



AUDIT, PENSIONS AND STANDARDS COMMITTEE

27 SEPTEMBER 2012

CONTRIBUTORS

VOLUNTARY DISCLOSURE TO HMRC

WARDS
All

This report is to update the Committee on progress with the voluntary disclosure made to HMRC on 16th April 2012 with respect to people who had been incorrectly treated by the council as being self employed and were paid without deduction of tax and National Insurance Contributions (NIC's).

RECOMMENDATION:

The Committee is asked to note progress with respect to the voluntary disclosure which LBHF has made to HMRC and the calculation of the council's liability.

1. PURPOSE

The purpose of this report is to update the Committee on progress with the voluntary disclosure made to HMRC on 16th April 2012 with respect to people who had been incorrectly treated by the council as being self employed and were paid without deduction of tax and National Insurance Contributions (NIC's).

The paper reminds the Committee of the oral report which it received on 28th June; sets out, based on further discussion with HMRC, how the council's liability will out be calculated; and explains what further steps have been taken with HMRC. It concludes with an explanation of the timeline which the disclosure is now expected to follow.

2. BACKGROUND

Report made on 28th June

The report made to the Committee on 28th June reminded members of the new process for the recruitment of additional resources that had been introduced, the review of all engagements that had been undertaken at the council's initiative and the work being done with schools to ensure that they understood their responsibilities with respect to employment status decisions.

Deloitte, who attended the meeting, explained that they had recommended a voluntary disclosure to HMRC following a detailed review of the cases identified by the council. LBHF wrote to HMRC confirming its intention to make such a disclosure in February 2012 and the disclosure was made on 16th April. A meeting with HMRC was organised and took place on 24th May to go through the disclosure.

The Committee was informed that the council had identified 52 people, out of a total of 215 cases, who had been incorrectly treated as self employed for the purposes of tax and NIC's. Tim Waterhouse from Deloitte explained the approach that had been adopted to the voluntary disclosure and the work that was being done to with HMRC to establish the quantum and extent of the council's liability. Jane West confirmed that the total liability of the council was at this stage estimated to be significantly less than £1m.

Calculating the council's liability

The calculation of the council's liability set out below is based on the approach adopted by HMRC when an error is disclosed or comes to light as a result of a compliance check. First, the council must pay the tax and NIC's which should have been deducted from the payments made to those wrongly categorised as self-employed. However, it can ask for any payments made by those people in this position as part of their own tax returns to be set off against this part of its liability.

Secondly, HMRC can impose a penalty which is based on its judgement of the nature of the error. Penalties are as follows:

- A careless error – up to 30% of the potential lost revenue
- A deliberate error – up to 70% of the potential lost revenue
- A deliberate and concealed error – up to 100% of the potential lost revenue

Thirdly, interest will be charged by HMRC on its lost revenue. The current rate of interest on late payments is 3.0%, but has been higher in previous years.

Steps taken since the last meeting of the Committee

Since the last meeting we have agreed the approach to be taken with HMRC, subject to some final details. We have submitted a detailed calculation of the council's liability to HMRC, which puts the total amount of tax and NIC's at £500,783. HMRC have confirmed that it will apply its procedure for setting off tax already paid in all re-categorisations of employment status. We have no reason to believe that those wrongly treated as self-employed did not deal with their own tax affairs entirely correctly. We expect the council's liability to reduce substantially as a result of the application of the set off procedure.

We have also begun with HMRC a discussion about the approach to penalties. We have accepted that the errors made would be classified as careless, but, with the criteria for the reduction of any penalty in mind, we have also underlined that LBHF:

- Took the initiative and made an unprompted disclosure;
- Told HMRC as much about the errors as it has been able to and why they happened;
- Put in place robust procedures to ensure that similar errors cannot happen again;
- Took time and trouble to assist HMRC in working out the size of the errors and the tax and NIC's liabilities to which they had given rise;
- Remains prepared to give HMRC access to any records or documents which it asks for; and
- Notified HMRC of payments being made without deduction of tax and NIC's on year end returns submitted annually to HMRC. There was, therefore, no intention to conceal the error.

We have suggested that all this constitutes reasonable grounds for HMRC to exercise their discretion to suspend any penalty which they might decide to charge. In such a case if the council meets the conditions imposed by HMRC and does not make any other careless or deliberate errors during the period of the suspension, then the penalty would be cancelled at the end of the

suspension period. We have no reason to believe that HMRC will classify the error as anything other than careless. We have some reason to believe that HMRC will be sympathetic to the argument that they should exercise their discretion to suspend the penalty. We have been told by HMRC that it is not unusual for them to suspend penalties in cases such as this.

That leaves only the calculation of interest, which would be charged on the amount of tax and NIC's after the application of set off. The greatest amount of interest that could be charged, assuming an average rate of interest over six years of 5.5%, would be £31k. HMRC do not charge interest on a compound basis.

The worst case scenario in terms of the council's liability, therefore, is around £734k. If we assume that set off will reduce the amount of unpaid tax and NIC's by 50% and that HMRC will exercise its discretion to suspend any penalty, then the liability would reduce to around £298k. We might regard this as a best case scenario.

3. FUTURE REPORTING NEEDS

We anticipate that HMRC will complete their review of the calculations which the council has submitted by the end of October. At that point we will have HMRC's view of the council's total liability. LBHF will be able to challenge HMRC's decisions about the correct treatment of people for tax and NIC's purposes if the decisions seem harsh or unfair.

Once a figure has been agreed, HMRC will write to each individual named in the voluntary disclosure asking them if they are prepared for the tax paid through their self assessment tax returns to be set off against the council's liability. The individuals concerned will have three months to reply and non-response will be taken as consent to the set off.

That would suggest a further report to the Committee in October or November 2012 and a final report in January or February 2013, depending on the speed of response of HMRC.

4. CONCLUSION

The Council has made a timely and detailed voluntary disclosure to HMRC. HMRC has complimented the council on the effectiveness and efficiency of its approach to the voluntary disclosure.

A worst case scenario would put the council's liability at £734k. However it has been agreed that HMRC's set off procedure will be applied and we have no reason to believe that the people to whom payments were made have not

dealt with their tax affairs properly. We can assume that this will significantly reduce the liability.

The penalty charged by HMRC will not exceed 30%. We would anyway expect to negotiate this and have proposed its suspension. In this case if the council makes no further errors in any of its tax affairs the penalty will be waived. Making no further errors will require a vigilant approach to:

- Compliance with the new procedure for the recruitment of additional resources; and
- To the management of the council's tax affairs as a whole. With this in mind we have let a one year contract for ongoing tax advice.

We should not expect to hear anything further from HMRC before the end of October and we will not be completely clear about the extent of the council's liabilities before the application of set off. We do not expect that to be concluded until the end of January 2013.

LOCAL GOVERNMENT ACT 2000- LIST OF BACKGROUND PAPERS

No.	Description of Background Papers	Name/Ext. of Holder of File/Copy	Department/ Location
1.	N/A		
2.			
3.			
4.			