



National Audit Office

HM REVENUE & CUSTOMS
Helping newly registered businesses
meet their tax obligations

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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)