



*B/F with further
 Treasury note
 AT 7/6
 C*

Treasury Chambers, Parliament Street, SW1P 3AG
 01-233 3000

4 June 1985

Andrew Turnbull Esq
 10 Downing Street
 LONDON
 SW1

Dear Andrew,

LATE PAYMENT OF VAT AND OTHER TAXES

... As requested in your letter of 25 April, I attach a note setting out whether tax payers are entitled to receive interest for late payment of refunds and what provisions there are to ensure that the Government pays its bills on time.

The Prime Minister was concerned that the implementation of the Keith Committee recommendations on late payment of VAT would discriminate against the taxpayer, particularly small businesses. As the note points out, the provisions for the Revenue departments to pay interest (or sometimes a flat-rate "bonus") on late repayment are very often as generous, if not more so, than the corresponding obligations on taxpayers paying late.

The Chancellor will however be seeking to improve and simplify the rules on the Inland Revenue side in the context of the forthcoming "Keith" legislation relating to Revenue taxes; cost-effective implementation of these changes will be one important outcome of the Revenue's current computerisation projects. So far as payment of Government bills is concerned, interest is not generally due, in line with wider commercial practice. But Departments are required to - and generally do - pay promptly.

*Yours ever
 Rachel.*

MRS R LOMAX
 Principal Private Secretary

LATE PAYMENT OF TAX

This note sets out the provisions under which taxpayers are entitled to receive interest for late payment of refunds from revenue departments; and also the arrangements for the payment of bills by Government departments.

Customs and Excise taxes and duties

2. There is at present no money sanction for late payment of VAT or other Customs and Excise duties, or for late refund by the Customs. In the nature of things, payment of Customs and Excise duties is immediate and very largely final. Late payment and refund of these duties are not significant problems and there are no plans to propose general interest charges either way. However given the present extensive zero-rating for VAT, repayments are a common and continuing feature of the tax and computerised arrangements are made to pay them promptly. Late payment of VAT by taxpayers gives rise to an average of £1200m of arrears at any time.

3. Following the Keith Committee's recommendations, we are introducing two sets of measures in this year's Finance Bill. First, we propose a flat surcharge at a starting rate of 5 per cent, irrespective of the length of the delay and subject to a minimum of £30, for taxpayers who are consistently late only (after two previous late payments within a year and issue of a warning notice at any stage) rising by 5 per cent steps to a top rate of 30 per cent after 5 further defaults. If, at any stage, the taxpayer pays promptly for a whole year, he leaves the surcharge system and starts again with a clean sheet.

4. So far as refunds by Customs are concerned, we propose that Customs should have the same one month's grace as the taxpayer to clear a claim (excluding time to pursue reasonable enquiries or clear up taxpayer errors in the return): after that a supplement will be due again at 5 per cent, subject to a minimum of £30, for all such delays, including the first, and not just where Customs are consistently late in paying.

5. In general our proposals favour the taxpayer - he can pay late from time to time free of surcharge, but the Customs will always pay a supplement on late refunds. The rates are only the same both ways where the taxpayer already has a history of recent late payment, and only higher for the taxpayer where default has been really persistent.

6. We also propose an interest charge where investigation shows that taxpayers have underdeclared, or overclaimed, VAT rather than simply paid it late. When this is put into

effect in 1988 interest will run at the same rate, currently 11 per cent, as already applies to Inland Revenue taxes. No issue of symmetry really arises here. Given that VAT is self-assessed, it is up to the taxpayer to see that he does not overdeclare or underclaim in his return; if and when he does discover an error he can claim back any VAT overdeclared (or underclaimed) in his next return. The supplement already mentioned then runs in the case of delay by Customs.

Inland Revenue taxes

7. There is already provision for interest at a common rate (currently 11 per cent) on both underpayments by the taxpayer and refunds by the Inland Revenue. But the present rules do not provide complete symmetry in other respects - particularly as regards the starting date from which interest begins to run. It may be helpful to look separately at the assessed taxes (notably corporation tax, Schedule D income tax and CGT) which are paid direct by the taxpayer; and Schedule E, almost entirely collected by deduction at source under PAYE.

8. Assessed taxes. The legislation in each case lays down clear "due dates" on which tax is meant to be paid. But interest on underpayments and refunds does not generally run from these dates. This is largely a reflection of the fact that, traditionally, liabilities are in practice often fixed only in estimated amounts by the due date, for lack of full information from the taxpayer. Final settlement - whether involving more tax from the taxpayer or a refund on tax to him - follows some time later. The detailed interest rules are complex: but their basic effect is to accommodate this process by allowing a "breathing space" before interest begins to run - broadly 6 months from the due date for the taxpayer in the case of underpayments, and 12 months from the due date for the Revenue in the case of refunds. We looked in 1980-81 at the possibility of harmonising this "breathing space" at 6 months either way, but decided against it partly on arguments of consistency with the position of PAYE/Schedule E (see below) but also because of the large revenue and staff costs involved.

9. The aim is to work towards a more symmetrical, and very much simpler, interest regime for the assessed taxes, once this can be achieved at acceptable staff cost. Two current developments will help in that direction: first the Keith compliance proposals relating the Inland Revenue - on which we are currently consulting with a view to legislation next year - and secondly, the completion of Inland Revenue computer projects now under way or projected.

10. PAYE/Schedule E. Two groups are involved here: employers, who are liable to deduct and pay over PAYE during the course of the year; and individual employees who are subject

to PAYE. So far as employers are concerned, there are currently no money sanctions for late payment. Following the Keith Committee's recommendations, however, we are consulting this year on a surcharge system parallel to that for VAT. The issue of symmetry does not generally arise here, since there is no analogue in the PAYE system to VAT "repayment traders" who are eligible for consistent and substantial refunds; but we will be considering what provision is appropriate to compensate for delay in the exceptional cases where payment is due from the Revenue to employers operating PAYE.

11. So far as the individual employee is concerned, overpayments or underpayments under PAYE are calculated as part of the Revenue's review of PAYE returns after the end of the tax year. Underpayments are not generally recovered in cash from the taxpayer, but collected, without interest, through extra PAYE deductions in a later year. Overpayments are refunded in cash: interest is payable if and to the extent that refund is delayed beyond 12 months from the end of the deduction year in question. As in the case of the assessed taxes, this "breathing space" is designed to cut out the heavy revenue and, particularly, staff costs involved in paying a large number of relatively trivial amounts of interest.

12. In this area, therefore, the present rules - paying interest on some refunds, but not charging it on underpayments - already operate asymmetrically in the taxpayer's favour. There are no plans to change that: indeed in the long run it should be possible to tilt the balance a little further in the taxpayer's favour by reducing the current "breathing space" on refunds to less than 12 months. Again this must rest on implementation of the Keith compliance recommendations and on the full implementation of the computerisation of PAYE project ("COP"), which together will allow interest on repayments to be processed on a larger scale at acceptable staff cost.

Government payment of bills

13. Turning to the question of payment to contractors, Departments are required to pay promptly, and generally do so. They will shortly be reminded of this requirement in updated accounting guidelines. Where there is delay, what interest may be due is of course determined by the terms of the contract with the supplier, in the absence of any duty in general law for purchasers at large to pay interest. Government contracts - as is quite normal - do not generally provide for interest on late payment, but we do exceptionally pay compensation ex gratia in cases of hardship or serious departmental default.

Econ Pol: Budget Pt 14

10
9
8
7
6
5
4
3
2
1

15 JUN 1995