National Audit Office

HM REVENUE & CUSTOMS

Filing VAT and Company Tax returns

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SUMMARY

1 **Value Added Tax (VAT) and Corporation Tax raised around £120 billion in revenue in 2005-06.** As at March 2006, some 1.8 million businesses were registered for VAT and 1.8 million companies registered to file Company Tax returns, which cover their liability for Corporation Tax. 600,000 businesses must file both types of return.

2 **This report examines the performance of HM Revenue & Customs in securing and processing VAT and Company Tax returns from businesses which should submit them. It covers:**

- **Getting the returns in on time** and the consequences of late filing (Part 1);
- **Efficiency in dealing with the returns**, including the use of online filing (Part 2); and
- **Customer service and the compliance burden on businesses** making returns (Part 3).

3 Until March 2005, Corporation Tax was managed by Inland Revenue and VAT by HM Customs & Excise. The Departments merged to form HM Revenue & Customs. Company Tax returns[1] are dealt with at 64 Area Offices across the United Kingdom, and by 11 Large Business Service offices for the largest companies. VAT returns are processed at a single location in Southend-on-Sea.

4 Our study methodology is at Appendix 1. The main elements were:

- analysis of the Department's financial and performance data and an overview of its processing systems;
- review of other countries' processing of online and paper business tax returns;
- research into the barriers and incentives for online filing by businesses; and
- consultation with organisations with a professional interest in VAT and Corporation Tax.

This report does not cover those businesses that seek to evade tax entirely by operating within the shadow economy, which we have examined in previous reports (Appendix 1).

Conclusions

5 Getting accurate tax returns in on time is important for HM Revenue & Customs in ensuring it is collecting the right amount of tax at the right time. Over the last three years the number of Company Tax returns filed on time has remained broadly stable at 77 to 79 per cent. Following the introduction of a 'default surcharge' penalty for businesses not paying on time the full VAT amount due, the VAT return compliance rate has stabilised at 85 per cent. As at mid October 2006, there remained 230,000 assessments of business' VAT liability (which the Department made in 2004-05 and 2005-06 in the absence of VAT returns from businesses) which had not been replaced by completed VAT returns. And 160,000 Company Tax returns which were due in 2004-05 had been outstanding for 12 months or more. The Department does not have readily available information on the total number of Company Tax returns outstanding from all previous years. It also does not know the potential tax liability arising from all missing returns. At least £1.5 billion of tax is in doubt from late and non-filed VAT and Company Tax returns. The level and the way in which penalties are applied for late filing for the two tax returns has not proved effective in further improving compliance.

6 The Department's current review *'Modernising Powers, Deterrents and Safeguards'*[2], provides an opportunity to improve value for money. This can be done by rewarding those with a good compliance record and ratcheting up the measures against those that persistently fail to meet their obligations, through more effective use and collection of penalties. Such an approach is being piloted by the Department's Large Payers Unit and Large Business Service on measures to tackle all forms of tax debt collectively. To underpin this approach, the Department needs to develop a better understanding of which businesses do and do not comply and why, and the barriers to compliance so that it can target its effort to best improve compliance.

1 Key facts and figures

2005-06 data	**VAT**	**CT**
Net Receipts	£74 billion	£42 billion
Nature of the tax	A tax that VAT registered businesses charge on goods and services they sell against which they can offset the VAT they incur on their purchases	A tax on the profits and gains of companies and unincorporated associations
Registered businesses	1.8 million	1.8 million
Filing deadlines	The majority file quarterly, one month after the end of the quarter	12 months after the end of the accounting period
Returns processed	7.8 million[1]	1.3 million
Processing of returns	All returns are processed at one location in Southend-on-Sea	Returns are processed by 64 Area Offices and 11 Large Business Service Offices
Returns filed by filing deadline	85%	79%
Returns filed online *First half 2006-07*	4.9% *7.8%*	1.9% *7.2%*
Cost of processing filed returns	£4.1 million	£5.1 million

Source: National Audit Office analysis

NOTE

1 The 7.8 million VAT returns filed annually is based on businesses who file monthly, quarterly and annually and changes through new registrations and deregistrations.

7 The Department spends £9.2 million a year on processing VAT and Company Tax returns. It also incurs further costs in chasing businesses for overdue returns and correcting errors. For example, in 2005-06, the Department spent £1.2 million correcting errors on VAT returns. Online filing of returns could improve the Department's efficiency and reduce costs to businesses. In 2005-06, the take up of online filing for both returns was below five per cent but increased to 7.8 per cent for VAT and 7.2 per cent for Company Tax returns in the first half of 2006-07. Although revenue departments overseas will have different priorities and activities[3], online filing in some other countries is higher.

8 Compatibility of software packages to prepare and submit tax returns, high set up costs and the greater convenience of paper returns are some of the barriers which businesses face in using the Department's online systems. The Department has begun to develop a strategy to implement Lord Carter's recommendations for mandatory online filing, which start from April 2008 for large and new businesses filing VAT returns and March 2010 for all Company Tax returns. This strategy will need to address several priorities – including the communication, wider use of electronic guidance around compulsory online filing, educating businesses/agents on how to file online, measures to encourage businesses to switch, ensuring data security, and robustness of the online service.

9 The Department reduced the staff costs of processing VAT returns by 12 per cent in 2005-06, without affecting the speed of processing and checking returns. However, the national average unit staff cost of processing Company Tax returns across the Department's 64 Area Offices increased marginally in 2005-06. Some Area offices managed to reduce their own unit costs by restructuring the work and sharing work between locations at peak times. The Department has not tracked Area Office performance against targets on their promptness and accuracy in processing Company Tax returns.

10 The Internal Revenue Service in the United States continuously monitors workloads, processing efficiency and accuracy to identify any problems, plan staffing levels and transfer peak workloads between sites. The Department could improve efficiency in processing Company Tax paper returns by drawing on the good practices adopted by some Area offices, good practice in VAT return processing and by overseas revenue departments. In response, the Department is reviewing its logging and data capturing process for Company Tax returns to ensure best practices are used consistently.

11 Customer satisfaction in dealing with the Department is broadly the same amongst those filing VAT returns and those filing Company Tax returns. The Department has taken various steps to improve customer service. It has measured the administrative burdens the tax system places on businesses and has set a target to reduce the burden by at least 10 per cent by 2011. It plans to require businesses to provide information only once, to enable them to contact a single number and receive a comprehensive service across the range of taxes and duties – a one-stop-shop. Through the *'Modernising Powers, Deterrents and Safeguards'* review and better risk management, it would give a lighter touch to businesses with a good record of compliance and also target education and guidance to help businesses that want to comply.

12 The creation of the new Department provides new opportunities to identify and share good practices in tax return management across both taxes, for example, in reducing processing costs, and improving customer satisfaction. There are also opportunities for the Department to learn from its approaches to other tax returns. For example, the Department has a much greater understanding of taxpayers who fail to file Income Tax Self Assessment returns on time than it does for businesses that file VAT or Company Tax returns late, and it uses this knowledge to improve compliance. The Department is undertaking work to increase its understanding. It could also learn from other revenue departments that have a greater understanding of the businesses that fail to comply with their obligations across a range of taxes.

Recommendations

13 Our recommendations aim to yield efficiency savings for the Department, reduce tax at risk and improve the Department's progress towards its targets. We recommend that the Department should undertake the following which may be implemented relatively quickly and at low cost:

Getting tax returns in on time

i Analyse the tax at risk from failures to file correctly (late, non-filed and inaccurate returns) and identify by sector the hardcore of businesses responsible, focusing on those which are late with both their VAT and Company Tax returns. The analysis should be subject to rigorous quality assurance to ensure the results are accurate for risk assessment purposes. Nine per cent of VAT returns are outstanding one month after the due date and 12 per cent of Company Tax returns are outstanding 12 months after the filing date. The Department has carried out initial analysis to identify which business sectors fail to meet VAT obligations and has identified areas of relatively poorer filing performance, but it has less understanding of the problem areas for Company Tax returns. The Department plans in future to quantify the filing risks for Company Tax returns as well. A better understanding of why businesses fail to comply would help the Department target its compliance work for both taxes (paragraphs 1.7 to 1.8).

ii Track the effectiveness of any new penalty regime in changing filing patterns and incentives to encourage compliance and improve filing performance. This should include the amount of penalties imposed and paid (paragraphs 1.11 to 1.12).

Efficiency in dealing with returns

iii Continue to develop, test and implement mechanisms to achieve the new targets for mandatory online filing, in consultation with stakeholders, agents and businesses. This should draw on good practice within the Department and lessons from other tax authorities that have moved to mandatory online filing or which have a high take-up of online filing. Moving to online filing for both types of return is expected to achieve savings for both businesses and the Department. The online systems need to be reliable and easy for businesses and agents to use. The Department should work on developing electronic communication with customers which meets their needs and requirements. All systems should include adequate system testing (paragraphs 2.1 to 2.8).

iv Until full online filing is achieved, promote good practice across Area Offices to achieve greater efficiencies in processing paper Company Tax returns. The Department did not, in 2005-06, monitor whether individual Area Offices met targets for processing returns promptly and accurately. It should set quality standards for logging and data input of returns across all its sites. It should also benchmark their costs and workloads and identify the reasons for variations, to improve performance. The experience of processing VAT returns should be used to identify any opportunities to transfer good practice to processing Company Tax returns (paragraphs 2.9 to 2.14).

Customer service and the compliance burden on businesses making returns

v Improve the HM Revenue and Customs website (www.hmrc.gov.uk) so that businesses have ready access to relevant information and advice. It should provide businesses with easy access to a full range of clear, simple, accurate and up to date information and advice needed to file VAT and Company Tax returns. Various independent reviews of Government websites provide useful insights about customers' needs and how to improve website content, presentation and navigation.[4] HM Revenue and Customs has reviewed its website to understand better customers' needs and best practice. It plans to transform its website in phases by 2008 in terms of look and feel, ease of navigation and provision of customer content (paragraph 3.4).

vi Update its VAT public notices promptly to provide clear, accurate and readily understood information. Public notices should include all the relevant points instead of cross-referring to other documents that businesses may find difficult to track down (paragraph 3.3).

vii Using its Business Customer Unit, work with businesses to improve the VAT return, in particular the associated guidance to make it easier to prepare (paragraph 3.3).

viii Ensure that staff on telephone helplines and in local offices have the training and experience to provide businesses with the information requested. This needs to go beyond repeating what is already available to the businesses by tailoring support to the needs of customers such as agents. It should draw on the results of the quality assurance process and analysis of common questions and errors made to ensure consistency of the information provided by helplines (paragraph 3.6).

The following recommendations would require further policy analysis and research into the costs and benefits of implementation, consultation with businesses and possibly legislative changes, some of which the Department has started to develop. The Department should:

ix On Corporation Tax, consider whether benefits for the smallest companies, with the simplest financial affairs and with no tax liability, could be secured through policy changes removing the need to file returns. The Department should research the potential savings in its own costs and in reducing the compliance burden, together with the risks to tax revenues from such a change (paragraph 3.5).

x Following the consultation in 2005-06, continue to explore aligning the dates for payment of Corporation Tax, the filing of accounts to Companies House and the filing of the Company Tax return to HM Revenue & Customs. This would mean that over 1.3 million of the smaller companies could submit their accounts to government once instead of twice and make any tax payment due at the same time, rather than in advance of filing. Any enquiries could begin earlier making the compliance process more efficient. It would bring the filing period in the United Kingdom for these companies more into line with the international average of five months (paragraph 3.8).

xi Provide businesses with an online statement of account showing tax payments and liabilities across all taxes, building on the development work already begun (paragraph 2.8, area 2).

xii Seek powers to offset any repayments due on VAT against outstanding debts on Corporation Tax or other taxes, and vice versa. The Department is already considering this along with a reference to a single financial account which will give the Department a complete view of an entity's financial position across the range of taxes and duties (paragraph 1.14).

xiii As part of the review *'Modernising Powers, Deterrents and Safeguards'*, explore the costs and benefits of introducing non-financial incentives such as tax clearance certificates for businesses that comply fully with their tax obligations across the range of taxes (such as Corporation tax and VAT). Such measures are already used by some revenue departments in other countries and are a powerful incentive to comply with taxation obligations as they may be required by businesses before they can be awarded public sector licences, grants and contracts (paragraph 3.14).