Further written evidence submitted by the Chartered Institute of Taxation (FB18)

Making Tax Digital

Finance Bill 2017-19
Clauses 60, 61 & 62, and Schedule 14

Summary

- We welcome the recent announcement by the Government of a relaxation to the Making Tax Digital (MTD) timetable
- It is vital that thorough piloting of MTD compliant software for digital record keeping and reporting for VAT can be carried out well in advance of April 2019. If it looks unlikely that this can be achieved, we would urge HMRC to consider a further delay to the MTD timetable
- We are sceptical whether MTD will reduce errors and poor record keeping by small businesses as the government intend.
- It is hard to reconcile the Government's promised reduction in the annual cost to business of tax administration with the introduction of compulsory digital record keeping and quarterly reporting, which will almost certainly increase the burden on business
- Continuing delays in granting access to Digital Tax Accounts to taxpayers' agents could hinder compliance
- The Government should wait until the cost savings that digitisation promises are being realised before considering any further cuts to HMRC's resources

1 MTD in Finance Bill 2017

1.1 Finance Bill 2017 contains enabling legislation for MTD. Much of the detail will be contained in Statutory Instruments and HMRC Directions, rather than in primary legislation.

1.2 <u>Clause 60 (digital reporting and record-keeping for income tax)</u>

The vast majority of the rules and requirements to which clause 60 refers are being delegated to Statutory Instrument, subject to the negative procedure. At some places, it appears that material delegated to secondary legislation can then be further delegated to directions and notices. This is giving HMRC extremely wide powers to make provisions without any scrutiny at all, which in our view is unacceptable for what is one of the biggest changes to the tax system in decades.

1.3 New Schedule A1 Paragraph 18(4) states that for the purposes of this legislation, regulations may specify that a change of accounting date may be disregarded. This might be to stop changes of accounting date being made simply to defer entry into MTD. As currently proposed, a business with a 5 April year end would be first to enter the quarterly reporting regime as it applies to the first accounting period beginning on or after 6 April 2020 (at the earliest). However, a change of accounting date from 5 April 2020 to 31 March 2020 would defer entry for nearly a year. The Government should say whether changing accounting date to defer entry into MTD will be counteracted by HMRC.

1.4 Clause 61 and Schedule 14 (digital reporting and record-keeping for income tax etc amendments to Taxes Management Act (TMA) 1970)

These provisions set out a new method for taxpayers who will be within MTDfB to declare their total (ie business as well as non-business) income and capital gains for a tax year and self-assess their liabilities for the year. They can do this either through their digital reporting software at the same time as they submit their End of Year Statement or by filing a separate return by 31 January after the end of the relevant tax year. In other words, unless their software can file their end of year business and non-business data together, some taxpayers within MTDfB may have to send data to HMRC six times (for their business - four quarterly submissions and one end of year submission and a final submission of other (non-business) information), and potentially more often if, for example, they have more than one business, are VAT registered and/or own a rental property.

1.5 The wording of clause 60 lacks the taxpayer safeguards of the TMA and Schedule 14. For example, Schedule 14 paragraph 3(5) states that only information that 'may reasonably be required' will need to be filed under new TMA 1970 section 8 (1AB). There is an absence of wording like 'may reasonably be required' in clause 60.

1.6 Any regulations which will be made pursuant to clause 61 (5) will use the affirmative procedure. Compare this to clause 60 (new Sch A1 para 18(6)) where the negative procedure is being used. If regulations are considered necessary, then they should all follow the affirmative procedure.

1.7 Clause 62 Digital reporting and record-keeping for VAT

Most of the rules for MTD for VAT are going to be in Regulations which have not yet been published so detail is still very sparse as to how MTD for VAT will work. We are concerned about the absence of any real level of detail or clarity in primary legislation.

2 Timetable, thresholds and pilots

2.1 We welcome the deferral for Income Tax and Corporation Tax until at least April 2020. This will give businesses more time to plan for MTD, and third party software providers and HMRC more time to develop and test digital products.

2.2 It is now unclear whether the threshold for mandation for MTD for Income Tax will be set at £10,000 or not. In our view, £10,000 is far too low a threshold. At this low level, it will mainly exclude hobby businesses, part-time businesses and landlords outside London and the South East with one rental property, but it will certainly include businesses whose turnover (and hence profit) is insufficient to pay tax. An initial threshold in line with the VAT registration threshold (currently £85,000) would be more appropriate.

2.3 It is unclear what benefits will arise from bringing large and complex businesses into MTD. The Government's rationale for MTD relates to closing the portion of the Tax Gap which comes from poor record keeping and errors by businesses. This almost entirely comes from businesses below the VAT threshold, not large businesses.

2.4 HMRC began a small scale Income Tax pilot on 3 April 2017. HMRC's intention was gradually to increase the number of businesses admitted into the pilot so that eventually several hundred thousand businesses would be involved. However, we understand that the Income

Tax pilot is still operating on an extremely small scale with fewer than 50 businesses taking part so far.

2.5 The Government need to take advantage of the delay to MTD for income tax to scale up the existing small scale pilots and run them over a full financial cycle, including four quarters and the end of year update. (This will take at least 20 months.)

2.6 It would be helpful to know whether any effort is being made to check that data being submitted in the MTD pilots is accurate. This could include checking that automatic nudges and prompts in software work as they should.

2.7 It would be helpful to know whether any work is being done to identify compliance costs sustained by businesses taking part in the MTD pilots. Given the disparities in estimates of compliance costs this would seem an obvious opportunity to obtain additional data.

2.8 HMRC have announced that they will start to pilot MTD for VAT by the end of this year, starting with small-scale, private testing, followed by a wider, live pilot starting in Spring 2018. This will allow for a year of testing before any businesses are mandated to use the system in 2019, but may still not provide enough time for a full cycle of four quarterly VAT updates to have been submitted before April 2019. It is vital that proper and thorough piloting of MTD compliant software for VAT can be carried out well in advance of April 2019. If this cannot be achieved, we would urge HMRC to consider a further delay to the MTD timetable.

3 MTD for VAT – specific comments

3.1 It is an oversimplification to say that businesses currently quarterly report for VAT, and therefore will be able to do so for MTD. Under MTD the proposal is for VAT returns to be filed directly through software, and not be input manually, but while 99 per cent of VAT returns are currently filed online, only around 12 per cent are filed via software. Critically, businesses will no longer be able to keep only manual records. Further, the use of spreadsheets in VAT accounting is commonplace; not only to maintain the underlying records, but typically to convert the output from accounting software into figures for the VAT return, and those spreadsheets will in future need to be able to interact with software in order to meet the requirements of MTD. So the requirement to submit through software creates a challenge which the vast majority of businesses and software developers are yet to overcome.

3.2 It is unlikely that large businesses will be able to take advantage of off the shelf commercial software on the basis that the information required to complete VAT returns is often taken from multiple source systems and often needs considerable manual adjustment to arrive at the correct figures.

3.3 If businesses need to implement an IT solution to meet the MTD requirements this takes significant investment (time, money and effort) to change not only how businesses report (ie, as mentioned above filing via software is not all that common at present) but also the scope of data they need to report (if different from the current 9 box VAT return). It is also likely that there will be a strain on available internal / external IT resources if businesses are all trying to comply by the relevant date.

3.4 MTD for VAT will take place at around the same time as the UK leaves the European Union, applying to VAT return periods commencing on or after 1 April 2019. Uncertainty around the VAT treatment of transactions between the UK and EU will inevitably arise, and businesses will need to both understand the tax-technical changes to the rules, and ensure that their accounting systems deal with such transactions correctly.

3.5 There are a number of other special schemes within VAT, such as Annual Accounting, the Flat Rate Scheme, margin schemes and retail schemes, each of which have their own record-keeping and reporting nuances.

3.6 The CIOT has produced a chart which compares the current position with the expected position under MTD for VAT in detail[1].

4 Burdens on businesses

4.1 Whilst MTD will bring benefits to HMRC, and to some taxpayers, it is our view that 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, whether for large or small businesses.

4.2 The results of a survey of our members about MTD, which we conducted during September 2016[2], support this view. We received some 1,082 responses to the survey. Over 90% (965) of respondents worked in accountancy practices, and 61% (647) of respondents were members in small practices, including sole traders, with 22% (234) of responses from members in medium sized practices. The key results from our survey include:

- Over 95% of members considered that compulsory digital record keeping and quarterly reporting will place an additional burden on their clients.
- Nearly 90% of members considered that compulsory digital record keeping and quarterly reporting will place an additional burden on their practice.
- 33% of members reported that over 75% of their clients will need to move from paper/hard copy accounting records to digital records, and over 25% of members reported that 51% to 75% of their clients would need to do so.
- 53% of members thought that over 75% of those clients will need help with moving to digital record keeping, with over 20% believing that would apply to 51% to 75% of clients.
- 68% of members considered that over 75% of their clients will need help with their MTD reporting obligations, including filing their quarterly updates with HMRC and completing their 'End of Year' activity, with 18% considering that help would be needed by 51% to 75% of clients.

4.3 Quarterly reporting will create additional work for businesses and taxpayers alike as there will be an increase in the number of times data will have to be transmitted to HMRC. It will require businesses to record their data in a specific digital format that can interact with HMRC's systems, so how they keep their records will no longer be a matter of choice for businesses. For many businesses, there will be initial set-up costs in moving their records

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[1] Making Tax Digital for VAT - Main issues for consideration https://www.tax.org.uk/policy-technical/technical-news/making-tax-digital-vat-main-issues-consideration

[2] The full results of our member survey can be found on our website at the following link: https://www.tax.org.uk/policy-technical/submissions/making-tax-digital-ciot-and-att-member-survey

into an ‘HMRC approved’ digital format, ie purchasing new software (unless they can use HMRC’s promised free software), hardware (if they don’t own this already) and training.

4.4 It is clearly good practice for businesses to keep their records up to date, and we are strongly supportive of efforts to improve record keeping by businesses. But it would be unrealistic of HMRC to assume that all businesses will seamlessly embrace digital reporting through software or smartphone apps. HMRC must accept that some businesses will find the changes challenging and will struggle to comply. An educative approach, with initiatives such as HMRC’s online learning packages, rather than a punitive approach, such as penalties for non-compliance, should be the preferred way forward.

5 Increased compliance costs for business.

5.1 We are sceptical about the accuracy of HMRC’s latest published financial impacts on businesses[3]. HMRC estimate that businesses will incur MTD transitional costs of some £900m, but it could be many years before those costs are repaid in the administrative burden savings that HMRC claim will arise from MTD[4]. HMRC’s estimates that average transitional costs will be around £280 per business and that MTD will bring ongoing administrative savings appear too optimistic.

5.2 We asked a small number of our members to estimate the additional one-off and recurring costs brought about by MTD. No-one thought the cost would be below £280, and no-one estimated that there would be ongoing compliance savings. In our view, it is probable that MTD will increase, not decrease, costs to business and that these may well be very significant. It is implausible that new IT equipment and software will not increase ongoing costs.

5.3 We expect that many businesses will ask their adviser to help them with their quarterly reporting obligations, thus increasing their compliance costs. There is a big expectation gap between what HMRC think people will do for themselves, and what our experience tells us they want or are able to do. We have already received anecdotal evidence from our members that their clients are expecting to ask them to do more work in preparing or reviewing quarterly figures for submission to HMRC.

5.4 There is evidence that past changes in reporting obligations have led to an increase in compliance costs for businesses, and that HMRC tend to under-estimate these costs. When compulsory online VAT filing was introduced, for example, this meant that some businesses either incurred additional compliance costs to do this themselves, or they paid a third party to file online for them, a compliance cost that the business would not have had previously. Similar consequences followed the introduction of Real Time Information (RTI) payroll reporting for PAYE. When HMRC introduced the requirement that company accounts forming part of the tax return must be in iXBRL format, many advisers starting charging clients to cover the additional cost of putting the data into the required format.

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[3] Policy paper Making Tax Digital for business Published 8 March 2017
https://www.gov.uk/government/publications/making-tax-digital-for-business/making-tax-digital-for-business

[4] Very crudely, if transition costs are nearly £1bn, and net savings will average £100m per annum, this suggests a 10-year payback period.

6 Reducing errors and potential impact on the Tax Gap

6.1 The government's aim with mandatory digital record keeping and digital reporting is to reduce the amount of tax revenue lost due to error and carelessness by taxpayers.

6.2 Since the majority of the tax loss is due to income tax errors and failure to take reasonable care by the smallest businesses, it is difficult to understand the logic behind bringing in MTD first for VAT, applying only to businesses trading above the VAT threshold.

6.3 At the Spending Review 2015,[5] the Government announced that £1bn of additional tax revenues by reducing errors through record keeping would be delivered across the term of the parliament (expected then to run for five years), and by 2020-21 the amount of tax lost to error would be reduced by £600m per year. We are not convinced that quarterly reporting will reduce errors and carelessness by taxpayers and thus we are sceptical that introducing these measures will help to close the Tax Gap.

6.4 Being forced to use a particular basis of record keeping, with which you are unfamiliar or have specifically chosen not to use before, is not a recipe for accurate record keeping. In the worst case scenario, a fully compliant business currently keeping non-digital/paper records could end up becoming non-compliant after failing to master a digital record keeping system accurately.

6.5 The results of our survey support this view. We asked what members thought the impact of digital record keeping and quarterly reporting would be on the level of clients' errors. 41% of members said it would have little impact, and nearly 40% thought 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.

6.6 HMRC ran a compliance programme known as 'Business Records Checks' (BRC) between 2012 and 2015 to try to confirm that a business was keeping sufficient records of its income (sales) and expenses to produce an accurate tax return. The BRC programme was launched in order to reduce that part of the Tax Gap which was believed to be caused by errors and carelessness in the maintenance of business records by small businesses, so on a similar premise to MTD. In October 2015 HMRC announced that they were scrapping BRCs. We understand this was because, despite efforts by HMRC to identify businesses at 'high risk' of having inadequate records, most of those they called on were found to be keeping records to an acceptable standard in accordance with current legal requirements.

6.7 If mandatory digital record keeping is introduced it needs to go hand in hand with a very strong communications and education strategy so that taxpayers know what they need to do to ensure they are keeping adequate records to enable them to produce accurate digital reports and returns when these are required.

7 Agent access

[5] HM Revenue and Customs' settlement at the Spending Review 2015 Published 25 November 2015 https://www.gov.uk/government/news/hm-revenue-and-customs-settlement-at-the-spending-review-2015

7.1 It is a taxpayer's right under HMRC's Your Charter[6] that HMRC will 'accept that someone else can represent you' in the management of their tax affairs. This means that tax agents should be able to see and do what their clients can see and do. The Digital Roadmap[7] foresaw agent access to the personal Digital Tax Account being granted between July and December 2016, but this access is not yet available. It would be helpful if the Government could say when such access will be granted.

7.2 In our view, maintaining and synchronising agent access is crucial to the success of the MTD project . Taxpayers engage agents because tax is complex, and they want to get it right. It would be completely unacceptable with serious implications for compliance levels, if taxpayers are required to file quarterly from April 2019, but their agents are unable to submit the filings on their behalf at that point. While quarterly filing has been piloted on a very small scale since April 2017, so far MTD compliant software for agents is not available.

8 The Chartered Institute of Taxation

8.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities.

18 October 2017

Appendix – filing obligations

By way of illustration the table below shows how the number of filing obligations could increase significantly for a relatively straight-forward taxpayer (say, a VAT-registered builder, who also owns a buy-to-let property). Under the current regime, only the VAT returns are filed quarterly, with one tax return covering his trading and property income, along with any claims such as for Gift Aid, pension contributions etc. Under MTD, the taxpayer will need to file quarterly updates for VAT, his trade, and his property rental business – the worst case scenario effectively resulting in an update for one purpose or another being required every month, as well as an end of year declaration / final submission by the following 31 January. Whilst it might be possible to align some of these deadlines, many taxpayers will be faced with a multitude of deadlines for different purposes.

[6] Para. 1.5 https://www.gov.uk/government/publications/your-charter/your-charter#A5
[7] p11 - https://www.gov.uk/government/publications/making-tax-digital

Trading business - accounting year ending 31 July
Property rental business - year ended 5 April (by law)
VAT return quarter ends February, May, August, November