaluated the results of its central catalogue of risk-profiling projects although it is planning to collect data on the results from Areas for this purpose. Our analysis indicated that Areas which were making greater use of projects for their full enquiries were not always those that had recorded higher additional tax yields. The Department considered that many project-based enquiries that had so far been concluded had needed less time to complete because they involved lower risk, and so the yields scored on their completion would have been lower than for others still underway. Nevertheless, some Areas using projects to select all of their full enquiries had recorded the lowest yield rates, suggesting a need to assess which projects are the most effective and how others might be refined.

2.22 Using our survey of Areas we examined the risk assessment practices of a group of higher performing Areas. Many, but not all, used databases extensively to target returns screening, and used projects not just for full enquiries but also to select many of their aspect enquiries. Some higher performing Areas also used locally developed databases to refine project criteria to more closely reflect the characteristics of their local company caseload. Our focus group identified that some Areas did not have staff trained in the use of some of the databases currently available and had therefore been unable to take full advantage of them for local risk assessments. The Department intends to focus its future staff training on using a new consolidated database that it is developing (paragraph 2.26).

2.23 The variations identified in the staffing, risk assessment, coverage and results of enquiry work suggest there is scope to achieve higher yields overall. The broad order of magnitude of the variations can be illustrated with the following example: if Areas with below average yields in 2004-05 (weighted for each Area's company tax base) could have secured the network average yield, the total yield might have been around £60-100 million more.[9] This estimate necessarily depends on proxy measures of the size and complexity of Areas' caseloads and potential additional yield.

Further initiatives to improve risk assessment

2.24 The Department has been developing a wider risk strategy over the last two years for the direct taxes paid by businesses, to help it refine its risk assessments and reassess enquiry coverage levels, including the relative coverage of different taxes. The risks posed by a particular company for Corporation Tax may also be indicative of its compliance risk in other taxes, for example Value Added Tax, Pay As You Earn and National Insurance contributions. Enquiry staff are typically organised into different tax-streams and risk-assessments also follow this division, although staff in Risk Intelligence & Analysis Teams are more flexibly assigned.

2.25 In the United States and Sweden, risk assessments by the tax authorities focus on the overall revenue risk presented by each business. The US Internal Revenue Service has two business-focused groups, including a Small Business group whose enquiries on a business are usually undertaken by a single inspector and deal with all taxes paid by the business. Similarly in Sweden, tax inspectors cover all aspects of a company's tax affairs. Our survey of Areas found that for Corporation Tax full enquiries, where the proper separation of the tax affairs of the business and its owners are important considerations, nine per cent also covered other taxes in 2004-05. The Department expects that setting a Department-wide target in 2005-06 for additional yield covering all taxes should encourage a more joined up approach to enquiries. The Department has developed a 'team working' system for enquiries to increase their efficiency (paragraph 4.9), and it is undertaking pilot projects in four Areas to examine how it could also help focus enquiries more on businesses and all of the taxes they pay.

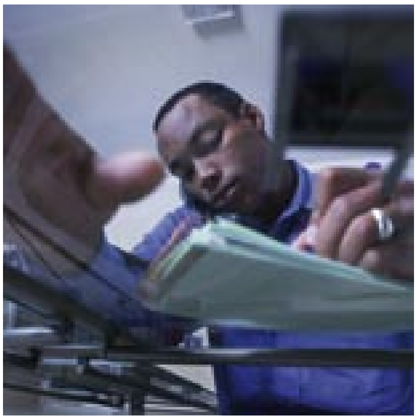
9 The figure of around £100 million includes the effect of some much larger than typical yields, from relatively few cases. To some extent, such larger-yield cases may be as much a reflection of the particular tax circumstances of those cases as a reflection of better enquiry performance in the Areas affected. Excluding the larger cases from the analysis suggests a figure of around £60 million.

2.26 The Department's risk assessment processes have become more sophisticated as more and better data, and tools for analysing data, have become available. The Department's 'Better Data for Corporation Tax' initiative should further help. It aims to bring together data from a range of existing databases into a new database, which will be more readily usable for risk assessments. In particular it will merge databases of company accounts and tax returns figures, and should be most useful for those Areas which do not currently invest much effort on merging such databases. The initiative has been introduced in the Large Business Service, and was due to be made available to Areas in December 2005. This could make risk assessments quicker and more effective, allowing Areas to undertake potentially higher yielding cases. The Department expects this to secure additional tax yield of £155 million a year by 2008-09.

2.27 To a large extent, this initiative is needed because the Department's Corporation Tax computer system does not record all of the data from the tax return form nor any of the data from the supporting company accounts or computations that companies submit with the form. The computer system was designed for tracking the receipt of returns and accounting for the tax, rather than to provide data for risk assessments. The present facility for electronic filing of company tax returns, introduced in 2003, does not enable the data in the accounts and computations submitted with the return to be captured electronically. The Department has developed an electronic filing system for electronic accounts and supporting tax computations, as well as for the return form itself, building on industry wide accounts coding standards. With further development, this will enable the Department to capture data from these submissions, which could enable it to draw on a much greater range of data in its risk profiling without having to key-in data from paper documents.

PART THREE

Enabling companies to comply



The costs for businesses in complying

3.1 Once it has started business, the main obligations on a company each year are to complete and file a company tax return which includes a self-assessment of the Corporation Tax it owes, and pay the tax due by the statutory deadlines. Those companies that are selected for enquiry also have to provide further assistance and information as required by the Department. The time and costs that companies may incur on these tasks depend on many factors including: the size and structure of the company; the nature of its business; whether it uses a third-party agent to prepare and file the return and handle any enquiry; and whether the company's accounting systems are configured to provide the data needed for the return.

3.2 We commissioned Professors John Hasseldine and Kevin Holland to review existing research on the costs and burdens on companies of meeting their Corporation Tax obligations, and the position for similar taxes in other countries. Appendix 3 provides an overview of overseas business tax regimes. They also reviewed published views of business and tax representative bodies, which supplemented discussions we held with individual stakeholders. There is relatively little academic research available on this subject, and most of it has found it difficult to quantify the compliance costs involved. Research in individual countries has tended to assess compliance costs as a proportion of tax revenue, but it is difficult to draw direct comparisons because the results are derived from separate studies with different methodologies. It nevertheless suggests that the costs in the UK are at the lower end of the range **(Figure 9 overleaf)**. Within the UK, a study conducted by Manchester Business School found that of the three main business taxes Corporation Tax was the least burdensome.[10]

3.3 Our consultants identified the following features of Corporation Tax in the UK as key elements that contributed to the costs of compliance, in the view of stakeholders:

- The complexity of Corporation Tax legislation and its increasing volume with each Finance Act;
- The costs of identifying and interpreting changes in legislation and administrative procedures;
- The administrative effort required to satisfy a particular item of legislation; and
- Uncertainty over the nature of the administrative requirements.

10 *Corporation Tax Self-Assessment Compliance Costs: Empirical evidence from the UK*, S. Kauser, F. Chittenden and P. Poutziouris (2002), Paper presented at 5th International Conference on Tax Administration, University of New South Wales, Sydney.

3.4 The burden falls most heavily on smaller companies. It is these in particular which are disadvantaged by the complexities of Corporation Tax as they are less able to afford specialist advice. In March 2005 the Department launched a consultation on priorities for reducing the administrative burden of the tax system on small businesses,[11] which parallels the wider Hampton Review of government regulation.[12] It outlined the responses to the consultation in November 2005, many of which were concerned with the burdens on small businesses as employers.[13] The Department is mapping the processes companies need to operate to satisfy its various tax and regulatory regimes (including Corporation Tax), which it will then cost to provide a baseline for designing and assessing the impact of future initiatives to reduce compliance costs. We noted that this type of approach is already used in Sweden, where the tax department uses a market research company to conduct an annual survey of 3,000 companies. It uses the results to quantify changes in companies' compliance costs and to identify any particular concerns at an early stage.

9 Compliance costs as a percentage of Corporation Tax revenues or equivalent taxes in other countries, drawn from a range of academic studies

EU countries overall	15.3%[14]
Australia	6.8%[15]
Canada	4.6 - 4.9%[16]
Netherlands	4%[17]
USA	3.2%[18]
UK	2.2%[19]

Source: 'The compliance costs and burdens associated with businesses meeting their Corporation Tax obligations', prepared for the NAO, March 2005, Professors Kevin Holland and John Hasseldine [Original research sources are cited in the footnotes]

Progress in helping companies to comply

3.5 The Department has introduced various measures and has further initiatives underway aimed at making it easier for companies and their agents to meet their obligations. These cover the administrative effort involved in preparing and filing returns; the handling of enquiries and wider initiatives to tackle the complexity of the tax itself. In New York State, a Business Ambassador from the private sector is employed to bring first-hand perspectives on companies' requirements and concerns. The Department's aim in establishing new customer-focused business units is to identify and better understand the requirements and behaviours of taxpayers and the risks associated with different groups so that it can make it easier for taxpayers to comply and reduce compliance costs. One of the units will address the needs and compliance risks of small and medium enterprises. Another focuses on larger companies that would be dealt with by the Large Business Service.

Preparing returns

3.6 In completing their company tax returns and self-assessing their tax liability, companies draw on data on income and expenses contained in their accounts. But the tax calculation depends on rules which differ from accounting conventions in a number of ways (paragraph 2.2), and this can lead to uncertainty for companies about how particular transactions should be treated in calculating their tax liability.

11 *Working towards a new relationship: a consultation on priorities for reducing the administrative burden of the tax system on small business*, March 2005.
12 *Reducing Administrative Burdens: effective inspection and enforcement*, Philip Hampton, HM Treasury, March 2005.
13 *Making the new relationship a reality: HMRC's response to small businesses' priorities for reducing the administrative burden of the tax system*.
14 European Union study 2004 SEC (2004) 1128/2.
15 *Compliance Costs and Taxation Impact Statements*, Evans, C. and Walpole M. (1997), Australian Tax Forum, 13, 227-274.
16 *The Compliance Costs of Canada's Major Tax Systems and the Impact of Single Administration*, Plamondon, R. and D. Zussman (1998), Canadian Tax Journal, 46, 761-785.
17 *National Report, Netherlands*, Imhof, F.W. (1989), in Studies in International Fiscal Law: Administrative and Compliance Costs of Taxation, Cahiers De Droit Fiscal International, Volume 74b, Rio De Janeiro: International Fiscal Association.
18 *The Income Tax Compliance Cost of Large and Mid-Sized Business, (A Report to the IRS LMSB Division)*, Slemrod, J. and Venkatesh V. (2002), Ann Arbor: Office of Tax Policy Research, University of Michigan Business School.
19 *Administrative and Compliance Costs of Taxation*, Sandford, C., Godwin M. and Hardwick P. (1989), Bath: Fiscal Publications.

3.7 In recent years, Areas have developed 'enabling' relationships with some of their larger local companies to discuss and resolve issues of this kind, and where necessary companies may provide supporting records to the Department for review, before they submit their returns. Enabling work accounted for one per cent of the time spent by Areas on Corporation Tax compliance work in 2004-05. The benefit for companies is that they are able to obtain informal clearance on some aspects of their tax return before filing formally, provided they fully disclose all details and their intentions to the Department. The advantage for the Department is that points of uncertainty can be resolved and compliance facilitated without the need for a formal enquiry. Our stakeholder panel indicated that companies welcomed these arrangements. Some were also keen to see a system for getting clearance on the tax treatment of certain transactions at an even earlier stage, before they actually entered into the transactions themselves. The Department had considered and rejected a similar arrangement in 1996, because it had had concerns about possible implications of a formal scheme for its existing informal advice arrangements, the additional work required to establish clear rulings, and about charging of fees for such a service.

Filing tax returns

3.8 Most companies or their agents currently submit their company tax returns on paper – the return form itself, the company's accounts and a computation linking the two sets of data. Many typically prepare the return and computation using the software for producing the accounts, and then print out and post the documents. In 2005 the Department introduced a shorter form of four pages, rather than 16, for 500,000 companies with simpler financial affairs. The Department estimate that the shorter form will bring time savings for companies worth £5 million, or around £10 per company.

3.9 The Department has also introduced a facility for companies to file an electronic version of the return. Companies have to save the accounts and computation in a 'pdf' (portable document file) format and submit them with the electronic return. As such, external stakeholders told us that this provided few advantages over paper submission, except that the electronic return had in-built checks to help correct errors and it provided an immediate acknowledgement that the return had been received by the Department. So far, fewer than two per cent of company tax returns have been filed electronically. The Department has developed a facility to accept accounts and computations as electronic data from November 2005, which will avoid the need for submitting documents in pdf format. The US Internal Revenue Service has made electronic filing mandatory for companies with net assets of $10 million for tax years ending on or after 31 December 2006.

The cost and speed of enquiries

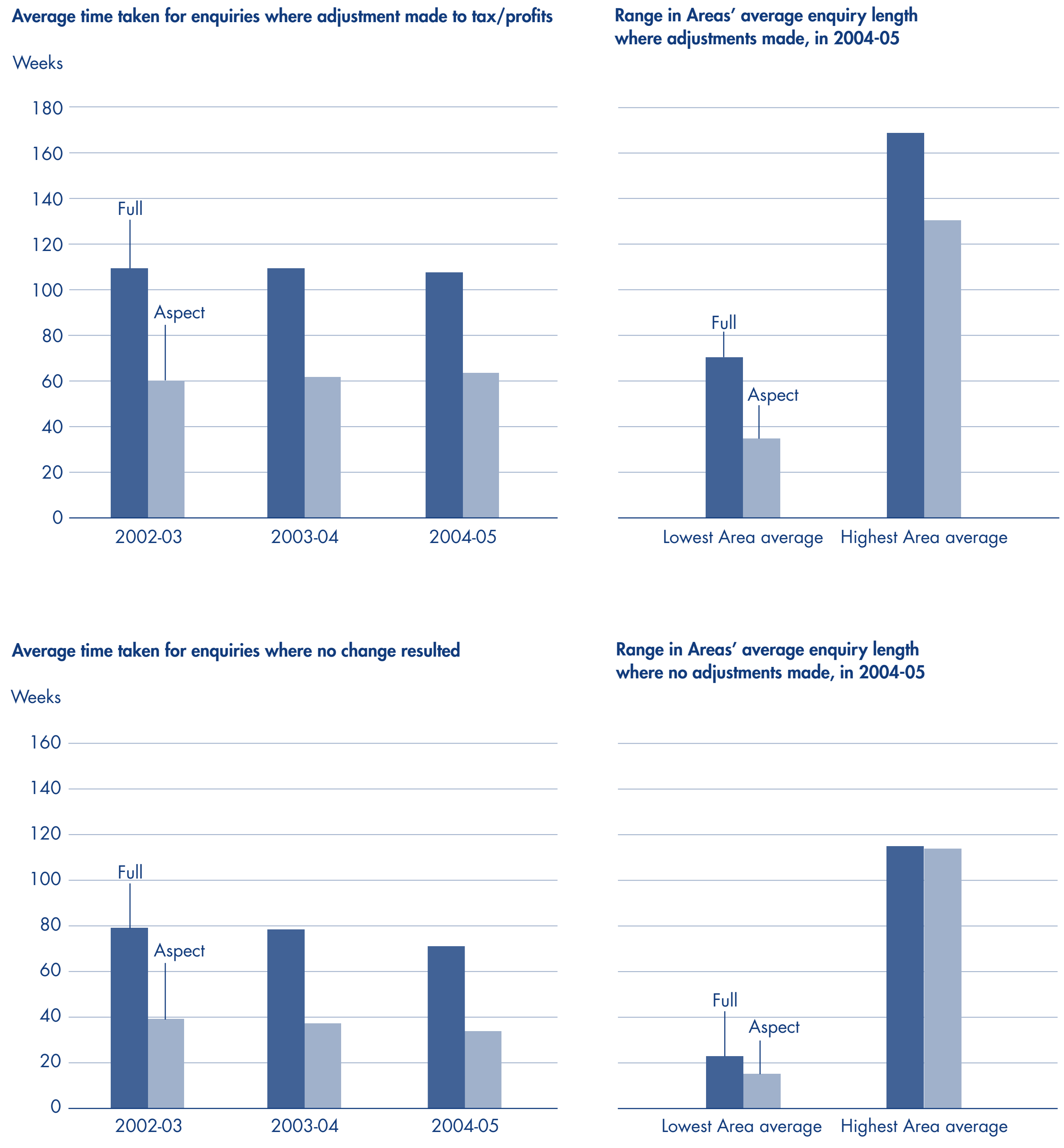
3.10 Enquiries inevitably incur additional costs for companies in dealing with requests for further information and providing assistance to tax inspectors to resolve the queries involved. There is little research on the costs to business but the major reduction in the number of enquiries over the last six years should have also reduced the overall costs to business. The Department's staff costs of its enquiries is around £46 million each year at an average of £1,100 per enquiry, and the costs for companies might be of a similar order of magnitude. Some insurance firms provide agents with cover for the costs of dealing with any enquiries for their clients. One insurance company told us that the cost of Corporation Tax enquiries claimed on its insurance policies averaged £2,900.[20]

3.11 The Department monitors the duration of its enquiries, not only to assess how well compliance workloads are being managed but also as a measure of the administrative burden for the companies involved. Over the past three years the Department has reduced their length **(Figure 10 overleaf)**, but enquiries still take many months. Corporation Tax enquiries also took longer than those on self-employed Income Tax returns. The Department's compliance audits of Regions and Areas, and its enquiry management training, have highlighted the need to reduce enquiry times.

3.12 The Department is particularly concerned to minimise the time taken on enquiries which do not generate any additional tax-yield or profits-adjustment, and it separately monitors such data. Full enquiry cases resulting in no Corporation Tax adjustment take on average 71 weeks, although some may secure adjustments for other taxes. Aspect enquiries resulting in no adjustment take on average 33 weeks. These national averages mask much wider differences between Areas, as illustrated in Figure 10, which shows for example that Area averages ranged from 23 weeks to 115 weeks for completing full enquiries which resulted in no adjustment to company tax or profits.

20 Abbey Tax Protection produce occasional analysis of the costs and enquiry timescales of those enquiries covered by its insurance policies. They provided additional analysis on claims for us, for which we are grateful.

10 Average times for completing full and aspect enquiries, 2002-03 to 2004-05



Source: National Audit Office analysis of HMRC data

3.13 The time taken to complete enquiries is affected by the time needed to check aspects of the return as well as the time taken by companies or their agents to respond to inspectors' questions. Enquiries have been worked episodically, as staff wait for companies or their agents to provide requested information. The Department is introducing 'team working' for enquiries (paragraph 4.9), through which it expects specific staff to be responsible for managing information requests. The Department has also trialled in one Area a new system for speeding up communications with businesses, using an internet-based electronic 'shared workspace', which offers the prospect of reducing elapsed times significantly. An initial pilot on Income Tax full enquiries with six local agents cut elapsed times by up to 20 per cent. A second pilot is now underway on 300 enquiries with 120 agents, which includes some Corporation Tax enquiries. By enabling both enquiry staff and agents to share analysis and update common records electronically, the Area found that time is saved in two main ways – reducing time while agents are dealing with requests for information, and from less duplication by staff of work undertaken by agents. The Department has recently decided to extend its trial of this approach, to examine the scope to apply it more widely for other types of taxpayer groups.

Addressing the complexity of Corporation Tax

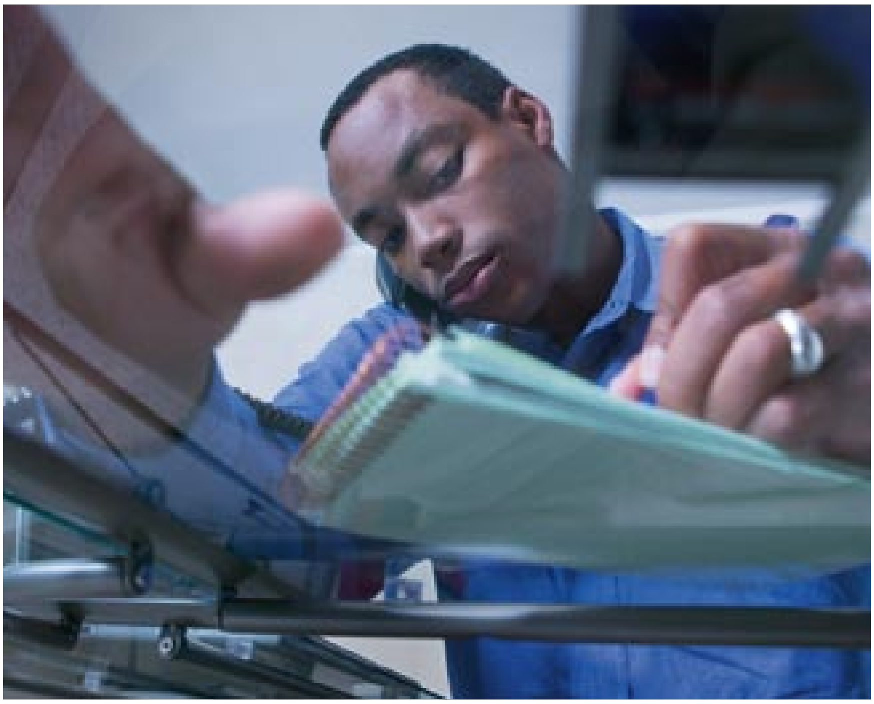
3.14 Companies have to give time and deploy expertise, or buy it from their agents, to ensure that their returns are compliant. Research has indicated that business and tax representative bodies have identified the complexity and volume of Corporation Tax legislation as contributing to the compliance burden. The Government consulted on possible changes to the structure of the tax in 2002, *Corporation Tax Reform*, aiming to 'produce a regime which is modern and competitive and reflects the realities of the business environment',[21] with a further consultation on a second set of proposals in August 2003.[22] Its proposals on removing an artificial distinction between trading and investment companies were welcomed by external stakeholders, and the Government introduced the necessary changes in the 2004 Finance Act.[23] Following the 2002 and 2003 consultations, the Government published a Technical Note in December 2004, which further developed potential reforms in two other areas:

- **Rationalisation of the 'schedular system'.** This system requires companies to differentiate sources of income for tax purposes, for example from property and trading activity. Apart from the complexity this involves, the schedular system can result in some companies being unable to set losses from one source against profits from another. In the initial rounds of consultation, external stakeholders indicated their preference for the abolition of the schedular system. In December 2004, the Government proposed a reform of the schedular system which would have involved merging trading and letting income, which would have encompassed the major sources of income of most smaller companies. The proposed partial, rather than full, rationalisation of the system focused on areas of business activity with most interdependence while containing the cost of any reform for the exchequer. But these proposals were rejected by respondents. External stakeholders generally felt that the benefits of a partial reform would not justify the compliance cost associated with any change and preferred the abolition of the schedular system[24] or the retention of the status quo.[25] In December 2005, the Government announced that it had no plans to take forward the proposals outlined in the 2004 Technical Note.
- **Restructuring the taxation of capital assets.** This heading covered a range of proposals initially aimed at bringing the tax treatment of capital assets closer to their accounting treatment (including using accounting depreciation of capital assets in place of capital allowances). Responses to the August 2003 consultation expressed a clear preference for retaining capital allowances and the Government announced their retention in Budget 2004. Proposals developed in December 2004 focussed on ways of modernising the taxation of capital assets to align it more closely with the taxation of income, while retaining the benefits for companies of capital allowances. There was no general consensus among stakeholders on the package of reform proposals, and the Government announced in December 2005 that it had no current plans to take them forward but would continue to consider the scope for reforming the capital allowances system.

21 *Reform of Corporation Tax*, HM Treasury & Inland Revenue, August 2002.
22 The second consultation was followed up by a series of papers on specific issues. These were a Technical Note, *CT Reform: The next steps*, issued in December 2003; draft consequential amendments relating to management expenses issued in February 2004; and another Technical Note in December 2004.
23 Finance Act 2004 ss 38-39.
24 *Corporation Tax Reform Technical Note*, December 2004, para 2.12.
25 *Summary of responses to the Corporation Tax Reform Technical Note*, December 2004, paras 1-6, published on 5 December 2005.

PART FOUR

Efficiency in managing Corporation Tax



4.1 The Department spent £320 million in 2004-05 on managing Corporation Tax, including the costs of work by Areas and the Large Business Service and related work by other divisions such as Policy and Finance. This was equivalent to 0.96 pence per £1 of Corporation Tax collected **(Figure 11)**. After rising over several years, the cost per pound collected has fallen back to near its level in 2000-01, reflecting a steady fall in tax receipts in real-terms which rose again in 2004-05, and lower costs in 2004-05. The costs associated with Area work in 2004-05 were about £220 million, including local overheads and a share of central policy, human resources and other support function overheads, equivalent to 1.4 pence per pound collected. Around 1,900 of the 39,000 staff in the Areas work on processing company tax returns and conducting enquiries.

11 Average cost of collecting Corporation Tax (pence per pound of Tax collected), 2000-01[1] to 2004-05

This figure shows that over a five year period the cost per pound collected increased by more than a quarter before returning to its earlier level.

	2000-01	2001-02	2002-03	2003-04	2004-05	Change over period
Corporation Tax receipts (in 2004-05 real terms)	£35.9 bn	£34.6 bn	£30.7 bn	£28.7 bn	£33.5 bn	(7%)
Costs (in 2004-05 real terms)	£352 m	£348 m	£351 m	£356 m	£321 m[2]	(9%)
Relative cost (pence per £ of receipts)[1]	0.98 pence	1.01 pence	1.15 pence	1.25 pence	0.96 pence	(2%)

Source: National Audit Office analysis of HMRC data

NOTES

1 The relative cost of collecting the tax in 1999-00 was 0.76 pence, but 1999-00 data has not been included in Figure 11 because the Department changed how it calculated the cost (£293 million at 2004-05 prices) to include additional staff and other costs.

2 For 2004-05, the cost of £321 million includes a £9 million share of the costs of the Valuation Office Agency, whose costs were not apportioned to Corporation Tax in previous years.

The efficiency of processing company tax returns

4.2 Area processing of company tax returns involves an initial check that the correct documents have been submitted and keying-in figures from the return onto the Corporation Tax computer system. Areas have absorbed the additional workload from the surge in new incorporations in the last three years. In 2004-05, about 800 staff across the network processed Company Tax returns, at an average of 1,300 returns per person. The work included logging and capturing returns, dealing with telephone calls and post regarding the companies' affairs and other administrative tasks. In some Areas, staff involved in processing returns also undertake tasks that otherwise would be dealt with by enquiry staff, but these are likely to be recorded as processing activities. Nevertheless, some Areas had six times the ratio of processing staff to returns processed as other Areas. Economies of scale did not account for such variations because Areas with more returns to process did not generally have higher processing rates. Our analysis of the Department's data indicated that if all Areas had undertaken tasks they recorded as processing work at the average rate nationally, staff costs might have been up to £2.2 million (13 per cent) lower. Because some Areas include some compliance activities in their 'processing' figures, however, any such improvement in processing rates might involve increased off-setting costs for enquiry work.

4.3 The scope to reduce costs by more centralised processing is to some extent restricted by the inflexibility of the computer system and the current practice of co-locating processing work with enquiry work. This is because staff who risk-assess returns to select enquiries need to have access to the paper returns because not all the data from the return, and none from the accounts and computations, are transcribed onto the Corporation Tax computer system. Efficiency savings will be possible as the need for processing paper returns is itself curtailed, and also when the Department is able to process and analyse the data in the accounts and tax computations filed electronically (paragraph 3.9). The Department expects to be able to make savings in processing work equivalent to 30 staff by 2007-08, as more companies file their returns electronically.

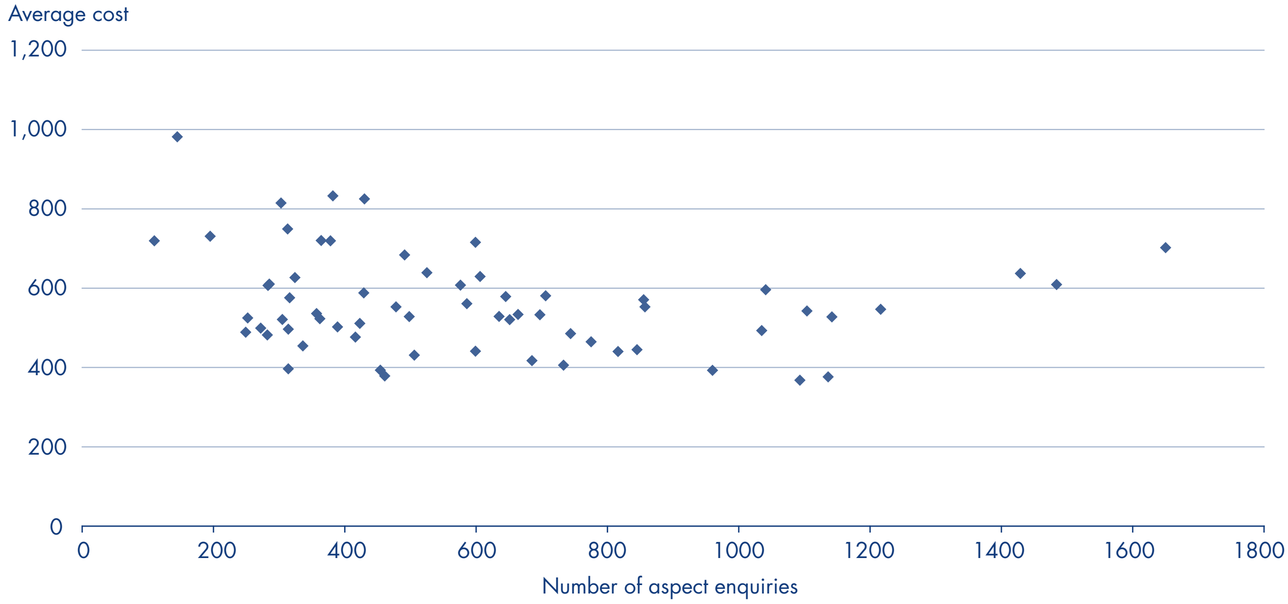
The efficiency of enquiry work

4.4 Some 1,100 staff worked on Corporation Tax enquiries in 2004-05, costing on average £1,100 per enquiry. Full enquiries require more staff time, and cost on average £5,600, whereas aspect enquiries cost £500 on average. As with the processing of returns, the cost of enquiries varied significantly between Areas, with the average cost for some Areas being more than twice that of others. The average staff cost for full enquiries ranged from £3,600 to £9,800; and for aspect enquiries from £400 to £1,000. While for many Areas the average cost of enquiries tended to be lower where workloads were higher, it was clear that higher average costs were not solely the product of lower workloads **(Figure 12)**.

4.5 We found there was a relationship between average enquiry costs and the additional tax yields produced. Yields are typically greater from larger more complex cases, worked by more senior staff, which take longer. Broadly speaking, £13 of yield required £1 in enquiry staff cost. Some Areas had similar average yield:cost ratios, while others had a markedly more or less efficient ratio than the average **(Figure 13)**. Paragraph 2.23 illustrated the magnitude of the variations in performance in Areas' enquiry work. An alternative way of estimating the possible extent of the effects of those variations in terms of enquiry efficiency is to look at the range in enquiry costs. As an illustration, if Areas with below-average yield: cost ratios (shown below the trend-line in Figure 13) had been able to secure their yields while incurring network-average costs, their enquiry costs might have been around £6 million less.

12 Average staff cost, and number, of aspect enquiries in each Area (2004-05)

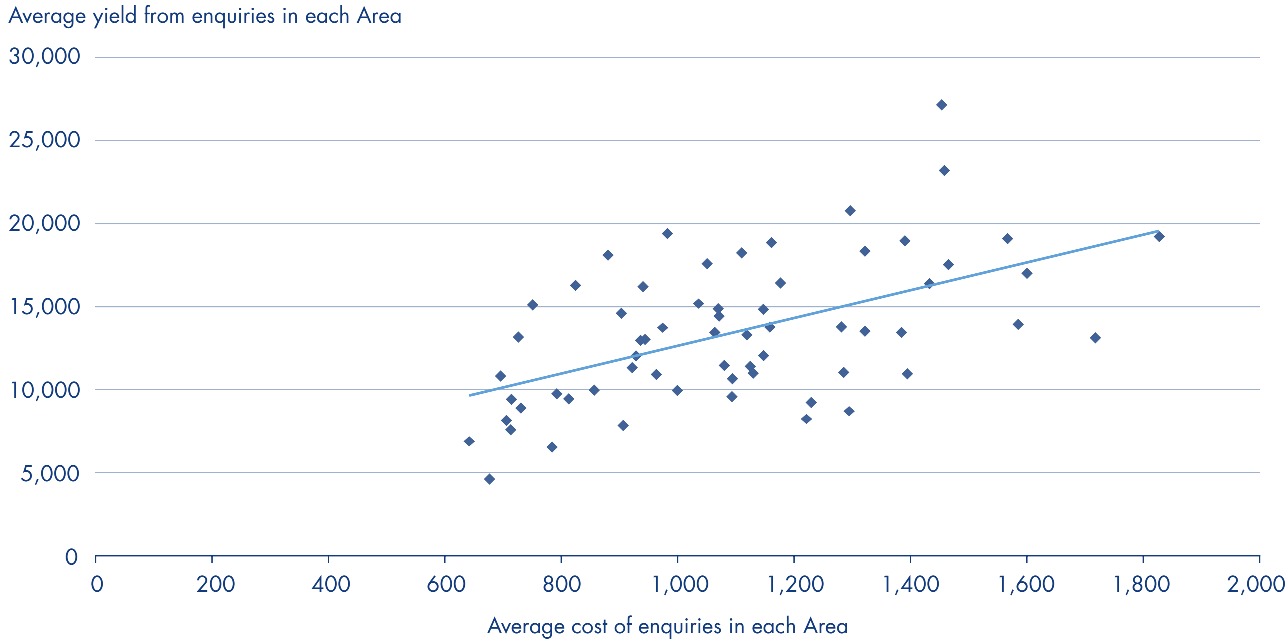
This figure shows that there is a trend where average staff costs of aspect enquiries are lower where workloads are higher, but this is not a statistically significant relationship and many Areas with high enquiry volumes had high costs. A similar analysis for full enquiries (not reproduced) showed a less discernable pattern.



Source: National Audit Office analysis of HMRC data

13 Average cost and average yields from Areas' enquiries, 2004-05

This figure shows that generally Areas with higher cost enquiries generated higher yields from those enquiries.

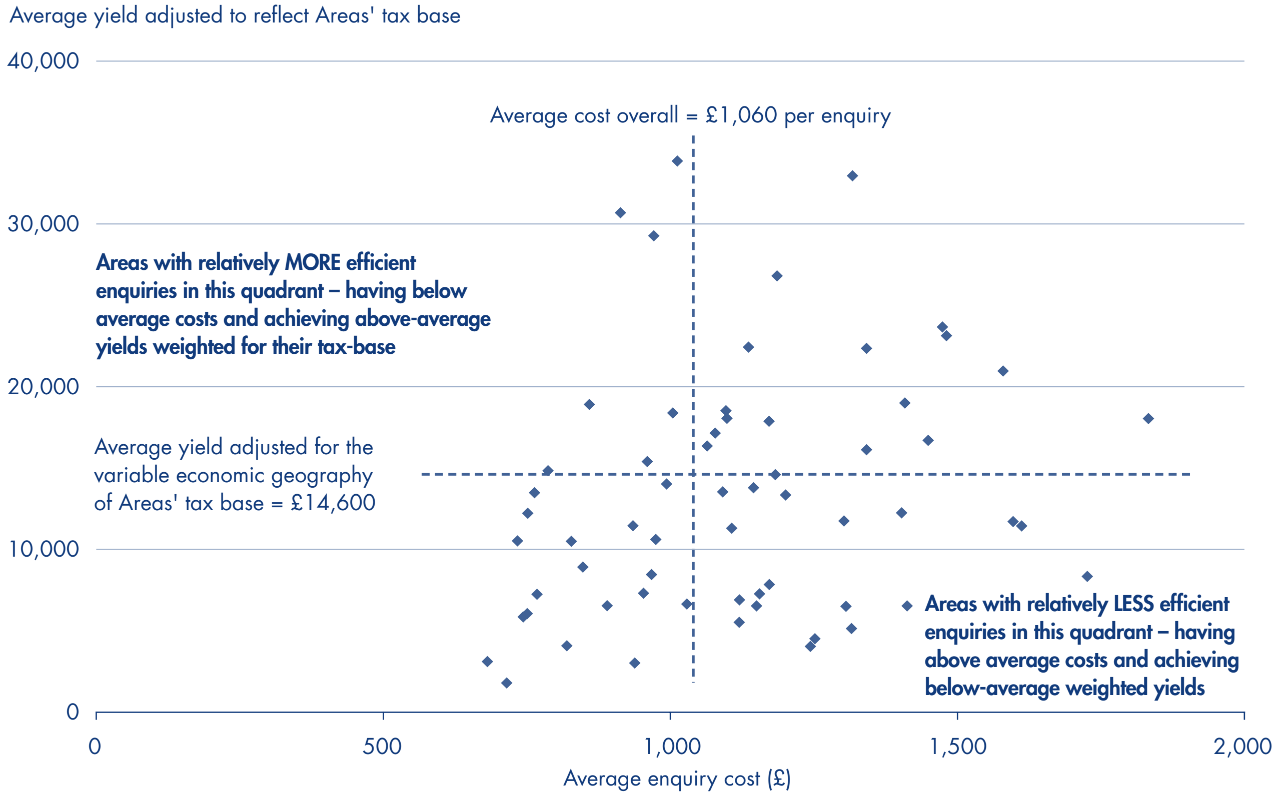


Source: National Audit Office analysis of HMRC data

4.6 This analysis does not take account of the economic geography of each Area where the make-up of the company caseload could affect the level of additional tax yield achieved from their enquiries. But we undertook further analysis which indicated that in taking account of the number and size of the companies in each Area the extent of higher-than-average enquiry costs was just as significant. Measuring the potential yield implied by caseloads is difficult, but the Department does assess companies according to how long enquiries might take for companies of different sizes and this could provide a proxy indicator of potential yield. We used this system of quantifying Areas' company caseloads to weight the yield achieved by each Area for the potential yield implied by the number and complexity of its company caseload, though this could not reflect the tendency to non-compliance of those companies. We mapped the results against the Area's average cost of enquiries **(Figure 14)**. This showed a wider range in performance, with some Areas incurring twice the average cost as other Areas while doing equally well in terms of realising their respective potential yields. There were 7 Areas which secured more potential yield than average from their enquiries and which also had lower than average enquiry costs (shown in the top-left quadrant in Figure 14).

14 Areas' weighted yield and average costs of enquiries for 2004-05

This figure shows that there was a wide variation in the efficiency of Areas' enquiries when their yields from enquiries were weighted to reflect the relative size and value of their company caseload.



Source: National Audit Office analysis of HMRC data

4.7 The unevenness of enquiry coverage, described in Part 2, may play a part in producing this range of enquiry efficiency across the Areas, because it affects the extent to which they undertake enquiries on cases with higher potential tax yields. The use of different risk-assessment approaches, also described in Part 2, might also have an influence. Our discussions with Area staff highlighted a number of other possible causes:

- Because Area complements for senior staff are typically much smaller than for other grades, the effect of vacancies could be greater, leaving senior staff in affected Areas having to spend more time on administrative and management duties, thereby reducing the time available for working on enquiries. As a result the higher cost of these staff would not be matched by the higher yields normally expected from their involvement in enquiry work.
- An untypical mix of staff can influence the average yield and the average cost of enquiries in an Area. Areas with a higher proportion of qualified inspectors, for example, are likely to undertake relatively more complex enquiries which would have higher yields and higher costs (tending towards the top-right quadrant in Figure 14).
- Areas have to ensure that returns are processed and this takes priority over enquiry work, so enquiry staff are sometimes redeployed to cover staffing gaps in processing returns.
- Although Areas are in the process of introducing new team working arrangements, in some Areas experienced inspectors might still be undertaking all of the tasks on an enquiry themselves, including some that could be undertaken at lower cost by more junior colleagues. Overall, we found no significant relationship between the proportion of more senior staff in an Area and average enquiry yields.

4.8 Following the creation of the new Department in April 2005, HM Revenue and Customs is seeking to redesign organisational structures and processes, including the organisation of Corporation Tax processing and enquiry work. The Department has now brought together the management of the local office networks of the Inland Revenue and HM Customs and Excise and is reviewing the number and location of local offices. This presents the Department with an opportunity to deploy staff to match workloads more consistently.

4.9 In the meantime, the Department has other initiatives underway which could bring more immediate improvements in the efficiency of Areas' enquiries:

- The pilot project on shared workspace (paragraph 3.13), has shown that cost savings can be made by reducing the need for staff to re-familiarise themselves with the details of an enquiry as and when companies provide additional pieces of information, and from less duplication by staff of work undertaken by agents.
- The Department has developed a 'team working' system to allocate enquiry tasks more closely to staff with the appropriate level of experience. Pilot projects have shown that cost savings are possible from more closely matching staff to tasks, and that some tasks can be done more efficiently when staff specialise in them such as initiating and pursuing 'information powers' directions to speed up enquiries.
- The Department is developing a new staff planning system to help match staff resources more closely to local workloads across tax-streams.

4.10 Further improvements could also be made from applying more widely techniques that only some Areas use at present. Our discussions with Area staff highlighted for example:

- using the risk-assessment scoring process to allocate cases automatically to inspectors and to track the progress of enquiries, eliminating the need for staff to work actively on these separate tasks; and
- organising workloads so that data-specialists and accountants guide risk assessments rather than undertake enquiries themselves. Some Areas found they could achieve greater yields when the expertise of such staff is focused on the selection of a range of enquiries rather than selecting and working on a smaller number.

APPENDIX 1
Methodology

Method	What we did
Discussions with key officials in HM Revenue and Customs	We interviewed staff in HM Revenue and Customs with responsibilities for Corporation Tax matters, both centrally and in local Areas.
Area Survey	We carried out a survey of the 68 Areas, to collect both quantitative and qualitative data on risk assessment approaches and enquiry performance. This enabled us to compare different local approaches and relate them to enquiry performance.
Statistical analysis	We analysed Departmental Corporation Tax data, including data on Area performance, staff resources and costs.
Focus Group	We held a focus group consisting of compliance staff from a range of Areas and Regions; including enquiry staff, Risk Intelligence & Analysis Team database specialists and accountant advisers. The group discussed current risk-assessment and enquiry practices, strengths and weaknesses and scope for improvements. This gave us a wider perspective and context on the results of our statistical analyses, Area survey and Area visits.
Area visits	We visited three Areas – Central London, Warwickshire/Coventry and Worcester & Hereford. This gave us an understanding of the working environment of Area offices and the challenges they face, as well as an opportunity to explore further the issues arising from the statistical analyses and the Focus Group.
International visits	We visited the Swedish Tax Authority, and in the USA the Internal Revenue Service in Washington and the Department of Finance & Taxation in New York State.
Use of Consultants	We commissioned Professor John Hasseldine from Nottingham University and Professor Kevin Holland from Aberystwyth University to review existing research and stakeholder views on the costs and burdens for companies in complying with their Corporation Tax obligations. Also, Guy Taylor of the Risk Forum at the London School of Economics advised us on risk-management best practices, including accompanying us on our Area visits.
Discussions with other stakeholders	We had discussions with key tax, accounting, industry and academic stakeholder groups; who were also represented on our Advisory Group (below).

Method

What we did

Advisory Group

We used an Advisory Group of experts to comment on our intended study scope at the start of the study, and on our emerging findings and recommendations. In addition to Departmental representatives, the membership of the group was as follows:

Derek Brownlee/Mike Templeman
Institute of Directors

Colin Davis/ Lakshmi Naraim
Chartered Institute of Taxation

Louis Ginglo
Former Head of Tax at Orange plc

Professor John Hasseldine
Professor of Accounting and Taxation, Tax Research Institute, University of Nottingham

Sebastian Hordern/Graeme Blair
Confederation of British Industry

Professor Kevin Holland
Professor of Accounting and Finance, University of Wales, Aberystwyth

Chas Roy-Chowdhury
Association of Chartered Certified Accountants

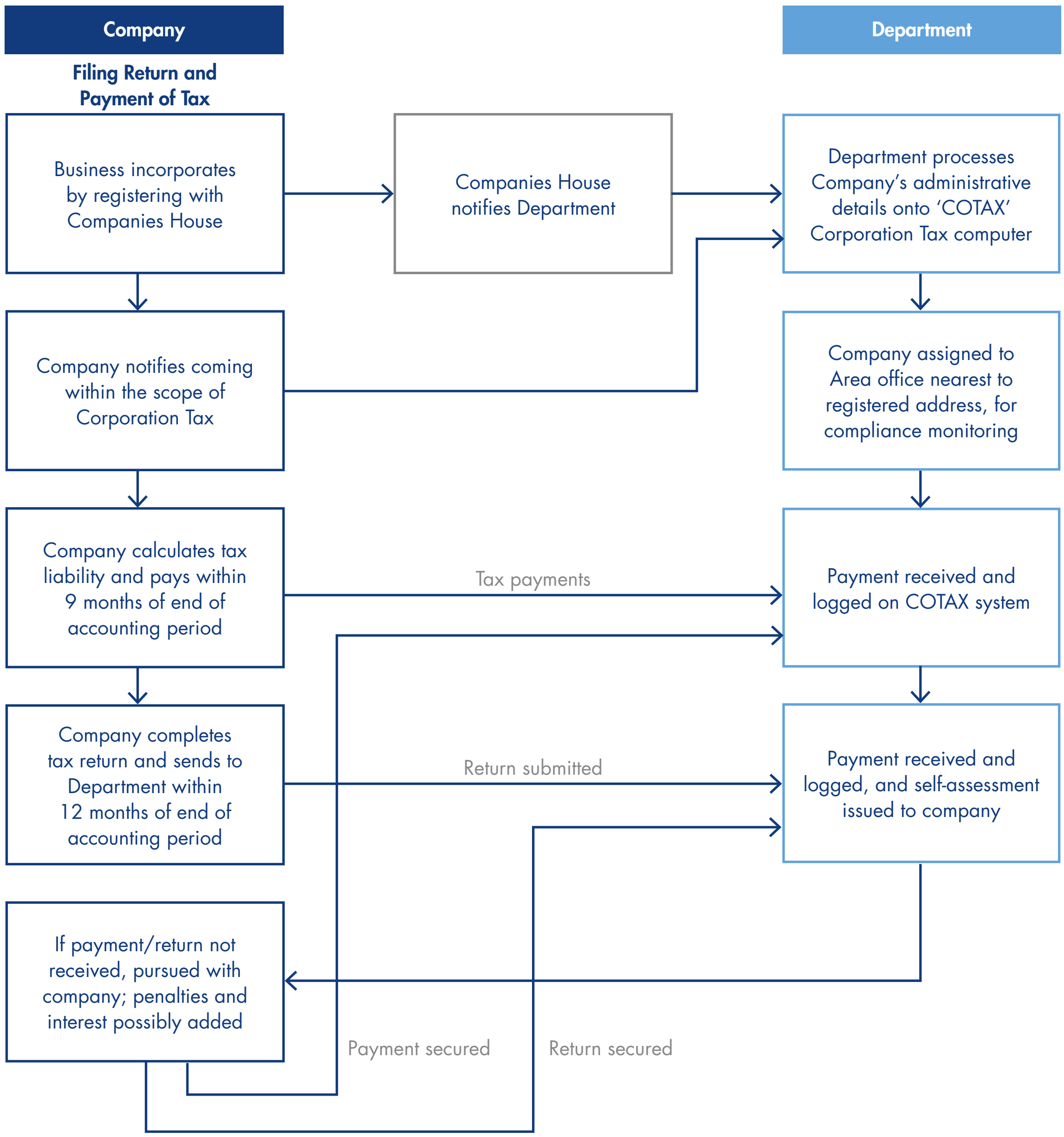
Simon Sweetman
Federation of Small Businesses

Ian Young
Institute of Chartered Accountants in England and Wales

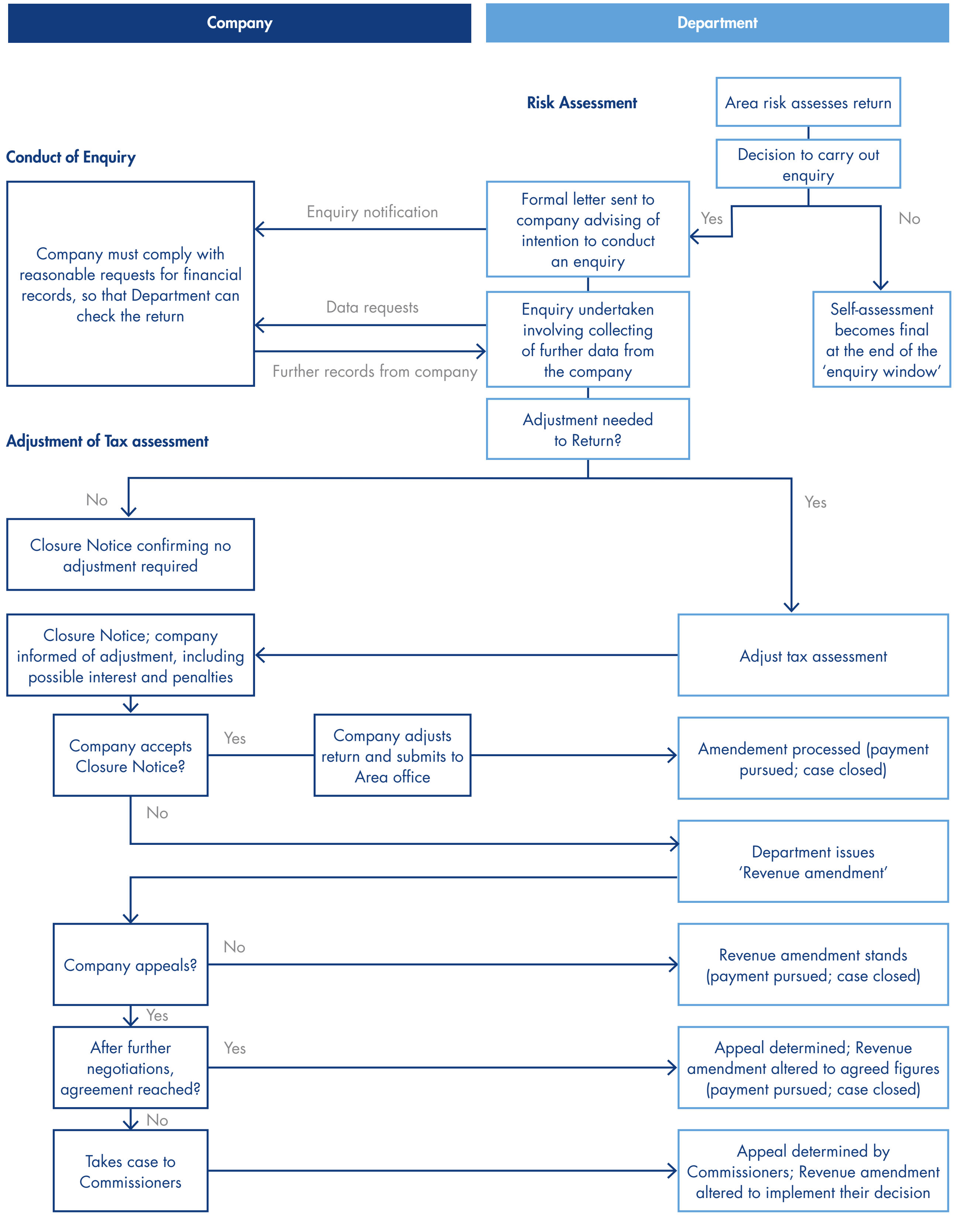
APPENDIX TWO

Corporation Tax process map

This map shows the interaction between the Department and a Company in terms of Corporation Tax: filing the return and paying the tax, conduct of an enquiry, and adjustment of tax assessment.



Source: HM Revenue and Customs



Source: HM Revenue and Customs

APPENDIX THREE

International comparisons

	Tax rate applied to profits	Depreciation	Treatment of losses	Incentives	Administration
Australia	30%	Capital allowances regime.	Indefinite carry forward.	125% deductions from profits for R&D expenditure.	Self assessment. Pay As You Go (PAYG) system for all companies with tax over A$8000.
Canada	37%	Capital allowances regime.	Seven year carry forward, three year carry back.	Regional development allowances and 10% investment tax credit in specified regions for capital investment.	Self assessment. Instalments paid on the final day of each month with any balance due after tax year.
France	33%	Straight line depreciation over useful life of asset with special rates for certain assets.	Indefinite carry forward, three year carry back.	Research expenses may give rise to a tax credit.	Self assessment. One third paid in four instalments during the year with the balance paid three and a half months after year end.
Germany	25% (with surcharge of 5.5%). Trade tax variable from 12%-20% (deductible as an expense).	Mixture of straight line and declining balance depreciation depending on type of asset.	Indefinite carry forward, one year carry back (with yearly limits).	Grants for investment in Eastern Germany.	Assessment issued when tax authority has reviewed the return. Quarterly instalments with balance paid when assessment is issued.

	Tax rate applied to profits	Depreciation	Treatment of losses	Incentives	Administration
Netherlands	35%	Any method in accordance with sound business practice.	Indefinite carry forward, three year carry back.	Special deduction for investment in energy efficient assets.	Provisional assessment prior to final assessment after full examination of return. Paid within two months of the final assessment.
Sweden	28%	Capital allowances regime.	Indefinite carry forward, no carry back.	Accelerated depreciation of machinery and equipment.	Assessment made by tax authority in following year. Monthly instalments with balance paid within 90 days of assessment.
UK	30% with marginal relief for profits under £1.5m.	Capital allowances regime.	Indefinite carry forward and 12 month carry back subject to streaming.	R&D credit of 150%.	Self assessment. Quarterly instalments for companies with profits over £1.5m. Single payment 9 months after year end for others.
US	35% with lower rates for lower profits.	Capital allowances regime.	Between two and five year carry back. Fifteen year carry forward.	Energy investment credit of 10% for solar and geothermal property.	Self assessment. Four instalments paid in tax year followed by balancing payment after year end.

Source: National Audit Office