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Economic Affairs Committee

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Draft Finance Bill 2017: Making Tax Digital for Business

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Select Committee on Economic Affairs Finance Bill Sub-Committee

The Economic Affairs Committee Finance Bill Sub-Committee was appointed by the House of Lords in this session “to consider the draft Finance Bill 2016”.

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<u>Lord Burns</u>	<u>Lord Livermore</u>
<u>Lord Darling of Roulanish</u>	<u>Lord Sharkey</u>
<u>Lord Forsyth of Drumlean</u>	<u>Lord Tugendhat</u>
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<u>Baroness Bowles of Berkhamsted</u>	<u>Lord Tugendhat</u>
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<u>Baroness Kingsmill</u>	

Declaration of interests

See Appendix 1.

A full list of Members’ interests can be found in the Register of Lords’ Interests:

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Evidence is published online at <http://www.parliament.uk/finance-bill-2017-sub-committee> and available for inspection at the Parliamentary Archives (020 7219 3074).

Q in footnotes refers to a question in oral evidence.

SUMMARY

The Government proposes that 1.6 million companies, 2.4 million self-employed individuals, 900,000 residential landlords will be required to make their tax digital.¹ Businesses that previously gave a box of receipts once a year to their accountant; sectors with seasonal or erratic incomes; rural businesses with poor internet connections; and ‘accidental’ residential landlords will all be required to interact with the tax authorities in a fundamentally different way.

Under the Government’s proposals, from April 2018 the current system of annual self-assessment will be replaced with mandatory digital record keeping which will require businesses to:

- keep their tax records digitally using software compatible with HMRC systems and capable of making submissions to HMRC. The software, including any free applications or programmes, will be provided by private companies;
- submit basic information on their income and expenses quarterly to HMRC using this software; and
- prepare and confirm an annual statement via the digital system.

The digitalisation of tax administration in a way that assists taxpayers is an objective to be welcomed. Where the Government is wrong is not in the principle but in the transitional arrangements, the treatment of the digitally disadvantaged, and the threshold for inclusion.

These changes have caused anxiety and disquiet among those affected. They coincide with other changes to small business taxation such as to business rates.

By announcing a 12 month delay in the mandating of the scheme for the smallest businesses, the Chancellor appears to acknowledge some of this concern. However this delay does not go far enough. It does not address the concerns we heard in evidence about the scheme’s underlying evidence base, design, piloting, roll out, and scope.

To ensure the effective implementation and operation of these plans we recommend four changes.

- (1) The Government must revise and improve its assessment of the benefits and costs of the new scheme. The Government’s estimates of the ‘tax gap’ savings are fragile and not based on adequate evidence. The assertion that the scheme will initially cost businesses £280 does not reflect the reality of small business operations and the initial expenses businesses will incur.
- (2) The Government should make keeping digital records and quarterly reporting optional for businesses with a turnover below the VAT threshold. The case for making it compulsory for smaller business has not been made. There is no evidence that these requirements will reduce taxpayer error: it does not follow that more frequently

¹ HMRC, *Making Tax Digital for Business*, 8 March 2017: <https://www.gov.uk/government/publications/making-tax-digital-for-business/making-tax-digital-for-business>. In addition over 400,000 ordinary partnerships, and about 600,000 businesses with income from different sources will be affected.

recorded information is more accurate information. The quarterly reports will impose an unnecessary burden on businesses, but will be of limited use in forecasting their tax liabilities.

- (3) The Government should delay the launch of the scheme until 2020. Crucial to the success of Making Tax Digital will be the software and apps. As currently planned the pilot of the software will begin in April 2017. This leaves insufficient time for the pilot to cover a full tax year, for any review of its findings, or further consultation before the full scheme launches.

This delay will also allow the Government to test the underlying behavioural assumptions; to raise awareness of the scheme amongst sectors who remain unaware of the forthcoming changes; and put in place support systems for those who are digitally excluded. The latter are vital: HMRC's own research reveals that 61 per cent of the self-employed (which may be up to two million people) are either unable to, or require assistance, to interact with Government online.

- (4) Finally, the government should look again at the enormous variety of businesses and should examine whether certain kinds of business, such as those with seasonal or highly irregular income, should be outside the scheme.

When the Chancellor first announced this scheme in 2015 its purpose was to "make tax easier".² For many businesses the Making Tax Digital proposals no longer achieve this and will instead make taxation more burdensome. Our recommendations will help the Government bring the scheme back to its original aims.

² HMRC, *Making tax easier: the end of the tax return*, March 2015: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/413975/making-tax-easier.pdf, [accessed March 2017]

Draft Finance Bill 2017: Making Tax Digital for Business

CHAPTER 1: INTRODUCTION

1. This is the twelfth report in a series which began in 2003 when the House of Lords Select Committee on Economic Affairs first appointed a Sub-Committee to inquire into selected aspects of that year's Finance Bill. The Finance Bill Sub-Committee's inquiries address technical issues of tax administration, clarification and simplification, rather than rates or incidence of tax.
2. This year the Sub-Committee decided to concentrate its inquiry on the provisions required to establish the new mandatory digital tax regime for businesses which, starting from April 2018, is to replace annual tax returns with digital tax accounts and to require digital reporting by most businesses and private landlords. The new system is generally referred to as 'Making Tax Digital' (MTD).
3. Although the draft Finance Bill 2017 was published on 5 December 2016, it did not contain any of the draft legislation to put Making Tax Digital in place. A limited number of the draft clauses were published on 31 January 2017 with the majority being deferred until the publication of the Finance Bill which is expected to be on 20 March 2017.
4. The Economic Affairs Committee usually publishes the report drawn up by its Sub-Committee on the draft Finance Bill before the Budget and the publication of the Finance Bill itself. However, the delays in publication of the legislation meant that the Sub-Committee's inquiry could not begin until 6 February 2017 and that, consequently, its Report could not be published at the usual time.
5. As in previous years, the Sub-Committee conducted its inquiry by taking written and oral evidence from stakeholders, as well as from HM Treasury and HM Revenue and Customs (HMRC) and the Office of Tax Simplification (OTS). This year the Sub-Committee received a high number of submissions from small businesses, individuals and accountancy practitioners. This reflects the level of concern about the proposed changes. Those who have contributed to the inquiry in this way are listed in Appendix 2. The Sub-Committee would like to thank all those who have contributed to its work.
6. Chapters 2 and 3 of this report briefly cover the development of the MTD proposals. Subsequent chapters set out the Sub-Committee's findings on the evidence supporting the case for the proposals and their impact on those taxpayers affected by them (Chapter 4), the readiness of the various stakeholders and the support they would require (Chapter 5), and the proposed pilot and robustness of the proposed timetable (Chapter 6). The final chapters consider the adequacy of the associated tax simplifications (Chapter 7), and the quality of the consultative process when measured against the tenets of the 'new' approach to tax policy-making (Chapter 8).

CHAPTER 2: DEVELOPMENT OF MAKING TAX DIGITAL

Initial announcements

7. The Government's intention to replace self-assessment tax returns with digital tax accounts by 2020 was first set out in *Making tax easier: The end of the tax return*, published with the March 2015 Budget³. Further details were outlined in the 2015 Autumn Statement, which included a roadmap with a timetable for consultations from early 2016, and for the various changes envisaged by 2020.⁴
8. The proposed changes included:
 - (1) establishing a digital tax account for each taxpayer, showing income information from employers, pension providers and other third parties and enabling the taxpayer to report any additional income as it arises;
 - (2) making more frequent adjustments to PAYE codes to collect tax due more accurately than at present and, where outstanding tax cannot be collected through PAYE, enabling taxpayers to settle their liabilities as they appear on their digital tax accounts; and
 - (3) requiring businesses (both self-employed and incorporated) to use digital tools to keep records of income and expenditure and send updates to HMRC every quarter, as well as completing an annual statement and calculation of tax liabilities as they do now.
9. This report is concerned with this third set of changes. The first two are already being implemented in stages in HMRC's systems. The 2015 Autumn Statement estimated that these changes would help to reduce the tax gap,⁵ contributing an additional £920 million to the Exchequer by 2020–21.⁶ The basis for these and later figures is discussed in Chapter 4.

Finance Act 2016

10. The Finance Act 2016 took the first steps towards the new system by introducing a new provision to enable HMRC "to issue an assessment (a simple assessment) to individuals with straightforward tax affairs where HMRC already have all the information needed to calculate their tax position without the need for them to complete a return."⁷
11. This Sub-Committee's inquiry into the draft Finance Bill 2016 covered the draft legislation introducing simple assessments and commented on the longer-term transition to digital tax accounts. It recommended that the forthcoming consultations should include:

3 HMRC, *Making tax easier: the end of the tax return*, March 2015: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/413975/making-tax-easier.pdf [accessed March 2017]

4 HM Treasury, *Spending Review and Autumn Statement 2015*, Cm 9162, November 2015: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/479749/52229_Blue_Book_PU1865_Web_Accessible.pdf [accessed March 2017]

5 The tax gap is the difference between the amount of tax that should, in theory, be collected by HMRC, and what is actually collected.

6 HM Treasury, *Spending Review and Autumn Statement 2015*

7 Finance Act 2016, [Clause 155 and Schedule 23](#); Finance Bill 2016, *Explanatory Notes*, March 2016, para 19: <https://www.gov.uk/government/publications/finance-bill-2016-legislation-and-explanatory-notes> [accessed March 2017]

“a full assessment of the impact of the ‘Making Tax Digital’ proposals, including any new reporting requirements and compliance costs, on smaller businesses. This should address the significant concerns raised with us by business representatives, particularly the proposed quarterly reporting and the associated possibility of quarterly payments, and include any evidence to support the Government’s claims that digital record keeping will yield business benefits; ... and a detailed outline of HMRC’s plans to educate and support taxpayers, particularly those not acquainted with, or without access to, new technologies, through the transition to and in the early years of the new system.”⁸

August 2016 Consultation

12. A major consultation exercise was originally scheduled to start in Spring 2016 but it did not begin until 15 August 2016 with the publication of six documents containing over 250 pages of proposals and related material.⁹
13. These documents outlined the Government’s proposals:
 - (a) on how the new mandatory obligations to keep records in digital form and to update HMRC at least quarterly would work, and how they would interact with an end-of-year statement to finalise the taxpayer’s tax liability;
 - (b) on who these obligations would apply to, initially unincorporated businesses and private landlords with an annual income above £10,000 who were not covered by proposed exemptions for those classified as ‘digitally excluded’; and
 - (c) on the timetable for their introduction: April 2018 for income tax and national insurance obligations; April 2019 for VAT obligations; 2020 for corporation tax obligations.
14. The many points on which HMRC sought views included:
 - (a) whether the low income threshold was correctly set at £10,000, on possible exemptions for charities and other non-profit organisations and on deferring the initial mandate of the digital record-keeping and quarterly reporting requirements for small businesses and landlords with an annual income above £10,000 but below some specified other limit;
 - (b) a new points-based penalty regime to apply to the new system;
 - (c) allowing more businesses to account for tax on the ‘cash basis’¹⁰ and various other potential simplification measures; and
 - (d) a voluntary ‘pay as you go’ scheme for settling tax liabilities in-year.

8 Economic Affairs Committee, *The Draft Finance Bill 2016* (2nd Report, Session 2015–16, HL Paper 108) para 184

9 HMRC, *Making Tax Digital: Consultations*, 15 August 2016: <https://www.gov.uk/government/collections/making-tax-digital-consultations> [accessed March 2017]. The individual consultations were: (1) Making Tax Digital: Bringing business tax into the digital age; (2) Business Income Tax: Simplifying tax for unincorporated businesses; (3) Business Income Tax: Simplified cash basis for unincorporated property businesses; (4) Making Tax Digital: Voluntary pay as you go; (5) Making Tax Digital: Tax administration; and (6) Making Tax Digital: Transforming the tax system through the better use of information.

10 The cash basis of accounts is explained in Chapter 7.

15. The documents also revised the estimated Exchequer impact to £945 million by 2020–21. They included an initial partial assessment¹¹ of the ongoing impact of the MTD proposals on small businesses (incorporated and unincorporated) employing fewer than 20 employees based on modelling two alternative scenarios. They produced estimates of steady-state administrative savings amounting to £85 million and £250 million respectively, and HMRC invited help from stakeholders in refining those estimates and gauging the transitional costs to businesses.¹²
16. The consultation closed on 7 November 2016 by which time HMRC had received 618 written responses, 1200 completed survey questionnaires and held various public consultation events, including ‘roundtables’ and ‘webinars’ which attracted over 2000 participants.¹³ The Government cited the high volume of responses as the reason it was unable to announce decisions and publish draft legislation with the draft Finance Bill 2017 on 5 December 2016.¹⁴

Treasury Committee Report

17. The House of Commons Treasury Committee heard evidence on the MTD proposals as part of a wider inquiry entitled *Shifting Sands: an inquiry into UK tax policy and the tax base* launched in February 2016. The Committee’s conclusions supported the broad principles of the MTD proposals, but challenged:
 - (a) their suggested cost impact on businesses and their tax gap benefits to the Exchequer, arguing that the former had been underestimated and the latter overestimated;
 - (b) the timetable for implementing the changes, suggesting delaying a start until at least 2019/20 to give businesses, accountants, software houses and HMRC more time to prepare for its introduction; and
 - (c) both the proposed general mandate of digital record-keeping and quarterly reporting, and the scope of the proposed exemptions, particularly the £10,000 low income threshold which it suggested aligning with the current £83,000 VAT registration threshold.¹⁵
18. The Report recommended:
 - (a) a comprehensive, large-scale pilot to inform plans for implementing the new system;¹⁶ and

11 HMRC, *Making Tax Digital: Consultations*, 15 August 2016: <https://www.gov.uk/government/collections/making-tax-digital-consultations> [accessed March 2017]

12 *Ibid.*

13 HMRC, *Making Tax Digital: Bringing business tax into the digital age, summary of consultation responses*, 31 January 2017: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/587433/Making_Tax_Digital_-_Bringing_business_tax_into_the_digital_age_-_Summary_of_responses.pdf [accessed March 2017]

14 HM Treasury, *Autumn Statement 2016*, Cm 9362, November 2016: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/571559/autumn_statement_2016_web.pdf [accessed March 2017]

15 Treasury Committee, *Making Tax Digital* (Tenth Report, Session 2016–17, HC 927)

16 *Ibid.*

- (b) the promotion of “a fully functioning market in appropriate software ... to include adequate free software for smaller and less complex businesses”.¹⁷
19. Following the publication of the Treasury Committee report, the House of Lords Select Committee on Economic Affairs concluded that an inquiry into the Government’s response to the consultation and the expected draft legislation (including simplification and administrative measures) could make a further contribution to the public debate on the proposed changes. The Finance Bill Sub-Committee’s Call for Evidence was published on 17 January 2017.

17 *Ibid.*

CHAPTER 3: GOVERNMENT'S RESPONSE TO THE MAKING TAX DIGITAL CONSULTATION

20. The Government's response to the comments HMRC received as part of the public consultation on the MTD proposals was published on 31 January 2017.¹⁸ It confirmed the main elements of the policy package announced in the 2015 Autumn Statement and amended some of the proposals put forward in August 2016. It also revised official estimates of the impact of the proposed package on Exchequer receipts and on business costs and published a very limited amount of the draft legislation necessary to put in place the new system. These estimates were further revised in the Spring Budget.¹⁹
21. HMRC adopted the term 'Making Tax Digital for Business' (MTDfB) in its publication, to describe the proposals that would apply to unincorporated businesses, the first to enter the new regime. Both the abbreviations MTD and MTDfB are used in the remainder of this report as appropriate.
22. In his Spring Budget on 8 March 2017, the Chancellor announced a deferral for businesses with turnover below the VAT threshold, currently £83,000,²⁰ from entry to the MTD mandatory digital record-keeping and quarterly reporting regime.²¹ Although this deferral was announced after all the evidence on which this report is based was received, it has been incorporated into the report commentary below.

Main policy decisions

23. The Government has confirmed that MTDfB will:
 - (a) include mandating all businesses within its ambit to keep their records in digital form and to update HMRC with income and expenditure information every quarter;
 - (b) apply to all businesses and private landlords whose annual income exceeded a specified limit (currently £10,000) and which did not fall into an exempt category (see paragraph 27 below); and
 - (c) begin in April 2018, applying first to income tax for businesses and landlords with turnover over the VAT threshold, followed in April 2019 by income tax for smaller businesses and landlords, and VAT. Corporation tax would be included from April 2020.

Operational policy decisions

24. The Government also confirmed that HMRC will not provide MTDfB-compliant free apps or software. Instead it will ensure that the computer software industry provided such products with the capacity to cater for the needs of the most straightforward small businesses.²²

18 HMRC Guidance, *Bringing Business Tax into the Digital Age: legislation overview*, 31 January 2017: <https://www.gov.uk/government/publications/bringing-business-tax-into-the-digital-age-legislation-overview/bringing-business-tax-into-the-digital-age-legislation-overview> [accessed March 2017]

19 HMRC, *Policy Paper, Overview of Making Tax Digital*, 8 March 2017: <https://www.gov.uk/government/publications/making-tax-digital/overview-of-making-tax-digital> [accessed March 2017]

20 The VAT registration threshold is generally revalorized annually in line with the Retail Prices Index, and will rise to £85,000 from 1 April 2017.

21 HM Treasury, *Spring Budget 2017*, HC 1025, March 2017: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/597467/spring_budget_2017_web.pdf [accessed March 2017]

22 Discussed in detail at Chapter 7.

25. HMRC will start piloting the new system from April 2017.²³ The proposed pilot, discussed in Chapter 6, goes some of the way towards one of the recommendations in the Treasury Committee report mentioned earlier.

Outstanding decisions

26. HMRC confirmed after the Spring Budget that the low income threshold, currently proposed at £10,000, below which businesses are exempted from MTDfB obligations, is still under review.

Relaxations and deferrals

27. The Government's response proposed some respite for those regarded as "unable to engage digitally". It also introduced a number of helpful easements to the original proposals, including agreeing that:

- the digital record-keeping and quarterly-reporting requirements could be met by transmitting spreadsheet data to an MTD compliant app (although the precise technical details of this link have yet to be determined);
- those businesses (with turnover up to £15,000 per year) currently permitted to submit three-line accounts could use similar data for their quarterly submission;
- the cash basis for calculating trading profits would be extended to businesses with a turnover up to £150,000 including property businesses;
- various other flexibilities, including that copies of receipts and invoices would not need to be stored digitally, should be permitted; and
- the application of the new rules to larger partnerships should be deferred until 2020.

28. The Government also announced further consultation concerning:
- (a) the penalty regime to apply to failure to comply with the requirements of MTD;
 - (b) changes to the current basis period rules for allocating business profits to tax years; and
 - (c) the introduction of any pay-as-you-go arrangements.

Impact on Exchequer and businesses

29. The documents published on 31 January also contained official estimates of the Exchequer yield from MTD tax gap reductions for an additional year, 2021/22. The profile of receipts was revised to reflect the deferral announcement in the 2017 Spring Budget but the overall expected Exchequer gain remains at nearly £2 billion over the period.

23 HMRC, *Making Tax Digital: Bringing business tax into the digital age, summary of consultation responses*, 31 January 2017: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/587433/Making_Tax_Digital_-_Bringing_business_tax_into_the_digital_age_-_Summary_of_responses.pdf [accessed March 2017]

30. Drawing partly on responses to the consultation questions, HMRC also presented, for the first time, estimates of the costs borne by businesses in transitioning to MTD and revised their estimates of the subsequent ongoing costs and benefits to businesses affected by the changes.²⁴

Draft legislation

31. As mentioned above, only a small proportion of the legislation necessary to establish the new MTD system was published on 31 January. This covered the simplification of the cash basis rules for capital expenditure (three pages) and extension of the cash basis rules to property businesses (18 pages) as well as some draft clauses providing enabling powers for regulations to be published later (seven pages).²⁵
32. Legislation covering remaining aspects of the scheme is expected to be included in the Finance Bill 2017 when published, along with the draft regulations enabled by that legislation.²⁶
33. The paucity of draft legislation available in January and February has limited both the scope of this inquiry and the scope for proper Parliamentary scrutiny since much of the detail is in secondary legislation.²⁷
34. **We welcome the Government’s announcement in the Spring Budget that the scheme would not apply to businesses with a turnover below the VAT threshold until April 2019. However, this deferral does not go far enough. We also welcome the amendments, announced in January, to the original proposals and the Government’s decision to consult further on the penalty regime appropriate to MTD, on the proposed pay-as-you-go arrangements and on further exemptions and tax simplification measures.**

24 The robustness of both the Exchequer gain and the business impact estimates is discussed further in Chapter 4.

25 Most of these draft clauses are considered in Chapter 7 on the simplifications introduced alongside MTDFB.

26 HMRC, *Policy Paper, Overview of Making Tax Digital*, 8 March 2017: <https://www.gov.uk/government/publications/making-tax-digital/overview-of-making-tax-digital> [accessed March 2017]

27 These issues are discussed further in Chapter 8 on the consultative process applied to the MTDFB proposals.

CHAPTER 4: ASSESSING THE CASE FOR MAKING TAX DIGITAL

35. The Government’s broad aspiration to encourage the use of digital tools when interacting with government departments and agencies was welcomed by all those submitting evidence to the inquiry.²⁸
36. Speaking for the Administrative Burdens Advisory Board (ABAB), Roger Southam captured the tone of many representations saying that he was “fully supportive” of MTD. He wanted to work with HMRC to ensure “the best possible outcome”.²⁹ Rebecca Benneyworth, Chair of the HMRC Digital Advisory Board, reflected the tax agents’ perspective in saying that they would be happy “when all their clients are using digital records to the extent of their capabilities”. Ms Benneyworth thought that overall HMRC were “absolutely doing the right thing.”³⁰
37. **The Government is right to modernise HMRC systems and seek efficiencies for taxpayers through the use of new technologies, but the digitally excluded, and less capable, should be properly catered for.**
38. Where the evidence we received parted company with the Government’s narrative was in its assessment of (a) the MTD project’s impact on Exchequer receipts and on the costs and benefits accruing to the businesses affected; (b) the extent to which those businesses are ready to take on the new obligations proposed; and (c) the timetable for implementation. Chapters 4, 5 and 6 consider each of these areas in turn.

Reducing the tax gap: the Exchequer case for Making Tax Digital

39. The proposals for MTD were explained in Chapters 2 and 3 above. Jim Harra, giving evidence on behalf of HMRC, put the case for MTD, and its implementation sequence, most succinctly when he said:

“the prime reason for introducing making tax digital is to close part of the tax gap, which is mainly the small business error and carelessness gap.”³¹

Basis for HMRC’s estimates of tax gap reductions

40. HMRC’s case appears to rest on three propositions:
- (1) that a substantial proportion of the ‘tax gap’—the difference between the amount of tax that should, in theory, be collected by HMRC, and what is actually collected—stems from taxpayer errors, or a failure to take due care, when completing tax returns;³²
 - (2) that a disproportionate amount of such errors are committed by smaller businesses,³³ and

28 This was also the case for witnesses giving evidence to the House of Commons Treasury Committee Treasury Committee, *Making Tax Digital* (Tenth Report, Session 2016–17, HC 927), paras 21–29

29 [Q 35](#) (Roger Southam)

30 [Q 21](#) (Rebecca Benneyworth)

31 [Q 47](#) (Jim Harra)

32 Written evidence from HM Treasury and HMRC ([FBS0065](#))

33 *Ibid*; see also [Q 49](#) (Jim Harra)

- (3) that requiring such businesses to keep digital records, on a timely basis, proven by making quarterly updates, will improve the quality of the information submitted to HMRC, thus reducing the annual loss of tax due to error and a failure to take due care.
41. According to HMRC's latest estimates, the total tax gap amounts to £36 billion or 6.5 per cent of total direct and indirect tax liabilities.³⁴ Professor Richard Murphy challenged HMRC's methodology, arguing that the figure is an underestimate.³⁵ For the purposes of this report we use HMRC's estimates of the overall gap.³⁶
42. On the first two propositions, Mr Harra of HMRC stated £8.7 billion of the tax gap stemmed from "error and carelessness". £5 billion of this figure "related to small businesses".³⁷ He pointed out that:
- "when you extrapolate forward both the growth in businesses and the growth in tax revenues it will probably go up to about £8 billion in the next few years. That is the scale of the error and carelessness gap that this solution is intended to reduce."³⁸
43. On the third proposition, Theresa Middleton, also representing HMRC, claimed, "there is £8 billion of error and failure to take reasonable care to go after in this [SME business] territory." She explained that the new taxpayer obligations introduced by MTD would, over time, reduce the tax gap due to error and carelessness by about 10 per cent through largely straightforward things including software that "designs out" basic arithmetical errors made by many small businesses.³⁹
44. On the basis of this analysis, HMRC estimates that the introduction of MTD would reduce the tax gap by £10 million in 2018/19, £400 million in 2019/20, £805 million in 2020/21, and about £1 billion per year thereafter.⁴⁰ These figures cover not only income tax effects, but also VAT and corporation tax to which MTD is planned to apply from April 2019 and 2020 respectively. It is also important to note that, in contrast to previous better record-keeping initiatives undertaken by it, HMRC regard the behavioural changes, and therefore the tax gap reductions resulting from them, as permanent.⁴¹
45. HMRC's estimates of the role of small business errors and carelessness in the total tax gap and of the likely reductions MTD might bring are based largely

34 HMRC, *Measuring Tax Gaps 2016 edition: Tax Gap estimates for 2014–15*, October 2016: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/561312/HMRC-measuring-tax-gaps-2016.pdf [accessed March 2017]

35 Prof Richard Murphy, *The Tax Gap: Tax evasion in 2014 and what can be done about it*, 2014: <http://www.taxresearch.org.uk/Documents/PCSTaxGap2014Full.pdf> [accessed March 2017]

36 HMRC defended their tax gap estimates: "they are produced in accordance with the Code of Practice for Official Statistics, which assures objectivity and integrity. The methodology is judged by independent third parties to be robust, having been intensively reviewed by the International Monetary Fund and scrutinized by the National Audit Office." Written evidence from HM Treasury and HMRC (FBS0065)

37 Q 48 (Jim Harra). This is across all taxes for all small and medium-sized enterprises (SMEs). The tax gap statistics use the EU definition of SME; businesses with up to 250 employees and either a balance sheet total of up to €43 million or turnover of up to €50 million.

38 *Ibid*; see also HMRC, *Policy Paper, Overview of Making Tax Digital*, 8 March 2017: <https://www.gov.uk/government/publications/making-tax-digital/overview-of-making-tax-digital> [accessed March 2017]

39 Q 55 (Theresa Middleton)

40 HMRC, *Policy Paper, Overview of Making Tax Digital*, 8 March 2017: <https://www.gov.uk/government/publications/making-tax-digital/overview-of-making-tax-digital> [accessed March 2017]

41 Q 52 (Jim Harra)

on analysis of its annual random sample of self-assessment tax returns and on the conclusions of experienced tax compliance experts “looking at the range of errors that were there and asking whether those errors lent themselves to being reduced by these proposals”.⁴²

Evidence from stakeholders

46. Most of the evidence submitted to the inquiry challenged HMRC’s analysis of the behavioural effects of the measures arguing that the estimated tax gap reductions would either never materialise in full or might even go the other way.⁴³ The Association of Chartered Certified Accountants (ACCA) spoke for many commentators in calling for greater clarity on how HMRC’s figures were arrived at, claiming that:
- “the model overestimated the level of inaccuracy in small traders’ initial record keeping, and underestimated the role played by advisers in ‘tidying’ records at year end”.⁴⁴
47. Some argued that, to the extent that record-keeping would improve, the result would not necessarily be in the Exchequer’s favour. Tina Riches of Smith and Williamson remarked that with smaller businesses she found “that when there are errors they go both ways ... If anything, we tend to find that the errors are in HMRC’s favour.”⁴⁵ Other submissions agreed that the impact could be asymmetrical, have more effect on the recording of expenses than income.⁴⁶
48. The Chartered Institute of Taxation (CIOT) commented that they were not convinced that MTD would help close the tax gap because “businesses will make mistakes, both during the transition, and thereafter.”⁴⁷ A survey of their members indicated that 41 per cent of them thought the changes would have little impact on the level of client errors and nearly 40 per cent considered that they would increase errors.⁴⁸ The Association of Accounting Technicians (AAT) was concerned that “time consuming and costly quarterly reporting requirements would result in businesses turning to the black economy.”⁴⁹
49. Professor Murphy was particularly critical about the impact of the quarterly update requirement considering it would “increase the error rate”. He pointed out:
- “People who are forced to prepare accounts in a short period of time tend to make a lot more errors than people who have a little more time to get the thing right ... there will be an inclination ... for people simply to dump in estimates to meet a deadline for submission when there is a penalty attached to it.”⁵⁰
50. HMRC’s response to these criticisms was that adjustments had been made in their estimates to take account of the various behavioural responses raised by critics and that its analysis suggested that a drift of small businesses to

42 [Q 55](#) (Theresa Middleton)

43 Professor Murphy challenged all three of these propositions in his evidence.

44 Written evidence from Association of Chartered Certified Accountants ([FBS0029](#))

45 [Q 10](#) (Tina Riches)

46 Written evidence from James Smith (accountant) Ltd ([FBS0006](#))

47 Written evidence from Chartered Institute of Taxation ([FBS0023](#))

48 *Ibid.*

49 Written evidence from Association of Accounting Technicians ([FBS0004](#))

50 [Q 2](#) (Prof Richard Murphy)

the hidden economy was unlikely.⁵¹ It emphasised that its methodology had withstood “rigorous scrutiny” from the OBR and that it was “confident that its estimates have a sound foundation, focus on relevant behaviours, and are prudent in what they are saying”.⁵²

51. In their evidence on the tax gap, HMRC also highlighted their finding that around 31 per cent of small businesses under-declared their self-assessment tax liabilities.⁵³ No detailed information is provided on how this is split across businesses of different sizes, but it states that approximately 20 per cent is attributable to businesses with annual turnover under £15,000; 60 per cent to businesses between £15,000 and the VAT threshold; and 20 per cent to businesses over that threshold.⁵⁴
52. In response to a challenge that the policy costing for MTD had been assigned a ‘high’ uncertainty rating by the OBR, Lucy Pink, for HM Treasury, replied that this was “pretty standard for what [the OBR] says about a number of HMRC operational measures”.⁵⁵
53. **We do not share the confidence of HM Treasury and HMRC in their estimates of the tax gap reductions from the introduction of MTD from April 2018. On the evidence presented to us, those estimates appear very fragile and little more than guess work. They rely heavily on the untested proposition that sufficient numbers of taxpayers currently making errors will provide HMRC with correct information as a result of adopting digital record-keeping and quarterly reporting and that on balance changes would be in HMRC’s favour. At this stage we regard those estimated tax gap reductions, the main drivers for the mandating the new obligations, as not yet proven.**
54. **The Government is proposing to impose new obligations on the majority of businesses and landlords in order to resolve errors attributable to less than one third of that taxpayer population.**
55. **We recommend that, before implementing MTDfB, HMRC revisits and tests thoroughly, as part of its pilot, the behavioural assumptions underlying its estimated tax gap reductions to take into account the evidence suggesting that taxpayers may in fact respond in ways that invalidate those estimates.**

Administrative costs and benefits for HMRC

56. Aside from the potential Exchequer benefits outlined in above, it is hard to set out the case for MTD from the viewpoint of HMRC as a department. It is clear from Mr Harra’s evidence that the overall cost of the MTD programme is £227 million, which is part of the £1.3 billion that the Government invested in HMRC in the spending review.⁵⁶ However, it is not clear at this stage what activities that sum will cover except that “the main running cost will be in the support model, which we will work up in much more detail in the trial period”.⁵⁷

51 Supplementary written evidence from HM Treasury and HMRC ([FBS0066](#))

52 *Ibid*, para 115

53 Written evidence from HM Treasury and HMRC ([FBS0066](#))

54 Written evidence from HM Treasury and HMRC ([FBS0066](#))

55 [Q 47](#) (Lucy Pink)

56 [Q 56](#) (Jim Harra)

57 [Q 56](#) (Theresa Middleton)

57. HMRC confirmed that the quarterly updates would consist of raw income and expenditure data, not adjusted to reflect taxable profits. This means that the argument for them stems from their presumed benefits:
- (a) to HMRC and the Exchequer, from their role in ensuring compliance with digital record-keeping requirements so helping to reduce the tax gap;
 - (b) to businesses generally by encouraging more timely record-keeping; and
 - (c) to businesses with regular income and few adjustments, who will be able to see an updated estimate of their tax liability on their digital tax account. This may also support a future pay-as-you-go taxation system.
58. More surprisingly perhaps, apart from the use of quarterly updates as a means of ensuring that business records have been kept in digital form, there are no initial benefits to HMRC of mandating quarterly reporting and future uses are yet to be determined.⁵⁸
59. It is also surprising, given the international evidence on the efficiency savings from digitalisation projects in other tax administrations,⁵⁹ that Mr Harra explained that in HMRC's view MTD:

“will generate a very modest efficiency saving for HMRC of about £3 million a year. In practice it is not being done to generate cost efficiencies in the department; it is being done to reduce the tax gap. We do not expect the cost or saving in HMRC to be material.”⁶⁰

60. **At this stage, apart from a headline figure of £227 million allocated to HMRC over the current spending review period, the nature of any costs to or benefits for HMRC remains opaque. Full details of how HMRC intends to use the money allocated should be made available.**

HMRC's impact assessment

61. The Government's response on 31 January included a revised assessment of the impact of the MTD proposals on those businesses affected by them, building on information gathered as part of the HMRC consultation. This impact assessment attempted to quantify: (a) any costs to businesses of complying with the new digital record-keeping and quarterly update requirements, and the revised end-of-year process; and (b) any administrative savings and other benefits accruing to businesses from the use of digital tools and more timely reporting.⁶¹
62. The transitional costs HMRC considered included the purchase of new apps and software, the purchase or upgrading of any hardware, familiarisation time, and any additional accountancy and agent fees. HMRC estimated that, although there would be significant variations between businesses, the average one-off cost per business would amount to £280 in the year of transition.

58 Q 56 (Jim Harra)

59 Institute of Chartered Accountants of England and Wales, *Digitalisation of Tax: International perspectives*, 2016: <http://www.icaew.com/-/media/corporate/files/technical/digital-tax.ashx?la=en> [accessed March 2017]

60 Q 56 (Jim Harra)

61 Summarised in written evidence from HM Treasury and HMRC (FBS0065)

63. HMRC argue that, following transition to MTD, businesses in general would experience increases in ongoing compliance costs (in the form of time, agents or software costs) and ongoing administrative savings (from tasks made unnecessary by the digital tools). These costs and benefits are set out in the table below:

Table 1: HMRC estimated costs (£ million)

	2017– 2018	2018– 2019	2019– 2020	2020– 2021	2021– 2022	2022– 2023
Steady state costs		£50	£150	£170	£170	£170
Administrative burden savings			- £150	- £270	- £270	- £270
Transitional costs (one-off)	£100	£200	£590	£100		
Net impact	£100	£250	£590	£0	- £100	£ -100

Source: HMRC, *Policy Paper, Overview of Making Tax Digital*, 8 March 2017: <https://www.gov.uk/government/publications/making-tax-digital-for-business/making-tax-digital-for-business>

64. The profile of total costs per year reflects the fact that the transition to MTD will not be completed until 2020–21.⁶² They amount to a total transitional cost of nearly £1 billion. The steady-state costs suggest that, in aggregate, businesses affected will experience a net benefit of £100 million per year from 2021/22 onwards.⁶³
65. HMRC stress that these estimates are not final:

“Estimated costs depend on final software solutions, the availability of free software and individual providers’ pricing structures. The government recognises that this produces a broad estimate, and so we will review and test this analysis and our assumptions through ongoing extensive engagement and consultation with businesses, and through further research and analysis.”⁶⁴

Stakeholder evidence on revised impact assessment

66. Commenting on HMRC’s methodology, some criticised the Standard Cost Model (SCM) they used to gauge compliance costs. John Whiting of the OTS noted that the model used was devised and developed 20 years ago. The OTS was not “convinced that it is capturing all the data and costs.”⁶⁵
67. Mr Southam of the ABAB noted that his organisation had been trying to persuade HMRC to adopt a more stratified approach to costing business impacts, breaking figures down by business type, moving away from a “blanket assessment”.⁶⁶
68. More specifically, the evidence we received reflected widespread criticism, sometimes verging on disbelief, of most aspects of the HMRC impact assessment. The CIOT, for example, was “concerned that HMRC has both

62 HMRC, *Policy Paper, Overview of Making Tax Digital*, 8 March 2017: <https://www.gov.uk/government/publications/making-tax-digital/overview-of-making-tax-digital> [accessed March 2017]

63 *Ibid.*

64 *Ibid.*

65 [Q 10](#) (John Whiting)

66 [Q 37](#) (Roger Southam)

underestimated the costs to businesses, and overestimated the revenue benefits of the measures”.⁶⁷

69. Kevin Hart, representing the Business Applications Software Developers Association (BASDA), pointed out that if training is required, “£280 will disappear in a morning seminar.”⁶⁸
70. Mr Hart thought that the transitional cost would be at least double the £280 average HMRC suggested. Kevin Dady of the IRIS Software Group concurred.⁶⁹ Michael Steed of the Association of Tax Technicians went further, suggesting the cost could be three times HMRC’s estimate.⁷⁰
71. Similar reservations were expressed about the ongoing cost estimates. Commenting on assisting clients with quarterly reporting, Tina Riches of Smith and Williamson estimated this increased interaction could cost her clients £2,000 plus VAT per client, a year.⁷¹
72. Most witnesses found it hard to see how HMRC’s administrative savings estimates had been derived. The CIOT reported that, of a small sample of volunteer participants, “not one respondent estimated an ongoing saving from MTD”.⁷²
73. Quarterly updates were an area of particular concern to the National Union of Farmers (NFU), who noted that for more complex and seasonal businesses already making quarterly VAT returns, MTDfB could increase burdens.⁷³ Their understanding was that “where accounting periods for multiple trades or businesses do not align multiple Making Tax Digital updates will be required for each.”⁷⁴
74. HMRC’s response suggested such businesses would have the flexibility to change their reporting periods to reduce this impact, which appears to reinforce concerns that the approach to digitalisation adopted by HMRC was that businesses needed to adapt to their systems rather than the reverse.⁷⁵
75. The NFU also commented that for diversified, seasonal businesses, quarterly cash flow is not a reliable indicator of accruing tax liabilities, so the figures provided by a digital tax account update were unlikely to reflect the tax liability accruing.⁷⁶
76. More generally, and contrary to the HMRC view, these updates were seen as providing little or no administrative benefit to most businesses. For the Residential Landlords Association (RLA), Douglas Haig stressed that there were unlikely to be any savings for smaller landlords, but for landlords with

67 Written evidence from Chartered Institute of Taxation ([FBS0023](#)); see also written evidence from Federation of Small Businesses ([FBS0032](#)) and written evidence from UK200Group ([FBS0049](#))

68 [Q 17](#) (Kevin Hart)

69 [Q 17](#) (Kevin Dady)

70 [Q 22](#) (Michael Steed)

71 [Q 22](#) (Tina Riches); see also written evidence from Anstee Gorst Ltd ([FBS0050](#))

72 Written evidence from the Chartered Institute of Taxation ([FBS0023](#))

73 Written evidence from the National Union of Farmers ([FBS0012](#))

74 Written evidence from National Farmers Union ([FBS0055](#))

75 HMRC, *Making Tax Digital: Bringing business tax into the digital age, summary of consultation responses*, 31 January 2017: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/587433/Making_Tax_Digital_-_Bringing_business_tax_into_the_digital_age_-_Summary_of_responses.pdf [accessed March 2017]

76 Written evidence from the National Union of Farmers ([FBS0012](#))

15 to 20 properties there would be “some saving because people can analyse their costs much better ... and they can do much better planning overall.”⁷⁷

77. **The Government’s estimates of both the initial and the ongoing costs of complying with MTD requirements do not fully reflect the costs likely to be borne by a very diverse range of businesses and the differences between them. This is particularly true of the smallest and least digitally engaged businesses, many of whom will have to purchase both new hardware and new software.**
78. **For the smallest businesses and landlords, any benefits from moving to digital record keeping are likely to be very limited. Only those simpler businesses with regular flows of income are likely to realise the benefits claimed for quarterly reporting, namely the potential to have a clearer view of their tax liabilities.**
79. **Under HMRC’s own estimates of the costs and benefits accruing to businesses, it would take more than 10 years for businesses to recoup their aggregate initial outlay. We find it difficult to see the case, from a business viewpoint, for proceeding with the MTD proposals.**
80. **We recommend that before proceeding with the implementation of Making Tax Digital, HMRC extend its assessment of the business impact by carrying out and publishing a comprehensive analysis of that impact stratified by business type, size and initial digital capability, and explain what financial support is available to assist them.**
81. **HMRC has yet to take a final decision on the threshold for inclusion in the scheme. We recommend that below the VAT threshold, digital record keeping and quarterly reporting should not be made mandatory. HMRC may argue that this would leave a lot of tax uncollected. We do not find this plausible. What is at stake is how much extra tax would be collected simply by mandating record keeping and quarterly reports.**
82. **We recommend that the Government consider whether businesses with diverse and seasonal affairs, such as agricultural businesses, should be exempt from the quarterly reporting requirements.**

77 [Q 36](#) (Douglas Haig)

CHAPTER 5: TAXPAYER READINESS AND SUPPORT NEEDS

83. This chapter considers in turn the readiness of the essential stakeholder groups—the wide range of businesses affected, tax agents, software houses and HMRC itself—for the proposed introduction of MTDfB from April 2018. It covers progress in developing MTDfB software products and the support HMRC needs to provide to achieve successful implementation. Finally, it considers the issue of ‘digital exclusion’ of businesses and the draft legislation exempting such businesses from the obligations of MTDfB.

Business readiness

84. HMRC originally anticipated that the MTDfB provisions will apply to up to half of the UK’s 5.4m unincorporated businesses, after excluding those with turnover below £10,000.⁷⁸ Our evidence is that the readiness of those businesses for MTDfB varies considerably. It depends on their awareness of their new obligations, the extent to which they have the necessary IT and book-keeping skills currently to use software for keeping business records, whether they rely on an agent, and the availability of internet connectivity.
85. Businesses which are aware of the impending changes, have an appropriate internet connection and currently have the IT and book-keeping skill to use appropriate software, or use a tax agent, might be said to be ‘ready’ for MTDfB. Crunch Online Accountants, whose clients do perhaps have these characteristics, noted that:
- “for our clients we believe they will experience no difference in their accounting and tax tasks, our service will simply automatically update HMRC as and when required”⁷⁹
86. A sizeable proportion of businesses do not operate in that way at present. Mr Dady of IRIS reported from a survey of their tax agent clients that only 47 per cent of businesses that are their customers currently use any sort of book-keeping product.⁸⁰
87. A survey of Residential Landlords Association (RLA) members also found limited current use of software to keep business records, with 48 per cent using spreadsheets, 38 percent paper records and only 13 per cent use software. The RLA added that this reflects the “scale of challenge” HMRC face “in seeking to transfer unincorporated property businesses to MTD in the first tranche”.⁸¹
88. A key concern of many representing small businesses and business organisations was that taxpayers had so far received little or no information on the significant changes expected.⁸² We heard a great deal of evidence

78 HMRC and Jane Ellison MP, ‘Digital revolution for the tax system to cut red tape for British business’, 15 August 2016: <https://www.gov.uk/government/news/digital-revolution-for-the-tax-system-to-cut-red-tape-for-british-business> [accessed March 2017]

79 Written evidence from Crunch Online Accountants ([FBS0001](#))

80 [Q 12](#) (Kevin Dady)

81 Written evidence from the Residential Landlords Association ([FBS0063](#))

82 For example Huw Baker, ([FBS0033](#)) “taxpayers are blissfully unaware that this is coming and it will be a great shock to them”; Linda Cotterill, ([FBS0059](#)) “most of my clients have no idea of this immense change”; and Douglas Haig ([Q 44](#)). These repeated concerns raised in Autumn 2016 with the Treasury Committee which led to a recommendation in that Committee’s Report on Making Tax Digital. Treasury Committee, *Making Tax Digital* (Tenth Report, Session 2016–17, HC 927), paragraph 39

that, despite the Government's claims, there remain an enormous number of taxpayers who are still unaware of what is proposed.

89. A related issue for those using tax agents is their agent's awareness of MTDfB, given the key role HMRC appear to be expecting agents to play in preparing their clients. HMRC informed us that as of mid-February 2017 awareness amongst agents was considered to be high, but lower among businesses, which, according to HMRC, did not have to do anything at the moment.⁸³ In a survey undertaken by IRIS in late 2016, 98 per cent of agents said they did not feel HMRC had informed them well about MTDfB.⁸⁴
90. HMRC told us that they "plan to ramp up our communications once we are confident that the software and our systems are working effectively together".⁸⁵ HMRC's communications plan for businesses in MTDfB may not start until the last quarter of 2017 at the earliest.⁸⁶
91. A common concern in the evidence was that some smaller businesses did not have sufficient IT and book-keeping skills to make a successful transition to MTDfB. A number of those submitting evidence to us described how some businesses experienced considerable difficulties in converting to digital systems. Such submissions often cited a lack of time to invest in software training and a lack of understanding of book-keeping.⁸⁷
92. HMRC accepts that small and micro businesses might be more affected by digital capability issues and find it more difficult to move to the new digital requirements.⁸⁸ It is concerning that HMRC is placing so much reliance on the Ofcom evidence that 97 per cent of small and medium sized businesses have access to online services, and 66 per cent of adults have a smartphone.⁸⁹ The gap between owning hardware, perhaps only for social purposes, and correctly using business software on that hardware can be wide. As Ms Benneyworth put it, "lots of people use Facebook but they could not in a million years use accounting software".⁹⁰
93. **A significant proportion of small businesses do not appear to have the skills or digital capability necessary to comply with MTDfB. While business size and digital capability may not directly correlate, it is more likely that larger businesses will have already adopted digital tools for commercial purposes or VAT compliance so that they are readier to adapt to the new system.**

83 Summarised in written evidence from HM Treasury and HMRC (FBS0065)

84 IRIS, *Making Tax Digital: results of a survey undertaken by IRIS Software to gauge the views of the accounting profession January 2017*: <https://www.ukdigitaltax.com/resources/making-tax-digital-survey/> [accessed January 2017]

85 Written evidence from HM Treasury and HMRC (FBS0065)

86 However although the pilot starts in April 2017, some software will not be available for testing until October 2017.

87 Written evidence from the Association of Chartered Certified Accountants (FSB0029); see also Q 21 (Rebecca Benneyworth)

88 HMRC, *Policy Paper, Making Tax Digital for Business*, 31 January 2017: <https://www.gov.uk/government/publications/digital-reporting-and-record-keeping-for-business-income-tax/making-tax-digital-for-business> [accessed March 2017]

89 HMRC, *Making Tax Digital: Bringing business tax into the digital age*, August 2016, para 8.37: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/545715/Making_Tax_Digital-Bringing_business_tax_into_the_digital_age-consultation.pdf [accessed March 2017]

90 Q 21 (Rebecca Benneyworth)

94. **Levels of awareness of these significant changes to the tax system are very low, particularly amongst the population likely to be most impacted, smaller and less digitally capable businesses.**
95. **We recommend that HMRC urgently develops and publishes an effective, targeted plan for proactively informing businesses of their new obligations. HMRC should replace their current approach to communications with a comprehensive strategy to make taxpayers aware of the changes. This strategy should include a public awareness campaign led by HMRC using a wide variety of media, including more traditional approaches. It should aim to inform businesses of their new obligations.**

Agent readiness

96. We did not hear any evidence that the tax agent community would not be able to adapt to the requirements of MTDfB, although many were concerned about the amount of staff training time needed and about agent software license costs. Many small accountancy firms expressed concerns that the additional demands on their time, particularly in helping their smaller clients through the transition, would mean they would not have time to support all of their clients.⁹¹ Despite concerns the issue of limited agent capacity to assist businesses does not feature in HMRC's analysis.

Software industry readiness

97. The software industry clearly has a central role in the MTDfB proposals, both as the supplier of the required digital tools and as a major beneficiary. However, it too has concerns about its readiness for the impending changes because its own plans depend on the timing of HMRC decisions on software specifications. Mr Hart of BASDA told us that the industry is committed to meeting HMRC's timescale, but that is "very dependent on HMRC being able to deliver clarity of information and services."⁹² In addition, Sage observed that the specification for 'prompts' in MTDfB software, a key element expected to help reduce tax gap errors, was not yet available from HMRC.⁹³
98. Mr Dady from IRIS accepted that a "greater intensity" of dialogue both within the industry and with HMRC was needed to address these issues.⁹⁴

Free Software

99. HMRC has repeatedly asserted that the software industry will provide free software to the smallest and simplest businesses. It has recently clarified its expectations about the scope of this software, saying that it was primarily designed for unincorporated businesses with no employees, turnover below the VAT threshold, and able to use the cash basis of accounting.⁹⁵ Around 1 million businesses currently use the cash basis and, whilst some of them may be below the low income threshold, the potential population able to use this free software could be substantial.

91 For example AJ Carter and Company ([FBS0047](#)) and Breckman and Company ([FBS0039](#))

92 [Q 12](#) (Kevin Hart)

93 Written evidence from Sage Group PLC ([FBS0064](#)); 'prompts' are pop-up items which will ask taxpayers if they need to check details or provide links to explanatory information on the particular item, with the aim of reducing mistakes.

94 [Q 18](#) (Kevin Dady)

95 [Q 50](#) (Theresa Middleton)

100. Whilst free software may benefit many small businesses, it also reduces the size of the commercial market. The scope of any such free offering, and the number of software houses willing to provide it, is uncertain and outwith HMRC's control. To encourage industry participation, HMRC appears to have accepted that free software will be provided on a so-called "freemium" basis whereby basic services are provided free of charge while more advanced features must be paid for.
101. An alternative model that may be deployed is one where the software is provided free to the business but fees are charged to agents collecting the business's data and using the agent version of the software to update HMRC. There may also be pricing incentives for agents to encourage them, and by implication their clients, to use only that provider's products.⁹⁶
102. The software industry also expressed some concerns about any possible limitations on the extent of mandation because, by shrinking the size of the potential market, they would make investment in new product development riskier.⁹⁷ Mr Hart of BASDA summed up the challenge:
- "the degree and depth of functionality HMRC is looking for in freemium is almost identical to that of a paid-for product, so coming up with a commercial proposition is not the easiest of matters."⁹⁸
103. It is concerning that these matters were not resolved before HMRC decided unilaterally that free software should be provided by commercial suppliers.

The use of spreadsheets

104. HMRC conceded in January that the many businesses keeping records on spreadsheets could continue to do so, provided they used software or an app to convert the data to a format suitable for a digital submission. This concession may not be as helpful as it seems given the lack of available conversion software and the wide range of spreadsheets in use:
- "The use of spreadsheets and workbooks differ from business to business and person to person and this means it is very difficult to build programmes that can read and understand the data held within them. To enable Sage and other software providers to work with spreadsheets we would need some standardisation and some parameters."⁹⁹
105. **Software houses do not yet have the full specifications and details needed to finalise the development MTDfB compliant software and apps. This appears to be because HMRC have not yet finalised the technical details or system requirements.**
106. **Although free software is key to the successful implementation of MTDfB, it is not completely within HMRC's control and the practical usefulness and functionality of such products may be limited even for the simplest cases for which it is intended.**
107. **We recommend that HMRC confirms as soon as possible, and provides to software houses, the remaining specifications necessary**

96 [Q 33](#) (David Lyford-Smith)

97 [Q 16](#) (Kevin Dady)

98 [Q 14](#) (Kevin Hart)

99 Written evidence from Sage Group PLC ([FBS0064](#))

to proceed with the development and testing of the software and apps, whether free or paid for.

HMRC's readiness

108. HMRC has informed us their systems are currently undergoing testing for the pilot and are on track for delivery for April 2017. Ms Pink commented that “the Infrastructure and Projects Authority ... was called in to scrutinise the delivery and the timetable. It assured us that it was deliverable.”¹⁰⁰ Business Tax Accounts and Personal Tax Accounts which should collate businesses’ submissions have been available to taxpayers for some time, so while key elements of the necessary IT infrastructure are in place this capability must be demonstrated through the pilot phase.
109. The OBR in its Policy Costings document alongside the Spring Budget confirmed that “the latest information suggests that delivery remains on track for an April 2018 launch.”¹⁰¹

Business support needs

110. The readiness of HMRC to provide taxpayer support is less clear. HMRC announced that it would need “to develop a customer support model to help businesses that need their help with the transition” and that small businesses will need significant support to make the change.”¹⁰² Its own research report highlighted that:
- “in enabling and ensuring positive engagement with the MTDfB proposals, all businesses felt that the design of support, communications and the software would be crucial in ensuring businesses are reassured, enabled and transitioned to MTDfB easily.”¹⁰³
111. HMRC has so far offered few details of what it plans to do. In its August 2016 consultation document it suggested a multi-channel approach with little personal contact but gave no details. Its written evidence went no further than confirming that it would build and test its existing support model “within the live-testing environment to ensure that the right help is available in a range of ways and through a range of channels to ensure it meets the diverse needs of the business and agent populations.”¹⁰⁴
112. The evidence submitted to this inquiry stresses that support to businesses must include specific initiatives to address skills shortages. HMRC appears to have no plans to address the IT and book-keeping skills gap. It seems instead to be assuming that agents (for those who have them) and software

100 Q 49 (Lucy Pink)

101 Office for Budget Responsibility, *Spring Budget 2017: policy costings*, March 2017, para B22: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/597335/PU2055_Spring_Budget_2017_web_2.pdf [accessed March 2017]

102 HMRC, *Policy Paper, Making Tax Digital for Business*, 31 January 2017, para 2.5: <https://www.gov.uk/government/publications/digital-reporting-and-record-keeping-for-business-income-tax/making-tax-digital-for-business> [accessed March 2017]

103 HMRC Research Report 431, *Exploring Small Business and Agent attitudes and engagement with Making Tax Digital*, Jigsaw Research, February 2017: <https://www.gov.uk/government/publications/exploring-small-business-and-agent-attitudes-and-engagement-with-making-tax-digital> [accessed March 2017]

104 Written evidence from HM Treasury and HMRC (FBS0066)

providers will offer support, or that civil society organisations may have to be prepared for requests for assistance with MDTfB.¹⁰⁵

113. The Federation of Small Businesses noted the OTS’s recommendation that for MTDfB HMRC should consider a “one-stop-shop call-centre” and enable small businesses to engage “in a way that suits their business.”¹⁰⁶
114. The Treasury Committee Report also concluded that assistance with software selection would be essential. This was echoed in evidence submitted to us, along with the need for early publication of detailed guidance, and accessible support from HMRC. The Association of Convenience Stores (ACS) summary was typical:
- “Guidance and support for businesses on MTD should go beyond publishing a list of available software packages against the type of business they are aimed at. HMRC must be prepared to go cope with a high volume of queries, and advise accordingly.”¹⁰⁷
115. HMRC informed us that it only proposes “publishing a register on GOV.UK, confirming which applications are registered with HMRC and are MTDfB-compatible, along with details of the software, in good time for the start of MTDfB in 2018.”¹⁰⁸
116. Finally, in its August 2016 consultation, HMRC also suggested that financial support might be provided to businesses to assist with their transition and additional costs. An announcement on this was expected around the time of the Spring Budget 2017, but is still awaited.¹⁰⁹ Speaking for the Low Incomes Tax Reform Group (LITRG), Robin Williamson made the case for financial support particularly in relation to assistive technology for those with disabilities.¹¹⁰
117. More widely, in the Digital Economy Bill 2017 the Government plans to make training in basic digital skills free for adults lacking relevant qualifications.¹¹¹ The details of this training and the level of qualification to which the new duty will apply will be the subject of future consultation.¹¹²
118. **We welcome HMRC’s plans to verify and identify for businesses, those software products that will be MTDfB compliant and that they will be required to meet minimum performance and security standards. However, there is insufficient publicly available information on**

105 HMRC, *Policy Paper, Making Tax Digital for Business*, 31 January 2017: <https://www.gov.uk/government/publications/digital-reporting-and-record-keeping-for-business-income-tax/making-tax-digital-for-business> [accessed March 2017]

106 Written evidence from the Federation of Small Businesses ([FBS0032](#))

107 Association of Convenience Stores, *Submission to HMRC consultation, Making Tax Digital: Bringing Business Tax into the Digital Age*: <https://www.acs.org.uk/wp-content/uploads/2016/11/ACS-Submission-Making-Tax-Digital.pdf> [accessed March 2017]

108 HMRC *Bringing Business tax into the digital age: Summary of responses*, 31 January 2017, para 13: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/587433/Making_Tax_Digital_-_Bringing_business_tax_into_the_digital_age_-_Summary_of_responses.pdf [accessed March 2017]

109 HMRC, *Policy Paper, Making Tax Digital for Business*, 31 January 2017: <https://www.gov.uk/government/publications/digital-reporting-and-record-keeping-for-business-income-tax/making-tax-digital-for-business> [accessed March 2017]

110 [Q 10](#) (Robin Williamson)

111 [Digital Economy Bill](#), section 95 [HL Bill 102 (2016–17)]

112 [Explanatory Notes to the Digital Economy Bill](#) [HL Bill 80]

HMRC’s strategy and resources for providing support to different taxpayer groups, or to tax agents and software providers.

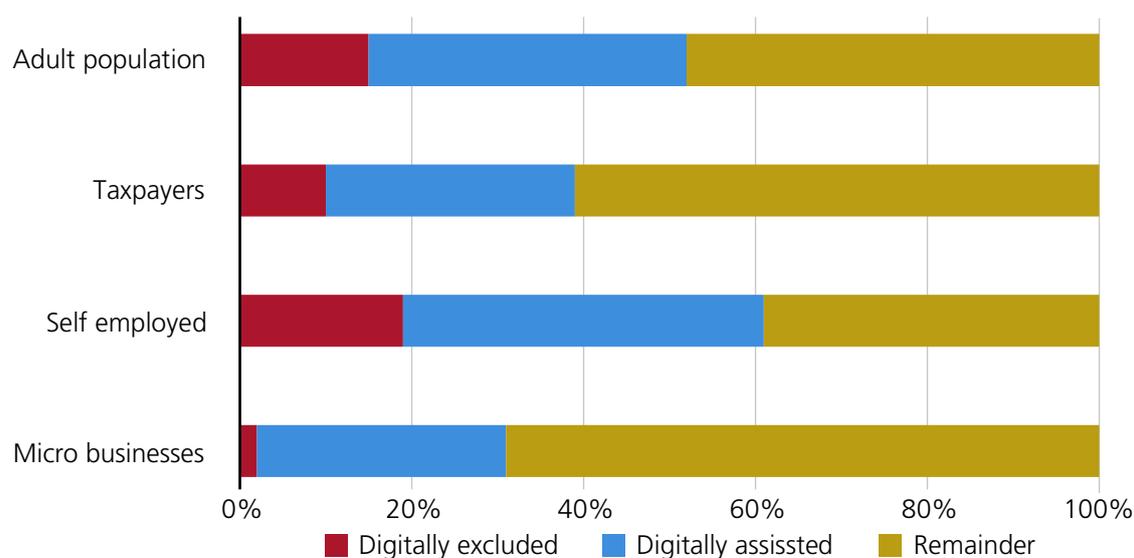
119. We recommend that HMRC urgently develops, and publicises:

- an updated assessment of the various types of support that different types of businesses are likely to need; and
- its wider plans for meeting those needs, including IT and book-keeping training.

Digital exclusion for businesses

120. In order to better understand digital access, use and skills, HMRC commissioned research to distinguish between people or businesses which were ‘digitally excluded’ and those, referred to as ‘assisted digital’, who would need some form of help to interact digitally with government.¹¹³ For these purposes ‘digital exclusion’ was defined as having no use of the internet because of either a lack of access at their place of work, or because, despite having access, the internet was not used.

Figure 1: Rates of ‘Digital Exclusion’ and ‘Digital Assistance’ in the self-employed, micro-business, taxpayers and general population



Source: HMRC: Research report *Digital Exclusion & Assisted Digital Research To understand digital access, use and skills among the UK population, August 2015*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/457800/Digital_Exclusion_and_Assisted_Digital_research_publication_report.pdf [accessed March 2017]

121. As illustrated by Figure 1, this research found that, amongst micro businesses (one to four employees), two per cent fell into the Digital Exclusion category and 29 per cent into the Assisted Digital category. Amongst individuals who are self-employed with no employees, 19 per cent were in the first category,

113 HMRC, *Research report Digital Exclusion & Assisted Digital Research: To understand digital access, use and skills among the UK population, August 2015*, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/457800/Digital_Exclusion_and_Assisted_Digital_research_publication_report.pdf [accessed March 2017]

and 42 per cent in the second.¹¹⁴ These could represent a significant proportion of those who are to be mandated into MTDfB, but for whom HMRC's plans are unclear.

122. Simply being connected to the internet is not sufficient, of course, if it is so slow as to be of no practical use to a business. The UK government's current minimum suitable service speed for connection is 2mbps, whilst the Universal Service Obligation proposed to be enacted in the current Digital Economy Bill offers the right to access 10 mbps from 2020.¹¹⁵
123. HMRC maintains 2mbps to be sufficient to submit an update.¹¹⁶ However we have received evidence that some Cloud accounting agent software is slow without superfast broadband.¹¹⁷
124. A survey of its members in 2015 by the NFU found that 80 percent of respondents had upload speeds of 2mbps or less. The NFU summarised the concerns of many, mainly but not always in rural areas, that the lack of connectivity would "make a move to a digital only form of record-keeping and more frequent digital reporting challenging, if not impossible".¹¹⁸

Draft legislation on digital exclusion

125. Schedule A1 to the draft 2017 Finance Bill setting out the draft statutory exclusion from online filing for MTDfB adopts the same definitions as apply to VAT Online filing. At present, the regulations attached to the VAT provision in practice mean that businesses who do not have internet access but can use available workarounds (friends, families or agents, a local library, or telephone filing), are expected to do so.¹¹⁹ Only if none of these options are possible can they apply for exemption.¹²⁰
126. This approach may give consistency with VAT legislation, but since in practice it exempts very few VAT registered traders, this definition is regarded as inadequate for MTDfB purposes by many giving evidence to us, including

114 HMRC: *Research report Digital Exclusion & Assisted Digital Research: To understand digital access, use and skills among the UK population*, August 2015, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/457800/Digital_Exclusion_and_Assisted_Digital_research_publication_report.pdf [accessed March 2017].

115 The Explanatory Notes to the Digital Economy Bill state, "In December 2015 the government launched a scheme offering a subsidised satellite broadband connection (including the option of superfast speeds) to homes and businesses unable to obtain an affordable broadband service of at least 2 Mbps. This scheme formed part of the government's commitment to make sure every home and business in the United Kingdom could access speeds of at least 2 Mbps by the end of 2015. This commitment is termed the "Universal Service Commitment" and currently acts as a non-statutory safety net. In November 2015 the Prime Minister announced that government was planning to create a broadband Universal Service Obligation ("USO") with the ambition to give people the legal right to request a broadband connection with speeds of 10 Mbps by the end of the Parliament. Unlike the non-statutory Universal Service Commitment, a broadband USO would be a legal right to request a connection, similar to the way the existing USO operates to request a telephone line or equivalent arrangements for utilities". Where such powers are devolved it will be for the respective parliamentary or other authority to make its own determination. [Explanatory Notes to the Digital Economy Bill](#) [Bill 45-EN (2016-17)]

116 HMRC, *Making Tax Digital: Bringing business tax into the digital age*, August 2016, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/545715/Making_Tax_Digital-Bringing_business_tax_into_the_digital_age-consultation.pdf [accessed March 2017]

117 Defined as at least 24 mbps

118 Written evidence from the National Farmers Union ([FBS0012](#))

119 The Value Added Tax Regulations 1995 ([SI 1995/2518](#)), Regulation 25A(6)

120 HMRC Internal Manual, *Vat Accounting Manual, Accounting for VAT: assistance with online filing*, July 2016: <https://www.gov.uk/hmrc-internal-manuals/vat-accounting/vatac1260> [accessed March 2017]

TaxAid.¹²¹ It does not specifically address how the 19 per cent of digitally excluded self-employed identified in HMRC's own research discussed above might be accommodated, and, as LITRG pointed out, the draft legislation does not include a right of appeal against the refusal of an exemption, although HMRC has informed us that it will be available.¹²²

127. Finally, Michael Parker of the NFU also expressed dissatisfaction at the unduly restrictive exemption, at Clause 12(3), for partnerships, where, in order for a partnership to be regarded as digitally excluded, each partner must be digitally excluded, despite the fact that the records may be kept on only one partner's business premises.¹²³
128. **We welcome the exemptions for digitally excluded businesses, but the proposed 'digital exclusion' criteria are too narrowly defined and should better reflect the practical reality of a lack of digital infrastructure across parts of the UK.**
129. **We recommend that HMRC works with representative bodies to produce detailed guidance on how the provisions applying to the digitally excluded might be made to work in practice, for those anywhere in the UK who do not benefit from broadband speeds which meet the UK government's Universal Service Obligation minimum of 10 mbps.**
130. **We recommend that HMRC considers revisions to clause 12(3) to apply to partnerships where the partner keeping records and making returns is digitally excluded, regardless of the status of other partners.**

121 Written evidence from TaxAid ([FBS0061](#))

122 Written evidence from HM Treasury and HMRC ([FBS0065](#))

123 [Q 36](#) (Michael Parker)

CHAPTER 6: PILOTING AND IMPLEMENTATION SCHEDULE

131. As mentioned in Chapter 3, the Government announced on 31 January that HMRC would start “piloting digital record keeping and quarterly updates for a full year from April 2017, building up to working with hundreds of thousands of businesses and landlords before rolling the services out more widely. This will ensure that the software is user-friendly and give individuals and businesses time to prepare and adapt.”¹²⁴ We welcome this announcement as a small step in the right direction.¹²⁵
132. This chapter considers the proposed pilot, and its objectives and aims, against established best practice, government standards and stakeholder expectations. It goes on to consider HMRC’s current implementation plans in the light of the piloting programme and the state of stakeholder readiness discussed in the previous chapter.
- HMRC’s Pilot**
133. HMRC’s proposed pilot will begin in April 2017 with a limited number of volunteers recruited with assistance from the software industry and agents.¹²⁶ The numbers participating in the pilot are intended to be increased gradually, building up to several hundred thousand businesses both unrepresented and represented by agents, and a statistically representative group.¹²⁷ The build up will also enable more MTD-compatible software, including agent software, to be tested as it becomes available.
134. In the proposed pilot, using that MTD-compatible software, participants will be required to keep their records in a digital form and to provide HMRC with quarterly summaries, drawn from those digital records, of income and expenditure. That means that by April 2018 when the new scheme is due to be implemented, the first wave of recruits to the pilot are expected to be about to submit their fourth quarterly update.¹²⁸ Later recruits will have completed fewer. None of the participating businesses will have prepared an end-of-year statement of their tax affairs for 2017/18, the tax year being piloted as this would not be due until 31 January 2019.¹²⁹
135. The overlap between the end of the reporting cycle for the 2017/18 tax year (the pilot year) and the start of the reporting cycle for the 2018/19 tax year (the ‘go live’ year) obviously has implications for the extent to which the full set of processes, software and other services can be tested, evaluated and refined in time for an April 2018 launch (now for fewer, larger businesses).

124 HMRC, *Bringing Business tax into the digital age: Summary of responses*, 31 January 2017: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/587433/Making_Tax_Digital_-_Bringing_business_tax_into_the_digital_age_-_Summary_of_responses.pdf [accessed March 2017]

125 The Rt Hon Andrew Tyrie MP, Chair of the Treasury Committee, commented in similar terms that “this is a welcome, albeit small, step in the right direction”. Treasury Committee, *Chair on HMRC response to Making Tax Digital*, 1 February 2017: <http://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/news-parliament-2015/making-tax-digital-chairs-statement-16-172/> [accessed March 2017]

126 Written evidence from HM Treasury and HMRC (FBS0066)

127 Q 49 and Q 53 (Theresa Middleton)

128 HMRC *Bringing business tax into the digital age: Summary of responses*, 31 January 2017: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/587433/Making_Tax_Digital_-_Bringing_business_tax_into_the_digital_age_-_Summary_of_responses.pdf [accessed March 2017]

129 HMRC Guidance, *Bringing Business Tax into the Digital Age: legislation overview*, 31 January 2017: <https://www.gov.uk/government/publications/bringing-business-tax-into-the-digital-age-legislation-overview/bringing-business-tax-into-the-digital-age-legislation-overview> [accessed March 2017]

Box 1: Aims and objectives of the pilot

To assess the scope and likely usefulness of the pilot, we asked HMRC to outline its objectives. These are:

- To enable appropriate and proportionate testing of the software with HMRC’s IT systems with a representative cross-section of the population (businesses and agents) for which the service will be provided.
- To enable appropriate and proportionate testing of the customer support model with a representative cross-section of the population (businesses and agents) for which the service will be provided.
- To ensure Customer Readiness for go live, including ensuring the right support is in place to support transition and providing assurance that businesses are aware of their obligations, and are in a position to meet them.
- To demonstrate progress and build external confidence in our ability (and software developers’ ability) to deliver MTDfB.
- To provide evidence and early insight to the effects of the policy on those participating in the pilot.
- To provide an agreed model against which communications can be developed and refined, to frame key messages, and their triggers, to ensure businesses know what they have to do, and when, both during the Public Beta and when MTDfB goes live.
- To validate the effectiveness of our Assisted Digital support model.

Source: Written evidence from HM Treasury and HMRC (FBS0066)

Scope of pilot

136. These aims and objectives cover a number of issues raised in the evidence we received. However, we were very concerned to note that it is not specifically intended to test the core proposition driving the MTD proposals, namely that mandatory digital record keeping and quarterly reporting will reduce the tax gap, as discussed at above.

Duration of pilot and best practice standards

137. As explained in paragraphs 134 and 135 above, none of the businesses recruited to the pilot will have completed a full reporting cycle before April 2018. Concerns were expressed in much of the evidence we received about the limitations the short duration of the pilot places on the scope for evaluating the results and applying any lessons learnt to improving the processes being tested and for validating key assumptions.¹³⁰ As Mr Lyford-Smith of ICAEW said:

“The pilot study that HMRC is proposing starts in two months, but by the nature of its timeline the full making tax digital will start before that could possibly be finished, because it will only be a year later, so of course we will not have had the full time to run it through the process ... It is all very condensed.”¹³¹

130 For example, written evidence from the Institute of Chartered Accountants of Scotland (FBS0056); the Country Land and Business Association (FBS0022); and the Association of Chartered Certified Accountants (FBS0062)

131 Q 30 (David Lyford-Smith)

138. It should be noted that businesses subject to MTDfB obligations will also have to select software by April 2018, when its end of year capabilities will not have been tested. For the first cohort, those whose businesses will have turnover over the VAT threshold, digital records may already be used to support online VAT filing.
139. The relatively short duration of the pilot appears to run counter to government guidelines and recognised best practice. The 2006 Carter Review of HMRC online services recommended that each new online service introduced by HMRC be “capacity tested at least a year before” implementation, “in order to ensure they are robust and high quality”.¹³² April 2017 to April 2018 testing will at most include three quarterly submissions, yet the Government’s Digital Service Standards requires departments to “test the end-to-end service”.¹³³ Deferring by one year the start date for businesses below the VAT registration limit does not remove any of these concerns.
140. This is consistent with the lessons learned from overseas tax jurisdictions’ experiences of digitalisation. An international study by the Institute of Chartered Accountants of England and Wales highlighted that “making new systems mandatory too quickly will pass costs on to taxpayers and will adversely affect the digitally excluded.”¹³⁴

Other concerns about the pilot

141. Ms Middleton, of HMRC, informed us that only the smaller software providers would join the pilot in April 2017, with others joining later.¹³⁵ This appears to be partly because some providers were delayed by HMRC changing the APIs on 19 January 2017.¹³⁶ Commenting on the tightness of the piloting timetable from a software industry perspective, Mr Daly, of IRIS, remarked that “there needs to be a far greater degree of clarity on the objectives”.¹³⁷
142. The objectives of the pilot include testing with agents, yet the Chartered Institute of Taxation and others tell us their involvement will only start sometime later in 2017.¹³⁸ IRIS told us that their software product for agents would not be ready for pilot testing until around October 2017. In practice this means only businesses not using tax agents will be testing the system before then. Given that HMRC estimates that 70 per cent of businesses have agents, the inability of agents to participate in the pilot from the outset limits the testing process significantly.
143. Finally, Ms Middleton of HMRC also told us that HMRC needed to recruit “a statistically representative group” of businesses including those

132 Lord Carter of Coles, *Review of HMRC Online Services*, March 2006: <http://webarchive.nationalarchives.gov.uk/20060719043117/http://www.hmrc.gov.uk/budget2006/carter-review.pdf> [accessed March 2017]

133 Government Digital Service, ‘Digital Service Standards’: <https://www.gov.uk/service-manual/service-standard> [accessed March 2017]

134 ICAEW Information Technology Faculty, *Digitalisation of tax: International perspectives*, November 2016: <https://www.icaew.com/-/media/corporate/files/technical/digital-tax.ashx?la=en> [accessed March 2017]

135 [Q 54](#) (Theresa Middleton)

136 Written evidence from HM Treasury and HMRC ([FBS0065](#)). An API is an Application Protocol (or Programming) Interface, which enables MTD-compatible software to communicate with HMRC’s systems

137 [Q 18](#) (Mr Dady)

138 Written evidence from the Chartered Institute of Taxation ([FBS0060](#))

who currently only keep records on paper.¹³⁹ Some concerns were expressed about HMRC's ability to recruit businesses with the right characteristics in sufficient numbers.¹⁴⁰ We understand that HMRC is still attempting to recruit volunteers to the pilot.¹⁴¹ It is not clear how the trial will proceed if the required volunteers are not recruited or, the sample is biased towards an unrepresentative degree of digital skills and confidence.

144. **The design and duration of the pilot proposed by HMRC does not conform to government best practice guidelines. It is too short and too limited to yield the learning and process improvement benefits that full testing would provide and that are necessary in view of the scale of the changes involved. The pilot should include a properly weighted representative sample group and be of sufficient scale to test the robustness of the software’.**
145. **We recommend that the pilot should be extended until after 31 January 2019 to include end of year statements for the 2017/18 tax year. This would allow the software and HMRC systems and business support processes to be properly developed, tested and improved before full implementation and a fully functioning market in compliant products to develop. The delay would also allow more time for HMRC and tax agents to raise awareness and prepare businesses for the change.**
146. **We also recommend that the pilot should include a comprehensive analysis of :**
- **Specific feedback from businesses on their experience and the actual costs;**
 - **the user experience of the free software and in particular its functionality and utility; and**
 - **the impact of MTDfB on error rates and the tax gap.**

Implementation from April 2018

147. There was also widespread scepticism about the proposed timetable for implementation, not only because of the concerns expressed over aspects of the pilot, but also because of the sheer magnitude of the task ahead to prepare businesses for the transition and to support them effectively. The ACCA were concerned that the short window for businesses to implement new processes increased the “likelihood of decisions being rushed and unnecessary costs incurred as a consequence”.¹⁴² In order to address these concerns, they recommended that businesses below the VAT threshold should be initially exempted, perhaps being phased in over three to five years.
148. Edward Woodall of the ACS commented about the wider impact on business processes in his sector where 53 per cent of independent retailers do not currently have electronic point of sale.¹⁴³
149. The evidence we received suggested that the software industry, as well as the tax practitioner community, was becoming increasingly concerned at

139 [Q 53](#) (Theresa Middleton)

140 For example, [Q 39](#) (Michael Parker)

141 [Q 53](#) (Theresa Middleton)

142 Written evidence from Association of Chartered Certified Accountants ([FBS0062](#))

143 [Q 38](#) (Edward Woodall)

the resources and preparation it would need in order to fill any gaps left by HMRC in supporting tax-payers.¹⁴⁴ Ms Riches of Smith and Williamson commented that the timescale limited what tax agents could do to prepare their clients and assist them to make the transition.¹⁴⁵

150. Mr Dady was also concerned about the uncertainties currently surrounding the timetable and other aspects of the scheme:

“If we are to maintain the current published timetable the supplier community needs to know that it will be maintained, so that we can resource adequately and lead our customers through it. Frankly, it will probably be the phones in my call centres that are ringing when people cannot use the products or find that there are some stumbling blocks. If they cannot get through to HMRC, they will probably ring me”¹⁴⁶

151. A similar perspective was put by the agent representatives, who were concerned about the time available to select software, train their staff and assist clients in the transition over the first quarter of 2018, a time of year when agents are at their busiest.¹⁴⁷

152. Perhaps most importantly, there is real concern over the proposals to mandate the smallest businesses into MTD first. Advice from ABAB was to build on the lessons learned from the rollout of RTI and phase implementation.¹⁴⁸ Mr Southam noted:

“Larger firms are the ones most likely to have digital solutions ... For small businesses, it seems crazy to put them at the front. The majority of these guys will not be in a position to meet the deadline currently envisaged”.¹⁴⁹

153. **The almost universal concern of witnesses is that the current timetable for mandating digital record keeping and quarterly reporting is too tight and entails unjustifiable risks for businesses, HMRC, tax practitioners and the software industry. It does not allow enough time for full end-to-end piloting and evaluation to avoid unnecessary risks for both HMRC and businesses.**

154. **We welcome the Chancellor’s decision to defer until 2019 the mandation of the smallest businesses into the new system. This will help address some of the most pressing concerns by reducing the risks of unnecessary costs and implementation difficulties for these businesses.**

155. **However, the Chancellor’s changes do not go far enough. We recommend that mandatory implementation of digital record keeping and quarterly reporting should be deferred until April 2020, after the extended pilot period.**

144 [Q 18](#) (Kevin Dady and Kevin Hart)

145 [Q 21](#) (Tina Riches)

146 [Q 18](#) (Kevin Dady)

147 Written evidence from UK200Group ([FBS0054](#))

148 Written evidence from the Administrative Burdens Advisory Board ([FBS0011](#))

149 [Q 39](#) (Roger Southam)

CHAPTER 7: SIMPLIFICATION

156. This chapter considers the relationship between simplification and digitalisation in the tax system, and the role of the Office of Tax Simplification in the MTD proposals, to set the context. It then goes on to examine the detail of the simplification measures announced on 31 January—the extension of the so-called ‘cash basis’ of accounting to businesses with a turnover up to £150,000 and to property businesses—and the published draft legislation that would enact these changes.

Simplification and digitalisation

157. Everyone submitting evidence to this inquiry shared a desire to simplify the tax system. However, they had concerns about the timing and extent of the simplifying measures proposed. Most of that evidence argued that it would have been better to simplify the tax system first, and let those changes bed in, before embarking on a reform of tax administration as fundamental as MTDfB.¹⁵⁰

158. The Chartered Institute of Taxation (CIOT) shared this view and was also concerned that the proposed changes might not be noticed by businesses in the transition to MTDfB noting that:

“Ideally, measures to simplify the taxation of small businesses would have taken place before MTD is introduced. The simplification measures also need to be widely publicised, in a manner which will reach the small businesses which are intended to be the main beneficiaries.”¹⁵¹

159. In its response to the consultation, HMRC acknowledged concerns about “whether businesses had the capacity to understand multiple changes at once”,¹⁵² but claimed that the software and apps that will be available can mask or overcome complexity in the tax system and enable taxpayers to deal with the simplifications that are proposed.¹⁵³

160. However the evidence we received is less confident about the ability of businesses to cope successfully, particularly in the light of our assessment of their readiness for MTDfB, discussed in Chapter 5 above.¹⁵⁴

161. Most respondents therefore welcomed the decision to defer, for further consultation, the introduction of proposed changes to the current basis period rules for allocating business profits for tax purposes. The ACCA, for example, commented that there was no immediate need to change those rules, and “welcomed HMRC’s announcement that further time will be taken to ensure that any changes made properly implement the intended policy outcomes”.¹⁵⁵

162. However, the NFU argued the changes had not simplified matters for many of the agricultural businesses it represented. It commented that the focus so far had been mainly on simplifying tax for the smallest, simplest businesses.

150 Written evidence from the Office of Tax Simplification (FBS0019)

151 Written evidence from the Chartered Institute of Taxation (FBS0060)

152 HMRC Guidance *Bringing Business Tax into the Digital Age: legislation overview*, 31 January 2017: <https://www.gov.uk/government/publications/bringing-business-tax-into-the-digital-age-legislation-overview/bringing-business-tax-into-the-digital-age-legislation-overview> [accessed March 2017]

153 Written evidence from HM Treasury and HMRC (FBS0065)

154 Written evidence from Low Incomes Tax Reform Group (FBS0053)

155 Written evidence from Association of Chartered and Certified Accountants (FBS0062)

The NFU also observed that, “far more work is needed to develop MTD for partnerships, those deemed to have multiple businesses for income tax purposes, and VAT registered unincorporated businesses.”¹⁵⁶

163. The Institute of Chartered Accountants of Scotland (ICAS) made similar points, emphasising the lack of overall coherence in HMRC’s approach to simplification.¹⁵⁷ The fact the consultation response document published by HMRC in January 2017 did not address these questions “fuels our concern, highlighted above, about the lack of a coherent approach to MTD.”¹⁵⁸
164. **It would have been preferable to introduce simplifying tax changes before MTDfB becomes mandatory in order to minimise the burden on, and potential for confusion among, taxpayers.**
165. **We agree with the Government’s decision to defer the introduction of the further simplification measures it had proposed. Whilst they may be welcomed in due course, introducing them at the same time as businesses have to focus on their transition to MTDfB would have added to their burden.**
166. **We recommend that the Government develop and publish a coherent road map outlining the principles governing further tax simplification measures to smooth the operation of MTDfB.**

The role of the Office of Tax Simplification

167. This Sub-Committee’s inquiry into draft Finance Bill 2016 covered the draft legislation putting the Office of Tax Simplification (OTS) onto a statutory footing and recommended that the statutory remit be extended to give it an integral role in tax policy design.¹⁵⁹ Although this recommendation was not accepted by the Government, we asked John Whiting of the OTS, what role they had played in developing the MTDfB proposals. He reported that, “We have been involved and we have talked to HMRC. Have we really been able to influence? Not as much as I would like, I have to say.”¹⁶⁰ He added that “it would have been good to look at” the current proposals for unincorporated businesses “far more coherently.”¹⁶¹
168. Mr Whiting did however suggest that the OTS might make a greater contribution to any measures paving the way for companies to join MTD in 2020, stemming from a project the OTS already has underway on simplifying and streamlining corporation tax computations.¹⁶²
169. **As part of the roadmap, we recommend that the Government considers, with the Office of Tax Simplification, which measures from that Office’s current reviews into the VAT and corporation tax regimes might be introduced before MTDfB is applied to them.**

156 *Ibid.*

157 Written evidence from the Institute of Chartered Accountants of Scotland ([FBS0056](#))

158 *Ibid.*

159 Economic Affairs Committee, *The Draft Finance Bill 2016* (2nd Report of Session 2015–16, HL Paper 108)

160 [Q 1](#) (Mr Whiting)

161 [Q 1](#) (Mr Whiting)

162 [Q 1](#) (Mr Whiting)

Draft simplifying legislation

170. At present trading businesses, other than landlords, are required to calculate taxable profits according to either:
- the ‘accruals basis’, using UK generally accepted accounting practice (GAAP), and applying any adjustments required by tax legislation; or
 - the ‘cash basis’ which applies to some smaller businesses whose annual turnover does not exceed £83,000. The cash basis was introduced from 2013/14 with the aim of simplifying the calculation of taxable profits for those smaller businesses which opt to use it.
171. The draft Clause and Schedule entitled “Calculation of profits of property businesses” propose to extend the application of the cash basis of determining taxable profits to property businesses. These changes were proposed as part of the August 2016 consultation, and the draft legislation was published for further consultation on 31 January 2017. A point that was not consulted on, was that, in contrast to trading businesses which have to opt into it, for MTDfB purposes, the cash basis will become the default basis for calculating taxable profits for property businesses. They will have to ‘opt out’ if they want to use the accruals method.
172. Also published in January was the draft Clause “Cash basis: treatment of capital” which aims to simplify the cash basis rules for trading businesses. The current provisions disallow capital expenditure unless it would qualify for plant and machinery capital allowances, the rules for which can be complex. The new provisions aim to set out a clear list of allowable and excluded capital expenditure.
173. A further measure to be published in Finance Bill 2017 is expected to extend the cash basis to businesses with annual turnover up to £150,000.

Stakeholder evidence

174. The introduction of the cash basis for property businesses was generally welcomed. Indeed a number of contributors reflected that they did not consider property businesses should have been excluded from the provisions when they were introduced in 2013. The Association of Accounting Technicians (AAT) observe “many unrepresented unincorporated landlords already report their letting property income and expenditure on a cash basis largely due to a lack of awareness of existing legislation.”¹⁶³
175. The decision to make the cash basis the default basis for calculating taxable profits for property businesses, with effect from April 2017, came as a surprise to many commentators. The Chartered Institute of Taxation commented that “having different rules for each cash basis might lead to confusion amongst taxpayers who could end up making inappropriate decisions”.¹⁶⁴
176. They considered HMRC guidance and communication urgently needed, in particular as “these changes are coming at the same time as other significant changes to the rules for loan interest relief for buy-to-let landlords”.¹⁶⁵

163 Written evidence from the Association of Accounting Technicians ([FBS0004](#)); see also [Q 43](#) (Douglas Haig).

164 Written evidence from the Chartered Institute of Taxation ([FBS0060](#))

165 *Ibid.*

177. The extension of the cash basis to businesses with turnover up to £150,000 received a mixed welcome. LITRG expressed caution arguing “the cash basis ... is not necessarily the best way to understand how a business is doing.”¹⁶⁶
178. The AAT members’ survey favoured retaining the turnover threshold at £83,000,¹⁶⁷ a position shared with the Chartered Institute of Taxation,¹⁶⁸ which was disappointed that the proposed simplifications did not go as far as relaxing the current restrictions on loss relief and finance costs.¹⁶⁹
179. A further point raised concerned unnecessary confusion that was likely to arise from the differences between the cash basis rules used for tax reporting and those used for universal credit claims.¹⁷⁰
180. The ongoing distinction between revenue and capital expenditure in the cash basis means some complexity remains. As a result, although it is a relatively minor measure, questions have been raised as to whether the rules as drafted do in fact constitute simplification. It is telling that witnesses have requested that HMRC publish accompanying guidance to assist interpretation of the measure.¹⁷¹
- 181. We support the Government’s plans to extend the cash basis for trading businesses and to include property businesses from 2017/18. However, some businesses who qualify for the cash basis may need the fuller financial insights provided by traditional accounts and they should be made aware of the consequences of opting for the cash basis.**
- 182. The difference between the rules for choosing to apply the cash basis to trading income and to property income is a potential source of confusion and error for many businesses, especially those with income from both sources.**
- 183. We recommend that HMRC develop a plan to communicate the cash basis changes to property businesses and to ensure that trading businesses are clearly informed of the advantages and disadvantages of traditional accounts as compared with opting for the cash basis.**

166 Written evidence from the Low Incomes Tax Reform Group ([FSB0053](#))

167 Written evidence from the Association of Accounting Technicians ([FBS0004](#))

168 Written evidence from the Chartered Institute of Taxation ([FBS0060](#))

169 *Ibid.*

170 Written evidence from the Low Incomes Tax Reform Group ([FSB0053](#))

171 *Ibid.*

CHAPTER 8: EFFECTIVENESS OF THE CONSULTATION PROCESS

184. This chapter begins by briefly outlining the main features of the five-stage consultation process which constitutes the ‘new’ approach to tax policymaking.¹⁷² It then goes on to consider the extent to which the process of developing the MTDfB proposals was consistent with this benchmark.

The ‘new’ approach and the Tax Consultation Framework

185. The new approach to tax policymaking was intended to promote a clearer, more stable and predictable tax system with more effective scrutiny of proposed tax and tax administration changes and legislation. It consists of a formal commitment to full and open consultation, except in exceptional circumstances, at every stage in the development and implementation of a new tax policy proposal.

Box 2: The Tax Consultation Framework

The five stages in the policy-making cycle at each of which full and open consultation should take place as a matter of course are:

- setting out policy objectives and identifying options;
- determining the best option and developing a framework for implementation, including detailed policy design;
- drafting legislation to effect the proposed change;
- implementing and monitoring the change; and
- reviewing and evaluating the change after its implementation.

Source: HM Treasury and HMRC, The Government’s Tax Consultation Framework: Summary of Responses and finalised Framework, March 2011: <https://www.gov.uk/government/publications/tax-consultation-framework> [accessed March 2017]

186. The main exceptions to this process, apart from changes to tax rates, allowances and thresholds, are measures to protect tax revenues or measures which carry a significant risk of forestalling.¹⁷³

187. The new approach means that, in practice, most tax legislation should be published in draft for consultation at least three months before the relevant Finance Bill is laid before Parliament, with consultation on the first two stages of the process having taken place in the preceding months.

188. The Framework also established a ‘Tax Professionals Forum’ (TPF) to consider and report on the Government’s performance against these principles and to identify and prioritise improvements to the way in which tax policy is made.

¹⁷² Adopted by the then Coalition Government in 2011.

¹⁷³ The conventions the then Government proposed to abide by in announcing changes outside the Budget were set out in a protocol contained in HM Treasury and HMRC, *Tackling Tax Avoidance*, March 2011, Chapter 4: http://webarchive.nationalarchives.gov.uk/20130129110402/http://cdn.hm-treasury.gov.uk/2011budget_taxavoidance.pdf [accessed March 2017].

Consultation on the Making Tax Digital proposals

189. Chapters 2 and 3 set out the main steps followed by HMRC in developing these proposals. They consisted of the following publications:

- alongside Budget 2015, *Making Tax Easier*, sketching in very broad terms the then Government’s vision for promoting digital interaction between HMRC and personal and business taxpayers. This contained few details;
- with the 2015 Autumn Statement, a slightly more detailed but still high level strategy document, *Making Tax Digital*, with a roadmap outlining consultations and other key events in the development and implementation of the proposals;
- on 15 August 2016, the first six consultation documents containing extensive proposals on the design and implementation of MTDfB. That consultation closed on 7 November 2016; and
- on 31 January 2017, the Government’s partial response to the August 2016 consultations which included a small proportion of the draft clauses necessary to put in place the new system.

190. Whilst the Spring Budget 2017 deferred the implementation of the new scheme for businesses below the VAT threshold, no other decisions were announced. The outstanding draft primary and secondary legislation are due to be published with the 2017 Finance Bill on 20 March.

191. It is clear from this brief chronology of events that the first stage of the Framework’s five-stage process was omitted entirely from the development of these proposals. Indeed, HMRC said as much in launching their August 2016 consultation:

“this consultation is taking place during stage 2 of the process. The purpose of the consultation is to seek views on the detailed policy design and a framework for implementation of a specific proposal, rather than to seek views on alternative proposals.”¹⁷⁴

192. It is also clear that the third stage—consulting on the draft legislation before its inclusion in the Finance Bill—has also been seriously curtailed.

Evidence from Stakeholders

193. Views about the value of the consultation process were mixed; the suggestion was that the sheer quantity of material was overwhelming, even if of a high quality, although some complained of a lack of detail in key areas. In spite of the large number of responses to the August 2016 consultation documents and the various outreach events undertaken by HMRC, few shared Mr Harra’s view that “the consultation and engagement we have had has been the richest the department has had”.¹⁷⁵

194. Ms Riches, of Smith and Williamson, for example, felt that the consultation in general had “not been anywhere near as good as some of the previous

174 HMRC, *Making Tax Digital: Bringing business tax into the digital age*, August 2016: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/545715/Making_Tax_Digital-Bringing_business_tax_into_the_digital_age-consultation.pdf [accessed March 2017]

175 [Q 56](#) (Jim Harra)

ones on digital transformation”, citing the Self Assessment, Real Time Information and iXBRL¹⁷⁶ consultations as examples.¹⁷⁷

195. The Administrative Burdens Advisory Board was more positive, however, and welcomed “the positive and constructive dialogue that we have had with HMRC ... around understanding business’s new digital journey and the potential benefits and impacts that brings.”¹⁷⁸ Given its formal status as an adviser to HMRC it may have had greater involvement than businesses at large.

Omission of Stage 1

196. The unfortunate omission of the first stage in the consultation was a point raised by a number of witnesses, including Ms Riches, of Smith and Williamson.¹⁷⁹ The view of Michael Steed, of the ATT, was that:

“It felt preordained. It was the tax gap driving the whip across HMRC’s shoulders. They knew what they wanted to do. There was consultation, yes, but arguably it was not much use.”¹⁸⁰

197. The Country Land and Business Association thought HMRC’s approach “was inward looking, starting with their requirements on tax collection, which will force taxpayers to adopt entirely new processes that focus on compliance.”¹⁸¹
198. The TPF pointed out that “failure to undertake stage 1 of the process means that consultation takes place within a fixed framework which may be sub-optimal.”¹⁸²
199. Omitting this first stage meant that there was no opportunity to consider alternatives, such as building on existing online reporting systems, including VAT or self-assessment—a point raised by Mr Whiting¹⁸³ and Mr Southam,¹⁸⁴ amongst others.

Consultation on Stage 3

200. The TPF were equally concerned about the drastically truncated timetable for consulting on the draft legislation. Writing at a time when it was still expected that all the draft legislation would be published in January 2017, they commented that “it is difficult to see how this package can do more than pay lip service to the government’s tax consultation framework”.¹⁸⁵ They concluded that:

176 iXBRL, or inline extensible business reporting language is the system whereby accounts supporting corporation tax computations are ‘tagged’ to enable them to be digitally read by HMRC’s systems, and became mandatory in 2011.

177 [Q 26](#) (Tina Riches)

178 Written evidence from the Administrative Burdens Advisory Board ([FBS0011](#))

179 [Q 27](#) (Tina Riches)

180 [Q 27](#) (Michael Steed)

181 Written evidence from Country Land and Business Association ([FBS0022](#))

182 Tax Professionals’ Forum, *Fifth independent Annual Report*, December 2016: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/574703/TPF_2016_report_final.pdf [accessed March 2017]

183 [Q 2](#) (John Whiting)

184 [Q 35](#) (Roger Southam)

185 Tax Professionals’ Forum, *Fifth independent Annual Report*, section B5

“The delay in launching the response clearly provides the government with more time to assimilate the responses but, unless the implementation timetable adjusts, does so at the cost of time for consultation.”¹⁸⁶

201. On the same point, ICAS was concerned that the project was proceeding “without the overall legislative detail being available With tax administration detail is vital.”¹⁸⁷

Insufficient legislative scrutiny

202. Concerns were also raised about the extensive use of secondary legislation in establishing the framework for MTDfB. ICAS objected in principle:

“The draft Finance Bill clauses that have been published are mainly enabling legislation, delegating much of the detail to regulations that will be issued at a later date. ICAS does not support the extensive use of secondary legislation ... The granting of powers, duties and functions are an important exercise of Parliament’s duties; these should be exercised through primary legislation so that there is consideration by Parliament before they are granted.”¹⁸⁸

203. A further issue is that some of the enabling primary legislation published so far is drafted so broadly that it will require particular scrutiny. For example, Clause 8(6), which requires what have been described as ‘end of year statements’, has been drafted so widely that such statements can be required at any time.

Is the Government listening?

204. Many witnesses also had reservations that, despite extensive consultations, widely-held concerns (particularly about the proposed pace of implementation) had not been properly addressed by HMRC.¹⁸⁹ Some questioned whether the Government was listening to what respondents to the consultation were saying. Kevin Hart, of BASDA, put it this way:

“We have regular engagement. I was on the digital advisory group for HMRC, to help point them in the right direction. We are heavily engaged, but there is a point about hearing and listening.”¹⁹⁰

205. The TPF’s annual report also reflected this sense of frustration:

“Overall the timetable for implementing a package of policy changes of this magnitude is extraordinarily short and we caution the government to reflect fully on the responses to its consultation and take the time to get it right.”¹⁹¹

206. **Not consulting stakeholders at the outset of the policy development process constituted a failure to comply with the Government’s own guidelines on tax policymaking.**

186 Tax Professionals’ Forum, *Fifth independent Annual Report*, section B5

187 Written evidence from Institute of Chartered Accountants of Scotland ([FBS0056](#))

188 Written submission from Institute of Chartered Accountants of Scotland ([FBS0056](#)); see also [Q 49](#) (Jim Harra)

189 For example Huw Baker complains of HMRC’s “reluctance to accept many valid points put forward in the consultation, particularly with regard to the timetable for implantation.” See written evidence from Huw Baker ([FBS0033](#))

190 [Q 18](#) (Kevin Hart)

191 Tax Professionals Forum, *Fifth Independent Annual Report*, December 2016, section B5

207. **The time now available for consultation on the draft legislation is woefully inadequate and consigning most of the detailed provisions to secondary legislation has reduced the scope for effective Parliamentary scrutiny. Given the scale and significance of the proposals this could have been anticipated and built into a more appropriate timetable.**
208. **We are concerned that some of the draft enabling legislation so far published, in particular Clause 8(6), is very widely drafted.**
209. **HMRC has still not adequately addressed a number of widely held concerns expressed during and after the formal consultation, particularly those concerning the pace of implementation. The 250 pages of consultation and response have done little to reassure those affected that their concerns are being listened to.**
210. **We recommend that when designing future tax policy initiatives, whether or not driven by Exchequer imperative, the Government allows sufficient time for full and open consultation at each stage of the policy development process, including the initial consideration of options.**
211. **We also recommend that where, as part of a consultation, particular concerns are widely held, the Government should provide convincing evidence that those concerns were unfounded or that they were being addressed appropriately.**

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

Chapter 3: Government's response to the Making Tax Digital Consultations

1. We welcome the Government's announcement in the Spring Budget that the scheme would not apply to businesses with a turnover below the VAT threshold until April 2019. However, this deferral does not go far enough. We also welcome the amendments, announced in January, to the original proposals and the Government's decision to consult further on the penalty regime appropriate to MTD, on the proposed pay-as-you-go arrangements and on further exemptions and tax simplification measures. (Paragraph 34)

Chapter 4: Assessing the case for Making Tax Digital

2. The Government is right to modernise HMRC systems and seek efficiencies for taxpayers through the use of new technologies, but the digitally excluded, and less capable, should be properly catered for. (Paragraph 37)

Impact on the tax gap

3. We do not share the confidence of HM Treasury and HMRC in their estimates of the tax gap reductions from the introduction of MTD from April 2018. On the evidence presented to us, those estimates appear very fragile and little more than guess work. They rely heavily on the untested proposition that sufficient numbers of taxpayers currently making errors will provide HMRC with correct information as a result of adopting digital record-keeping and quarterly reporting and that changes would be in HMRC's favour. At this stage we regard those estimated tax gap reductions, the main drivers for the mandating the new obligations, as not yet proven. (Paragraph 53)
4. The Government is proposing to impose new obligations on the majority of businesses and landlords in order to resolve errors attributable to less than one third of that taxpayer population. (Paragraph 54)
5. We recommend that, before implementing MTDfB, HMRC revisits and tests thoroughly, as part of its pilot, the behavioural assumptions underlying its estimated tax gap reductions to take into account the evidence suggesting that taxpayers may in fact respond in ways that invalidate those estimates. (Paragraph 55)

Administrative costs to HMRC

6. At this stage, apart from a headline figure of £227 million allocated to HMRC over the current spending review period, the nature of any costs to be borne by and any benefits to accrue to HMRC remains opaque. Full details of how HMRC intends to use the money allocated should be made available. (Paragraph 60)

Impact on businesses

7. The Government's estimates of both the initial and the ongoing costs of complying with MTD requirements do not fully reflect the costs likely to be borne by a very diverse range of businesses and the differences between them. This is particularly true of the smallest and least digitally engaged businesses, many of whom will have to purchase both new hardware and new software. (Paragraph 77)

8. For the smallest businesses and landlords, any benefits from moving to digital record keeping are likely to be very limited, and that only those simpler businesses with regular flows of income are likely to realise the benefits claimed for quarterly reporting, namely the potential to have a clearer view of their tax liabilities. (Paragraph 78)
9. Under HMRC's own estimates of the costs and benefits accruing to businesses, it would take more than 10 years for businesses to recoup their aggregate initial outlay. We find it difficult to see the case, from a business viewpoint, for proceeding with the MTD proposals. (Paragraph 79)
10. We recommend that, before proceeding with the implementation of Making Tax Digital, HMRC extend its assessment of the business impact by carrying out and publishing a comprehensive analysis of that impact stratified by business type, size and initial digital capability, and explain what financial support is available to assist them. (Paragraph 80)
11. HMRC has yet to take a final decision on the threshold for inclusion in the scheme. We recommend that below the current VAT threshold, digital record keeping and quarterly reporting should not be made mandatory. HMRC may argue that this would leave a lot of tax uncollected. We do not find this plausible. What is at stake is how much extra tax would be collected simply by mandating record keeping and quarterly reports. (Paragraph 81)
12. We recommend that the Government consider whether businesses with diverse and seasonal affairs, such as agricultural businesses, should be exempt from the quarterly reporting requirements. (Paragraph 82)

Chapter 5: Taxpayer readiness and support needs

13. A significant proportion of small businesses do not appear to have the skills or digital capability necessary to comply with MTDfB. While business size and digital capability may not directly correlate, it is more likely that larger businesses will have already adopted digital tools for commercial purposes or VAT compliance so that they are readier to adapt to the new system. (Paragraph 93)

Awareness

14. Levels of awareness of these significant changes to the tax system are very low, particularly amongst the population likely to be most impacted, smaller and less digitally capable businesses (Paragraph 94)
15. We recommend that HMRC urgently develops and publishes an effective, targeted plan for proactively informing businesses of their new obligations. HMRC should replace their current approach to communications with a comprehensive strategy to make taxpayers aware of the changes. This strategy should include a public awareness campaign led by HMRC using a wide variety of media, including more traditional approaches, it should aim to inform businesses of their new obligations. (Paragraph 95)

Software industry readiness

16. Software houses do not yet have the full specifications and details needed to finalise the development MTDfB compliant software and apps. This appears to be because HMRC have not yet finalised the technical details or system requirements. (Paragraph 105)

17. Although free software is key to the successful implementation of MTDfB, it is not completely within HMRC's control and the practical usefulness and functionality of such products may be limited even for the simplest cases for which it is intended. (Paragraph 106)
18. We recommend that HMRC confirms as soon as possible and provides to software houses the remaining specifications necessary to proceed with the development and testing of the software and apps, whether free or paid for. (Paragraph 107)

HMRC support for taxpayers

19. We welcome HMRC's plans to verify and identify for businesses, those software products that will be MTDfB compliant and that they will be required to meet minimum performance and security standards. However, there is insufficient publicly available information on HMRC's strategy and resources for providing support to different taxpayer groups, or to tax agents and software providers. (Paragraph 118)
20. We recommend that HMRC urgently develops, and publicises:
 - An updated assessment of the various types of support that different types of businesses are likely to need; and
 - HMRC's wider plans for meeting those needs, including IT and book-keeping training. (Paragraph 119)

Digital exclusion

21. We welcome the exemptions for digitally excluded businesses, but the proposed 'digital exclusion' criteria are too narrowly defined and should better reflect the practical reality of a lack of digital infrastructure across parts of the UK. (Paragraph 128)
22. We recommend that HMRC works with representative bodies to produce detailed guidance on how the provisions applying to the digitally excluded might be made to work in practice, for those anywhere in the UK who do not benefit from broadband speeds which meet the Government's Universal Service Obligation minimum of 10 mbps. (Paragraph 129)
23. We recommend that HMRC considers revisions to clause 12(3) to apply to partnerships where the partner keeping records and making returns is digitally excluded, regardless of the status of other partners. (Paragraph 130)

Chapter 6: Piloting and implementation schedule

24. The design and duration of the pilot proposed by HMRC does not conform to government best practice guidelines. It is too short and too limited to yield the learning and process improvement benefits that full testing would provide and that are necessary in view of the scale of the changes involved. The pilot should include a properly weighted representative sample group and be of sufficient scale to test the robustness of the software'. (Paragraph 144)
25. We recommend that the pilot should be extended until after 31 January 2019 to include end of year statements for the 2017/18 tax year. This would allow the software and HMRC systems and business support processes to be properly developed, tested and improved before full implementation and a fully functioning market in compliant products to develop. The delay

would also allow more time for HMRC and tax agents to raise awareness and prepare businesses for the change (Paragraph 145)

26. We also recommend that the pilot should include a comprehensive analysis of:
- Specific feedback from businesses on their experience and the actual costs;
 - the user experience of the free software and in particular its functionality and utility; and
 - the impact of MTDfB on error rates and the tax gap. (Paragraph 146)

Implementation Timetable

27. The almost universal concern of witnesses is that the current timetable for mandating digital record keeping and quarterly reporting is too tight and entails unjustifiable risks for businesses, HMRC, tax practitioners and the software industry. It does not allow enough time for full end-to-end piloting and evaluation to avoid unnecessary risks for both HMRC and businesses. (Paragraph 153)
28. We welcome the Chancellor's decision to defer until 2019 the mandating of the smallest businesses into the new system. This will help address some of the most pressing concerns by reducing the risks of unnecessary costs and implementation difficulties for these businesses. (Paragraph 154)
29. We recommend that mandatory implementation of digital record keeping and quarterly reporting should be deferred until April 2020, after the extended pilot period. (Paragraph 155)

Chapter 7: Simplification

30. It would have been preferable to introduce simplifying tax changes before MTDfB becomes mandatory in order to minimise the burden on, and potential for confusion among, taxpayers. (Paragraph 164)
31. We agree with the Government's decision to defer the introduction of the further simplification measures it had proposed. Whilst they may be welcomed in due course, introducing them at the same time as businesses have to focus on their transition to MTDfB would have added to their burden. (Paragraph 165)
32. We recommend that the Government develop and publish a coherent road map outlining the principles governing further tax simplification measures to smooth the operation of MTDfB. (Paragraph 166)
33. As part of the roadmap, we recommend that the Government considers, with the Office of Tax Simplification, which measures from that Office's current reviews into the VAT and corporation tax regimes might be introduced before MTDfB is applied to them. (Paragraph 169)

Cash Basis

34. We support the Government's plans to extend the cash basis for trading businesses and to include property businesses from 2017/18. However, some businesses who qualify for the cash basis may need the fuller financial

insights provided by traditional accounts and they should be made aware of the consequences of opting for the cash basis. (Paragraph 181)

35. The difference between the rules for choosing to apply the cash basis to trading income and to property income is a potential source of confusion and error for many businesses, especially those with income from both sources. (Paragraph 182)
36. We recommend that HMRC develop a plan to communicate the cash basis changes to property businesses and to ensure that trading businesses are clearly informed of the advantages and disadvantages of traditional accounts as compared with opting for the cash basis. (Paragraph 183)

Chapter 8: Effectiveness of the Consultation Process

37. Not consulting stakeholders at the outset of the policy development process constituted a failure to comply with the Government's own guidelines on tax policymaking. (Paragraph 206)
38. The time now available for consultation on the draft legislation is woefully inadequate and that consigning most of the detailed provisions to secondary has reduced the scope for effective Parliamentary scrutiny. Given the scale and significance of the proposals this could have been anticipated and built into a more appropriate timetable. (Paragraph 207)
39. We are concerned that some of the draft enabling legislation so far published, in particular Clause 8(6), is very widely drafted. (Paragraph 208)
40. HMRC has still not adequately addressed a number of widely held concerns expressed during and after the formal consultation, particularly those concerning the pace of implementation. The 250 pages of consultation and response have done little to reassure those affected that their concerns are being listened to. (Paragraph 209)
41. We recommend that in designing future tax policy initiatives, whether or not driven by Exchequer imperative, the Government allows sufficient time for full and open consultation at each stage of the policy development process, including the initial consideration of options. (Paragraph 210)
42. We also recommend that where, as part of a consultation, particular concerns are widely held, the Government should provide convincing evidence that those concerns were unfounded or that they were being addressed appropriately. (Paragraph 211)

APPENDIX 1: LIST OF MEMBERS AND DECLARATIONS OF INTEREST

Members

Lord Bilimoria
 Baroness Bowles of Berkhamsted
 Baroness Drake
 Lord Flight
 Lord Hollick (Chairman)
 Baroness Kingsmill
 Lord Leigh of Hurley
 Lord Tugendhat
 Lord Turnbull
 Lord Wakeham
 Lord Wrigglesworth

Declaration of Interests

Lord Bilimoria
*Residential properties in London.
 Member of the Institute of Chartered Accounts of England and Wales*

Baroness Bowles of Berkhamsted
*A residential holding in Brussels from part of which rental income is received
 Consultancy business*

Baroness Drake
Independent member of the Private Equity Reporting Group for which she is paid a fee by the British Venture Capitalist Association (BVCA)

Lord Flight
*Farmland in Worcestershire from which rental income is received
 Flat in semi-basement of Member's house in London SW1 from which rental income is received
 Chairman, Board of Directors, The EIS Association Limited (assists in flow of capital to UK small/medium-sized enterprises)*

Lord Hollick
No relevant interests

Baroness Kingsmill
No relevant interests

Lord Leigh of Hurley
*Associate Member of the Chartered Institute of Taxation
 Fellow of the Institute of Chartered Accountants [CIOT FCA]*

Lord Tugendhat
No relevant interests

Lord Turnbull
No relevant interests

Lord Wakeham
*Director, Genner Securities Ltd (family-owned investment company)
 Chartered Accountant (retired)
 Genner Securities Ltd, owned jointly with family*

Lord Wrigglesworth
*Director and Shareholder of Durham Group Estates Ltd, Durham Group Investments Ltd, Rudchester Estates Ltd, Northern Corporate Finance Ltd
 Shareholder of Caspian Learning Ltd*

A full list of Members' interests can be found in the Register of Lords Interests:
<http://www.publications.parliament.uk/pa/ld/ldreg.htm>

Specialist Advisers

Elsbeth Orcharton, Specialist Adviser

Member of the Institute of Chartered Accountants of Scotland

Member of ICAS Scottish Taxes Sub-Committee

Member of the ICAS Tax Committee

Member of Court of the University of Glasgow

Tony Orhrial CB, Specialist Adviser

Trustee, Child Poverty Action Group

APPENDIX 2: LIST OF WITNESSES

Evidence is published online at <http://www.parliament.uk/finance-bill-2017-sub-committee> and available for inspection at the Parliamentary Archives (020 7219 3074).

Evidence received by the Committee is listed below in chronological order of oral evidence session and in alphabetical order. Those witnesses marked with * gave both oral evidence and written evidence. Those marked with ** gave oral evidence and did not submit any written evidence. All other witnesses submitted written evidence only.

Oral evidence in chronological order

- | | | |
|----|---|---------------------------------|
| * | Mr John Whiting, Tax Director, Office of Tax Simplification | <u>QQ 1–10</u> |
| ** | Professor Richard Murphy, Director of Tax Research UK and Professor of Practice in International Political Economy, City, University of London, Tax Research UK | |
| * | Mr Robin Williamson, Technical Director, Low Incomes Tax Reform Group (LITRG) | |
| ** | Mr Kevin Hart, Head of Payroll and Third Party Integration at B&CE (The People’s Pension), Business Application Software Developers Association (BADSA) | <u>QQ 11–18</u> |
| ** | Mr Kevin Dady, Group CEO, IRIS Software Group | |
| ** | Ms Tina Riches, National Tax Partner, Smith and Williamson | <u>QQ 19–27</u> |
| ** | Mr Michael Steed, Co-chair of ATT’s Technical Steering Group, Kaplan Leadership and Professional Development | |
| ** | Ms Rebecca Bennyworth, Council member, Institute Of Chartered Accountants In England and Wales (ICAEW) | |
| ** | Mr David Lyford-Smith, Technical Manager, Institute Of Chartered Accountants In England and Wales (ICAEW) | <u>QQ 28–34</u> |
| * | Mr Michael Parker, Head of Tax, National Farmers’ Union (NFU) | <u>QQ 35–41</u> |
| * | Mr Roger Southam, Member, Administrative Burdens Advisory Board (ABAB) | |
| ** | Mr Edward Woodall, Head of Policy and Public Affairs, Association of Convenience Stores (ACS) | |
| * | Mr Douglas Haig, Vice-Chairman and Director of Wales, Residential Landlords Association (RLA) | <u>QQ 42–46</u> |
| * | Ms Theresa Middleton, Programme Director, Making Tax Digital (Business), HM Revenue and Customs | <u>QQ 47–56</u> |

- * Mr Jim Harra, Director General, Customer Strategy and Tax Design, HM Revenue and Customs
- * Ms Lucy Pink, Deputy Director, Tax Administration Spending and Reform, HM Treasury

Alphabetical list of all witnesses

	Association of Chartered Certified Accountants (ACCA)	<u>FBS0029</u> <u>FBS0062</u>
	Accounts Direct	<u>FBS0007</u>
*	Administrative Burdens Advisory Board (ABAB)	<u>FBS0011</u>
	AJ Carter & Co	<u>FBS0047</u>
	Anstee Gorst Ltd	<u>FBS0050</u>
	Association of Accounting Technicians (AAT)	<u>FBS0004</u>
	Huw Baker	<u>FBS0033</u>
	Breckman & Company	<u>FBS0039</u>
	Martin Chance	<u>FBS0041</u>
	Charity Tax Group	<u>FBS0058</u>
	Chartered Institute of Taxation (CIOT)	<u>FBS0023</u> <u>FBS0060</u>
	Linda Cotterill	<u>FBS0059</u>
	Country Land and Business Association	<u>FBS0022</u>
	Crunch	<u>FBS0001</u>
	DP Marshall	<u>FBS0035</u>
	Carol Duckfield	<u>FBS0030</u>
	Dyke Ruscoe & Hayes Ltd	<u>FBS0020</u>
	Equity	<u>FBS0009</u>
	Federation of Small Businesses (FSB)	<u>FBS0032</u>
	Fiona Fielder	<u>FBS0043</u>
	Margaret Fuller	<u>FBS0068</u>
	Galbraith Pritchards	<u>FBS0040</u>
	Chris Gladwell	<u>FBS0027</u>
	Joyce Griffiths	<u>FBS0034</u>
*	HM Treasury and HMRC	<u>FBS0065</u> <u>FBS0066</u>
	Neil Houstoun	<u>FBS0017</u>
	Institute of Chartered Accountants of Scotland (ICAS)	<u>FBS0024</u> <u>FBS0056</u>
	James Smith (Accountant) Ltd	<u>FBS0006</u>
	Joint Tax Committee of Construction	<u>FBS0067</u>

JT AccountS	FBS0046
Keith Gibbons Limited	FBS0057
Diana Kimpton	FBS0048
Knights & Co	FBS0044
KzzJ Ltd	FBS0026
Sarah Lawrence	FBS0042
LCB Limited	FBS0014
* Low Incomes Tax Reform Group (LITRG)	FBS0053
Rich Mellor	FBS0045
Michael C Feltham and Associates (MCFA)	FBS0021
Moore Stephens South LLP and Moore Stephens LLP	FBS0010
Richard Murphy	FBS0028
Nadim Buksh	FBS0051
* National Farmers' Union (NFU)	FBS0012 FBS0055
Northamptonshire Chamber of Commerce and Milton Keynes Chamber of Commerce	FBS0025
Oaktree Accountancy	FBS0008
* Office of Tax Simplification	FBS0019
P McKelvey & Co	FBS0038
* Residential Landlords Association (RLA)	FBS0063
Richardson Accountancy Ltd	FBS0036
Ross Martin Tax Consultancy	FBS0031
Sage Group Plc	FBS0064
Dawn Saunders	FBS0037
Simon Hollingdale Accounts	FBS0016
Stour Business Partners Limited	FBS0018
TaxAid	FBS0061
UK200Group	FBS0049 FBS0054
Yorkshire Education Support Services	FBS0052

APPENDIX 3: CALL FOR EVIDENCE

The House of Lords Economic Affairs Committee has set up a Finance Bill Sub-Committee (the FBSC) to inquire into the draft Finance Bill 2017, most of which was published on 5 December 2016.

The FBSC's inquiries focus on issues of tax administration, clarification and simplification rather than on rates or incidence of tax.

This year the FBSC intends to inquire into the provisions required to establish the new mandatory digital tax account regime ('Making Tax Digital') which is due to replace the current system of annual tax returns starting in April 2018. Her Majesty's Revenue and Customs (HMRC) indicate that the relevant draft Finance Bill 2017 clauses will be published in January 2017, following HMRC's consideration of the responses to its 2016 consultation on the proposed changes.

Background to the inquiry

The Government plans to 'make tax digital' by 2020 by replacing tax returns with digital tax accounts for individuals and requiring digital reporting by businesses and private landlords. In 2016 the Sub-Committee considered the first step on this road: the introduction of Simple Assessments of tax liability calculated by HMRC to replace the self-assessment system for a limited number of individuals.

The 2017 Finance Bill is expected to contain the provisions that affect businesses and private landlords. Based on HMRC's consultations in 2016, the draft clauses may include:

- (a) the obligations of taxpayers covered by the new scheme, including any proposal to mandate the use of computer software or 'apps' to keep their business records and to provide quarterly returns of this data to HMRC;
- (b) the timing of the introduction of these provisions, starting from April 2018;
- (c) the possible 'points-based' penalty regime which will apply to failures to comply with the new obligations;
- (d) the scope of any exemptions for the smallest businesses and landlords and for the 'digitally excluded';
- (e) any proposed simplifications to the rules governing tax accounts drawn up by small businesses and partnerships and property businesses; and
- (f) an in-year voluntary pay-tax-as-you-go scheme based on digital records and updates.

Evidence sought

Subject to publication of the relevant clauses, the inquiry will consider the extent to which the measures proposed in the draft legislation will contribute to the modernisation, simplification and efficiency of the tax system, as well as their impact on the compliance and other costs borne by taxpayers, particularly smaller businesses and private landlords.

The focus of the inquiry may alter should the scope of the draft provisions differ substantially from the proposals consulted on. Subject to this, the FBSC invites evidence on the following topics:

1. **the evidence underlying the case for the Making Tax Digital proposals and their suggested impact.** The FBSC would be interested in statistical and other evidence, including that drawn from the experience of other tax jurisdictions, relevant to an assessment of the potential impacts of these proposals on businesses, landlords and other taxpayers;
2. **the evidence base for mandatory digital reporting.** In particular the potential impact on the ‘tax gap’ and for HMRC resources;
3. **the scope of the exemptions and measures to help the digitally excluded;**
4. **the robustness of the proposed timetable** from the perspective of each of the groups affected, including the software industry, different taxpayer groups (such as small businesses and landlords), intermediaries and HMRC;
5. **the adequacy of the proposed measures to simplify the calculation of taxable profits and basis periods and the timing of their introduction;** and
6. **the consequential revisions to the penalty regime.**

Timetable

The written submissions will guide the FBSC’s deliberations in oral evidence sessions and also inform the Sub-Committee’s final conclusions and recommendations.

Written evidence on the background and general issues (questions 1 and 2) should reach the Committee by 27 January 2017.

Written evidence on the draft clauses (questions 3–6) should reach the Committee by 15 February 2017.

Public hearings will be held in February 2017. The report will be published by the end of March 2017.

Information about the FBSC including membership and recent inquiries can be found on this link: <http://www.parliament.uk/business/committees/committees-a-z/lords-select/economic-affairs-finance-bill-sub-committee/>

17 January 2017