



National Audit Office

HM REVENUE & CUSTOMS

Helping newly registered businesses meet their tax obligations

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LONDON: The Stationery Office
£13.50

Ordered by the
House of Commons
to be printed on 4 December 2006

This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act.

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24 November 2006

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EXECUTIVE SUMMARY

1 Around 700,000¹ new businesses start up each year. Businesses have to register with HM Revenue & Customs (the Department) for different taxes as they become liable to pay them which can be at different times. For example, as businesses take on employees they will need to pay PAYE and if their turnover exceeds £61,000 they become liable for VAT. Even where a business needs to register for a number of different taxes at the same time, the Department requires them to register for most separately. This leads to around 1.2 million registration applications a year. Once registered, the Department expects businesses to file their tax returns on time, calculate the right amount of tax, and pay amounts due on time.

2 Since the Department was set up in April 2005, it has continued with the work of the former Inland Revenue and HM Customs and Excise in helping businesses understand and comply with their tax obligations. It is also seeking to support the Government's drive to increase business enterprise and entrepreneurship in the UK. The Department aims to make it as easy as possible for businesses to comply by providing: simple processes for registering; accessible and easy to understand guidance; and forms that are straightforward to complete. It provides a wide range of help through its website, printed guidance, telephone helplines, workshops and seminars. The Department spends over £10 million a year in salary costs on registering new businesses and a further £23 million in providing help.

¹ The figure is based on the number of businesses registering with HM Revenue & Customs for Income Tax Self Assessment and Corporation Tax. Some 370,000 self employed people register for Self Assessed Income Tax and 330,000 companies for Corporation Tax. Around 630,000 businesses also deregister for these taxes each year because they are no longer trading.

3 The Department has an objective to demonstrate a measurable improvement by 2007-08 in new and growing businesses' ability to deal with their tax affairs. In dealing with new tax obligations for the first time, new businesses may be unfamiliar with what is expected and they may need particular help in getting their tax affairs right. If new businesses get their tax right first time they are more likely to continue to comply as they grow and their tax obligations increase. The Department recognises that the costs of compliance can be more onerous for smaller businesses and they have most to gain from simplifying requirements. It has recently measured the administrative burdens on businesses in complying with tax requirements and has set targets to reduce these costs.

4 The Department is currently developing a strategy for the help it provides to all types of businesses. This will help it use available resources in the most cost-effective way to improve the compliance of businesses in meeting their tax obligations. Improved compliance will also reduce the Department's own costs in chasing-up outstanding tax returns, examining and correcting returns and recovering tax debts.

5 Against this background, this report examines the opportunities for the Department to further improve the help provided to new businesses while it is still developing its approach. For the purposes of this report a business is regarded as new until it completes its first tax return which can be up to 30 months after registering. The report looks at:

- the compliance record of newly registered businesses (Part 1);
- the process of registering for a tax (Part 2); and
- the guidance and advice provided by the Department (Part 3).

It focuses on businesses registering for the main taxes – Income Tax Self Assessment, Corporation Tax, PAYE, National Insurance contributions² and VAT. Some key information on the performance of newly registered businesses is not available and where this is the case we used other data such as for small businesses as an indicator.³ Details of our methodology are in Appendix 1.

Main conclusions

6 Newly registered businesses are a diverse group. Some are setting up in business for the first time. Others have been in business for some time but are taking on new tax obligations for the first time. Still others start up new businesses having had previous business experience. Some businesses manage their tax affairs themselves whereas others rely on a tax agent or other assistance. Attitudes to compliance also vary. All of these factors affect the level and type of help or intervention that a newly registered business needs, and in turn how the Department should target its help to best effect.

7 The proportion of new businesses filing their returns on time⁴ is generally lower than for the business population as a whole. If the Department could improve the filing performance of new businesses to the level achieved by the general business population, it would receive an additional 119,000 returns on time. This would also reduce the substantial costs that businesses currently incur in penalties for late filing of returns. On making accurate returns and paying on time, comparisons between newly registered businesses and the business population as a whole give a mixed picture but there are opportunities for improvement, as the proportion of businesses failing to pay the correct amount of tax is significant. The Department, however, does not have complete information on the compliance record of newly registered businesses as a group, or on the track record and history of individual businesses as they take on new tax obligations.

² The majority of National Insurance contributions are accounted for through Income Tax Self Assessment returns for the self employed (Class 4) and through the PAYE system for employees (Class 1).

³ For the purposes of this report, small businesses consist of all of the self employed (Income Tax Self Assessment); VAT registered businesses where the turnover is below £1 million a year and those with less than 10 employees (PAYE and Corporation Tax).

⁴ On the different taxes, the proportion of newly registered businesses filing on time ranges from 61 per cent to 80 per cent.

8 Research indicates that the help provided by the Department has improved the compliance of newly registered businesses. For example, six per cent more businesses filed their VAT returns on time after receiving help and advice compared to those that had received no help. Initiatives from 2002 to remind new businesses to file their Income Tax Self Assessment returns have led to an increase of five per cent to eight per cent in returns submitted on time by those contacted. Similarly, initiatives to encourage payment on time have met with some success. The Department does, however, need a better understanding of what type of help and advice improves compliance and its cost effectiveness. A clearer view of new businesses' problems and needs would help the Department to target assistance on those who need it most.

9 Around three quarters of small businesses rely on tax agents or others to help them comply although it is not known how many newly registered businesses seek such help. The Department is examining whether those seeking such help are more or less compliant than businesses that are unrepresented to determine the extent to which it may need to work more closely with tax agents. It usually only becomes aware of a new business⁵ when it registers for a tax, which may be some time after the start up. The Small Business Service, tax agents and other financial organisations are often involved with new businesses at a much earlier stage when planning the business start up. The Department could enlist more support from these organisations in helping to educate new businesses at this stage about how to manage their tax affairs effectively.

10 In 2005-06, almost 70 per cent of tax registrations were in paper form; 27 per cent by telephone and three per cent online. VAT and PAYE are the only taxes where businesses can register online.⁶ By July 2006 take up of online registration had increased from 13 per cent of VAT registrations in 2005-06 to 16 per cent, and 10 per cent of PAYE registrations were by email two months after the system was introduced. The requirement to register separately for each tax can duplicate effort for businesses and the Department in providing and processing the same information each time. The Department could reduce the burdens on businesses by unifying the common elements of registering for different taxes and by expanding the facility to register online.

11 The Department's current practice is to issue separate reference numbers each time a business registers for a tax. The experience of tax authorities overseas suggests that a unique reference number for all taxes would involve significant costs and take several years to introduce. But it would bring benefits to businesses and enable the Department to link data on taxpayers across its separate computer systems: thereby achieving more efficient processes and improving the service provided to businesses. The Department is currently examining ways in which its data on taxpayers can be linked.

12 Additional main findings are summarised under each recommendation below.

Recommendations

13 During our study we identified a range of options which the Department could implement to encourage voluntary compliance, reduce the Department's costs and the burden of compliance on newly registered businesses and to improve its customer service. We used a technique known as multi-criteria decision analysis⁷ to assess and compare each option to determine which were likely to be the most cost effective. We used the following criteria:

- the likely implementation costs, including the Department's start up and running costs and possible costs to businesses;
- the likely scale of benefits in improving businesses' compliance; simplifying processes and reducing costs to the Department and businesses; and
- the likely administrative difficulty of implementation, including the amount of time it might take and the likelihood of a successful outcome.

⁵ The main exception is limited companies where Companies House informs the Department of new incorporations. Companies are required to let the Department know when they commence trading by completing a form to notify the Department that they have come within the charge of Corporation Tax.

⁶ VAT from December 2004 and PAYE from June 2006.

⁷ Multi-criteria decision analysis is a technique that takes account of multiple and conflicting criteria to help make decisions on priorities. Appendix 1 provides further details.

14 We used the analysis to develop a shortlist of recommendations set out below. These included some options that could be implemented relatively quickly and at low cost (**a1–a5**). Other options would require more substantial resources and changes to implement but could bring significant benefits in the longer term (**b1–b4**). On the basis of this analysis, we recommend that the Department should:

- a1 Target help at those newly registered businesses which are likely to benefit most from it. For example, those that are entirely new to business and are least likely to understand their obligations and those businesses that have been previously non-compliant on other taxes. This would be aided by further research into the problems met by newly registered businesses and the support that would help them.**

The Department has data on the extent to which businesses, as a whole, meet their obligations for each tax, but cannot always readily break this down for different groups of taxpayers such as newly registered businesses. Nor does it have good information on the track record of individual businesses or on the cost effectiveness of the different types of help it provides. The Department currently offers education to newly registered businesses and during 2006-07 will be contacting those not represented by a tax agent to discuss the different types of help it can provide.

The Australian Tax Office has concentrated help on those businesses which have inexperienced owners who have not sought the assistance of a tax agent, because they are least likely to understand their tax obligations. It tracks the compliance of those that are new to business for up to two years, with swift action on non-compliance including education, information and assistance. The initiative has produced improvements in compliance. (paragraphs 1.9 to 1.26)

- a2 Encourage newly registered businesses to use the email alert service provided by Business Link⁸ to remind them to file their return and pay tax on time, or telephone those which do not use this service.**

The Department sends letters to remind businesses to file their return and pay any tax one month before the due dates. Following up on these reminders can help improve compliance. The Department estimates that telephone reminder exercises have led to a five per cent to eight per cent increase in filing performance for those contacted. Reminders are also effective in encouraging employers to pay on time, particularly where it is the first time they have paid late. The Department could encourage newly registered businesses to use the email alert service on the Business Link website (containing information and advice for small businesses) which automatically reminds businesses to file their returns and pay their tax on time. (paragraphs 1.10, 1.16 and 3.7)

- a3 Make guidance and forms easier to understand and complete by increasing the use of plain English and improving the layout and guidance.**

Our analysis showed that several of the Department's forms examined were relatively straightforward to complete and none was in the category of difficult. The more difficult to complete forms are the VAT registration form and the full length tax returns for Corporation Tax and Income Tax Self Assessment. The shorter tax returns on Income Tax Self Assessment and Corporation Tax are easier to complete. The VAT registration form is one of the more difficult to complete partly because of the amount of information the Department needs to carry out checks to prevent fraud, in particular missing trader intra-Community fraud. This is a particular type of fraud that depends on the fraudster obtaining a VAT registration. Around 50 per cent of businesses registering for VAT complete the registration form incorrectly, so the Department is redesigning the form and is planning further work to help businesses complete it. It is also redesigning the full Income Tax Self Assessment return. (paragraphs 2.8 to 2.10, 3.15 to 3.18 and Appendix 5)

⁸ Business Link is a part of the Small Business Service, which is an agency of the Department for Trade and Industry. It provides a national advice service for business information such as on business finance and grants; tax; health and safety issues; IT and commerce; sales and marketing; international trade; growing a business and buying and selling a business. More information on its services for start-up businesses can be found at www.sbs.gov.uk/SBS_Gov_files/corporateinfo/BLCustomerProposition.pdf.

The Department's guidance is complex, contains long sentences and a lot of acronyms and uses technical terms, principally to ensure the advice accurately reflects the law. As a result it requires an average reading age of 16 to 17 years old to understand. But over five million adults in the UK have literacy skills that fall well below this level. The Department is therefore currently aiming for a reading age of 11. We concluded that, even with presentational improvements, some of the more technical information will not be easily understood by some taxpayers. (paragraphs 3.9 to 3.11)

a4 Work more closely with other organisations such as tax agents, Business Link and financial institutions to coordinate the help available to those who are entirely new to business and ensure that it is consistent.

New businesses often seek business advice from financial advisers and from Business Link in starting up a new business. These organisations provide channels of contact which the Department could use to help more businesses register for taxes when they should, thereby reducing the penalties they incur from registering late. The Department recognises that Business Link, tax agents and their professional bodies can help to improve the compliance of businesses and is building up its relationship with them. (paragraphs 2.1, 3.2 and 3.7)

The Department's website and the Business Link website both provide tax information for businesses but with different formats, styles and content which is confusing. The Business Link website is increasingly seen as a significant source of Government advice on the range of issues affecting small businesses. The Department is looking at ways to ensure greater consistency between the two websites on the tax information provided, and is examining how to align better the services it provides with the Business Link website. The Department is also looking at updating information on its own website in response to feedback from taxpayers. It could draw on the practice of the Canada Revenue Agency which updates its website regularly with the most frequently asked questions handled by its telephone helplines. (paragraphs 3.6 to 3.8)

a5 Cooperate with other organisations to increase awareness by businesses of the various tax simplification schemes and the benefits they can bring.

There are a number of schemes for small businesses, including those newly registered, that simplify tax requirements and reduce their costs of complying, mostly for VAT. For example, small businesses can file one VAT return each year rather than the usual four and account for VAT when cash is received rather than on the issue of the invoice. Around one half of small businesses are aware of the schemes. Take up, however, has been low and the Department is currently looking at ways to improve the situation. The Department could work with Business Link, tax agents and financial institutions to advertise more widely the benefits of the various schemes. We estimate that if all eligible businesses took advantage of just two of the schemes offered they would save at least £50 million a year in administrative costs and cash flow benefits. (paragraphs 3.19 to 3.22 and Appendix 6)

There is also a PAYE scheme where businesses can pay quarterly rather than monthly, and an Income Tax Self Assessment scheme where the self-employed with turnover of less than £15,000 a year can submit three line accounts to the Department. The Department does not have complete data on the number of businesses that use these schemes and whether it needs to do more to encourage their use. (paragraph 3.22, Figure 11 and Appendix 6)

b1 Introduce a single online tax registration for businesses, with checks to ensure that the business has completed it correctly before it can be submitted.

At present the Department has separate registration processes for each tax with over two thirds of those registering completing a paper form. Prior to 2006, VAT was the only tax where businesses could register online. Take up was around 13 per cent at the end of March 2006 and had increased to 16 per cent by July. Since June 2006 businesses can also register for PAYE online where take up was 10 per cent within the first two months. The experience of the Australian Tax Authority where 96 per cent of new businesses register for a business tax number online and Companies House in the UK where 85 per cent of businesses are registered online by their agents suggests that the Department should be able to achieve much higher levels. The experience of Canada and Australia also shows that the process can be streamlined further by offering a single registration online for all taxes. This allows businesses to provide basic information only once and provide additional details as and when they become liable for additional taxes. (paragraphs 2.5, 2.11, 2.12 and 2.15)

b2 Use a unique identifier to cover all taxes to link data on individual businesses across the Department's various computer systems and help develop a whole view of individual customers' tax affairs.

A number of other overseas tax authorities issue businesses with a unique reference number which is used for all taxes. The unique identifier has also provided the basis for a single reference number across government. Their experiences show that introducing a unique reference number for all taxes would take some time to introduce and involve significant costs but would be worthwhile. At present the Department holds information on each business on separate computer systems for each tax. As a consequence it does not have a clear view of the entire tax affairs of an individual business. It also has difficulties in drawing the information together which would help it understand the needs of different taxpayer groups and developing services for them. The Department is examining options for linking its data on taxpayers using an IT solution. (paragraphs 2.13 to 2.15)

b3 Experiment with alternative ways of delivering workshops and seminars such as providing them online.

The Department spends over £6 million a year providing workshops and seminars on Income Tax Self Assessment, PAYE and VAT for newly registered businesses. Around eight per cent of newly registered businesses attend a workshop or seminar. Those attending viewed the workshops and seminar favourably. For PAYE, the Department's evaluation shows that new employers attending a workshop or seminar have a higher compliance rate on filing their returns on time than newly registered employers in general. The Department has found that one reason newly registered businesses do not accept the offer of a workshop or seminar is because they are held during normal business hours, although, a 2004 pilot study suggested very little demand for workshops at other times. It is looking at whether IT technology could be used to provide businesses with the same educational material. (paragraphs 1.22 to 1.24 and 3.4 to 3.5)

b4 Work towards a one stop telephone information system to cover all taxes.

The Department operates 10 helplines all businesses can contact for information. These include three helplines which cost over £4 million a year to provide information to new employers and the newly self-employed. For VAT, newly registered businesses can telephone the National Advice Service which deals with all VAT-related enquiries. It can be frustrating for businesses to have to contact different helplines to discuss different taxes. The Department is exploring the scope for reducing the number of different helplines and telephone numbers to offer a more joined up service and in the longer term a single initial point of telephone contact with the Department. This will take some time to implement as among other things helpline staff will need to have access to taxpayers' computer records for all taxes, and the technical and operational capability is needed to route enquiries to advisers with the requisite expert knowledge. (paragraphs 3.12 to 3.14)

PART ONE

The compliance record of businesses

The tax obligations of new businesses

1.1 Around 700,000⁹ new businesses start up each year. Businesses have to register with HM Revenue & Customs (the Department) for different taxes as they become liable to pay them which can be at different times. For example, as businesses take on employees they will need to pay PAYE and if their turnover exceeds £61,000¹⁰ they become liable for VAT. Even where a business needs to register for a number of different taxes at the same time, the Department requires them to register for most separately. This leads to around 1.2 million registration applications a year. Once registered, the Department expects businesses to file their tax returns on time, calculate the right amount of tax and pay it on time.

1.2 Since the Department was set up in April 2005, it has continued with the work of the former Inland Revenue and HM Customs and Excise in helping businesses understand and comply with their tax obligations. In doing so it is seeking to support the Government's drive to increase business enterprise and entrepreneurship in the UK. The Department aims to make it as easy as possible for businesses to comply by providing: simple processes for registering; easy to understand and accessible guidance; and forms that are straightforward to complete. It provides a wide range of help through its website, printed guidance, telephone helplines, workshops and seminars and other educational help. The Department spends over £10 million a year in salary costs on registering new businesses, and a further £23 million in providing help.

1.3 New businesses are an important group for the Department. In dealing with new tax obligations for the first time, new businesses may be unfamiliar with what is expected and they may need particular help in getting their tax affairs right. At the same time they face a number of pressures on their time and resources. But it is also likely that if new businesses get their tax right first time they are more likely to continue to comply as they grow and their tax obligations increase.

1.4 Newly registered businesses are a diverse group. Some are setting up in business for the first time. Others have been in business for some time but are taking on new tax obligations for the first time. Still others start up new businesses having had previous business experience. Some businesses manage their tax affairs themselves whereas others rely on a tax agent or other assistance. Attitudes to compliance also vary. For the purposes of this report a business is new until it completes the first tax return which can be 30 months after registering (**Figure 1**).

The Department's approach to helping newly registered businesses

1.5 In April 2005 HM Revenue & Customs was set up, bringing together the former Inland Revenue and HM Customs and Excise. The new Department has an objective to demonstrate a measurable improvement in new and growing businesses' ability to deal correctly with their tax affairs by 2007-08. One of its customer units is responsible for ensuring that all parts of the Department take account of the needs of small and medium enterprises. The Department is currently developing a new strategy to provide clear, coordinated and helpful support at the right time to these businesses, primarily targeting those businesses that make unintentional mistakes.

⁹ The figure is based on the number of businesses registering with HM Revenue & Customs for Income Tax Self Assessment and Corporation Tax.

¹⁰ The threshold for registering from April 2006.

1 The tax obligations of newly registered businesses

Business type	Definition of newly registered	Main Tax obligations
A sole trader/ partnership	Until they have filed their first Income Tax Self Assessment form (31 January in the year following the start of trading) – up to 22 months after registering.	<ul style="list-style-type: none"> ■ keeping relevant financial records; ■ filing accurate Income Tax Self Assessment returns on time; ■ paying the correct amount of Income Tax and Class 2 and 4 National Insurance contributions on time.
A new employer	Until they have filed their end of year PAYE return between 1 and 12 months after registering.	<ul style="list-style-type: none"> ■ applying details of employees' personal tax codes in calculating the amounts due; ■ submitting forms to the Department with details of new and departing employees; ■ calculating and deducting the right amount of Income Tax and National Insurance from staff; ■ filing annual returns for its PAYE and taxable benefits in kind; ■ paying over all the amounts deducted from staff to the Department on time.
Turnover exceeding £61,000	Until first VAT return is filed – usually after three months but can be up to one year after registering.	<ul style="list-style-type: none"> ■ charging the correct amount of VAT on sales; ■ keeping VAT accounts and financial records; ■ filing accurate VAT returns on time; ■ paying VAT due on time.
A limited company	Until the company files its first tax return – up to 30 months after registering.	<ul style="list-style-type: none"> ■ keeping relevant financial records; ■ filing accurate company tax returns on time; ■ paying the correct amount of Corporation Tax on time.

Source: HM Revenue & Customs

1.6 The Department recognises that the costs of compliance can be more onerous for smaller businesses and they have most to gain from simplifying requirements and better delivery. In March 2005 the Department issued a consultation document on *Working towards a new relationship: reducing the administrative burden of the tax system on small business* which set out proposals for simplifying the relationship between the Department and business to reduce costs. The Department has introduced a number of measures to simplify the tax requirements for small businesses.

1.7 In 2005-06 the Department measured the administrative burdens of the taxation system on businesses using a costing model developed for the public sector in the Netherlands.¹¹ The model measures the costs to business of meeting requirements to record and supply information to others including Government. The research estimated where the administrative burden may be

relatively higher or lower within the entire tax system. In Budget 2006 the Government published *Progress towards a new relationship: How HMRC is working to make life easier for business* in which it announced the results of the Department's measurement work. This showed that the Department estimated the administrative burdens on businesses in complying with tax requirements to be £5 billion a year. Although the figures are not statistically robust they do provide an indication of the relative burden of the taxes. The Department was set targets to reduce:

- by at least 10 per cent the administrative burden on business of dealing with the Department's forms and returns, over a five year period; and
- the administrative burden on business of dealing with the Department's audits and inspections by 10 per cent over three years, and at least 15 per cent over five years.

11 *Administrative Burdens – HMRC Measurement Project: March 2006.*

1.8 Eighty-five obligations impose 85 per cent of total costs on businesses, mainly from dealing with the Department's forms and returns. The top ten obligations cost businesses £2.1 billion. Businesses with less than 10 employees bear just over one half of this burden. The highest administrative burdens are on VAT and Income Tax Self Assessment mainly from businesses having to gather information to complete the Department's forms and returns. There is also a large 'tail' of over 2,600 obligations that apply to a small number of businesses but which cause irritation and contribute to an impression that the tax system is complex and difficult to understand. Budget 2006 announced that the Department, in discussion with business, would analyse the research to identify and prioritise further areas for action.

Compliance record of newly registered businesses

1.9 The latest available data shows that the proportion of new businesses filing their returns on time is lower than for the business population as a whole. On making accurate returns and paying on time, comparisons between newly registered businesses and the business population as a whole, give a mixed picture and are less clear because of gaps in the Department's data. The available data shows that the levels achieved by newly registered businesses are between 53 per cent and 69 per cent (**Figure 2**).

2 The levels of compliance with different tax obligations for all businesses and newly registered businesses

	Income Tax Self Assessment (2003-04)		PAYE/Class 1 National Insurance Contributions (2003-04 and 2004-05)		Corporation Tax (2004-05)		VAT ¹ (2004-05)	
	All businesses %	New businesses %	All businesses %	New businesses %	All businesses %	New businesses %	All businesses %	New businesses %
Filing tax return on time	89	79	80	61 ²	77	72	85 ³	80 ³
Accurate returns	46	54	63	69	61	Not available ⁵	65	Not available
Paying on time	Not available ⁴	Not available ⁵	53	Not available	60	64	60	53

Source: HM Revenue & Customs and National Audit Office analysis

NOTES

- VAT figures exclude around 1,000 large groups of businesses.
- 2004-05 data.
- Percentage of returns where no penalty imposed.
- The Department's data shows that 89 per cent of businesses and individuals pay on time. It is unable to produce separate figures for businesses.
- Insufficient numbers of new businesses were available within the Department's annual sample of taxpayers to calculate a reliable figure.

a) Filing returns on time

1.10 Tax returns enable businesses to determine their tax liability and the Department to know how much tax is due. Businesses are required to submit separate returns for each tax – an annual return for Income Tax Self Assessment and PAYE¹², for an accounting period (normally 12 months) for Corporation Tax and quarterly returns for the majority of VAT registered businesses. The Department sends out written reminders to businesses to file their returns on time with the exception of VAT.¹³ In accordance with legislation the Department can impose penalties where a business files late (Appendix 4). The Department uses penalties along with other measures such as telephone reminders to encourage taxpayers to comply with their obligation to file by the due date. If the Department could improve the filing performance of new businesses to the level achieved by the general business population it would receive an additional 119,000 returns on time.

1.11 All unincorporated businesses are required to file an Income Tax Self Assessment return by 31 January after the tax year to which it relates. The self-employed with turnover of less than £15,000 can complete a shorter form of four pages. Seventy-nine per cent of newly registered businesses file their tax returns on time, which is lower than for all business Income Tax Self Assessment returns at 89 per cent. The Department issues automatic penalties of up to £100 to taxpayers who have not filed by the deadline. We estimated that newly registered businesses incurred penalties of around £3.1 million a year because they file late. Businesses may file late for a number of reasons including ignorance of the tax requirements, mistakes by the taxpayer or their agent or personal problems. Since 2002, the Department has telephoned taxpayers new to Income Tax Self Assessment including new businesses to remind them to file their tax returns on time. The Department estimates that more on time returns were received from new businesses as a result, representing a five per cent to eight per cent increase in compliance levels for those contacted. Its research shows that most taxpayers who file on time continue to do so in later years.

1.12 For Corporation Tax, businesses are required to file a tax return within 12 months of their accounting period, which can be up to 30 months after the start of trading. In 2005 the Department introduced a shorter return form of four pages, rather than eight, for 500,000 companies with simpler financial affairs, including most newly registered businesses. The Department has also introduced a facility for companies to file an electronic version of the return. In 2004-05 around 72 per cent of newly registered companies filed their tax returns on time compared with 77 per cent of all businesses. We estimated that newly registered businesses incurred penalties of around £5.5 million a year as a result.

1.13 Employers are expected to file their annual PAYE returns by 19 May each year. They can complete a paper return or file online. The compliance of newly registered employers in filing their returns (61 per cent) is much lower than for employers in general (80 per cent). The Department's research identified no clear reasons why employers filed late. Those employers which filed on time tended to have more experience of dealing with PAYE or had outsourced their payroll to an agent. Some employers did not know the filing dates for their returns. Most knew there was a financial penalty for late filing but did not know the amount involved or when it would be imposed (Appendix 4, Figure 18). The Department has been working to raise employers' levels of awareness of their obligations.

1.14 Businesses above the VAT threshold are usually required to file quarterly VAT returns to the Department. They can complete a paper return or file online. The compliance of newly registered VAT businesses at 80 per cent is lower than established businesses at 85 per cent. Tax agents have told the Department that, in their experience, the main reasons businesses file late are because: they are too involved with their own work to spend time completing their returns; were distracted because of financial difficulties or other problems; or did not have the relevant information to hand to complete the return.

12 National Insurance contributions are accounted for through Income Tax Self Assessment returns for the self-employed and through the PAYE system for employees and employers.

13 The Department sends the business the paper VAT return to complete. Since June 2006, businesses filing their returns electronically can enrol for an e-prompt service to remind them to file their returns.

b) Making accurate returns

1.15 In carrying out checks on businesses' tax returns to ensure they are accurate, the Department concentrates its resources on the main areas of risk to the revenue. In the main, the Department assesses newly registered businesses as posing low risks to the revenue and only carries out checks on individual businesses where high risks are identified. The Department, however, carries out random checks on taxpayers registered for Income Tax Self Assessment, Corporation Tax and PAYE to assess the level of compliance overall and to identify areas where it may need to take further action to improve compliance. Where the Department identifies areas of non-compliance which are unintentional it seeks to help businesses understand their obligations. The results of these exercises show that:

- Self-employed people are in general more likely to file inaccurate returns and to have significantly understated tax liabilities. For the 2003-04 tax year, around 54 per cent of the newly self-employed calculated the correct amount of tax due which is higher than for the self-employed generally (46 per cent), possibly because their tax affairs are more straightforward. Most make relatively small errors with around three quarters of returns either correct or containing errors of less than £1,000. To help taxpayers with filing correct returns in the future the Department has written to thousands of taxpayers to draw their attention to aspects of their return which are more likely to be completed inaccurately.
- Around 61 per cent of all companies calculate the correct amount of Corporation Tax due. The Department's random enquiry programme detected errors by companies in around 40 per cent of returns, with under-assessments of tax of around £2,700 on average.¹⁴ The Department has identified around 60 main types of error, of which eight accounted for half of all the errors. It provides detailed information on its website on how to calculate the tax due covering the main errors to avoid and plans to publish further information on common errors. Separate figures for newly registered companies are not available but the Department considers that any errors are likely to be small because such companies tend to have low profits.

- On PAYE newly registered employers are more likely to calculate the correct amount of tax due (69 per cent) compared to employers in general (63 per cent). The Department sends a CD-ROM to all new employers which provides comprehensive guidance on the operation of PAYE. In addition all new employers are offered access to a range of workshops designed to help businesses with specific aspects of PAYE.
- Around 65 per cent of VAT registered businesses calculate the correct amount of tax due. The Department's latest estimate (based on 2001-02 data) is that businesses' returns had errors totalling £2.5 billion to £4.0 billion in underpayments because of genuine mistakes or deliberately understating a portion of their sales or falsely inflating the value of purchases to reduce their VAT liability. No separate figures for newly registered businesses are available. The Department's guides provide information on the common mistakes that businesses make when calculating the VAT due. It has also more recently developed a free CD-ROM guide to *Getting started in VAT* which provides an insight into VAT for small businesses and contains pointers as to where to go for more help and information.

c) Paying on time

1.16 The Department expects taxpayers to pay their taxes when they are due. One month before the due date the Department sends reminders¹⁵ to businesses and where they do not pay on time it sends demand letters. The Department also contacts them by telephone to ask for payment and provides them with advice on paying on time in the future. In certain circumstances the Department will allow taxpayers to pay in instalments. Where the taxpayer still does not pay the Department may take enforcement action or take bankruptcy or winding up action. The Department can impose surcharges and/or interest charges on the amount owed.

1.17 Each of the taxes has different payment dates. New businesses normally only have to make one payment in their first year for Income Tax Self Assessment or for Corporation Tax, whereas those that are VAT registered usually make VAT payments quarterly and those that are employers pay PAYE and National Insurance contributions monthly. Businesses that have a PAYE liability of £1,500 a month or less are entitled to make PAYE payments quarterly. One third of newly registered businesses pay their Corporation Tax late and almost one half pay VAT late – owing the Department an average of £6,200 in VAT after 12 months of trading.

¹⁴ This figure excludes 900 larger companies that pay around £18 billion in Corporation Tax.

¹⁵ The Department does not send out reminders for VAT.

1.18 Businesses may pay late because:

- They have cash flow difficulties. A survey by Kingston University on the impact of the tax system on the cash flow of small businesses shows that in the last two years nearly one third of small businesses said they have had difficulties in paying their tax on time particularly VAT.
- The Department does not impose a penalty or interest for late monthly payments of PAYE/National Insurance contributions except for any balance due at the year end in May each year. The Department's research found that the main reason employers paid late was because of cash flow problems. Reminders by the Department are, however, effective in getting employers to pay over the amounts due, particularly on the first occasion they miss a payment deadline.

1.19 The Department offers Budget Payment Plan arrangements to help taxpayers save for an income tax bill but not other taxes. There are around 3,000 of these arrangements and they are particularly useful for the self-employed in helping them meet future tax liabilities. There are also obvious advantages for the Department in preventing the build up of large debts but it does not publicise extensively the arrangements.

1.20 The Department wrote-off around £660 million from November 2004 to October 2005 in unpaid taxes owed by businesses which went into voluntary or enforced liquidation, ceased trading or could not be traced. It does not specifically identify how much of this was owed by newly registered businesses. Analysis by the Small Business Service shows that the survival rate for new businesses after one year is around 90 per cent and after three years just below 70 per cent.¹⁶ Businesses may not survive for a number of reasons including being wound up, liquidated or sold.

The effects of the Department's help on compliance

1.21 The Department has a number of teams that help businesses, including those newly registered, to comply with their tax obligations for Income Tax Self Assessment, PAYE and VAT. It does not provide similar support for businesses paying Corporation Tax because around three quarters use a tax agent from whom they can seek advice.

1.22 Up to April 2006 the Department had compliance management teams located around the UK. The teams sought to raise the level of compliance by telephoning businesses to obtain up to date information, offered them help and advice and reminding them to file their returns and make payments on time. Since 2003-04 the teams contacted nearly all newly registered businesses within 12 months to help instil good compliance habits before they filed their first VAT return. The teams also telephoned defaulting filers to remind them of their obligations and provided them with education and advice on their responsibilities. In 2004 and 2005 the Department undertook research examining whether the help provided to newly registered businesses improved compliance. It compared the compliance record of over 100,000 businesses which had received help with 64,000 businesses which had not received any help (**Figure 3 overleaf**). The Department found that those businesses receiving help were more compliant but that the average amount of VAT declared by businesses in the two groups did not differ significantly.¹⁷ There was no difference on average in the amounts declared in returns between the two groups up to one year after registering, but there was a difference of four per cent (on average £100 more in the group receiving help) in returns submitted one year after registering¹⁸.

¹⁶ *Survival rates of VAT registered businesses 1994-2003*, Small Business Service – February 2006.

¹⁷ The group which received help were registered between April 2002 and March 2004 and the group which had not received help were registered between April 2001 and March 2002. The results are not fully comparable because other factors may have influenced performance such as the economic climate.

¹⁸ Businesses which had received help from the Department declared on average £2,350 in VAT compared to £2,250 on average for businesses which had not received help.

3 The results of the Department's research into whether education and support improves compliance on VAT for newly registered businesses

Aspect of compliance	Businesses which are compliant		
	Support received from the Department %	No support received from the Department %	Difference %
Businesses submitting their VAT return on time	92.0	86.0	+6.0
Businesses making payments on time	85.0	76.0	+9.0
Businesses owing the Department VAT after 12 months	4.0	8.6	- 4.6
Businesses deregistering in their first year	3.3	7.4	- 4.1

Source: HM Revenue & Customs

1.23 Also up to April 2006, the Department's Business Support Teams provided help and advice to all businesses on how to comply with tax requirements on PAYE and Income Tax Self Assessment. When a business registered with the Department they were informed of the range of support provided, including the role of the Business Support Teams, and that they could decide if they wished to contact their local team. The teams provided one-to-one advice and ran workshops. Up to the end of March 2005, the performance target of the Business Support Teams was for 90 per cent of attendees to feel more confident following contact. This was exceeded each year. Since April 2005 the teams' target was to ensure that 90 per cent of newly registered businesses filed on time where a representative from a business attended a workshop. Preliminary results for PAYE show that just over 70 per cent of new employers attending a workshop filed on time compared with just over 60 per cent for all newly registered employers.¹⁹

1.24 Since April 2006, the Compliance Management Teams and the Business Support Teams have been merged to cover all taxes with around 650 staff located around the UK helping newly registered businesses at a cost of £19 million a year. The unit provides help to businesses by letter, telephone, workshops, seminars, face to face meetings and by using IT technology. It is targeting education at all newly registered businesses. During 2006-07 the unit will be contacting businesses not represented by a tax agent soon after registering for any of the taxes and before their first return is filed to discuss the different types of help that can be provided.

1.25 During the period November 2004 to June 2006 the Department ran a Joint Education Trial, costing £125,000, covering businesses in East London and West Scotland to trial a programme of integrated help across the Department. The Department's staff telephoned the newly registered self-employed, new employers and VAT payers to offer them education options. It recognised that businesses taking advantage of this help were more likely to be those who would be compliant but it also tried to understand the reasons businesses were not taking advantage of the help offered. Early results show that the trial did not make any significant difference to compliance levels in the pilot areas.

1.26 The Australian Tax Office's approach is to focus on those businesses that are entirely new and have no previous experience of paying business taxes rather than established businesses or those using tax agents, because the former are most likely to make mistakes. The initiative involves providing education and assistance to these businesses and then tracking their compliance for up to two years and swiftly taking action to provide help according to the type of non-compliance and how often it occurs (Appendix 2). The Tax Office's analysis of the compliance record of new businesses in filing returns shows that there was an improvement in compliance levels for businesses which have been provided with this help compared to those which had not.

¹⁹ The Department reviewed a sample of around 500 employers that had attended a workshop. The filing rate for those attending was 71 per cent, + or - 4 per cent at the 95 per cent confidence level. The sample did not include those attending workshops in Wales.

PART TWO

Registering for a tax

The requirements to register

2.1 Businesses are required to register separately with the Department to pay each of the four taxes and National Insurance contributions when their circumstances mean that they are liable for the particular tax (**Figure 4**). The Department informs businesses of their responsibilities through its website, in printed guidance and media campaigns. The Business Link website²⁰ also contains information on businesses' tax responsibilities.

The number of businesses registering

2.2 In 2004-05 around 1.2 million businesses registered with the Department (**Figure 5 overleaf**). There are over 890,000 businesses which deregister each year. Businesses deregister for a number of reasons including where their turnover falls below the threshold for VAT, they have ceased trading or have been sold. There are also businesses that should be registered with the Department to pay tax but which do not and as such are operating in the shadow economy.

4 The responsibilities of businesses to register for taxes

Tax	Businesses' responsibility to register
National Insurance contributions for the self-employed/Income Tax Self Assessment	Businesses such as sole traders and partnerships should register with the Department to pay National Insurance contributions within the first three months of becoming self-employed. When they register for National Insurance contributions a record is also set up on Income Tax Self Assessment.
PAYE/ National Insurance contributions for employees	The employer should register for PAYE when they first make a payment to an employee who is liable for Income Tax and/or National Insurance contributions.
Corporation Tax	The Department is automatically notified by Companies House of all newly incorporated businesses. It then sends a form to the new company to collect information about it.
VAT	Businesses must register for VAT if: <ul style="list-style-type: none">■ at the end of any month the total value of the taxable supplies they have made in the past twelve months is more than the current threshold of £61,000, or■ at any time they have reasonable grounds to expect that the value of their taxable supplies in the next 30 days will be more than £61,000.

Source: HM Revenue & Customs

²⁰ The Business Link website is funded by the Small Business Service to provide advice and information for new and small businesses on a range of topics such as: finance and grants; health and safety issues; taxation; sales and marketing; international trade; and growing a business.

5 The number of business tax registrations 2004-05

Tax	New registrations	Number deregistering	Total registered
Self-employment (Income Tax Self Assessment)			
Sole traders	330,000 ¹	389,000	3,065,000
Partnerships	41,000 ¹	57,000	Not available
Corporation Tax ²	330,000	185,000	1,600,000 ³
PAYE	272,000	97,000	1,163,000
VAT	270,000	170,000	1,825,000
Total	1,243,000	898,000	7,653,000

Source: HM Revenue & Customs

NOTES

- 1 Based on businesses submitting first Income Tax Self Assessment for the 2003-04 tax year.
- 2 The Department is notified by Companies House of all incorporations and the company is required to notify the Department of the commencement of trading rather than having to register with the Department.
- 3 Excludes some 500,000 dormant companies.

2.3 Some businesses voluntarily register with the Department after the deadline has passed. In accordance with legislation the Department can impose a penalty on businesses registering late for VAT and Class 2 National Insurance contributions. On Corporation Tax the company must inform the Department within three months of “coming within the charge of Corporation Tax” (when it starts trading) otherwise the Department can impose a penalty. There are no penalties for registering late for PAYE.²¹ In 2004-05 the Department imposed penalties totalling £6.7 million in nearly 70,000 cases of late registration for Class 2 National Insurance contributions and VAT. Penalties for Corporation Tax were only introduced in July 2004 but none have been imposed so far. This is because the Department will only start to identify cases when a company files its first return and realises that it should have notified the Department of the start of trading. The earliest such cases occur is July 2006.

2.4 The Department carried out advertising campaigns costing £1.5 million in July and August 2005 to encourage the newly self-employed to register on time. In total, around 5,000 registered as a result. When self-employed people register to pay National Insurance contributions,

the Department sets up a computer record to show that an Income Tax Self Assessment return is also expected from them. Some taxpayers who file an Income Tax Self Assessment return may not realise that they should also be registered for National Insurance contributions.

The methods used by business to register and the costs

2.5 Most businesses register by completing a paper form (**Figure 6**). Businesses have been able to register online for VAT since December 2004 and for PAYE since June 2006. The take up on PAYE was around 10 per cent in the first few months. Take up on VAT is also increasing: it was 13 per cent in 2005-06 and 16 per cent by July 2006. The Department estimates that if VAT online registration take up increases to 50 per cent it will save around £1.7 million a year. It intends to encourage businesses to register online by advertising the service more widely. In Australia, 96 per cent of businesses register for a business tax number online and, in the UK, 85 per cent of companies register online with Companies House using authorised agents.

²¹ Employers are required to make annual returns to the Department. If they do not so by the required date the Department can impose a late filing penalty. There is no penalty for failing to register as an employer but by default the business could be liable to a late filing penalty. The Department will also apply interest charges to late payments of tax and National Insurance deductions.

6 The proportion of businesses using each method of registration 2005-06

Tax	Paper form %	Telephone %	Online %
Self-employment ¹	78	22	Businesses cannot register using this method
Corporation Tax ²	100	Businesses cannot register using this method	Businesses cannot register using this method
PAYE	Businesses cannot register using this method	100	0 ³
VAT	87	Businesses cannot register using this method	13 ⁴
Average	69	28	3

Source: National Audit Office analysis

NOTES

- 1 Figures include non business registrations for National Insurance and Income Tax Self Assessment.
- 2 The Department is notified by Companies House of all incorporations and the company is required to notify the Department of the commencement of trading rather than having to register with the Department.
- 3 Online service available from June 2006 and is now achieving 10 per cent of PAYE registrations.
- 4 Online registrations have increased to 16 per cent in April/July 2006.

2.6 The Department deploys over 400 staff costing over £10 million a year to register businesses for National Insurance contributions and/or Income Tax Self Assessment, PAYE and VAT (Appendix 3). The Department's staff also set up computer records on new companies for Corporation Tax purposes using details of all new incorporations provided by Companies House. In addition they deal with forms completed by new companies notifying the Department of the commencement of trading. The cost of this work cannot be identified separately because it is a small part of the Department's total processing costs. For VAT the Department spends more on registering each business than for any other tax because of the various checks needed to ensure the businesses are legitimate and have not been set up to commit fraud, in particular VAT missing trader intra-Community fraud.²²

2.7 The Department has a target to provide 95 per cent of businesses with a VAT number within 15 days for correctly completed application forms. It achieved this target in 2004-05 but narrowly missed it in 2005-06 (93.9 per cent). For Income Tax Self Assessment and PAYE, businesses can usually obtain a tax reference

number within a week of applying to the Department. For Corporation Tax, companies are informed of their number as soon as the company's record has been set up on the Department's computer system.

The ease of completing the paper registration forms and registering online

2.8 We assessed each of the registration forms against a checklist produced by the London School of Economics for our report on *Difficult Forms: How government agencies interact with citizens* (HC 1145, Session 2002-03). The checklist assigns a score from 0 to 2 for each of 69 features that tend to make forms difficult to use. A score of 25 or less indicates an easy to use form and a score of 70 a more difficult form. Our analysis showed that several of the Department's forms examined were relatively straightforward to complete and none were in the difficult category (Appendix 5, Figure 20). The easiest to complete paper registration form is on National Insurance contributions/Income Tax Self Assessment which scored 34. These are short forms where a person requires little guidance to complete them.

²² The fraud involves fraudsters obtaining VAT registration to acquire goods VAT free from other Member States. They then sell on the goods at VAT inclusive prices and disappear without paying over the VAT paid by their customers. The fraud is usually carried out very quickly with the fraudsters disappearing by the time the Department follows up the registration with their regular checking activities. In 2004-05 the Department estimates that it lost £1.2 to £1.9 billion from this type of fraud. We examined how the Department tackles VAT missing trader fraud in our reports on *Tackling VAT Fraud* (HC 357, Session 2003-04) and the *Standard Report on the Accounts* (HC 1159, Session 2005-06).

2.9 The VAT registration is the most difficult registration form to complete with a score of 56. This is because the person completing it needs to understand technical terms and complex concepts. Around one half of businesses registering for VAT complete the VAT registration form incorrectly or do not complete all of the boxes. This involves the Department in the expense of contacting businesses for additional information. The Department is redesigning the registration form and is improving the guidance to make it easier to complete. Our analysis shows that a person completing the form would need the reading age of a 17 to 18 year old to understand the accompanying guidance, which the Department intends to bring down to a reading age of around 11 years old.

2.10 There are advantages to businesses in completing the VAT form online. For example, the address and some other information on the form are automatically completed after entering the post code. The completed form is easily submitted to the Department with immediate acknowledgement of its receipt. The error rates for registrations completed online are, however, similar to those on the paper forms because a lack of computer validation checks allows applicants to bypass boxes that they should complete and because they cannot submit online additional documents required by the Department. If the Department does not receive these supplementary papers by post within five days the application is classified as incomplete. The Department is looking at how to resolve these problems.

Streamlining registration

2.11 The Department has developed separate registration processes and computer systems for the different business taxes over a number of years. It recognises that separate processes may lead to inconvenience for its customers and is examining how to introduce a single registration process for all business taxes which would allow businesses to provide basic information only once and provide additional details as and when they register for additional taxes. For example, a self-employed person may register for Income Tax Self Assessment as a start up business, and then some time later pass the VAT threshold. At this point the business would need only to provide the Department with VAT specific details.

2.12 To introduce a unified registration process, the Department would need to make major changes to its current systems. At present the Department holds information on each taxpayer on separate computer systems for each tax, partly because prior to April 2005 the responsibility for direct and indirect taxes was split between the former Inland Revenue and HM Customs and Excise. These information systems have their own customer data, data capture mechanisms, validation and processing rules and referencing systems for identifying businesses. This leads to inconsistencies in the information held by the Department, for example, if an address is updated on one system it is not automatically updated on others because the systems are not linked electronically. The Department is currently examining ways to link customer data across the taxes using an IT solution. It has concluded that combining all data on businesses across the taxes is unnecessary as much of the data is specific to particular taxes. The Department intends to concentrate on bringing together the data that is common to a range of taxes such as address and telephone number.

2.13 At present, each time a business registers for a tax the Department issues it with a reference number. For example, a business will have different reference numbers for PAYE, VAT and Corporation Tax. The O'Donnell report on the Review of the Revenue Departments published in 2004 recommended that the new Department should consider the possibility of introducing a single business identifier to help develop a whole customer view and bring together the data on each taxpayer. In response, the Department is intending to develop a "customer index" that would hold together all the reference numbers for a customer. In March 2006 the *Review of HMRC Online Services* by Lord Carter of Coles emphasised that the key to offering joined up services from the Department, and across government, is a single business identifier used for all types of tax and for other interactions with government. This would take some time to introduce and involve significant costs.

2.14 By bringing together information on the taxpayer, the Department would be able to:

- pre-populate forms with specific taxpayer information;
- provide its telephone contact centre operators with on-screen details on a taxpayer, so that in responding to enquiries the operators can answer questions across the taxes; and
- set up an online account for each business showing the payments they have made and the net amount of tax due. The business could also update their details online through the Department's website.

2.15 Of the five countries we contacted:

- all use a single registration form which in Australia, Canada and Denmark can be completed online. They also issue businesses with a single business reference number (**Figures 7 and 8**).
- Canada and Sweden have used the VAT/GST (the equivalent to VAT) number as the basis for the unique business number.

The experience of other tax authorities in introducing a unique business reference number suggests significant costs would be involved and take several years to introduce.

7 Unique business numbers in Canada

In 1993 the Canada Revenue Agency launched a project to provide each business with a unique business number. Each business verified the data the Agency held on them to ensure it was accurate. To reduce the costs to businesses, the existing General Service Tax (the equivalent to VAT) number became their unique business number. Extra digits are added to the GST number to identify the other taxes for which a business is registered such as PAYE. Businesses not registered for GST were issued with a new 8-digit number. The project took three years to complete at a cost of around £20 million.

Source: National Audit Office

8 Unique business numbers in Australia

Over four years the Australian Tax Office introduced the Australian Business Number, a unique 11-digit number, and the Australian Business Register at a cost of A\$129 million (£65 million). The Register is the central collection, storage and verification system for basic business information, supplied by businesses with a business number. The Register is a whole-of-government initiative, primarily developed to make it easy for businesses to transact with all government organisations. Businesses can update their details online. Although the Australian Tax Office maintains these records, they are available to other government organisations.

Source: National Audit Office

PART THREE

The guidance and advice provided by the Department

The type of help provided

3.1 The Department offers businesses different types of help with meeting their tax obligations. This includes educational workshops and seminars; information on the Department's website, in printed and telephone guidance (**Figure 9**). The Department also offers a number of schemes that simplify the tax requirements for small businesses, to reduce the costs of compliance. A business may need help from the Department at different stages in its life, for example, when it:

- starts in business;
- makes its first tax return for a tax;
- takes on its first employee;
- exceeds the VAT threshold for registration;
- changes its business status from a sole trader to a limited company; or
- owes the Department money.

3.2 The amount of help a business needs will vary, with most likely to be needed when people are planning to start up a business. The Department usually first identifies a newly self-employed person when they register to pay National Insurance contributions and/or for Income Tax Self Assessment which can be some three months after the start of trading. During the pre-start-up phase new businesses can obtain a range of information and advice from a number of different organisations such as accountants, financial institutions and Business Link.²³ Around three quarters of small businesses rely on others such as accountants to deal with their tax affairs although it is not known how many newly registered businesses seek such help. To help improve the compliance of businesses, the Department is developing its relationship with agents and their representative bodies.

The Department's educational workshops and seminars on tax matters

3.3 The Department offers five different types of workshop aimed at newly registered businesses for Income Tax Self Assessment, PAYE and VAT. Ninety eight per cent of those attending said they felt more confident in complying with their tax obligations as a result. In 2005-06 the Department ran over 14,000 of these workshops at a cost of over £6 million which were attended by nearly 75,000 business representatives or around eight per cent of newly registered businesses. On average five people attend each workshop whereas the capacity can be up to 15. The Department found that less than one half of those who say they will attend actually attend on the day. It also found that one reason newly registered businesses did not accept the offer of a workshop or seminar is because they are held during normal business hours, although a pilot study in 2004 suggested that there was little demand for workshops at other times. The Department is looking at how to increase the numbers attending workshops and whether IT technology could be used to provide businesses with the same educational material.

3.4 In 2004 the Department carried out research on how it could encourage more new employers to attend a workshop or seminar. It segmented new employers into four different types according to the way these businesses preferred to be contacted (for example, by letter or telephone) and the type of training that would be most appropriate for them. Around 25 per cent of those contacted by the Department booked onto a workshop and less than half of these actually attended.

²³ There are 42 Business Link Operators which reach out to small and medium-sized businesses to provide them with better access to support services. The Small Business Service is the owner of the Business Link brand and is responsible for its strategic direction. During 2004-05, Business Link helped over 172,000 pre-start-up businesses.

9 The range of support available from the Department

Tax	Helplines	Guides	Website	Education
PAYE	New Employers Helpline Tel: 0845 60 70 143	The New Employer Pack which includes <i>Paying someone for the first time</i> booklet and Employers CD-ROM	New Employers section of the Department's website which includes Frequently Asked Questions on PAYE	One to one consultation with a business advisor, workshops and one day Employer Talk events for employers
National Insurance contributions/ Income Tax	Helpline for newly self-employed Tel: 0845 91 54 515	<i>Working for yourself – The Guide</i>	Information on registration, filing returns, making payments and calculating tax	One to one consultation with business advisor and workshops for the self-employed
Corporation Tax	None ¹	<i>A general guide to Corporation Tax Self Assessment and Notes for New Companies</i> which accompany the Department's form on notifying the commencement of trading	Information on record keeping, tax returns, forms, leaflets and how to calculate tax. Frequently Asked Questions on Corporation Tax	On demand telephone advice from Local Tax Offices
VAT	The VAT National Advice Service Tel: 0845 010 9000 and advice from Compliance Management Teams	The VAT pack and CD-ROM on <i>Getting Started in VAT</i>	VAT pages on registration, filing returns, making payments, calculating VAT payable and a range of technical guidance	VAT seminars and Business Advice Open days

Source: HM Revenue & Customs

NOTE

¹ Companies can obtain information from the Department's local offices.

3.5 On VAT the Department has found that those businesses receiving help were more compliant (paragraph 1.22). For PAYE the Department found that new employers attending a workshop or seminar have a higher compliance rate on filing their returns on time than newly registered employers in general (paragraph 1.23).

The Department's website

3.6 The Department wants businesses to obtain tax information of a general nature from its website (www.hmrc.gov.uk). The website is convenient for businesses to use because it is available seven days a week, 24 hours a day. It is also a cost effective way for the Department to provide information compared with dealing with telephone calls. The Department estimates

that the website costs £900,000 a year to run and maintain and has around 30 million hits each year. Its annual survey of taxpayers shows that small businesses paying Corporation Tax make most use of the website. The Department recognises that its website is not easy to use and is currently improving it. The Department's plan is for the core content to be purpose written for the website and to be based on customer needs. Navigation of the website and the search facilities will also be improved. As a result the Department believes that businesses will be able to find quickly what they are looking for; read and understand easily what they have found and be confident that it is authoritative and up to date. The Department is also looking to update the website regularly in response to feedback from taxpayers.

3.7 Newly registered businesses can obtain tax information from the Department's website and from the highly regarded Business Link website (www.businesslink.gov.uk)²⁴ which has general tax information updated by the Department. For example, the Department has recently helped with updating information on Corporation Tax on the Business Link website. Both websites have links to each other. The Department is currently examining how to align better the services it provides with the Business Link website. The Business Link website has a number of online tools to help businesses with their tax obligations which are easier to use than written guidance. One of the tools helps businesses to identify the taxes they need to pay based on their answers to a number of questions. Another helps businesses identify the dates when they need to file returns and make payments to the Department and allows them to set up email alerts based on the results. The Australian Tax Office has found that one of the key risks with small businesses is poor record keeping and has developed a computer tool for its website which helps businesses assess whether they are meeting their record keeping obligations.

3.8 The Canada Revenue Agency has developed its website to operate more closely with its telephone helplines. The Agency's website has a Smartlink button at the bottom of key pages of its website. If the taxpayer needs further information on the content of the webpage, they can click on the button for the telephone number of the contact centre and are provided with a reference number to quote to the operator. The reference number enables the telephone operator to display the same web page on their screen and to talk to the taxpayer on the issues they do not understand or on which they require further information. The operator also asks for the reasons the caller did not understand the webpage so that improvements can be made to the website. The Agency plans to introduce a click to talk service which links them on screen to a call centre operator. The Agency regularly analyses callers' questions and where there are common patterns posts the answers on its website.

The Department's printed guidance for newly registered businesses

3.9 The Department produces guidance packs on Income Tax Self Assessment, PAYE, and VAT which are targeted specifically at new businesses. The Department sends the guides to businesses when they first register to pay a tax. For Corporation Tax when the company is notified of its tax reference number the Department sends it a *New Company Details* form to complete together with a set of *Notes for New Companies*. Companies can also request *A general guide to Corporation Tax Self Assessment* or download it from the Department's website. The guides and leaflets provide an overview of business' obligations and what they need to do to comply. Because different parts of the Department contribute to the production of guidance for taxpayers there are inconsistencies in their layout and style. To ensure a more consistent approach the Department has produced a guide for authors and editors of taxpayers' guidance.

3.10 A customer survey conducted for the Department in 2003 showed that new employers found the number of help books, tables and forms that they contained bewildering and off-putting. In response the Department has redesigned and simplified the *New Employer Starter Pack* to highlight their key early tax obligations and included a CD-ROM. The Department has also used feedback from businesses to develop a CD-ROM for VAT called *Getting Started in VAT* which businesses now receive instead of the printed guidance. The CD-ROMs are easier to use because they are not as bulky as the printed guidance, contain worked examples and tax calculators and allow the user to search on specific words.

²⁴ See footnote 20 on page 17.

3.11 It is important that information in booklets and leaflets can be understood by taxpayers from a wide range of backgrounds and levels of education. The results of our tests²⁵ on the readability of the Department's printed guidance show that all of the leaflets and booklets require an average reading age of at least 16 or 17 years. Over five million adults in the UK have literacy skills that fall well below this level. The Department is therefore aiming for the equivalent of an adult with a reading age of 11 years. The reasons for the higher reading age are partly due to the complexity of the subject and the use of technical terms to give accurate advice, but also include the use of long sentences and the large number of acronyms. The *VAT Guide* in particular is confusing because of the large number of correction slips. But it also has the most worked examples which help with understanding a complex subject. The Department could make the guides easier to understand by using shorter sentences and paragraphs, and using examples and tables to illustrate complicated points. It could also produce the guidance in a standard format to convey a more uniform feel and create instant familiarity for those having to read more than one set of guidance. We concluded that even with presentational improvements some of the more technical information will not be easily understood by some taxpayers.

The Department's helplines for newly registered businesses

3.12 The Department has 10 helplines all businesses can contact for information. Three of the Department's telephone helplines provide substantial support to newly registered businesses, at an estimated cost of around £4 million a year (Appendix 3, Figure 16). They deal with some three million telephone calls from newly registered businesses. Two are helplines for the newly self-employed and one for new employers. For VAT, businesses can call the National Advice Service which provides assistance and support on VAT and other indirect taxes and duties. The helplines provide basic information on the related tax including advice on the registration process and arrange for printed guidance and leaflets to be sent to businesses. The Department is also telephoning newly registered businesses to offer help with issues they do not understand about their obligations, which should reduce the need for them to telephone the helplines in the future (paragraph 1.24).

3.13 In 2005-06 the Department's helplines met most of their targets covering:

- The percentage of calls answered in a day. For example, the Newly Employed helpline answered 87 per cent of calls in a day compared with a target of 85 per cent. Some 49 per cent of calls were answered within 20 seconds. The National Advice Service missed its target of answering 80 per cent of calls within 20 seconds having answered 69 per cent. Calls were not answered because of difficulties the Department faced in dealing with peaks of workload during the year. In 2006 the Department increased the capacity of its contact centres so that they can deal with a higher volume of calls.
- Less than 10 per cent of calls to be engaged or abandoned.
- 90 per cent of calls to be classified as good quality. A target on the percentage of calls to be classified as good quality was set for the National Advice Service half way through 2005-06.

3.14 By 2008 the Department wants the helplines to deal with all of a taxpayer's questions at first point of contact, so that when a business calls a helpline, their questions on any of the taxes will be dealt with immediately or, for more technical questions, they will be passed to the Department's staff with the appropriate knowledge. To help with this process the Department has developed an online Customer Adviser Guide with up to date and accessible guidance on the taxes to which the operators can refer in dealing with questions. Under the Department's Integrated Customer Management Programme, helpline staff may also be provided with online access to business taxpayers' records for all business taxes to help them deal with specific questions on their affairs. This will help to overcome the current problem where taxpayers may have to telephone a number of different helplines to obtain information on each tax.

²⁵ The Simple Measure of Gobbledegook (SMOG) is a readability test designed to match the reading level of written material to the 'reading with understanding' level of the reader.

The tax returns newly registered businesses need to complete

3.15 Tax returns which are easy to understand and complete can help businesses avoid making errors and the subsequent costs to the Department and businesses of correcting them. The Department has a target that, by 2008, 90 per cent of small businesses should find it easy to complete their tax returns. Its annual survey of taxpayers for 2005 shows that the Department has met the target overall (**Figure 10**). The results for VAT exceed the target and are close for the other taxes.

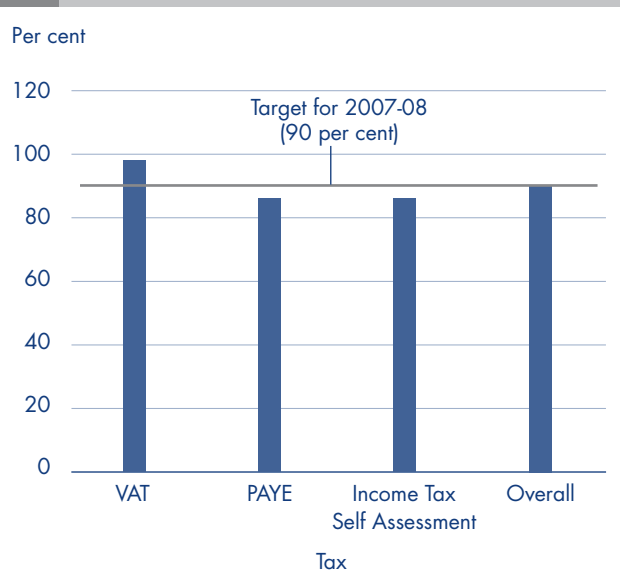
3.16 We assessed the Department’s tax returns to see whether they are easy to understand and complete. The results show that the easiest forms are those which can be completed online because: there is no bulky guidance to read; the system automatically calculates the amount of tax due; and the completed form can be sent to the Department over the internet (Appendix 5, Figure 20).

Security considerations, however, mean that registering to use the Department’s online services including VAT registration is not immediate. A business must first register with the Government Gateway which sends them a PIN through the post allowing them to use the service. This can take several days. In March 2006 Lord Carter of Coles’ report on the *Review of HMRC Online Services* recommended that the Department, working with the Government Gateway, should improve the facilities for managing the secure credentials required to access and use online services. Lord Carter suggested that it would be helpful if customers who use ID and password authentication could change them to something more memorable or be allowed to use a digital certificate to authenticate their online transactions.

3.17 The easier to use paper based forms have: simple numbering systems for the questions; provide quick start up guidance on the form; have short, well laid out; easy to understand guidance; do not use technical language; and have a checklist so that the business can check quickly it has been completed correctly. The Department has also introduced shorter tax returns for those with simpler tax affairs registered for Income Tax Self Assessment and Corporation Tax (paragraphs 1.11 and 1.12). It is also redesigning the full Income Tax Self Assessment return for issue from April 2008 specifically to make it easier to complete.

3.18 The company tax return form is the most difficult return to complete.²⁶ This is mainly because: it reflects the complexity of the Corporation Tax regime; the large number of questions on the form; and the complex routing instructions between different parts of it. Businesses also need to make complex tax calculations and provide a range of supporting documents to the Department as part of the company tax return form. Around three quarters of small companies, however, employ a tax agent to complete the return on their behalf. Completing the return online is more straightforward and overcomes many of the difficulties with the paper returns. In 2005-06 fewer than two per cent of all companies had filed their tax returns online but by September 2006 this figure had increased to around eight per cent. In March 2006, Lord Carter of Coles recommended that all companies should be required to file their company tax returns online for returns due after 31 March 2010.

10 The proportion of small businesses that find it easy to complete their tax returns



Source: HM Revenue & Customs: Customer Service Survey for 2005

NOTE

For this question the survey did not cover Corporation Tax.

²⁶ We used a checklist developed for us by the London School of Economics to assess how easy it is to complete the Department’s forms. The checklist assigns a score between 0 and 2 for each of 69 features that tend to make a form difficult to use. A score of 25 or less indicates an easy-to-use form. A score of 70 or more indicates a difficult form. The tax-related forms covered by this study scored between 17 and 62.

Simplification schemes to make compliance easier

3.19 The Department offers a number of schemes mainly on VAT aimed at simplifying tax requirements (Appendix 6), and thereby reducing the costs small businesses incur in complying. As part of the Joint Education Trial that ended in May 2006 (paragraph 1.25) the Department explained to newly registered businesses in appropriate cases the availability of the various schemes. It has worked with Chambers of Commerce to raise small businesses' awareness of the schemes.

3.20 Take up of the VAT schemes by businesses has been low (**Figure 11**). In some circumstances small businesses can use more than one scheme. For example, the Department points out on its website that businesses can make significant cost savings by operating the VAT annual accounting scheme in conjunction with the flat rate scheme. Around 1,800 do so. The Department estimates that these businesses save on average around £700 a year in compliance costs. If all eligible businesses took advantage of these schemes they would save £50 million a year.

3.21 A Departmental survey of VAT registered businesses and accountants in 2004 found that nearly all accountants were aware of the schemes. Around one half of businesses were aware of the Flat Rate and Cash Accounting schemes and 39 per cent were aware of the Annual Accounting Scheme. Most of those not using the schemes were happy with their current method for calculating and accounting for VAT.

3.22 Our discussions with organisations representing the views of new and small businesses found that:

- businesses are unclear about the benefits of joining the VAT Flat Rate Accounting Scheme;
- cash accounting can only be used for VAT and not for the other taxes, requiring businesses to use separate accounting arrangements for each;
- small businesses would like to calculate their income tax liability based on their turnover; and
- the PAYE Quarterly Payments Scheme is not widely promoted by the Department.

The Institute of Chartered Accountants in England and Wales consider that the simplification schemes should not be used as a substitute for simplifying the whole tax system, which they consider would drive down the cost of using intermediaries and the time spent on complying with tax obligations.

11 Take up by businesses for the simplified schemes by the end of 31 March 2006

Scheme	Number of businesses eligible	Number of businesses using the scheme	%
VAT: Cash Accounting Scheme	733,000	159,500	22
VAT: Flat Rate Accounting Scheme ¹	705,000	110,000 ²	16
VAT: Annual Accounting Scheme	1,000,000	10,500	1
PAYE: Quarterly Payments Scheme	Not available	Not available	–
Income Tax Self Assessment: three-line accounting	Not available	Not available	–

Source: National Audit Office analysis

NOTES

1 1,800 businesses use this scheme in conjunction with the Annual Accounting Scheme.

2 Increasing by 3000–4000 per month.

3 Businesses whose PAYE liability is less than or equal to £1,500 per month are entitled to make PAYE payments quarterly instead of on a monthly basis.

4 For self-employed taxpayers who have a turnover of less than £15,000. They can supply three-line accounts which give the total turnover less total expenses equalling net profit.

APPENDIX ONE

Methodology

1 The methodology was divided into two main aspects:

- Establishing a baseline on the Department's current approach and performance in helping newly registered businesses comply. This included: collecting data on the compliance record of businesses in registering for tax; filing returns on time; calculating the correct amount of tax due; and paying tax on time. We also collected data on the types of help and advice provided by the Department and the costs involved. A full list of the data we sought to collect is at paragraph 4 below.
- Developing evaluative criteria to assess options for changing the Department's approach covering:
 - the likely costs of each option including the Department's start up and running costs and the possible additional burdens on businesses;
 - the benefits of each option from improving businesses' compliance in filing on time, complete and accurate forms, improving the quality and availability of information and guidance, from simplifying processes and reducing the costs to the Department and businesses; and
 - the administrative difficulty of delivering each option by taking account of the amount of time it might take to implement them and the likelihood of a successful outcome.

2 We used multi-criteria decision analysis with the help of a leading academic (Professor Valerie Belton University of Strathclyde Business School) to analyse the results and identify those options which are most likely to deliver the greatest benefits for the Department at the lowest cost. Multi-criteria decision analysis is a technique that takes account of multiple and conflicting criteria to help make decisions on priorities. The baseline enabled us to assess the extent of the changes the Department needs to make to implement the selected options.

The baseline

- 3 In developing the baseline we drew on:
- the Department's performance data and research including taxpayer surveys. We appointed a consultant with expertise in examining risk management systems, Louise Bennett from Vivas Ltd. She examined the Department's research and data on the compliance of businesses including those newly registered;
 - we mapped the Department's main processes for registering businesses and for providing help and advice to newly registered businesses and interviewed its key staff;
 - we costed the Department's processes for registering businesses for a tax, providing telephone support through helplines and providing workshops and seminars;
 - we appointed Jonquil Lowe, freelance financial researcher, to assess the usability of HM Revenue & Customs' registration forms and tax returns to the non-professional. The assessment compared each form with a checklist developed in earlier work by the National Audit Office: *Difficult forms – How government agencies interact with citizens* and *Improving and reviewing government forms: a practical guide*. The results of this work are summarised in Appendix 5; and
 - we also reviewed the Department's guidance using the Simplified Measure of Gobbledygook (SMOG) readability formula. SMOG testing is recognised as the most simple readability test by both the Basic Skills Agency and the National Literacy Trust. The test attempts to match the readability of written material to the "reading with understanding" level of the reader. A SMOG readability level of under 10 should, in most cases, be understood by the majority of people.

Options for change

4 In developing and evaluating options for change, we drew on:

- the O'Donnell report, the Department's consultation paper on *Working towards a new relationship with small businesses* and other Departmental plans to identify proposals to improve the help and advice provided to newly registered businesses;
- the results from three focus groups comprised of the Department's staff involved in: providing help and advice to newly registered businesses; in registering businesses; and, in carrying out compliance checks on businesses. The purpose was to identify current good practice, or plans and ideas which could be adopted more widely. The focus groups helped us to identify the constraints/obstacles faced by the Department in adopting new practices and ways of overcoming them. Each focus group comprised 8 to 12 people with at least one front line member of staff and one manager from each of the taxes within the scope of the study;
- the results from our overseas contacts with the tax authorities in Denmark, Sweden, Netherlands, Canada and Australia. Canada merged their Revenue and Customs operations over six years ago. Sweden, Denmark and the Netherlands provided comparisons as European countries with a single tax authority. Australia also has one body responsible for all taxes and has recently introduced GST, the equivalent to VAT;
- the input from an Advisory Group to the NAO study team which helped to validate the results from our own evaluation. The Advisory Group comprised people from organisations with knowledge and experience of the issues faced by newly registered businesses (**Figure 12**); and
- the results from our consultation with stakeholders including those in **Figures 12 and 13** with an interest in the subject to identify and discuss the issues of greatest importance to them and to gain an external perspective on the issues examined in our study.

Data collected from the Department

5 We sought to collect the data in **Figure 14 overleaf** from the Department.

12 Members of the NAO Advisory Group

Name	Organisation
Louise Bennett	Director, Vivas Ltd
Danish Chopra	Small Business Service (Department of Trade and Industry)
Chas Roy Chowdhury and Glenn Collins	Association of Chartered Certified Accountants (ACCA)
Brian Dunsby	Institute for Small Business & Entrepreneurship (ISBE)
Tim Evans	Director of External Relations, National Council for Graduate Entrepreneurship
David Fredericks	Institute of Business Advisers
Helen Harvey	Nannytax
Jim Johnson	Federation of Small Businesses
Nigel Packham	HMRC, Small and Medium Enterprises and Employers Unit
Ilyas Patel	Council for Small Businesses
Robin Summers	Institute of Chartered Accountants in England and Wales (ICAEW)

Source: National Audit Office

13 Stakeholders consulted

Prof. Robert Blackburn	Kingston University
Victoria Carson	Forum of Private Business
Frances Corrie	TaxAid
Gavin Dollin	Business Link
Lucy Findlay	Confederation of British Industry
Teresa Graham	Administrative Burden Advisory Board
Martina Milburn	The Prince's Trust
Angela Silberberg	Federation of Small Businesses

Source: National Audit Office

14 Data we sought to collect from the Department

Data Sought

Number of businesses registering for a tax

Compliance record of businesses

The number of workshops/seminars run each year, the number attending the courses, their cost, the level of satisfaction with the courses and the compliance record of those who have attended and those who have not

The amount of debt owed by newly registered businesses and how long these amounts have been outstanding; the number of newly registered businesses given time to pay arrangements and the amounts involved; the number of newly registered businesses liquidated and the amount of debt written off

The penalties imposed on newly registered businesses because they have failed to register on time or failed to file their tax returns on time

The performance of the Department's helplines

The Department's administration costs

The compliance costs incurred by newly registered businesses

The costs of the Department's website and the extent to which it is used by taxpayers

Availability

The Department has data on the number of businesses registering/deregistering for each tax.

The Department has data on the compliance of taxpayers paying each tax. It has difficulties, however, in obtaining data from its computer systems on the compliance record of different taxpayer groups paying each tax.

The Department holds most of this information except on whether attendance on a course increases compliance. The Department is currently carrying out research on this. Early indications are that compliance improves, supporting the case for increased take up.

The Department has overall data for all taxpayers but is unable to provide the data by taxpayer group.

The Department has data on the number and value of penalties imposed for failing to register on time but not for failing to submit their returns on time where the data does not distinguish between new and established businesses.

The Department sets performance targets on:

- the quality of the handling of calls by contact centre staff (% measured in the contact centre);
- abandoned call rate (% calls abandoned);
- speed-to-answer (% calls answered in 20 seconds); and
- callers answered within the day (%)

The Department has various time recording systems for some of its activities on how staff split their time between different tasks/functions. In the areas examined in the study the cost information held by the Department was not in sufficient detail for our purposes. We therefore estimated the Department's costs on the amount of time staff spend registering businesses (using average salary costs). It was not possible to estimate the Department's costs of dealing with companies' notifications that they have commenced trading and become liable for Corporation Tax as the function is devolved to local offices where it is a minor task. We also estimated the costs of the Department's call centre staff, Compliance Management and Business Support Teams on the same basis.

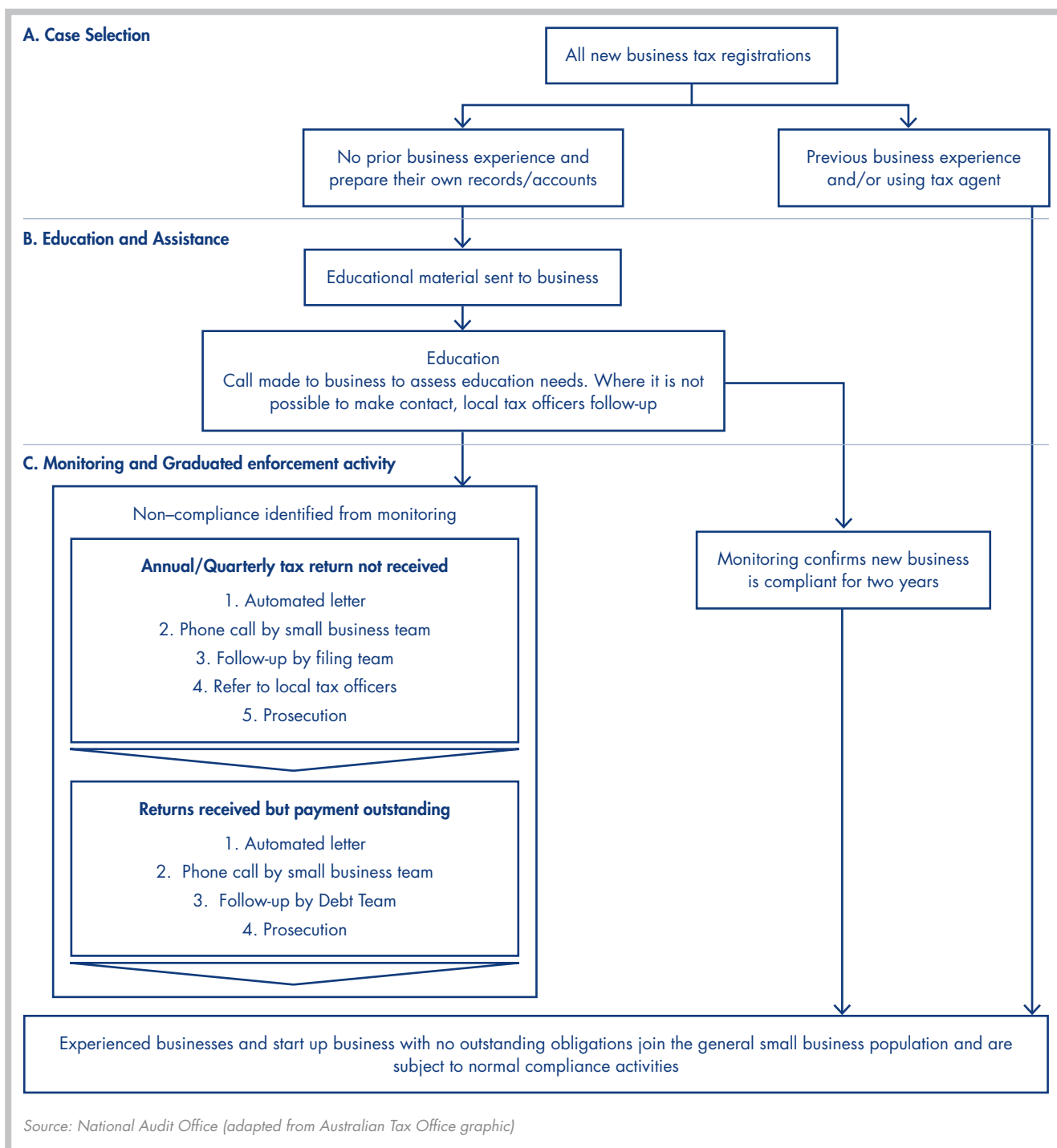
The Department commissioned a comprehensive review of tax compliance costs from KPMG. In total the study identified over 2,600 separate requirements and estimated that compliance costs total £5 billion a year for all businesses. The review does not separately identify newly registered businesses as a group. The data is enabling the Department to identify those obligations which are most onerous for businesses and to research ways in which these could be reduced.

The Department's website is hosted on four independent servers and the system is not currently configured to produce immediate records of the extent to which it is accessed by taxpayers. The Department estimate the cost of running and maintaining the website is £900,000 a year. Usage data would enable the Department to identify those pages which are most popular and where effort may be needed to develop them further.

Source: National Audit Office

APPENDIX TWO

The Australian Tax Office approach to “new to business” taxpayers



APPENDIX THREE

The costs of the Department's registration of newly registered businesses

15 The Department's direct salary costs of registering businesses

Tax	Location of staff	Number of staff involved in registration	Total direct cost £ million	Average direct cost £
VAT	Wolverhampton, Carmarthen, Grimsby, Aberdeen and Newry	293	7.0	25.90
PAYE	East Kilbride	75	1.8	6.60
Income Tax Self Assessment	Newcastle	84	2.0	5.40
Corporation Tax	Cardiff, Edinburgh and Belfast		Not separately identifiable.	
All		452	10.8	11.80

Source: National Audit Office

16 The direct cost of the Department's helplines for newly registered businesses

Helpline	Calls	Staff	Total direct cost £ million
The Helpline for the Newly Self-Employed	569,000	105	1.9
The New Employer's helpline	495,000	Estimated that of around 226 staff, around 100 deal with registrations	1.6
The National Advice Service (VAT and other indirect taxes and duties)	Estimated that of 21 million calls, some 10 per cent are from newly registered businesses	Estimated that of 400 staff, around 40 deal with new businesses	0.7
All	3,164,000	245	4.2

Source: National Audit Office

NOTE

Average staff cost varies due to actual mix of staff at each location.

APPENDIX FOUR

Dates for filing, making payments and penalties

17 Dates for filing tax returns and making payments to the Department

	VAT	Corporation Tax	Income Tax Self Assessment	PAYE/NI
Tax Return	Monthly/quarterly (or annual) on agreed dates	12 months after the end of the company's accounting period	31 January (10 months after tax year end)	Annual PAYE return by 19 May & 6 July (Expenses)
Payments	Monthly/quarterly in instalments if annual accounting	9 months and 1 day after the end of the company's accounting period (but larger companies pay by instalments during and following the accounting period)	31 January (10 months after tax year end)	Monthly/quarterly with balancing payment by 19 April (19 July for Class 1A NI)

Source: HM Revenue & Customs

18 Penalties for late filing of tax returns and late payments of tax

	VAT	Corporation Tax	Income Tax Self Assessment	PAYE/NI
Tax Returns	<p>i) First default: issue of a surcharge liability notice with a warning of a surcharge.</p> <p>ii) Subsequent default: will incur a surcharge of 2% of the tax unpaid on the return, increasing progressively to 5%, 10% and 15% for further payment defaults in a surcharge period. (Surcharge at the rates of 2% or 5% not issued if less than £400)</p>	<p>i) Flat rate of £100 (£200 if more than 3 months after the filing date) increased to £500 (or £1000) if late for three consecutive accounting periods.</p> <p>ii) Additional tax-related amount if tax unpaid 18 months after the end of the accounting period:</p> <ul style="list-style-type: none"> ■ 10% of any tax outstanding where return delivered within 2 years of end of the return period; or ■ 20% in any other case. 	<p>£100 1–6 months late A further £100 if 6+months (daily penalty also available)</p>	<p>PAYE: £100 per 50 employees per month late plus up to 100% of tax NI: £300 plus daily penalties of up to £60</p>
Payments	As above	Interest is charged from the date tax should have been paid (if tax paid early interest is paid to company)	Interest charged from 1 February with a 5% surcharge if amount not paid in full by 28 February.	Interest from 19 April (PAYE) and 19 July for Class 1A NI after the tax year end.

Source: HM Revenue & Customs

19 The penalties imposed by the Department on businesses which register late

Tax	Penalty	No. of penalties issued 2004-05	Total value 2004-05 £ million	Average value of penalty £
National Insurance contributions/Income Tax Self Assessment	Individuals must register for Class 2 NI contributions within three months of the month end in which they commenced self-employment. The penalty for failing to register on time is £100 which can be reduced or waived where there are extenuating circumstances.	60,920	1.0	16
VAT	<p>The majority of businesses are required to notify the Department of their liability to be registered for VAT when they exceed or anticipate exceeding certain turnover limits. The business must notify their liability to be registered for VAT where their turnover exceeds £61,000 in any 12 month period or at any time when they anticipate their turnover will exceed £61,000 in the next 30 days. A minority of businesses must notify their liability to be registered for VAT on other grounds. The penalty is a percentage of the VAT due from the date when the business should have been registered to the date when the application to be registered is received:</p> <ul style="list-style-type: none"> ■ Not exceeding 9 months late – 5%. ■ Exceeding 9 months but not exceeding 18 months late – 10% ■ More than 18 months – 15% ■ There is a minimum penalty of £50 	6,460	5.7	882

Source: National Audit Office and HM Revenue & Customs

APPENDIX FIVE

Our analysis of the Department's registration forms, paper and online tax returns and guidance

1 Based on work undertaken for the NAO report on *Difficult Forms: How government agencies interact with citizens* (HC 1145, Session 2002-03), the London School of Economics developed a checklist of features that most often cause customers to have problems with filling in government forms. The checklist was developed to:

- allow agencies to make a systematic and comprehensive evaluation of each of their forms; and
- give them the tools to consider the overall level of difficulty of each of their forms.

Running through the checklist is also helpful in identifying features that might be simplified or implemented in different ways.

2 We completed an analysis of the ease of completing paper based and online registration forms and tax returns likely to be completed by new businesses (**Figure 20**). The checklist assigns a score from 0 to 2 for each of 69 features that tend to make forms difficult to use. A score of 25 or less indicates an easy to use form. A score of 70 or more indicates a difficult form. The score for the Department's forms ranged from 17 to 62. None of the Department's forms are therefore classed as difficult to complete. The analysis shows that online forms are easier to complete than the equivalent paper based form.

3 For those forms with lower scores, the features which tended to make the forms easier to complete included:

- very short form, or online forms where the length is not so apparent;
- simple language;
- easy navigation around the forms;
- clear signposting to help or, for online forms, access to frequently asked questions and email enquiries;
- short guidance or access to context-sensitive guidance; and
- single return address, or online submission.

4 For those forms with higher scores, the features which tended to make the forms more difficult included:

- technical language;
- lengthy guidance;
- complex routing between questions;
- guidance largely text based;
- the calculations required; and
- warnings of legal/financial penalties.

20 Registration and tax return forms, ranked by score

Form	Score
Paper forms: Registration/notification	
VAT Simplification schemes (VAT 600AA/FRS)	33–40
National Insurance and/or Income Tax Self Assessment (CWF1)	34
Corporation Tax notification (CT41G)	42
VAT registration (VAT1)	56
Paper forms: Annual/Quarterly/Monthly tax returns	
PAYE/NI - Employer's Annual Return (P35)	42
Income Tax Self Assessment – Short Return (SA200)	46
PAYE/NI Employer's End of Year Summary (P14)	53
Standard VAT return (VAT100)	54
Company tax return – with simple tax affairs (CT600 – short)	56
Income Tax Self Assessment return (SA100)	57
Company tax return (CT600 – full)	62
Online forms	
PAYE/NI Employer's Annual Return (P35)	17
PAYE/NI Employer's End of Year Summary (P14)	19
Company tax return (CT600 – full)	37
Standard VAT return (VAT100)	43
Income Tax Self Assessment return (SA100)	48

Source: National Audit Office analysis

APPENDIX SIX

The various simplification schemes offered by the Department

Scheme	Description	Costs and savings
VAT: Cash Accounting Scheme	The Cash Accounting Scheme allows the business to pay VAT on the basis of payments made or cash received, rather than on the usual basis of invoices raised and received. A business is eligible to join the scheme if it expects the value of taxable supplies (excluding VAT) during the next year will be £660,000 or less. The Scheme can also be used with the Annual Accounting Scheme but not the Flat Rate Scheme. The Flat Rate Scheme has its own version of cash accounting.	Businesses receive a notional interest benefit totalling around £18.5 million a year because payments to the Exchequer are delayed until businesses have been paid by their customers. There is also automatic bad debt relief for the VAT element of any debts. The Department's costs in running the scheme are negligible because it does not need to be notified of the businesses' adoption of the scheme. There are ongoing notional interest costs arising from the deferred payment of VAT estimated at £12.5 million a year.
VAT: Flat Rate Accounting Scheme	The Scheme allows businesses to calculate their VAT by applying a flat rate percentage to their total VAT inclusive turnover. The percentage is dependent upon the trade sector. The Scheme can simplify normal VAT accounting and remove the need to worry about deductible input tax. Some businesses will pay more and some will pay less VAT by using the Scheme as the flat rates are averages. The annual turnover ceiling is currently £150,000 excluding VAT. This Scheme can be adopted in conjunction with Annual Accounting Scheme, but not the Cash Accounting Scheme. The Flat Rate Scheme has its own version of cash accounting.	New entrants to the Scheme are entitled to a 1% reduction on the flat rate of VAT for their trade sector. Other benefits for newly registered businesses include a reduced compliance burden from the simplified accounting requirements.
VAT: Annual Accounting Scheme	Businesses with an annual turnover of up to £1.35 million can use the Scheme from their date of VAT registration. The Scheme can be used in conjunction with the Flat Rate Scheme or Cash Accounting Scheme. Payment is made in monthly or quarterly instalments based on an estimated liability for the year. There is a single 12 month return that must be filed two months after the year end along with any balancing payment. The Scheme allows all businesses with a turnover up to £150,000 to join in their first year of registration. Businesses with turnover of £150,000 to £1.35 million can join after one year. This Scheme can be used in conjunction with the Flat Rate Scheme or the Cash Accounting Scheme.	The proprietor saves on the administration costs of filling in returns. Cash flow can also be managed with more certainty as a set amount is due for each payment. Savings to the Department result from a reduced number of returns received (approximately 31,800 fewer). The savings are offset to some extent by the costs of processing around 3,600 applications each year to join the Scheme.
PAYE: Quarterly Payments Scheme	Businesses whose PAYE liability is less than or equal to £1,500 per month are entitled to make PAYE payments quarterly instead of on a monthly basis but the employer must still operate PAYE weekly and monthly.	The Scheme reduced the compliance costs of newly-registered businesses. The Department estimates the ongoing compliance cost savings in businesses are £6.5 million a year.
Income Tax Self Assessment: three-line accounting	This Scheme is available to self-employed taxpayers who have a turnover of less than £15,000. They can supply three-line accounts which simply give the total turnover less total expenses equalling net profit. The Department will then calculate the tax liability. They do not need to submit a set of full accounts.	Newly registered businesses are likely to have a low turnover and thus be eligible for this scheme. Lack of experience in business may mean owners are unaware of how to put together a set of accounts and thus would otherwise need to employ an agent to help them complete the longer form return.

Source: National Audit Office analysis