House of Commons

Treasury Committee

Making Tax Digital

Tenth Report of Session 2016–17

Report, together with formal minutes relating to the report

Ordered by the House of Commons to be printed 10 January 2017

HC 927
Published on 14 January 2017
by authority of the House of Commons

The Treasury Committee

The Treasury Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of HM Treasury, HM Revenue and Customs and associated public bodies.

Current membership

Mr Andrew Tyrie MP (*Conservative, Chichester*) (Chair)

Mr Steve Baker MP (*Conservative, Wycombe*)

Helen Goodman MP (*Labour, Bishop Auckland*)

Stephen Hammond MP (*Conservative, Wimbledon*)

George Kerevan MP (*Scottish National Party, East Lothian*)

Kit Malthouse MP (*Conservative, North West Hampshire*)

John Mann MP (*Labour, Bassetlaw*)

Chris Philp MP (*Conservative, Croydon South*)

Mr Jacob Rees-Mogg MP (*Conservative, North East Somerset*)

Rachel Reeves MP (*Labour, Leeds West*)

Wes Streeting MP (*Labour, Ilford North*)

The following member was also a member of the committee during the Parliament:

Mark Garnier MP (*Conservative, Wyre Forest*)

Powers

The Committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the internet via www.parliament.uk.

Publication

Committee reports are published on the Committee's website at www.parliament.uk/treascom and in print by Order of the House.

Committee staff

The current staff of the Committee are Sarah Rees (Committee Clerk), Amelia Aspden (Second Clerk), Gavin Thompson (Senior Economist), Marcus Wilton (Senior Economist), Dan Lee (Senior Economist), Darren Hackett (Senior Committee Assistant), Elektra Garvie-Adams (Committee Support Assistant), Matt Panteli (Senior Media and Policy Officer), Toby Coaker (Committee Specialist on secondment from the NAO), David Hook (on secondment from HMRC), Foeke Noppert (on secondment from the FCA), George Barnes (on secondment from the Bank of England) and Victoria Sena (on secondment from the Bank of England).

Contacts

All correspondence should be addressed to the Clerk of the Treasury Committee, House of Commons, London SW1A 0AA. The telephone number for general enquiries is 020 7219 5769; the Committee's email address is treascom@parliament.uk.

Contents

Summary

Making Tax Digital (MTD) will mark a fundamental change in the way that businesses interact with HMRC. The Government is proposing that, subject to a relatively small number of exceptions, all businesses will be required to keep their accounting records in a prescribed digital format and submit quarterly updates to HMRC. These updates will be followed by an end of year reconciliation to ensure that the entire year's activities are properly recorded for tax. It is proposed that businesses will start this form of record keeping and reporting for income tax and National Insurance from 1 April 2018 or 1 April 2019, depending on their size, and for VAT from 1 April 2019. At least two and a half million businesses are likely to be affected, and possibly as many as five million.

The Government consulted on its proposals over the summer and early autumn of 2016 and it is proposing to respond to that consultation, and publish draft Finance Bill clauses to legislate for the necessary changes, in January 2017.

Based on the evidence it has heard, and on published responses to HMRC's consultation, the Committee supports the idea of the digitisation of the reporting of tax. However it considers that mandating the digitising of record keeping and quarterly reporting, as currently envisaged, has not yet had its overall benefits proven. Just over a year is too short a lead time for such a fundamental change in any event. There should be a comprehensive set of pilots of the end-to-end system before it is made mandatory for all businesses. The Committee is very concerned about the costs to businesses of introducing MTD, as well as the continuing costs of maintaining digital records and submitting quarterly updates. There is not yet enough information about the free software that will be available, but even if it remains free in perpetuity, businesses will face costs in terms of time and accountants' fees. In aggregate, these costs may well exceed the benefits to the exchequer in terms of tax gap reduction as a result of fewer taxpayer errors and the overall impact of MTD could even be negative. This requires further investigation.

As it prepares its response to the consultations about its proposals to make MTD mandatory with very few exemptions, the Government needs very carefully to consider the legitimate concerns about the costs and benefits to business, and set them against any benefits to the Exchequer from the proposed approach.

1 Introduction

1. Making Tax Digital (MTD) is shorthand for a proposed new system whereby businesses are required to keep their records in a digital format and submit quarterly updates to HMRC followed by an end of year reconciliation. For many taxpayers, this would take the place of their annual tax return. HMRC has confirmed that the quarterly updates will be "summary totals of the digital record of income and expenditure and not transaction records[1]". It is proposed that businesses will be required to start this form of record keeping and reporting for income tax and National Insurance from 1 April 2018 or 1 April 2019, depending on their size, and for VAT from 1 April 2019.

2. It was included in the Terms of Reference for the Treasury Committee's inquiry into UK Tax Policy and the Tax Base[2]. Since then, the Committee has received a great deal of evidence, both oral and written, and its members have heard of a wide variety of concerns about the Government's proposals. Perhaps acknowledging the strength, or at least the volume, of the concerns that had been raised in the responses to its consultation papers, the Government has announced that its response to the consultation will not be until January[3]. **After receiving representations from the Committee and other parties, the Government has put back its response to the consultation from the Autumn Statement, when it would ordinarily have been expected, to January 2017. This is welcome.** The Government has said clearly that it is listening to the concerns being raised. For example, the Financial Secretary said:

> "Several significant concessions regarding the number of small businesses that were exempt from the system were announced over the summer, but I am listening carefully to the points being made both by colleagues in the House and by some of the important stakeholders with whom we have been engaging. That is why we said that we will respond in the new year. We do not want to rush our response; we want to consider all the points carefully."[4]

3. The Committee is therefore taking the unusual step of publishing a report on a small part of a bigger inquiry, and without having had the opportunity to hear evidence from the Government. The Committee expects the Government to consider this report before it publishes its response to the Making Tax Digital consultations and the provisions to implement the changes, expected in January 2017. The report makes a number of suggestions to mitigate the widespread concerns over MTD. If these suggestions are unacceptable to the Government, it is likely that pressure will increase for the Government to introduce MTD as a voluntary scheme.

4. There were six consultations about different issues, each of which could be implemented independently, but all form part of the single ambition to achieve a digital tax system. This report focuses on just one - "Bringing Business Tax into the Digital Age". The others are either simplification measures which it is suggested could assist this, or are around new payment and administrative methods, powers and penalties. The Committee has not delved into these supplementary issues at this stage.

1 HMRC, Making Tax Digital: consultation, "Bringing Business Tax into the Digital Age", 15 August 2016, Page 6
2 The terms of reference for this Inquiry are on the Committee's website, www.parliament.uk/treascom
3 Autumn Statement 2016, Cm 9362 paragraph 4.42
4 Official Report, 29 November 2016, Volume 617, Column 1383

2 Background

The End of the Tax Return?

5. In the March 2015 Budget, the then Chancellor heralded "the end of the tax return". He said that:

> "12 million people and small businesses are forced to complete a self-assessment tax return every year. It is complex, costly and time-consuming. So, today I am announcing this. We will abolish the annual tax return altogether. Millions of individuals will have the information the Revenue needs automatically uploaded into new digital tax accounts. A minority with the most complex tax affairs will be able to manage their account on-line. Businesses will feel like they are paying a simple, single business tax – and again, for most, the information needed will be automatically received. A revolutionary simplification of tax collection. Starting next year. Because we believe people should be working for themselves, not working for the tax man. Tax really doesn't have to be taxing, and this spells the death of the annual tax return."[5]

6. At the same time, the then Financial Secretary to the Treasury articulated the vision in more detail a paper entitled "Making tax easier: The end of the tax return":

> "In future, people will only need check their tax information online to know how much they owe. Millions of people will no longer have to complete a tax return at all — while those with more complex tax affairs will be able to use their account to declare income and pay tax in year. It will also be a major help for small businesses, which will be able to link their accounting software to their personalised tax account and have the option to pay as they go. This will give them more certainty about what they need to pay and when, so they can manage their cash flow better."[6]

"Making Tax Easier" becomes "Making Tax Digital", and concerns mount

7. On 14 December 2015, HMRC published a "roadmap" that made clear that for the first time that the new process would be mandatory for most businesses:

> "By 2020 most businesses, self-employed people and landlords will be required to keep track of their tax affairs digitally and update HMRC at least quarterly via their digital tax account. These changes will be introduced for some businesses from April 2018, and will be phased in by 2020, giving businesses time to adapt."[7]

8. It is notable that the title had changed from "Making Tax Easier" to "Making Tax Digital".

5 Official Report, 18 March 2015, Volume 594, Column 777
6 HMRC, Making Tax Easier: The end of the tax return, page 3
7 HMRC, Making Tax Digital, page 7

9. The 2015 Autumn Statement linked this with the Government's plans to:

> "invest £1.3 billion to transform Her Majesty's Revenue and Customs (HMRC) into one of the most digitally advanced tax administrations in the world, with access to digital tax accounts for all small businesses and individuals by 2016-17".[8]

10. The roadmap said that the government would consult on the details in 2016. At different places in the document, it promised this consultation in "spring 2016" and in a timeframe of "January to June 2016"[9].

11. The initial welcome for "Making Tax Easier" quickly dissipated, and by the beginning of January, the Treasury Committee had been made aware of enough concerns for the Chairman to write to the Financial Secretary[10]. An online petition[11] received enough signatures to warrant a debate, which took place on 25 January 2016[12].

12. Correspondence continued over January and February[13], and written evidence submitted to the Committee in March included the following concerns:

> "Pursuing the mandating of the digital agenda without simplifying the tax system will and already is causing consternation across the small business community, especially among those who are not able to complete tax returns online."[14]

> "We also have very considerable concerns that mandating every business to keep its records digitally is wrong in principle and that this should be a business led decision"[15].

> "We are concerned that implementation of Making Tax Digital will be rushed, when in reality it will be both challenging and costly for individual taxpayers and businesses to comply with, and will likely require many corrections post-implementation. We question whether the hoped-for benefits of reducing the tax gap by 'forcing' smaller businesses to keep better records by more frequent reporting are sufficiently large or reliably estimated to justify departing from what would be the more 'standard' approach; to roll it out starting with the larger businesses and willing volunteers and ironing out problems with that population before extending to those with fewer capabilities."[16]

> "We have concerns about the likely impact on agents and taxpayers and around the role and resourcing of HMRC. In particular we believe some

8 Spending Review and Autumn Statement 2015 (Cm 9162) November 2015, paragraph 1.288
9 HMRC, Making Tax Digital, pages 7 and 11
10 Letter from the Rt Hon Andrew Tyrie MP to David Gauke MP, 8 January 2016
11 House of Commons Petitions, scrap plans forcing self employed & small business to do 4 tax returns yearly
12 Official Record, Westminster Hall, 25 January 2016, Volume 605
13 Letters from David Gauke MP to Rt Hon Andrew Tyrie MP, 12 January 2016; Rt Hon Andrew Tyrie MP to David Gauke MP, 25 January 2016, David Gauke MP to Rt Hon Andrew Tyrie MP, 1 February 2016
14 Written evidence to the Committee from the Federation of Small Businesses for the Inquiry into UK Tax Policy and the Tax Base
15 Written evidence to the Committee from the ICAEW for the Inquiry into UK Tax Policy and the Tax Base, paragraph 32
16 Written evidence to the Committee from the Chartered Institute of Taxation for the inquiry into UK Tax Policy and the Tax Base, paragraph 2.6

small businesses (and individuals) are likely to be pushed into non-compliance due to an inability to use the mandatory digital systems in this over-ambitious timeframe. We are also concerned about the negative messages about tax agents which are being suggested by publicity around Making Tax Digital and the current exclusion of agents from viewing their clients' online accounts. We believe agents are vital to implementation and every effort should be made to work with agents."[17]

"Whilst we support the long-term ambitions of the Government's Making Tax Digital agenda, greater clarity of this agenda is still needed and moreover, technology should equally enable HMRC at the frontline to be able to add value and interact with its customers more effectively and innovatively. [...] In a global context, we encourage HMRC to collaborate with other tax authorities on this agenda, to prevent the overall administrative burden on businesses increasing as different digital approaches and interfaces are adopted around the world."[18]

"'Making Tax Digital' is an overly ambitious project, given the suggested timescales, and there are very genuine concerns that forcing digital record keeping on small businesses and landlords in such a short timescale will have a potentially disastrous effect on the UK tax system. "[19]

"We support the Making Tax Digital (MTD) initiative as we view it as a necessary part of 'future proofing' the tax system. It is the logical 'next step' and should be undertaken" but "the timetable for implementation is ambitious which makes it more imperative that the input from various stakeholders is sought and used."[20]

Consultation offers some concessions but still major concerns persist

13. In the March 2016 Budget, the Government reiterated its intention to consult on the proposed changes[21]. However, the expected post-Budget consultation was delayed because of the EU Referendum[22]. During that period, further information came out informally, which did little to assuage the fears of bodies such as the Institute of Chartered Accountants for England and Wales. For example, HMRC suggested that businesses would be required to do all their record keeping in a prescribed digital format and that spreadsheets might not be acceptable.[23]

14. The consultation papers were finally issued on 15 August, with a closing date of 7 November[24]. At the time of publication, the Government announced some concessions. Its press release on 15 August 2016 said that

17 Written evidence to the Committee from the Institute of Chartered Accountants of Scotland for the inquiry into UK Tax Policy and the Tax Base, Paragraph 44
18 Written evidence to the Committee from the CBI for the inquiry into UK Tax Policy and the Tax Base, page 5
19 Written evidence to the Committee from the Association of Taxation Technicians, for the inquiry into UK Tax Policy and the Tax Base, page 2
20 Written evidence to the Committee from KPMG for the inquiry into UK Tax Policy and the Tax Base, paragraphs 56 and 58
21 Budget 2016, HC 901, paragraph 1.185
22 Accountancy Age 12, May 2016
23 Letters from Rt Hon Andrew Tyrie MP to David Gauke MP, 26 April 2016; and David Gauke MP to Rt Hon Andrew Tyrie MP, 10 May 2016
24 HMRC, Making Tax Digital: consultations, 15 August 2016

> "The decision to exempt the smallest businesses and landlords from digital record-keeping and quarterly updates follows months of constructive engagement with business and agent groups.
>
> The government is also considering deferring digital record-keeping and quarterly updating for a further group of small businesses and will explore options to assist businesses with the transition. Finally the consultation documents confirm that those who cannot go digital will not be required to."[25]

15. These concessions were initially welcomed by the Federation of Small Businesses:

> "Removing small firms and the self-employed with modest turnovers altogether from the proposals will now mean that in addition to the 1.6 million small businesses and landlords that were already excluded, as a result of these changes announced, a further 1.3 million small firms and landlords will no longer be in scope. This means that half of the UK's 5.4 million small businesses will not be affected by quarterly tax reporting. The expansion of cash accounting, a longer lead-in time for implementation and the offer of direct financial assistance will also help. "[26].

16. One of the consultation papers was about "voluntary pay as you go". The voluntary nature of this system made it clear that there was no intention to use MTD to enhance cash flows to the Treasury by requiring tax payments earlier than would otherwise have been the case. But there will be an option for businesses to pay earlier than necessary if they want to avoid large tax bills at a later date.

17. During the consultation period, the Treasury Committee held two oral evidence sessions with small businesses and with tax professionals, including the Policy Director of the Federation of Small Businesses and the Chair of HMRC's "Digital Advisory Group"[27].

18. Following each of these hearings, the Chairman wrote to the Chancellor, emphasising the key points made in evidence to the Committee:

> "It is tantamount to prescription by HMRC, for the first time, of a particular form in which accounting records must be maintained. […]
>
> "There will be an exemption for people whose income is less than £10,000. But this is below the level of the Personal Allowance. So it appears that this concession will only be for those who do not pay tax, including new businesses who would otherwise be obliged by MTD to notify HMRC within four months of starting a business. In such cases, there would be no benefit, to the businesses or to HMRC, if they were to submit quarterly reports. […]
>
> "Those businesses with a turnover of just over £10,000 (and with profits of far less than £10,000) will be hardest hit if they are obliged to change

25 HMRC and Jane Ellison MP, Digital revolution for the tax system to cut red tape for British business, 15 August 2016

26 Ibid

27 Treasury Committee Oral Evidence: Shifting Sands: an inquiry into UK tax policy and the tax base, HC 314, hearings on 6 September and 25 October

> their working practices; those who currently employ a book-keeper once a year to prepare their tax return might find themselves having to employ the book-keeper four times a year. […]
>
> "There may be a case for delaying the implementation of MTD. A year's extension for an unspecified group of businesses may not be enough.
>
> "There may also be merit in piloting the systems in a number of areas. From this, the lessons from customers' experiences can be learnt, and well before digital reporting is made mandatory."[28]
>
> "The Federation of Small Businesses' estimate was "that implementing MTD will cost £2,770 per business per year on average. […]
>
> "A fully costed impact assessment is essential. […]
>
> "It is clear from the evidence that the Committee heard that HMRC needs mandatory MTD to fulfil its business case for much needed investment in its IT. But it is equally clear that businesses will have to pick up the bill for this. […]
>
> "Given these points, the evidence we heard suggests that the introduction of MTD should not be rushed. Every effort should be made fully to pilot its introduction, perhaps over several years. Only after the lessons have been learned from the pilot should consideration be given to a mandatory scheme."[29]

19. In addition to its 15 face-to-face roundtable events and 14 webinars (with over 3,000 participants), HMRC has received over 600 responses to the key consultation paper on "Bringing Business Tax into the Digital Age".[30] The main professional bodies have published their responses on their websites,[31] as have a number of bodies which represent taxpayers rather than accountants[32].

20. The main concerns expressed to the Treasury Committee are outlined in the next chapter.

---

28 Letter from Rt Hon Andrew Tyrie MP to Rt Hon Philip Hammond MP, 15 September 2016

29 Letter from Rt Hon Andrew Tyrie MP to Rt Hon Philip Hammond MP, 27 October 2016

30 HMRC, Overview of Legislation in Draft, published on 5 December 2016

31 Chartered Institute of Taxation website, Press release: UK Government must review unrealistic timescales for delivery of digitised tax system, say experts; Institute of Chartered Accountants in England and Wales website, ICAEW representation 171/16 -making tax digital: bringing business tax into the digital age; Association of Chartered Certified Accountants website, Making Tax Digital: Bringing business tax into the digital age -Comments from ACCA to HMRC, November 2016 Ref: TECH-CDR-1428; Institute of Chartered Accountants of Scotland website, HMRC Making Tax Digital Bringing business tax into the digital age, 3 November 2016; Association of Accounting Technicians website, Association of Accounting Technicians response to the HMRC consultation "Making Tax Digital: Bringing business tax into the digital age"; and Low Income Tax Reform Group website, Making Tax Digital: Bringing business tax into the digital age HM Revenue & Customs (HMRC) consultation document Response from the Low Incomes Tax Reform Group (LITRG)

32 NFU website, Making tax digital - consultations; Country Land and Business Association, Countryside concerned over making tax digital, 4 November 2016.

3 Key points made in evidence to the Committee and elsewhere

Support for the Principle

21. Both the witnesses who gave evidence to the Committee and the larger organisations, whose responses to the consultation are published online, supported the principle of digital reporting to HMRC, albeit with significant reservations. For example, the Chartered Institute of Taxation said:

> "We welcome measures that simplify the tax system, and assist businesses in keeping accurate accounting records, but we remain concerned that there is insufficient detail available to be sure that MTD – in its present form – will deliver tangible benefits to businesses and individual taxpayers."[33]

22. The Institute of Chartered Accountants in England and Wales said that it supported the move to a digital tax system, but that

> "A digital Tax System fit for the 21st Century should be designed and built not just around the needs of HMRC but also the needs of taxpayers and what works best for them."[34]

23. From a software provider's perspective, IRIS software prefaced the summary of their customer survey on MTD with:

> "IRIS fully supports HMRC's digital transformation and strongly believes that this is the right approach to taking the tax system forward in this digital age. … However, we do have our concerns and reservations. These would mainly be around the time scales and the amount of change required to carry out such ambitious plans."[35]

24. The IRIS survey went on to suggest that 86% of their customers considered that the changes were not achievable in the timeframe given by HMRC.[36]

25. And the current lack of detail prevented the Country Land and Business Association from extending its support at this stage:

> "The general move towards standardising tax administration is to be welcomed. However, we consider that the consultation documents contain inadequate details, and there is still considerable cause for concern with the way it is being implemented and how it would impact businesses. … We therefore believe that the MTD project should be delayed by at least one year if not longer."[37]

33 CIOT press release, UK Government must review unrealistic timescales for delivery of digitised tax system, say experts
34 ICAEW Representation 171/16 Making Tax Digital: Bringing Tax into the Digital Age, paragraph 5.
35 IRIS software, report on Making Tax Digital survey, page 3
36 Ibid, page 5
37 CLA Consultation Response, Making Tax Digital, paragraph 9

26. The other main reservation was around the principle of making it mandatory for the smallest or least profitable businesses at all. For example, the Institute of Chartered Accountants of Scotland said that it:

> "supports the overall objectives of 'Making Tax Digital' (MTD), as set out by HMRC in December 2015. The four 'foundations' are laudable goals but we have significant reservations about the planned rollout, timescale and the mandatory approach, particularly for small and medium enterprises."[38]

27. The Association of Certified Chartered Accountants said that:

> "While the MTD proposals may well go with the grain of small business owner's adoption of technological change, that adoption is slow and has for the most part been voluntary."[39]

28. And the Low Incomes Tax Reform Group said that:

> "We generally support the HMRC digital strategy and recognise that many benefits may be possible in the digital world. We are though hugely concerned that much of the detail of the MTD programme is still to be considered and finalised, and as a result implementation of MTD for unincorporated businesses from April 2018 is totally unrealistic and unachievable in the timescale."[40]

29. **Digitisation will provide many opportunities for increasing efficiency of tax collection. This needs to be done not just in a way that may better secure the yield, but also taking into account the reasonable needs of millions of taxpayers. This will require a great deal of care and sensitivity on the part of HMRC. A large proportion of the UK's businesses, particularly the millions of small businesses, are not currently well equipped to move over to digital record keeping and reporting. Nor may they be so for several years.**

Timing issues

30. The Government's proposal is that, subject to the exemptions described below, all businesses will be required to keep records in a digital format and submit quarterly updates to HMRC for their income tax and national insurance obligations from April 2018, for their VAT obligations from April 2019 and for the Corporation Tax obligations (which will be subject to a separate consultation and are therefore not covered in this report) from April 2020.

38 ICAS Consultation Responses, HMRC Making Tax Digital Overview, page 2

39 Comments from ACCA to HMRC November 2016, TECH-CDR-1428 Making Tax Digital: Bringing business tax into the digital age, page 2

40 Making Tax Digital: Bringing business tax into the digital age HM Revenue & Customs (HMRC) consultation document Response from the Low Incomes Tax Reform Group (LITRG), paragraph 2.1

Implementation should be deferred

31. There was widespread support for the view that April 2018 was too early. In oral evidence to the Committee, the Federation of Small Businesses suggested that:

> "Our indicative timescale would be something like 2025, which would enable businesses to latch on to something perhaps that does work, after being properly tested."[41]

32. The Association of Accounting Technicians suggested a compromise between that date and the Government's proposals:

> "AAT has an alternative solution that goes some way to meeting the needs of both sides of this argument. The threshold should be set at £83,000 (the current VAT threshold) falling to £11,000 (the personal allowance) over a three year period.
>
> A three year phasing exemption of this nature provides:

- more time for agents to educate and raise awareness amongst their client base;
- agents scope to improve their familiarity with the MTD processes through experience with VAT registered businesses prior to full implementation;
- clarity that MTD remains compulsory, that there will be no delay but there will be phased implementation to both help the business community and help HMRC achieve the best possible outcomes;
- the maintenance of customer confidence and goodwill."[42]

33. Other written responses to the consultation were less specific about when might be an appropriate implementation date, but the consensus was that:

> "the timetable for mandation of MTD is far too optimistic and must be pushed back" to "allow a smoother and more effective transition"[43]

34. and that:

> "the current timetable for implementing Making Tax Digital (MTD) is unrealistic and this undue haste is not in the best interests of taxpayers. While we support the move to digital, it will take at least five years to do this properly."[44]

35. The Association of Certified Chartered Accountants said that:

> "Out of a population of up to 5m businesses who will be affected by these changes, just 30,000 currently use accounting apps of the sort which appear

41 Treasury Committee Oral Evidence: Shifting Sands: an inquiry into UK tax policy and the tax base, HC 314, 25 October 2016, Q 312

42 Association of Accounting Technicians response to the HMRC consultation "Making Tax Digital: Bringing business tax into the digital age", paragraphs 3.83 and 3.84

43 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraph 2.2 and 2.3

44 ICAEW Representation 171/16 Making Tax Digital: Bringing Tax into the Digital Age, paragraph 19.

> likely to be fundamental to the quarterly reporting process. Achieving universal take-up of such apps within 5 years (and the associated investment in equipment and process change for many of them) will impose a significant cost on UK business."[45]

36. The Low Incomes Tax Reform Group suggested that general negativity towards MTD might be:

> "as a reaction to the timescale in which it is to be introduced and by which they will be expected to have evaluated new software options, make the transition, introduce and embed new routines or processes in the way they do business and so forth".[46]

37. Among the specific reasons for delaying the implementation were the need for taxpayer education and training. For example, the Institute of Chartered Accountants in England and Wales said that:

> "A major change of this nature needs an extensive taxpayer education exercise. Education, both of HMRC staff and of business, must form a key part of any implementation plan, together with an agile approach which has been fully consulted on and agreed to be achievable"[47] and

> "We do not consider that HMRC has sufficient staff or funding to be able to undertake a sufficiently intense training programme before 2018, so as to be able to reduce the number of individuals as could be managed within a consistent definition of persons 'unable to engage digitally' built on current legislation."[48]

38. As well as the *time* required for training, businesses highlighted the *cost* to them of training staff in the use of MTD.

> "We consider that training needs will be significant in order to make MTD work. The new requirement is far from simply entering a handful of totals as is currently the case with an online VAT return. It requires a basic understanding of accounting and some tax knowledge, as well as being IT proficient. It is crucial that free workshops are provided".[49]

39. **The Government has been invited, in a series of letters, to explain its position. But the Government has not yet had the opportunity to give detailed oral evidence to this Committee in support of its proposed timetable. The Committee will take further evidence from the Government after it has published its proposals in the light of the consultations that it has undertaken. On the evidence that the Committee has seen, the Government appears intent on keeping to its original schedule. This now leaves little over a year to complete the work. This looks over-ambitious. The Government has yet to publish draft legislation to address crucial concerns raised by this Committee,**

45 Comments from ACCA to HMRC November 2016, TECH-CDR-1428 Making Tax Digital: Bringing business tax into the digital age, page 3

46 Making Tax Digital: Bringing business tax into the digital age HM Revenue & Customs (HMRC) consultation document Response from the Low Incomes Tax Reform Group (LITRG), paragraph 10.1.8

47 ICAEW Representation 171/16 Making Tax Digital: Bringing Tax into the Digital Age, paragraph 27

48 Ibid, paragraph 150

49 CLA, Making Tax Digital Consultation Response, paragraph 47

among others, at early stages of their consultation. Among these concerns are: the need for adequate, free software; the overall costs and benefits of the project; the proposed speed of implementation and the fact that it will be mandatory for the vast majority of businesses within little over two years.

40. **The imposition of a requirement to move to digital record keeping and reporting is a fundamental change to the system of tax administration in the UK which requires much wider debate and consultation. Even after the concessions announced to date, it is still likely to affect two and a half million taxpayers[50] and possibly as many as five million[51]. It is extremely unlikely that the vast majority of businesses will be capable of adapting to that start date at reasonable cost. Nor should they be expected to do so. The Committee therefore recommends a delay of the full implementation of MTD until at least 2019/20.**

41. **In the view of the Committee, a start date of April 2018 for mandatory MTD is wholly unrealistic. Whether a start date of 2019, for the 2019/20 tax year, would be possible will depend on the exact shape of the Government's proposals. These have yet to be published. But on the evidence that the Committee has seen so far, this also looks unlikely.**

42. Implementation of MTD for VAT will be a year later than for income tax, but it is too early to tell whether that leaves adequate time for developing an appropriate system which can cope with the adjustments that are currently required for VAT accounting and the changes that are likely to take place, at least for intra-EU transactions, after the UK leaves the EU.

43. Witnesses highlighted the specific complications for VAT, with MTD implementation coinciding with the likely date of the UK's exit from the EU:

> "In 2019, with the Brexit situation, if we have left the EU, the VAT system in the European Union is predicated on the Sixth VAT Directive, and if we choose to move away from VAT we just do not know what the system might be, what we might choose to have or what the threshold would be. We could have a much higher threshold for registration. We could change the rules. We do not have to stay with the Sixth VAT Directive rules, so it will be entirely down to us. I imagine 2019 might be too soon—it might be 2020, or whatever—for people to think about what the new tax system could be. We just wonder if it is the right time to marry the two things together and bring VAT within MTD, or for MTD to come in, before we actually know what the full holistic tax regime is going to be."[52]

44. The Chartered Institute of Taxation emphasised this uncertainty over the future of VAT and the distinction between filing online (which is almost universal for VAT) and using software for filing:

---

50 HMRC and Jane Ellison MP, Digital revolution for the tax system to cut red tape for British business, 15 August 2016.

51 Comments from ACCA to HMRC November 2016, TECH-CDR-1428 Making Tax Digital: Bringing business tax into the digital age, page 3

52 Treasury Committee Oral Evidence: Shifting Sands: an inquiry into UK tax policy and the tax base, HC 314, 25 October 2016, Q 337

> "First, it is likely to coincide with the UK's exit from the EU, which could involve significant changes to the UK VAT system, particularly for international transactions. Secondly, only 12% of businesses currently use software to file their VAT returns. This is because of the myriad of adjustments which might be needed to the underlying data, which software companies have yet to accommodate, and the case for automating these adjustments has not been made."[53]

45. When the UK leaves the EU, new VAT accounting arrangements for intra-EU transactions are likely to be required, even if the Government chooses to make no other changes to the VAT regime for the time being. It is possible that the UK's departure from the EU will require more fundamental changes to the VAT system. The Committee will look further at this when the Government's intentions are clear.

46. **Any decisions about VAT and the EU are relevant for the timing of MTD. This is because each could cause disruption and costs to businesses. Whether these can be mitigated, or would be aggregated, by implementing MTD and post Brexit related VAT changes simultaneously will depend on the government's decision for each. Neither of these is currently known in enough detail to form a view. In the absence of clarity about the Brexit-relevant changes, it would be imprudent to press ahead with MTD. To do so could – depending on the shape of the final decisions – leave firms vulnerable to considerable and unacceptable disruption to the VAT reporting. The Committee will expect the Government to provide detailed evidence on this point.**

The end to end process should be adequately piloted

47. The other main reason that was cited for the deferral of the implementation of MTD was the need to pilot the process and systems. The point was made eloquently by the small businesses themselves at the first oral evidence session:

> "This is a huge programme with potentially more than 5 million businesses involved, and huge IT programmes have a history of not running to time, budget or quality. This seems to be a tight timeline, because it is all to be rolled out within two or three years, so I would very much recommend that a pilot is done for 1,000 or 10,000 businesses to see how it goes. It would be useful to get that feedback, learn from experience and incorporate best practice before rolling it out and mandating it. Early adopters could potentially be given a tax advantage, such as a 5% or 10% discount, to encourage their active involvement.
>
> "It would be madness to go ahead without trialling this in the real world and seeing what the burden is on business. It is suggested that it is going to save between £85 million and £250 million for business. I cannot see how something that brings in quarterly reporting is going to save industry

53 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraph 3.8

money; the reverse would be the case, surely. "I may be missing a point, but let's do a pilot, trial it and see if it is going to save, or indeed see what the delta is if it is going to cost."[54]

and

"A pilot is a good idea, but across businesses of larger scale. Beginning with the smallest businesses and then working up means you are only getting a cross-section of people earning the least. The money that this is going to save is going to be for the much larger businesses; the smaller businesses are going to be hit dramatically by accountancy costs."[55]

48. It was repeated by the Federation of Small Businesses and the ICAEW at the Committee's second oral evidence session:

"It is fair to say that piloting has to be, from our point view, the right way forward. It is a massive project. So much will depend on the APIs[56] and working with the software industry. The fact is that there is a tripartite relationship here, and agents need to work with software companies and HMRC to make this work. Any one of those links is potentially going to break this. We need proper piloting over a reasonable period of time, for the results to be assessed and for people to then scale it up. That is the way that large IT projects like this should work. I think the principle of that has to be the right way forward."[57]

49. The Country Land and Business Association cited a potential analogy in the Common Agricultural Policy Delivery Programme, where the Public Accounts Committee had referred to the failures and subsequent abandonment of the online application portal, where:

"A significant contributing factor to this abandonment appears to be the acknowledgement by the government's Chief Technology Officer that "a lack of performance testing meant that potential issues with the IT system were not picked up until it was too late to resolve them". One aspect of that was the need for affected business to call heavily on professional time and support to make any sense of matters. Even the Common Agricultural Policy (CAP) is not as complex as our tax system which also makes more calls on more areas of a business than the CAP does."[58]

50. They went on to point out that:

"As software developers have yet to give their undertakings in producing free software, beta testing is unlikely to start before April 2017. We are therefore concerned that the software will not be thoroughly tested before

54 Treasury Committee Oral Evidence: Shifting Sands: an inquiry into UK tax policy and the tax base, HC 314, 6 September 2016, Q233
55 Ibid, Q234
56 An API, or Application Programming Interface, defines how one application talks to another application, allowing it to access a resource, some data or a service. It is the gateway through which taxpayers will communicate with HMRC's systems using their MTD compatible software.
57 Treasury Committee Oral Evidence: Shifting Sands: an inquiry into UK tax policy and the tax base, HC 314, 25 October 2016, Q334
58 CLA, Making Tax Digital Consultation Response, paragraph 11

> implementation. At the very least user testing before implementation should encompass the 4 quarterly reports and the year end certification submission which may be up to 9 months after the financial year."[59]

51. And they referred to the building blocks identified in 2006 by Lord Carter for HMRC when developing online services, which include:

> "robust testing of any new system for at least a year before implementation and be customer-centric, as well as starting the implementation with the larger organisations first and working down to smaller businesses. The current proposal seems to have ignored these helpful guidelines as well as the government's Digital Service Standard."[60]

52. **HMRC's "agile" approach – that is, varying the software during the course of a pilot in response to customer feedback – will no doubt provide some useful information. However, it is understood that these pilots are composed of volunteers, therefore are unlikely to obtain information from those most vulnerable to the burdens of the scheme's introduction. The voluntary scheme will provide limited information about the robustness, or otherwise, of the whole tax system in an MTD environment, and over the entire annual reporting cycle of four quarterly submissions and an end of year reconciliation. An obligatory pilot of the process, "end-to-end", should take place before full implementation to obtain this information. Such an extended pilot regime would allow empirical assessment of likely compliance costs and benefits over an entire reporting cycle. There will, of course, need to be safeguards in place to protect those in the pilot.**

53. For example, they would need to be relieved of their current (annual) filing obligations for income tax.

54. **It is also important that such pilots reflect the role of agents in tax. The majority of tax returns are currently submitted by accountants and tax advisers and the system being piloted has yet to include this. The Government needs to explain the pilot process that it envisages for agents.**

Mandation

55. The Government's proposal is that digital record keeping and reporting (MTD) should be mandatory for all businesses with a turnover of more than £10,000 (although there would be a year's deferral for businesses above that threshold but below another, as yet unspecified threshold).

59 Ibid paragraph 23
60 Ibid, paragraph 24

The proposed £10,000 threshold for making MTD mandatory is too low

56. Although it was initially welcomed by the Federation of Small Businesses, the Government's concession of exempting businesses with a turnover of £10,000 or less was universally considered to be unacceptable.

> "If you go to a very cost-effective, cheap accountant or bookkeeper, you are unlikely to spend less than £200 for a very small set of accounts. Realistically, it is more likely to be £300 or £400—maybe £500 or more. For a business that is turning over £10,000, doing that four times a year is simply going to put them out of business; they are just not going to bother, or they will try to do it themselves and get it wrong. I would say that £50,000 to £100,000 is a more realistic figure. It is still a significant burden for a business turning over £100,000 to have to spend £1,500 or £2,000 instead of £500. However, I do think that the £10,000 threshold is far, far too low."[61]

> "You might want to stage that threshold, so that it starts at £10 million, £1 million, £250,000, and then bring it down to the point where it becomes far too costly. By testing this out, you will find out whether or not a business of £250,000 turnover incurs so much cost that you do not want to bring the threshold any lower. By doing it in a more agile, stage-by-stage, iterative manner, you will get it right, as opposed to trying, as we say in software, to "pin the tail on the donkey" at the beginning, which is very difficult."[62]

> "I am not sure where the £10,000 comes from. That is even below the personal allowance threshold. What was the thinking behind that? If there was something around the VAT threshold, £83,000, it might be different. In terms of timing, where the smaller businesses—and it is yet to be defined what they are—will be in the MTD system later, that is probably worthwhile, but where is that level going to be?"[63]

> "We are, alongside my colleagues at the table here, recommending at least the VAT threshold as an exemption, mainly because those businesses are used to having to keep their records more frequently. They are likely to be a little more digitally engaged, although a recent Lloyds Bank report said that 1.4 million small businesses have no digital skills whatsoever."[64]

57. The Chartered Institute of Taxation reported that nearly 87% of its members who responded to a survey agreed that £10,000 was too low, with over half (55%) considering the threshold should be more than £20,000, and around 41% favouring a figure of £50,000 or higher. Of those who said that it should be more than £20,000 and who expressed a preference: 232 (22%) suggested the VAT registration threshold (currently £83,000); 106

61 Treasury Committee Oral Evidence: Shifting Sands: an inquiry into UK tax policy and the tax base, HC 314, 6 September 2016, Q231

62 Ibid, Q241

63 Treasury Committee Oral Evidence: Shifting Sands: an inquiry into UK tax policy and the tax base, HC 314, 25 October 2016, Q 298

64 Ibid, Q 305

(10%) suggested £50,000; 93 (9% of the total who responded to the question) suggested between £20,000 and £50,000; 47 (4%) suggested £100,000; and 48 (5%) suggested a figure of over £100,000[65].

58. There was no clear consensus on what the exemption threshold should be. There seems to be support for a threshold that is at least equal to the current VAT registration threshold (proposed by the Low Incomes Tax Reform Group[66] and the Institute of Chartered Accountants in England and Wales[67]). The Association of Certified Chartered Accountants summarised the arguments as follows:

> "£10,000 is an arbitrary figure, set far too low for any meaningful impact. There are strong arguments in favour of setting the initial MTD threshold at the VAT registration threshold, although maintaining it at this level in the long term would create a significant artificial cliff edge which would operate to distort business behaviour. Setting the threshold at an even higher level initially, and slowly reducing it over time, is another area for discussion. [….]
>
> "Wherever the final threshold for MTD reporting is set, it should be based upon a properly researched and considered analysis of the costs to business of implementing digital record keeping and the corresponding benefits to the business which might arise from such records. […] Establishing the point at which the benefits to society of requiring some degree of digital record keeping will outweigh the costs will be an extremely complex process, and will inevitably involve some final degree of compromise since the simplest measure for setting the threshold (turnover) is itself a fairly inconsistent indicator as between different sectors and geographical regions of likely tax complexity and propensity for growth."[68]

59. **The £10,000 threshold, for the requirement on businesses to record and report digitally, is too low. A turnover threshold at that low level would catch many businesses whose profits are far less than the personal allowance. They currently pay no tax. To impose MTD on them would palpably be absurd. Nor does a possible liability of these firms for National Insurance Contributions create a need for MTD. It is one thing for HMRC to impose digital record keeping on taxpayers. For them to impose it on non-taxpayers would be quite another - it would be seen to be as unreasonable as it is disproportionate. Aligning the threshold for MTD with the VAT threshold would be a simplifying approach. There may well be case for going above this. We heard no strong evidence for setting it at a lower level**.

65 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraph 9.22 and 9.23

66 Making Tax Digital: Bringing business tax into the digital age HM Revenue & Customs (HMRC) consultation document Response from the Low Incomes Tax Reform Group (LITRG), paragraph 3.5

67 ICAEW Representation 171/16 Making Tax Digital: Bringing Tax into the Digital Age, paragraph 18

68 Comments from ACCA to HMRC November 2016, TECH-CDR-1428 Making Tax Digital: Bringing business tax into the digital age, pages 30 and 31

There should be no mandation, even for larger businesses

60. There was a widely held view that, even if there were an exemption for businesses above a reasonable threshold, MTD should not be mandatory, irrespective of the business' size. In oral evidence, a small business owner told us that:

> "For me, the problem lies with the word "mandatory". This is a great system for opting in for the next four or five years, but this is a huge burden"[69].

61. The problems of mandating MTD, even for large businesses were highlighted by the Chartered Institute of Taxation, the Institute of Chartered Accountants in England and Wales and the Low Incomes Tax Reform Group:

> "The case for mandating larger businesses into MTD has not been made out. These businesses are already likely to have comprehensive record-keeping systems, already in a digital format, and many corporates will be subject to independent external audit."[70]

> "Taxpayers and Society need to have trust and confidence in the move to MTD and this is likely to be best served by adopting a non-mandatory approach at the outset. There should be no question of mandation during the implementation period. Each part of HMRC's IT system and support function needs to be in place, properly tested and working for taxpayers. This obviates the need to make specific provision for the digitally excluded in the medium term. Once the system is up and running successfully and taxpayers are taking it up then the question of mandation can be reassessed."[71]

> "We do not support the principle of mandating MTD and are wholly opposed to this approach. If we compare it to self assessment (SA) online filing which has been very successful without being mandatory, we can see that if a product is good and beneficial, taxpayers will naturally migrate to it. Mandation is very likely to have the opposite effect to that which it is intended to foster: instead of increasing tax receipts, it may act as a disincentive to businesses to trade legitimately and encourage some into the hidden economy."[72]

62. **The Government has argued that businesses may benefit from a requirement to keep records and submit information digitally. But the Committee has yet to see the evidence to support the view that the benefits to business would outweigh the costs. Were digital record keeping as beneficial to business as HMRC claimed, it is plausible to suppose that most businesses would be doing it now.**

69 Treasury Committee Oral Evidence: Shifting Sands: an inquiry into UK tax policy and the tax base, HC 314, 6 September 2016, Q231

70 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraph 2.5

71 ICAEW Representation 171/16 Making Tax Digital: Bringing Tax into the Digital Age, paragraph 17

72 Making Tax Digital: Bringing business tax into the digital age HM Revenue & Customs (HMRC) consultation document Response from the Low Incomes Tax Reform Group (LITRG), paragraph 2.4

63. HMRC's experience of online filing provides a useful analogy:

> "Between 2000 and 2003, HMRC introduced the facility to file tax returns online for Income Tax Self-Assessment, VAT, Corporation Tax and Pay-As-You-Earn (PAYE) in-year returns. Lord Carter's 2006 review noted that HMRC was ahead of most other government departments in the range of transactional services it offered online, but, while there had been progress, take-up rates were relatively low."[73]

64. It is now almost universal (and mandatory) for VAT and Corporation Tax, while it remains voluntary for income tax, although last year:

> "More than 89% of customers (9.24 million) opted to use HMRC's online Self Assessment service to calculate and pay the tax they owe, continuing the growing trend to deal with the tax authority electronically."[74]

65. **The Government should draw on the experience gained at the beginning of this century from introducing online filing for income tax self-assessment over a period of many years. This suggests that there is merit, both for the customer and for HMRC, in moving gradually. To rush it might imperil the yield.**

Exemptions

66. On the assumption that MTD will be mandated for businesses above a certain size, HMRC has proposed a few exemptions - notably for the "digitally excluded", charities and community amateur sports clubs - and invited suggestions for other specific groups who should be exempted.

The MTD exemption for the "digitally excluded" should be applied widely

67. The proposed definition of "digitally excluded" is based on the current exemption from online filing for VAT, which refers to "persons for whom online filing is not reasonably practicable for reasons of disability, age, remoteness of location or any other reason".[75]

68. This was generally welcomed as a starting point, although the Low Incomes Tax Reform Group suggested that "any other reason" should be expanded with explicit examples:

> "We therefore recommend that HMRC use the VAT Regulations as a starting point for MTD exemptions, but these should be qualified such that financial difficulty can be expressly considered amongst the reasons for non-compliance.
>
> "We recommend that HMRC carefully consider the valid security fears within the scope of 'any other reason' for claiming exemption from MTD. There are already large numbers of scams – for example using tax refunds – as a means of extracting personal data and bank account details from people. It is not unlikely that MTD will spawn a whole new spectrum of

73 National Audit Office, The expansion of online filing of tax returns, November 2011
74 HMRC press release, Another record breaking year for Self Assessment, 1 February 2016
75 HMRC consultation document "Making Tax Digital: Bringing Business Tax into the Digital Age", paragraph 7.21

such scams. If a person has been a victim of online fraud, it is likely they would be justified in seeking exemption from MTD for 'any other reason' – that is, the valid fear that something similar could happen to them again."[76]

69. Witnesses were concerned that "remoteness of location" should encompass places where there is not good broadband access and that "not reasonably practical" should refer to people for whom digital reporting would be particularly stressful.[77] The Country Land and Business Association said that in determining whether an area has adequate broadband access, HMRC should acknowledge that, while download speeds may be adequate, the slower upload speeds may not be adequate for rural taxpayers to file their tax information quarterly. After Real Time Information (RTI) was introduced for PAYE, they had "seen cases where a bookkeeper has to go home to get sufficient bandwidth for the RTI submission."[78]

70. Others implied that people who were familiar with using computers and smart phones for simple functions might be "digitally excluded" for the purpose of MTD, simply because they are unfamiliar with the use of accounting software.[79] One witness spoke of a very able client who:

> "had gone out and got himself some software, phoned his accountant and said, "I am getting on really well with this new software I bought, but my VAT has gone up". When the accountant looked at it, he had reported all of his sales twice, which no doubt HMRC would welcome, but it is introducing additional error".[80]

71. The Institute of Chartered Accountants in England and Wales referred to a survey conducted by HMRC in 2015 which:

> "highlighted that over half of the self-employed were either digitally excluded or were assisted digital. This can be for a variety of reasons, including poor broadband connectivity, lack of digital skills, education and lack of confidence or disability."[81]

72. They also referred to "clients who do not even have mains electricity".[82] It is assumed that such clients would certainly be people for whom digital record keeping and reporting are "not reasonably practicable for reasons of remoteness of location". However, at the other end of the continuum, they spoke of "a fine line between being 'unable to engage digitally' and being 'able to if you try very hard and spend a long time doing it and in so doing incur disproportionate cost'"[83].

76 Making Tax Digital: Bringing business tax into the digital age HM Revenue & Customs (HMRC) consultation document Response from the Low Incomes Tax Reform Group (LITRG), paragraphs 9.6.6 and 9.6.8
77 Treasury Committee Oral Evidence: Shifting Sands: an inquiry into UK tax policy and the tax base, HC 314, 6 September 2016, Q247
78 CLA, Making Tax Digital Consultation Response, paragraph 21
79 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraphs 4.10 and 9.5
80 Treasury Committee Oral Evidence: Shifting Sands: an inquiry into UK tax policy and the tax base, HC 314, 25 October 2016, Q332
81 ICAEW Representation 171/16 Making Tax Digital: Bringing Tax into the Digital Age, paragraph 30
82 Ibid, paragraph 47
83 Ibid, paragraph 149

73. The issues around those who were not digitally excluded but who would need support if they are to comply with MTD were summarised by the Association of Certified Chartered Accountants:

> "another 1.42m businesses fall within the "digital assist" population, and will require assistance from HMRC, professional advisers or family and friends if they are to comply with the proposed new obligation. These businesses will fall into the Cabinet Office bandings 2-5 for digital inclusion. Since the current online tax return is rated at 8, confident user, the design of any new record keeping and reporting process will clearly need to be simplified significantly if the degree of support required is not to exceed even that suggested by the "digital assist" categorisation in HMRC's research. Such simplification would obviously be easier if the tax system itself were simplified to reduce and rationalise the number of adjustments required."[84]

74. They concluded that:

> "Any business which is unable to access consistent and reliable fast broadband (for interim reports to HMRC) at a commercially and economically viable cost at its main premises should be considered "unable to engage digitally". Any business which conducts a significant proportion of its transactions at remote locations where a reliable mobile data connection (for uploading of transaction information) cannot be guaranteed should be considered "unable to engage digitally."

> "Given that MTD record keeping will potentially affect every business transaction undertaken, rather than just a quarterly or annual filing requirement, the daily cost implications suggest that the number of businesses "for whom online filing is not reasonably practicable for reasons of disability, age, remoteness of location, or any other reason" will potentially be considerable if the exemption thresholds are not set at a level where businesses are sufficiently profitable to absorb the extra costs without trading at a loss."[85]

75. **The Government appears to be starting with the premise that MTD should be mandatory for all businesses, with a few exemptions. The Government has suggested that it intends to exclude those for whom MTD is not "reasonably practical". For this to provide meaningful protection for the "digitally excluded", HMRC will need to provide clear guidance, including a more detailed explanation of what they mean. Without it, a larger body of case law, to define "reasonably practical", is likely to develop than would otherwise be the case.**

84 Comments from ACCA to HMRC November 2016, TECH-CDR-1428 Making Tax Digital: Bringing business tax into the digital age, page 6

85 Comments from ACCA to HMRC November 2016, TECH-CDR-1428 Making Tax Digital: Bringing business tax into the digital age, page29

Specific types of organisation that should be exempt

76. As well as the digitally excluded, the consultation paper proposed an exemption for charities (and possibly their trading subsidiaries) and Community Amateur Sports Clubs, because they enjoy a special tax status and do not routinely have to file direct tax returns. It also asked for suggestions for other types of organisation which should be exempt from MTD even if they are not digitally excluded.

77. There have been many such suggestions, all of which can be justified for various reasons, including "organisations which do not pay tax; not for profit entities such as membership organisations; small community organisations/ clubs which are neither charities or CASCs but which operate through a limited company; trusts and estates with property income; farmers and those with very seasonal businesses; partnerships, bodies registered under the Industrial and Provident Societies Acts; Community Interest Companies; Local Authorities; Pension Schemes; Non-profit residential property management companies; overseas businesses and landlords that otherwise have tax obligations in the UK; GP partnerships/NHS Practices; older taxpayers (eg over 60s); landlords (or at least those with fewer than, say, three properties)[86]; those with irregular income; those with good records but not in the prescribed form; those renting out property to help pay for residential care; some carers; universal credit claimants (until the rules on calculating self-employed income using the cash basis for income tax and UC are fully aligned and until there can be a single report of income to satisfy both the Department for Work and Pensions and HMRC requirements); businesses in financial difficulties; those about to retire, and short term temporary exemptions for 'time to comply'[87]; individuals with more than one business interest; individuals with sole as well as shared business interests; individuals with personal difficulties involving literacy or numeracy; Lloyd's underwriters; those MPs and members of the Judiciary who are currently unable to file tax returns online for security reasons; overseas businesses whose only UK tax obligations are for VAT[88]; Welsh language taxpayers.[89]"

78. The Institute of Chartered Accountants of Scotland made the more general point that there should be an exemption for those business sectors for whom quarterly digital updates do not line up well with the overall objectives of cost saving and certainty around tax liabilities. For example the nature of farming means that quarterly updates are unlikely to provide either meaningful business management information or figures from which tax liability can be accurately estimated, and rural businesses may be carried out on a small scale, with significant turnover, but low profits:

> "For many businesses here the aim is to break even and cover essential private living expenses. Cloud accounting, if feasible, would be akin to using a Rolls-Royce for a journey which could be done by bicycle."[90]

86 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraphs 3.13, 9.45 and 9.46

87 Making Tax Digital: Bringing business tax into the digital age HM Revenue & Customs (HMRC) consultation document Response from the Low Incomes Tax Reform Group (LITRG), paragraph 3.7

88 ICAEW Representation 171/16 Making Tax Digital: Bringing Tax into the Digital Age, paragraphs 137 and 140

89 Comments from ACCA to HMRC November 2016, TECH-CDR-1428 Making Tax Digital: Bringing business tax into the digital age, page 32

90 ICAS Response to the Consultations, HMRC Making Tax Digital Overview, pages 4-5

79. The consultation paper included some proposals for partnerships, and while IRIS's survey suggested that 58% of customers thought this could work[91], others have raised concerns that anything other than a two-person partnership is complex and the Institute of Chartered Accountants in England and Wales asserted that:

> "A start date of 2018 is not possible for many simple income tax paying businesses and certainly not for larger and more complex partnerships."[92]

80. **HMRC's current approach will require it to give very careful consideration to the many requests for specific exemptions, particularly in cases where the costs to the businesses concerned would be disproportionate. It may be that much more extensive transitional arrangements are preferable to an ever lengthening list of exemptions, both to reduce business costs and uncertainty and also to protect the yield.**

Costs and Benefits

81. The other major concern which has been drawn to the Committee's attention is the cost for businesses in implementing MTD and the fact that, even with mandation, the business case for investment in HMRC's IT looks weak, because the benefits to HMRC will not outweigh the costs to businesses. For example the Chartered Institute of Taxation said that:

> "Whilst MTD will bring benefits to HMRC, the likely impact on most businesses and taxpayers will be an increased workload and / or increased costs. It is not at all clear that there will be commercial benefits to offset such costs, particularly for smaller businesses."[93]

82. And the Institute of Chartered Accountants in England and Wales said:

> "It is clear that the costs of MTD to taxpayers, and in particular businesses, have not been identified in anything like sufficient detail to justify this change. However, we believe that the costs to businesses of MTD are far higher than suggested. Taxpayers are being asked to fund a £1.3bn investment that will cost them somewhere between £3bn and £7bn to implement, with ongoing costs on top of that."[94]

83. Only 7% of respondents to the IRIS survey believed that there was an opportunity for MTD to create savings for their business or their clients' businesses.[95]

Making Tax Digital will bring extra costs for businesses

84. The headline message from the oral evidence heard by the Committee was the Federation of Small Business' estimate that the actual cost is likely to be around £2,770 per year per business, on top of the £3,600 that they already spend on regulatory compliance. Mike Cherry said that:

91 IRIS software, report on Making Tax Digital survey, page 11

92 Written evidence to the Committee from the ICAEW for the Inquiry into UK Tax Policy and the Tax Base, paragraph 178

93 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraph 2.1

94 ICAEW Representation 171/16 Making Tax Digital: Bringing Tax into the Digital Age, paragraph 16

95 IRIS software, report on Making Tax Digital survey, p 14

"that is a fairly valid estimate, even though we do not at the moment know the full detail of what quarterly reporting is going to mean in practice."[96]

85. The Institute of Chartered Accountants in England and Wales said:

"While we have not ourselves undertaken a detailed survey of costs, and such evidence as exists needs to be treated with caution, it seems to us self-evident that the need to submit quarterly reports on top of a year-end reconciliation (by whatever name called) will increase costs as compared to completing and submitting one annual return. For example, one of our practice members undertook a survey of his firm's SME clients and concluded that the transitional costs for all their clients would be an increase by an average of £1,250 per annum."[97]

86. The Association of Certified Chartered Accountants said:

"A number of our Members have attempted to quantify more or less sophisticated estimates of the likely additional costs and time spent in helping clients move to the new regime. Typical estimates range from 50-100 hours of initial familiarisation time, with ongoing support in the range from 30-50 hours per year. Cost estimates range from £1,250 per year to around £3,000, with most around the £2,000 mark. It is quite clear that in the case of smaller businesses these costs will come directly from owners and will directly impact their capacity to operate and grow their businesses, as they have no capacity in time or savings from which to fund the costs of change."[98]

87. The small businesses who gave evidence referred to the additional costs for micro businesses because "they are going to have a book-keeper of accountant to do that work for them"[99] and that doing an update quarterly will not commensurately reduce the size of the job at the end of the year: "It is not going to be a quarter of my time to do this every quarter; it is going to be half to three quarters. In fact it will probably take the full amount of time it would take me to do my annual returns for the first one or two times. That is a lot of profit to my business"[100]. In addition, it was noted that "the greatest pressure on businesses, particularly small businesses, is time"[101] and that:

"On top of the financial costs [of MTD], there will be time costs to business in familiarising themselves with the new digital record keeping obligations and in researching, and then acquiring / engaging, the most appropriate software / hardware / training / agent etc for their business. It is very difficult to quantify what these costs could be per business." [102]

96 Treasury Committee Oral Evidence: Shifting Sands: an inquiry into UK tax policy and the tax base, HC 314, Q300 and Q301
97 ICAEW Representation 171/16 Making Tax Digital: Bringing Tax into the Digital Age, paragraph 13
98 Comments from ACCA to HMRC November 2016, TECH-CDR-1428 Making Tax Digital: Bringing business tax into the digital age, pages 33 and 34
99 Treasury Committee Oral Evidence: Shifting Sands: an inquiry into UK tax policy and the tax base, HC 314, 6 September 2016, Q227
100 Treasury Committee Oral Evidence: Shifting Sands: an inquiry into UK tax policy and the tax base, HC 314,25 October 2016, Q231
101 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraph 5.2
102 Ibid 4.18

88. **The average cost to business of implementing MTD cannot be substantiated until there is more detail of the requirements and more examples of the software. However, the cost is likely to be significant for a small business. There will be both implementation costs and continuing costs. Evidence given to the Committee suggests that under the current timetable, the total cost to business (including software, hardware, training, agent fees and, above all, time) might exceed the total benefits in improved tax yield. In other words, even if the yield were to rise, the return to the whole economy could be negative. The Government's estimate of the yield may therefore neglect the effect of overall behavioural changes.**

The revenue from reduced errors is unlikely to materialise

89. The Impact Assessment published alongside the consultation documents stated that "the Making Tax Digital changes will help reduce the tax gap and contribute £945 million to the Exchequer by 2020/21" (£625 million in the first full year).[103]

90. It is assumed that revenue loss due to errors and failure to take reasonable care will be reduced if businesses record and report digitally on a regular basis. Since "those most motivated to adopt the new processes would be the ones least likely to be making mistakes currently"[104], HMRC considers it necessary to make MTD mandatory in order to realise the return on the £1.3bn investment to transform HMRC into one of the most digitally advanced tax administrations in the world.

91. However the premise that digital record keeping will increase the tax take through a reduction in errors was challenged by both the Chartered Institute of Taxation and the Institute of Chartered Accountants in England and Wales:

> "We asked what members thought the impact of digital record keeping and quarterly reporting would have on the level of client's errors. 41% of members said it would have little impact, with nearly 40% considering it would increase errors. Only 9% of members thought it would have a small reduction in errors, with 1% thinking it would have a significant reduction."[105]

> "HMRC is hoping that through MTD, businesses will make fewer errors in their record keeping and so the tax gap would be reduced. We support the government's efforts to reduce the tax gap but we are not convinced digitalisation is the answer. In our opinion, using digital tools to record transactions close to 'real time' is more likely to capture previously omitted expenses, while those who suppress sales in an analogue world will continue to try and do so in a digital world."[106]

92. The potential over-estimate in the expected yield from error reduction may also be compounded by loss of tax revenue from the businesses who will face costs from MTD:

---

103 HMRC Consultation Document, Making Tax Digital: Bringing Business Tax into the Digital Age, 15 August 2016, page 67

104 Ibid, paragraph 2.6

105 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraph 5.7

106 ICAEW Representation 171/16 Making Tax Digital: Bringing Tax into the Digital Age, paragraph 22

> "Mr Rees-Mogg: The costs that are additional advice and software will come off the profit that businesses are making. What I am trying to get at is that, in this figure, in the tax gap, it is not including the tax that would be lost, because every business has a £2,770-a-year cost. On a very rough calculation, assuming a 20% tax rate, that is going to be £2.8 billion of loss, against, at the higher figure, £945 million of gain, or £640 million on your figure. I just wonder whether this is in HMRC's calculations or whether it is assuming the tax gap narrows, and that is wonderful, but ignoring the fact that, if business cost goes up, corporation tax receipts are lower, with 5.2 million small businesses in the country having this extra charge. Is what I am saying plausible?
>
> […]
>
> Chas Roy-Chowdhury: You are right about the way that the £945 million yield has been worked out. It probably does not include the additional costs that businesses would suffer. I do not think it would have had any chance to have the kinds of numbers that Mike or Frank have come up with. It cannot have been included. If you include those with what I was saying earlier, I wonder which way the tax gap really has gone by introducing this."[107]

93. This point about the tax loss as MTD hits businesses' bottom line was also made in the Association of Certified Chartered Accountants' response to the consultation:

> "The cost to the exchequer of having e.g. a well-run family furniture business maintain its accounts in paper form is nil; the cost of having them divert funds and resources into a new (unnecessary) primary record keeping system will be lost profitability, and the taxes thereon, while society as a whole loses the productivity now diverted into learning new systems."[108]

94. **A detailed explanation of how it has arrived at its conclusions on the potential revenue yield will form a crucial part of the Government's response to the consultations. Even if the total economic return were shown to be modestly positive, the Government must convince Parliament that it is worth the candle.**

95. **A core part of the Government's case for MTD is that, by sharply reducing the net value of errors, an important part of the tax gap will be closed. This may or may not turn out to be the case.**

96. **It is plausible to suppose that, in so far as MTD results in fewer customer errors, those errors will have been as much in the exchequer's favour (such as forgetting to record deductible expenses) as they have been in favour of the individual taxpayers. It is also plausible to suggest that errors will increase as taxpayers become accustomed to a new type of record keeping. Furthermore, some businesses might cease trading as a result of the additional costs that they face, and others might elect to move into the hidden economy rather than comply with their new MTD obligations.**

107 Treasury Committee Oral Evidence: Shifting Sands: an inquiry into UK tax policy and the tax base, HC 314, 25 October 2016, Q346 and 349

108 Comments from ACCA to HMRC November 2016, TECH-CDR-1428 Making Tax Digital: Bringing business tax into the digital age, page 5

97. **The tax gap for "errors" and "failure to take reasonable care" form a relatively small part of the overall Tax Gap[109]. Some parts of the Tax Gap, such as "criminal attacks" and "non-payment" will never be completely removed, so the elements of the UK Tax Gap that can credibly be reduced are relatively small. The UK compares favourably with other economies[110]. The relatively low tax gap in the UK is in part due to a widely understood culture of mutual trust between HMRC and the vast majority of taxpayers. Unlike some countries, most UK taxpayers try to pay the right amount. Trust is built upon respect for taxpayers' confidentiality and a feeling that taxpayers are being treated fairly, even if they do not like having to pay tax. That trust could be eroded if HMRC rushes into dealing with individuals in a faceless and automated way before they are ready for it, and with what some taxpayers may perceive to be risks to confidentiality.**

98. **Before proceeding, the Government needs to provide further evidence that real time reporting does indeed provide the large yield claimed by them for it. This is the sort of information with which the evaluation of a pilot could considerably assist. HMRC also needs to reflect on the Exchequer consequences of the reduced business profits which might well arise from the costs of implementing MTD.**

Software issues

99. The other major area of concern is around the software that will be necessary for Making Tax Digital, especially if that software is additional to the software that businesses currently require:

> "Software should be free to all businesses as far as possible. Businesses put their current processes in place to support their strategic objectives. This may be in the form of paper records as well as digital records that may not be easily converted (e.g. there are mobile apps that record business accounts). As this is a mandatory change, businesses should not be expected to invest in the additional IT requirements, which they do not necessarily need to run their businesses."[111]

100. Some businesses may have sufficiently simple systems that they can use software with limited functionality, but the Chartered Institute of Taxation said that they were:

> "concerned that free software will be a poor relation to paid software. HMRC will need to work closely with the software companies to ensure that free software has sufficient functionality, as well as comprehensive prompts and nudges, for it to be a viable choice for small businesses."[112]

Businesses will need help from HMRC in choosing the right software

101. Given the wide variety of software that may be available through the marketplace, it was considered important that HMRC provide some guidance to businesses.

109 HMRC, Measuring Tax Gaps 2016 edition, Tax Gap estimates for 2014-15
110 Treasury Committee Oral evidence: HMRC Annual Report and Accounts 2014-15, HC 588, 10 November 2015, Q2
111 CLA, Making Tax Digital Consultation Response, paragraph 44
112 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraph 3.1

> "HMRC should provide clear guidance and / or an online tool to help businesses (and their agents) choose the right software for their circumstances. This is not a responsibility that HMRC can shun."[113]

102. and

> "the amount of choice will make it very difficult for a business to choose without help and a subsidiary market offering this guidance could develop, adding yet another layer of cost."[114]

103. The Chartered institute of Taxation went on to say that

> "HMRC should produce a list of available software products and apps, recognising that businesses will need assistance to choose the most suitable product for their own circumstances and make it as easy as possible for them to decide (either for themselves or in conjunction with their agent) which product to choose. This is not currently the case with software lists provided on GOV.UK, which tend just to be a list of names in alphabetical order with links to the websites of the software companies. It is left to the taxpayer to research each product and decide which one is best for them. In our view, HMRC need to do more than this if MTD is to work effectively."[115]

104. **The Government needs to ensure that taxpayers receive adequate guidance to help them choose the most appropriate software for their business. This needs to be done in a way which does not disrupt the software market.**

Many free software and apps are likely to be inadequate

105. The consultation documents made clear that free software will be available. For example, in her foreword, the Financial Secretary to the Treasury said:

> "For those businesses who aren't already keeping records digitally, there will be free software and straightforward advice on how to use it."[116]

106. However, deep concerns have been raised about the ability of free software to cope with anything more than the most basic of businesses, and about the consequences of a business relying on such software which subsequently turns out to be inadequate resulting in errors in the business's submissions to HMRC.

Reliance on the market for provision of free software

107. There was a general concern about the ability of the market to deliver appropriate free software. The Low Incomes Tax Reform Group summarised the issue:

113 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraph 3.3

114 ICAEW Representation 171/16 Making Tax Digital: Bringing Tax into the Digital Age, paragraph 56

115 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraph 4.35

116 HMRC consultation document "Making Tax Digital: Bringing Business Tax into the Digital Age", page 4

> "Relying on commercial businesses to make free software available is, in our view, fraught with very significant problems and is wholly unsatisfactory."[117]

108. They went on to stress that:

> "The free software offering will be critical in making MTD a success for the small businesses and we firmly believe it is HMRC's responsibility to provide good quality free software that is adequate to comply with the new requirements. HMRC should therefore reconsider the statement at 2.22 of the consultation: 'HMRC has no plans to offer its own free software product'."[118]

109. The Association of Certified Chartered Accountants said that:

> "It is very difficult to see how comprehensive software needed by businesses can be made available by commercial software providers free. Any free software product must incorporate sufficient fail-safes and warnings to prevent taxpayers from filing an incorrect return as a consequence of weaknesses in the software design.
>
> It must be kept up to date for all aspects of tax law which it is designed to deal with. It must either be platform agnostic, or make very clear to users the implications of attempting to use it on other than the intended device/operating system combination."[119]

110. The Institute of Chartered Accountants of Scotland said that:

> "The consultations are predicated on the availability of free software for the smallest businesses. It is difficult to see how HMRC can ensure that this becomes a reality. Commercial software providers are unlikely to be able to supply free products with adequate functionality to enable all small businesses to meet the filing requirements.
>
> The reality is that businesses will incur additional costs to comply with their tax obligations. There may be a basic free product, but most businesses will need add-ons to deliver the functionality they need.[120]

Functionality of the free software

111. The functionality of the free software will be extremely important, with the risk that "businesses using free products may find themselves at a disadvantage since free products may be of poorer quality than paid-for products."[121] Expanding on this, the Chartered Institute of Taxation said:

117 Making Tax Digital: Bringing business tax into the digital age HM Revenue & Customs (HMRC) consultation document Response from the Low Incomes Tax Reform Group (LITRG), paragraph 2.6

118 Ibid, paragraph 4.3.1

119 Comments from ACCA to HMRC November 2016, TECH-CDR-1428 Making Tax Digital: Bringing business tax into the digital age, page 8

120 ICAS Response to the Consultations, HMRC Making Tax Digital Overview, paragraphs 35 and 36

121 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraph 4.50

> "We are concerned that free software will be a poor relation to paid software. HMRC will need to work closely with the software companies to ensure that free software has sufficient functionality, as well as comprehensive prompts and nudges, for it to be a viable choice for small businesses.
>
> "Evidence to date indicates, for example, that free apps do not cater for even the simplest sole trader. One recently released app cannot cope with both cash and bank payments, let alone by credit card, invoicing or disallowable expenses as it ignores basic double entry bookkeeping principles.[122]
>
> "Taking a photo of a receipt on a smart phone and linking it to financial records is extremely attractive, as storage space can be expensive. However, it will be crucial that HMRC does not endorse or effectively advertise software that cannot cope with the basics of many simple businesses; anything other than double entry bookkeeping will often fail. Making apps look simple with single entry bookkeeping, an inability to differentiate between revenue and capital, and inappropriate character recognition will lead to more problems, particularly non-compliance, in the future."[123]

Funding of the free software

112. Concerns were also expressed about how the commercial providers of free software will generate income. For example, the Low Incomes Tax Reform Group said that:

> "It is likely that a commercial supplier will use the free software to generate contacts to whom they can potentially sell more sophisticated – and useful – software in due course and in our experience this can lead to free software users being bombarded with marketing calls in an attempt to get them to move to paid products. This is not acceptable and should not be part of the free software offering. Similarly, free software users should not be bombarded by advertisements and pop-ups pushing in-app purchases – the traditional means of 'paying for' free software."[124]

113. And there was a widespread concern that free software will not be available in perpetuity. For example, the Chartered Institute of Taxation said that:

> "There should be some way that the Government can ensure that free products will be available indefinitely to businesses that want them, otherwise what is there to prevent software companies withdrawing them?"[125]

114. **The Government has stated that some free software will be provided. This is welcome. In order to honour this commitment, the Government needs first to define what it means by free software and to whom this will be available. Second, it should ensure that there is a functioning market to produce free software without disruptive marketing material in it. Third, it should ensure that access would remain free.**

122 Ibid, paragraphs 3.1 and 3.2
123 Ibid, paragraph 4.22
124 Making Tax Digital: Bringing business tax into the digital age HM Revenue & Customs (HMRC) consultation document Response from the Low Incomes Tax Reform Group (LITRG), paragraph 4.3.5
125 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraph 4.51

Prompts and Nudges

115. It is clear that software tax guidance (or "prompts and nudges") will form a key part of MTD if it is to achieve the aspiration of reducing errors.

> "MTD-compatible software will incorporate a range of nudges and prompts, for example in the form of pop-ups and questions within the software, which flag to the business any areas where a potential inconsistency or error is being made. In such instances, the business will be asked within the software to double check they are happy with the figures they are updating HMRC with."[126]

116. In principle the idea of such prompts and nudges was welcomed.

> "the concept of software providing prompts and nudges is an appealing one."[127]

117. However, there was a concern that

> "the tax system is too complicated to enable most individuals to make informed decisions about their tax affairs."[128]

118. and

> "In many cases taxpayers would need to understand some of the fundamentals of accounting to be able to understand the prompts and nudges, so the benefit of these should not be overstated, particularly in the early stages of MTD, unless taxpayers receive adequate training".[129]

119. Furthermore,

> "there is a risk that taxpayers could assume that their software will provide protection for errors, even if the software provides an incorrect 'nudge', or fails to provide a 'nudge'. All software will need warnings and caveats so the user understands its limitations."[130]

120. And the Institute of Chartered Accountants in England and Wales sought

> "reassurance that a taxpayer will not be considered to have been careless or negligent if it is later found that, having relied on a prompt or a nudge, they make a mistake in their filing." [131]

121. Both the Chartered Institute of Taxation and the Institute of Chartered Accountants in England and Wales mentioned the possibility of switching off the prompts and nudges:

> "For example a taxpayer, after receiving one prompt about petrol station receipts, might then understand that the individual elements must be

126 HMRC consultation document "Making Tax Digital: Bringing Business Tax into the Digital Age", page 24
127 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraph 5.47
128 Ibid, paragraph 5.46
129 Ibid, paragraph 10.5
130 Ibid, paragraph 5.48
131 ICAEW Representation 171/16 Making Tax Digital: Bringing Tax into the Digital Age, paragraph 95

> itemised separately (eg fuel, newspaper, sandwich etc) rather than as a single expense. It would be annoying if that prompt appeared every time a petrol station receipt was captured, and so the taxpayer might need the option 'don't show this again' like with other software prompts."[132]

122. And they asked "how HMRC would view the returns of a taxpayer who does this"[133], with the suggestion that "if they were to 'override' a prompt they should not be automatically considered to have been careless or negligent."[134]

123. **The Committee notes the potential benefit of "prompts and nudges". But HMRC will have to accept that they cannot hold taxpayers accountable for errors made in good faith in response to a prompt or a nudge and that given the complexity of the system, these exhortations could cause confusion and more cost.**

Spreadsheets

124. It appears that there is an open question about the MTD compatibility of spreadsheets.

> "HMRC is exploring, with specialists, the role of spreadsheets in business record keeping and their ability to meet the requirements and benefits of MTD compatible software."[135]

125. Both the Chartered Institute of Taxation and the Institute of Chartered Accountants in England and Wales emphasised the widespread current use of spreadsheets by small businesses and urged HMRC to find a way of making them MTD compatible:

> "We welcome the news that HMRC are 'currently exploring with specialists the role of spreadsheets in business record keeping and their ability to meet the requirements and benefits of MTD-compatible software' (paragraph 2.12). A substantial number of members report that they and their clients use spreadsheets to record, analyse and summarise accounting and tax data and are particularly concerned that this facility should remain an option in the MTD regime. Furthermore, it should be stressed that spreadsheet use is not confined to small businesses. Many large partnerships and companies also use spreadsheets, in many cases because suitable commercial software is not available."[136]

> "Currently, spreadsheets are the solution to many of the above issues [VAT adjustments such as partial exemption and special accounting schemes]. We suspect that most businesses, even those that use software for their record-keeping, use spreadsheets in order to calculate their VAT return. Unless MTD software is developed to accommodate spreadsheet-like functionality, MTD for VAT will only work for a fraction of businesses."[137]

---

132 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraph 5.51
133 ICAEW Representation 171/16 Making Tax Digital: Bringing Tax into the Digital Age, paragraph 97
134 Ibid para 95
135 HMRC consultation document "Making Tax Digital: Bringing Business Tax into the Digital Age", paragraph 2.12
136 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraph 4.25
137 Ibid, paragraph 5.28

126. **Spreadsheets are a valuable tool for record keeping and should be accepted for MTD. However difficult it might be in software terms, HMRC needs to ensure that tools are available to convert information from spreadsheets into information that can be submitted as part of the quarterly digital update.**

Communication about MTD

127. There was a general consensus that communication to individual businesses is vital, but that it has to date been inadequate.

128. 98% of respondents to the IRIS survey considered that they or their clients had not been informed at all well by HMRC.[138]

129. The Chartered Institute of Taxation summed up the issue by saying that:

> "communication of MTD, direct to businesses and individuals, is vital. There is much work to be done to educate and inform the public about these very significant proposals, and how they change the interaction they will have with HMRC. In our view, HMRC will need to step-up its promotion of MTD. Digital communications such as YouTube and Twitter will not reach businesses that currently do not use digital tools. Traditional mechanisms such as television, radio and newsprint should be considered."[139]

130. However, "the vast majority of businesses will be completely unaware of these consultations because HMRC has not publicised MTD in a way which gets business' attention"[140].

131. The witnesses who gave evidence to the Committee on 6 September were a small, and not necessarily representative, sample of the small business community. However, were unaware of MTD before they were invited to give oral evidence[141] and the taxi driver of one of our tax professional witnesses "was absolutely horrified. He knew nothing about it."[142]

132. Given the lack of digital engagement among some sectors of the population, the Low Incomes Tax Reform Group stressed that:

> "the exemptions must be made known to taxpayers – and not just digitally. Any communications sent to taxpayers relating to the MTD reforms, and promotion of MTD via the media should make it very clear that there are exemptions and make it very easy to find out about them in full. Ideally, we recommend a factsheet containing the exemptions is sent to all taxpayers at the time the reforms are introduced, and to new businesses when they register with HMRC."[143]

138 IRIS software, report on Making Tax Digital survey, page 4

139 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraph 2.8

140 Ibid, paragraph 4.32

141 Treasury Committee Oral Evidence: Shifting Sands: an inquiry into UK tax policy and the tax base, HC 314, 6 September, Q243

142 Treasury Committee Oral Evidence: Shifting Sands: an inquiry into UK tax policy and the tax base, HC 314, 25 October, Q306

143 Making Tax Digital: Bringing business tax into the digital age HM Revenue & Customs (HMRC) consultation document Response from the Low Incomes Tax Reform Group (LITRG), paragraph 9.6.18

133. **Once the precise shape and timing of MTD is known, HMRC will need to engage on an intensive publicity campaign so that all taxpayers become aware of their new obligations.**

Other issues

134. Businesses and representative bodies raised a number of other concerns, which are too detailed to cover adequately in this report. Examples are the impact of MTD on existing simplification schemes, and the point that HMRC should not be prescribing the form in which accounting records are kept.

135. But one other issue does warrant inclusion in this report:

Cyber security

136. Businesses are right to be concerned about cyber security when their base records are stored in the Cloud - on someone else's computer. If that data storage is not in the UK, there needs to be adequate protection over taxpayers' data, especially if software providers choose to store it outside the UK. There is no reason to doubt the security of HMRC's IT systems, but, as the Chartered Institute of Taxation pointed out:

> "The potential for hacking and cyber-attacks will increase and should not be ignored if government is effectively forcing businesses to place confidential information online. Guidance on protecting businesses and individuals needs to be available."[144]

137. They also pointed out that:

> "a business will want to have reassurance about the security of the software, given that large amounts of data (including personal data) will be sent by the software to HMRC on a regular basis.
>
> "Advice on cyber security and best practice should be available to both agents and their clients alongside both the paid-for and free software. From an agent perspective cyber security will be a key issue to protect their own practices and client data.[145]

138. As well as cyber security in the narrowest sense, there were concerns about more general cyber housekeeping issues such as the need for data to be adequately backed up. The Institute of Chartered Accountants in England and Wales stated that that:

> "There could be issues if, say, the scans/digital images are stored on a smartphone or tablet and the device is lost, stolen or develops a fault so that the stored files are no longer available. An adequate backup practice might minimise the risk of this, but not everyone routinely backs up their

144 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraph 5.10

145 Ibid, paragraph 4.40, 4.41

device and many do not have the means to do so. The scope for data loss here seems to be considerable and HMRC needs to consider how it will deal with the issues flowing from that."[146]

139. The Chartered Institute of Taxation pointed out that:

> "Worryingly, at least one of the major cloud software suppliers does not guarantee to keep the records adequately backed up and suggests that taxpayers do this themselves, although they do not seem to provide guidance on how their package can be backed up by a taxpayer. Surely to be listed on HMRC's website, HMRC should insist that software packages must be capable of being copied onto a local drive for backup or have a separate facility for online backup."[147]

140. The Low Incomes Tax Reform Group made the reasonable request that:

> "We would like to see HMRC assessing the security of the various software packages that will be available to use and rating them all (maybe a 1-5 star system, where 1 indicates weak security and 5 indicates strong security. This would give users some peace of mind as to the level of security they can expect, and it would almost certainly also have the effect of generally driving up security standards in all products".[148]

141. **The Committee has heard evidence that the scope for hacking and cyber attacks might well increase with MTD. This could extend to disclosure, to third parties, of customers' data. HMRC will need to provide adequate assurances about the security of customers' data held by software providers. Were the data to be stored outside the UK in the Cloud, this would be all the more important.**

142. **A related issue is that of "housekeeping", particularly computer back up. It is for consideration whether software providers should acquire a duty to ensure that taxpayers' data is adequately backed up.**

146 ICAEW Representation 171/16 Making Tax Digital: Bringing Tax into the Digital Age paragraph 76

147 Making Tax Digital: Bringing business tax into the digital age, response by the Chartered Institute of Taxation, paragraph 5.9

148 Making Tax Digital: Bringing business tax into the digital age HM Revenue & Customs (HMRC) consultation document Response from the Low Incomes Tax Reform Group (LITRG), paragraph 4.61.

Conclusions and recommendations

Introduction

1. After receiving representations from the Committee and other parties, the Government has put back its response to the consultation from the Autumn Statement, when it would ordinarily have been expected, to January 2017. This is welcome. (Paragraph 2)

Key points made in evidence to the Committee and elsewhere

2. Digitisation will provide many opportunities for increasing efficiency of tax collection. This needs to be done not just in a way that may better secure the yield, but also taking into account the reasonable needs of millions of taxpayers. This will require a great deal of care and sensitivity on the part of HMRC. A large proportion of the UK's businesses, particularly the millions of small businesses, are not currently well equipped to move over to digital record keeping and reporting. Nor may they be so for several years. (Paragraph 29)

3. The Government has been invited, in a series of letters, to explain its position. But the Government has not yet had the opportunity to give detailed oral evidence to this Committee in support of its proposed timetable. The Committee will take further evidence from the Government after it has published its proposals in the light of the consultations that it has undertaken. On the evidence that the Committee has seen, the Government appears intent on keeping to its original schedule. This now leaves little over a year to complete the work. This looks over-ambitious. The Government has yet to publish draft legislation to address crucial concerns raised by this Committee, among others, at early stages of their consultation. Among these concerns are: the need for adequate, free software; the overall costs and benefits of the project; the proposed speed of implementation and the fact that it will be mandatory for the vast majority of businesses within little over two years. (Paragraph 39)

4. The imposition of a requirement to move to digital record keeping and reporting is a fundamental change to the system of tax administration in the UK which requires much wider debate and consultation. Even after the concessions announced to date, it is still likely to affect two and a half million taxpayers and possibly as many as five million. It is extremely unlikely that the vast majority of businesses will be capable of adapting to that start date at reasonable cost. Nor should they be expected to do so. The Committee therefore recommends a delay of the full implementation of MTD until at least 2019/20. (Paragraph 40)

5. In the view of the Committee, a start date of April 2018 for mandatory MTD is wholly unrealistic. Whether a start date of 2019, for the 2019/20 tax year, would be possible will depend on the exact shape of the Government's proposals. These have yet to be published. But on the evidence that the Committee has seen so far, this also looks unlikely. (Paragraph 41)

6. Any decisions about VAT and the EU are relevant for the timing of MTD. This is because each could cause disruption and costs to businesses. Whether these can be

mitigated, or would be aggregated, by implementing MTD and post Brexit related VAT changes simultaneously will depend on the government's decision for each. Neither of these is currently known in enough detail to form a view. In the absence of clarity about the Brexit-relevant changes, it would be imprudent to press ahead with MTD. To do so could – depending on the shape of the final decisions – leave firms vulnerable to considerable and unacceptable disruption to the VAT reporting. The Committee will expect the Government to provide detailed evidence on this point. (Paragraph 46)

7. HMRC's "agile" approach – that is, varying the software during the course of a pilot in response to customer feedback – will no doubt provide some useful information. However, it is understood that these pilots are composed of volunteers, therefore are unlikely to obtain information from those most vulnerable to the burdens of the scheme's introduction. The voluntary scheme will provide limited information about the robustness, or otherwise, of the whole tax system in an MTD environment, and over the entire annual reporting cycle of four quarterly submissions and an end of year reconciliation. An obligatory pilot of the process, "end-to-end", should take place before full implementation to obtain this information. Such an extended pilot regime would allow empirical assessment of likely compliance costs and benefits over an entire reporting cycle. There will, of course, need to be safeguards in place to protect those in the pilot. (Paragraph 52)

8. It is also important that such pilots reflect the role of agents in tax. The majority of tax returns are currently submitted by accountants and tax advisers and the system being piloted has yet to include this. The Government needs to explain the pilot process that it envisages for agents. (Paragraph 54)

9. The £10,000 threshold, for the requirement on businesses to record and report digitally, is too low. A turnover threshold at that low level would catch many businesses whose profits are far less than the personal allowance. They currently pay no tax. To impose MTD on them would palpably be absurd. Nor does a possible liability of these firms for National Insurance Contributions create a need for MTD. It is one thing for HMRC to impose digital record keeping on taxpayers. For them to impose it on non-taxpayers would be quite another - it would be seen to be as unreasonable as it is disproportionate. Aligning the threshold for MTD with the VAT threshold would be a simplifying approach. There may well be case for going above this. We heard no strong evidence for setting it at a lower level. (Paragraph 59)

10. The Government has argued that businesses may benefit from a requirement to keep records and submit information digitally. But the Committee has yet to see the evidence to support the view that the benefits to business would outweigh the costs. Were digital record keeping as beneficial to business as HMRC claimed, it is plausible to suppose that most businesses would be doing it now. (Paragraph 62)

11. The Government should draw on the experience gained at the beginning of this century from introducing online filing for income tax self-assessment over a period of many years. This suggests that there is merit, both for the customer and for HMRC, in moving gradually. To rush it might imperil the yield. (Paragraph 65)

12. The Government appears to be starting with the premise that MTD should be mandatory for all businesses, with a few exemptions. The Government has suggested that it intends to exclude those for whom MTD is not "reasonably practical". For this to provide meaningful protection for the "digitally excluded", HMRC will need to provide clear guidance, including a more detailed explanation of what they mean. Without it, a larger body of case law, to define "reasonably practical", is likely to develop than would otherwise be the case. (Paragraph 75)

13. HMRC's current approach will require it to give very careful consideration to the many requests for specific exemptions, particularly in cases where the costs to the businesses concerned would be disproportionate. It may be that much more extensive transitional arrangements are preferable to an ever lengthening list of exemptions, both to reduce business costs and uncertainty and also to protect the yield. (Paragraph 80)

14. The average cost to business of implementing MTD cannot be substantiated until there is more detail of the requirements and more examples of the software. However, the cost is likely to be significant for a small business. There will be both implementation costs and continuing costs. Evidence given to the Committee suggests that under the current timetable, the total cost to business (including software, hardware, training, agent fees and, above all, time) might exceed the total benefits in improved tax yield. In other words, even if the yield were to rise, the return to the whole economy could be negative. The Government's estimate of the yield may therefore neglect the effect of overall behavioural changes. (Paragraph 88)

15. A detailed explanation of how it has arrived at its conclusions on the potential revenue yield will form a crucial part of the Government's response to the consultations. Even if the total economic return were shown to be modestly positive, the Government must convince Parliament that it is worth the candle. (Paragraph 94)

16. A core part of the Government's case for MTD is that, by sharply reducing the net value of errors, an important part of the tax gap will be closed. This may or may not turn out to be the case. (Paragraph 95)

17. It is plausible to suppose that, in so far as MTD results in fewer customer errors, those errors will have been as much in the exchequer's favour (such as forgetting to record deductible expenses) as they have been in favour of the individual taxpayers. It is also plausible to suggest that errors will increase as taxpayers become accustomed to a new type of record keeping. Furthermore, some businesses might cease trading as a result of the additional costs that they face, and others might elect to move into the hidden economy rather than comply with their new MTD obligations. (Paragraph 96)

18. The tax gap for "errors" and "failure to take reasonable care" form a relatively small part of the overall Tax Gap. Some parts of the Tax Gap, such as "criminal attacks" and "non-payment" will never be completely removed, so the elements of the UK Tax Gap that can credibly be reduced are relatively small. The UK compares favourably with other economies. The relatively low tax gap in the UK is in part due to a widely understood culture of mutual trust between HMRC and the vast majority of taxpayers. Unlike some countries, most UK taxpayers try to pay the

right amount. Trust is built upon respect for taxpayers' confidentiality and a feeling that taxpayers are being treated fairly, even if they do not like having to pay tax. That trust could be eroded if HMRC rushes into dealing with individuals in a faceless and automated way before they are ready for it, and with what some taxpayers may perceive to be risks to confidentiality. (Paragraph 97)

19. Before proceeding, the Government needs to provide further evidence that real time reporting does indeed provide the large yield claimed by them for it. This is the sort of information with which the evaluation of a pilot could considerably assist. HMRC also needs to reflect on the Exchequer consequences of the reduced business profits which might well arise from the costs of implementing MTD. (Paragraph 98)

20. The Government needs to ensure that taxpayers receive adequate guidance to help them choose the most appropriate software for their business. This needs to be done in a way which does not disrupt the software market. (Paragraph 104)

21. The Government has stated that some free software will be provided. This is welcome. In order to honour this commitment, the Government needs first to define what it means by free software and to whom this will be available. Second, it should ensure that there is a functioning market to produce free software without disruptive marketing material in it. Third, it should ensure that access would remain free. (Paragraph 114)

22. The Committee notes the potential benefit of "prompts and nudges". But HMRC will have to accept that they cannot hold taxpayers accountable for errors made in good faith in response to a prompt or a nudge and that given the complexity of the system, these exhortations could cause confusion and more cost. (Paragraph 123)

23. Spreadsheets are a valuable tool for record keeping and should be accepted for MTD. However difficult it might be in software terms, HMRC needs to ensure that tools are available to convert information from spreadsheets into information that can be submitted as part of the quarterly digital update. (Paragraph 126)

24. Once the precise shape and timing of MTD is known, HMRC will need to engage on an intensive publicity campaign so that all taxpayers become aware of their new obligations. (Paragraph 133)

25. The Committee has heard evidence that the scope for hacking and cyber attacks might well increase with MTD. This could extend to disclosure, to third parties, of customers' data. HMRC will need to provide adequate assurances about the security of customers' data held by software providers. Were the data to be stored outside the UK in the Cloud, this would be all the more important. (Paragraph 141)

26. A related issue is that of "housekeeping", particularly computer back up. It is for consideration whether software providers should acquire a duty to ensure that taxpayers' data is adequately backed up. (Paragraph 142)

Formal Minutes

Tuesday 10 January 2017

Members present:

The Rt Hon Andrew Tyrie MP, in the Chair

George Kerevan	Chris Philp
Kit Malthouse	Wes Streeting

Draft Report (*Making Tax Digital*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 142 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Tenth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Wednesday 11 January at 2.00 pm

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the inquiry publications page of the Committee's website.

Tuesday 6 September 2016

Question number

Bill Dodwell, Head of Tax Policy, Deloitte, and President, Chartered Institute of Taxation, **Cara Bendon,** Founder, Cara Bendon Brand Consultancy, and Prince's Trust Young Ambassador**, Toby Parkins,** Founder and Director, Headforwards and UKNetWeb, and President of the Board, Cornwall Chamber of Commerce**,** and **Adam Fox-Edwards,** Owner, Arundell Arms Hotel, and Managing Director, Devon Hampers Q224–294

Tuesday 25 October 2016

Chas Roy-Chowdhury, Head of Taxation, Association of Chartered Certified Accountants**, Frank Haskew,** Head of the Tax Faculty, Institute of Chartered Accountants in England and Wales, **Mike Cherry,** Policy Director, Federation of Small Businesses**,** and **Rebecca Benneyworth,** Tax Practitioner and Chair of HMRC's Digital Advisory Group Q295–356

Published written evidence

The following written evidence for the UK tax policy and the tax base inquiry, of which Making Tax Digital is a part, was received and can be viewed on the inquiry publications page of the Committee's website.

TAX numbers are generated by the evidence processing system and so may not be complete.

1 ActionAid UK (TAX0032)

2 Adam Smith Institute (TAX0013)

3 Anneliese Dodds (TAX0037)

4 Associate Professor John Vella (TAX0028)

5 Association of Taxation Technicians (TAX0039)

6 CBI (TAX0038)

7 Centre for Policy Studies (TAX0020)

8 Chartered Institute of Taxation (TAX0027)

9 Clifford Moggs (TAX0003); (TAX0006); (TAX0009); (TAX0010); (TAX0011)

10 Deloitte LLP (TAX0023)

11 Dr Anthony Evans (TAX0014)

12 Environmental Services Association (TAX0029)

13 EY (TAX0035)

14 Federation of Small Businesses (TAX0005)

15 ICAEW (TAX0022)

16 ICAS (TAX0026)

17 IFC Forum (TAX0034)

18 Institute for Fiscal Studies (IFS) (TAX0041)

19 Institute of Directors (TAX0012)

20 jg mo (TAX0004)

21 KPMG LLP (TAX0040)

22 Mark Ockendon (TAX0007)

23 Moore Stephens LLP (TAX0016)

24 Mr Grant Cowley (TAX0002)

25 Mr Richard Baron (TAX0015)

26 Ms Wendy Bradley (TAX0030)

27 Oxfam GB (TAX0033)

28 PricewaterhouseCoopers LLP (TAX0044)

29 Professor Peter Bishop (TAX0017)

30 R3 (TAX0024)

31 SSE (TAX0001)

32 Tax Professionals Forum (TAX0036)

33 The Institute of Economic Affairs (TAX0021)

34 The TaxPayers' Alliance (TAX0019)

35 VocaLink (TAX0031)

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the publications page of the Committee's website.

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2015–16

First Report	Reappointment of Robert Chote as Chair of the Office for Budget Responsibility	HC 459
Second Report	The appointment of Dr Gertjan Vlieghe to the Monetary Policy Committee of the Bank of England	HC 497
Third Report	The re-appointment of Ian McCafferty to the Monetary Policy Committee of the Bank of England	HC 498
Fourth Report	Appointment of Tim Parkes as Chair of the Regulatory Decisions Committee	HC 735
Fifth Report	Appointment of Angela Knight as Chair of the Office of Tax Simplification	HC 734
Sixth Report	Spending Review and Autumn Statement 2015	HC 638
Seventh Report	Reviewing the Office for Budget Responsibility	HC 514
Eight Report	The Treasury Committee's scrutiny of appointments	HC 811
Ninth Report	Re-appointment hearing of Dame Clara Furse and Richard Sharp	HC 895

Session 2016–17

First Report	The economic and financial costs and benefits of the UK's EU membership	HC 122
Second Report	Appointment of Jon Thompson as Chief Executive of HMRC	HC 232
Third Report	Appointment of Edward Troup as Executive Chair of HMRC	HC 498
Fourth Report	Review of the reports into the failure of HBOS	HC 582 Cm 9340
Fifth Report	Appointment of Sam Woods as Deputy Governor for Prudential Regulation and Chief Executive of the Prudential Regulation Authority	HC 567
Sixth Report	Appointment of Andrew Bailey as Chief Executive Officer of the Financial Conduct Authority	HC 568

Seventh Report	Appointment of Professor Sir Charles Bean to the Budget Responsibility Committee of the Office for Budget Responsibility	HC 642
Eighth Report	Appointment of Michael Saunders to the Monetary Policy Committee	HC 729
Ninth Report	Appointment of Anil Kashyap to the Bank of England Financial Policy Committee	HC 730