



HOUSE OF LORDS

Economic Affairs Committee

3rd Report of Session 2017–19

Making Tax Digital for VAT: Treating Small Businesses Fairly

Ordered to be printed 16 November 2018 and published 22 November 2018

Published by the Authority of the House of Lords

HL Paper 229

Select Committee on Economic Affairs Finance Bill Sub-Committee

The Economic Affairs Finance Bill Sub-Committee was appointed by the House of Lords in this session “to consider the draft Finance Bill 2018.”

Membership

The Members of the Select Committee on Economic Affairs are:

<u>Baroness Bowles of Berkhamsted</u>	<u>Lord Lamont of Lerwick</u>
<u>Lord Burns</u>	<u>Lord Layard</u>
<u>Lord Darling of Roulanish</u>	<u>Lord Livermore</u>
<u>Lord Forsyth of Drumlean</u> (Chairman)	<u>Lord Sharkey</u>
<u>Baroness Harding of Winscombe</u>	<u>Lord Tugendhat</u>
<u>Lord Kerr of Kinlochard</u>	<u>Lord Turnbull</u>
<u>Baroness Kingsmill</u>	

The Members of the Select Committee on Economic Affairs Finance Bill Sub-Committee are:

<u>Baroness Drake</u>	<u>Lord Lee of Trafford</u>
<u>Lord Forsyth of Drumlean</u> (Chairman)	<u>Lord Leigh of Hurley</u>
<u>Viscount Hanworth</u>	<u>Baroness Noakes</u>
<u>Lord Hollick</u>	<u>Lord Turnbull</u>
<u>Baroness Kramer</u>	

Declarations of interests

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

<http://www.parliament.uk/mps-lords-and-offices/standards-and-interests/register-of-lords-interests>

Publications

All publications of the Committee are available at:

<https://www.parliament.uk/finance-bill-2018-sub-committee>

Parliament Live

Live coverage of debates and public sessions of the Committee’s meetings are available at:

<http://www.parliamentlive.tv>

Further information

Further information about the House of Lords and its Committees, including guidance to witnesses, details of current inquiries and forthcoming meetings is available at:

<http://www.parliament.uk/business/lords>

Committee staff

The current staff of the committee are Sam Newhouse (Clerk), Luke Hussey (Clerk), Lucy Molloy (Committee Assistant) and Lloyd Whittaker (Committee Assistant). Ms Elspeth Orcharton and Ms Robina Dyll are the specialist advisers to the Committee.

Contact details

All correspondence should be addressed to the Economic Affairs Committee, Committee Office, House of Lords, London SW1A 0PW. Telephone 020 7219 5358. Email financebill@parliament.uk

CONTENTS

	<i>Page</i>
Summary	2
Summary of conclusions and recommendations	4
Chapter 1: Introduction	11
Chapter 2: Development of Making Tax Digital	12
The 2017 report—key conclusions and recommendations	12
Policy developments and implementation progress	13
Chapter 3: HMRC’s preparations for Making Tax Digital for VAT	15
Understanding business systems and concerns	15
Pilot programme	16
Communications and taxpayer support	17
Assisting the digitally excluded	18
Chapter 4: The new software market	19
Software industry	19
Development of MTD-compliant software	20
Chapter 5: Taxpayer readiness	22
Business awareness and planning	22
Software selection challenges	23
Progress towards implementation	24
Long-term strategy for MTD	27
Chapter 6: The Making Tax Digital penalty and interest regime	28
The current penalty and interest regime	28
Consultation process	28
Draft legislation on penalties	29
Impact of the penalty reforms	29
VAT default surcharge and repayment supplement, and proposed interest regime	31
Taxpayer awareness	31
Chapter 7: Revisiting the case for Making Tax Digital	33
HMRC’s estimates of tax gap reduction	33
Taxpayer costs and benefits	34
Table 1: One practitioner’s estimate of transition costs of MTD for VAT for their clients	36
Chapter 8: HMRC’s responsiveness to our 2017 report	38
The impact of Brexit	38
Appendix 1: List of Members and declarations of interest	40
Appendix 2: List of witnesses	42
Appendix 3: Private roundtable meeting	46
Appendix 4: Call for evidence	49

Evidence is published online at <https://www.parliament.uk/finance-bill-2018-sub-committee> and available for inspection at the Parliamentary Archives (020 7219 3074).

Q in footnotes refers to a question in oral evidence

SUMMARY

On 1 April 2019, the Government intends to mandate Making Tax Digital for VAT for all businesses with taxable turnover of over £85,000. It is the first step towards an ambitious programme of reform in the UK's tax system. This report follows up on the Committee's 2017 *Draft Finance Bill 2017: Making Tax Digital for Business* report, in which we wrote: "Where the Government is wrong is not in the principle, but in the transitional arrangements". Despite the efforts of our Committee and many others, the evidence we have collected shows that this is still the case. In particular, we are concerned about Making Tax Digital for VAT's potential impact on smaller businesses.

Many businesses will not be ready for Making Tax Digital for VAT. As much as 40 per cent of affected businesses have not heard of Making Tax Digital, let alone have started to prepare for a substantial change to their accounting processes. The emerging software market appears difficult to navigate. It is unfair to expect businesses to make choices about their accounting software without a better understanding of the future Making Tax Digital regime.

HMRC expects Making Tax Digital for VAT to yield considerable amounts of tax revenue, as businesses make fewer errors filing their tax returns. This, it seems, is the Government's primary justification for the speed and rigidity with which the programme is being introduced. We were not convinced of this logic in 2017, and we remain unconvinced now.

We also remain confused about the assumptions underlying HMRC's analysis of costs to businesses. HMRC's definition of 'small' businesses includes any business with taxable turnover between £85,000 and £10 million, taking in 1.15 million (96 per cent) of the 1.2 million businesses for whom MTD for VAT could be mandatory. It is not evident to us that there has been any attempt to calculate the impact of Making Tax Digital for VAT on the smallest businesses. HMRC has also assumed that the programme will result in no additional accountancy fees, either during or after transition. This conflicts with the weight of evidence we have received. In our 2017 report, we recommended HMRC update the assumptions behind its impact assessment in light of what we considered undermining evidence. In response, HMRC published updated impact assessments, but without any substantial change to the approach it was taking.

Making Tax Digital for VAT will make life even more difficult for small businesses given their scarce resources to devote to preparing for the change. If HMRC insists on mandating Making Tax Digital for VAT, it has a duty to support small businesses with its implementation. So far, HMRC appears to have neglected this duty.

We recommend that the Government:

- Defers the introduction of mandatory Making Tax Digital for VAT by at least one year, while encouraging businesses to join voluntarily;
- Plans a staged transition for businesses to join Making Tax Digital for VAT and future stages of Making Tax Digital which allows for businesses, not just HMRC, to be fully ready;

- Waits until at least April 2022 to implement the next stages of Making Tax Digital, to allow time to learn lessons from the implementation of Making Tax Digital for VAT; and
- Publishes its plan for the long-term development of Making Tax Digital, to encourage businesses to choose digitalisation for productivity, efficiency and modernisation reasons rather than just tax compliance.

The Government and HMRC have failed to listen to our previous report, and the warnings of many others, in preparing for Making Tax Digital for VAT. They must address the concerns raised by this Committee, businesses, and accountants. In particular, they must start listening to small businesses. Otherwise, the burdens on small businesses may outweigh any potential benefits of the Making Tax Digital programme. By failing to properly engage with small businesses, HMRC risks alienating them from any future modernisation of the tax system.

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

Development of Making Tax Digital

1. We acknowledge the announcement on 16 October 2018 of the deferral for some of the more complex organisations, and extension of the pilot programmes. We regret that this deferral was given mainly to other public sector bodies and a selection of small organisations with the most complicated tax affairs, and not to the smaller businesses for whom implementation will be most burdensome, and who have the fewest resources to devote to implementation. (Paragraph 18)

HMRC's preparations for Making Tax Digital for VAT

2. HMRC's failure to appreciate fully or take account of business and accounting processes early in its project planning, combined with a rushed timetable, is unhelpful. The soft-landing is welcome but does not address all of businesses' concerns. (Paragraph 24)
3. We are disappointed that HMRC has not done more to consider the business perspective and challenges in preparing for Making Tax Digital for VAT. A more engaged and collaborative approach will be needed if Making Tax Digital for Business, or Making Tax Digital for corporation tax, is rolled out. (Paragraph 25)
4. We recommend that HMRC reviews and learns lessons from its Making Tax Digital for VAT experience. It must fully consider the practicalities affecting underlying business and accounting systems before Making Tax Digital is extended to other taxes. (Paragraph 26)
5. The timetable for introducing Making Tax Digital for VAT from piloting to implementation is too rushed and the pilot so far has been too narrow and too late. The expansion of the pilot over the coming weeks is welcome but there is too little time before 1 April 2019 to make up lost ground and respond to implementation issues identified by taxpayers. HMRC's systems are still unproven at scale. (Paragraph 32)
6. HMRC has not done enough to communicate with taxpayers or agents to support their preparations to meet their Making Tax Digital obligations. HMRC's dependence on agents to ensure businesses understand their Making Tax Digital for VAT obligations does not recognise the needs of unrepresented taxpayers. It also has the effect of shifting the costs of supporting taxpayers through this significant change, which HMRC should bear, to taxpayers by increasing their compliance costs. (Paragraph 38)
7. We recommend that HMRC urgently publishes full details of how its communication and support systems will meet the needs of taxpayers and agents across different levels of digital capability and skills. (Paragraph 39)
8. We recommend that HMRC develops guidance on the practicalities of claiming digital exemption with the representative bodies and publishes it as a matter of urgency. HMRC should notify taxpayers in writing of its guidance and claims process for digital exemptions when it invites them to join the pilot. (Paragraph 42)

The new software market

9. The software industry is, unsurprisingly, responding to the commercial opportunity of Making Tax Digital for VAT. We have seen no evidence that any free software products will be offered. (Paragraph 56)
10. We question the logic of requiring taxpayers to spend additional money to pay their tax. Since a free option has not emerged from the software industry, the Government should consider again the case for providing a basic, free software option. (Paragraph 57)
11. Businesses and accountants using the latest versions of mainstream digital accounting software are likely to be well supported for Making Tax Digital for VAT compliance in April 2019. It is not clear that older packages or specialist software will be updated to be compliant with Making Tax Digital for VAT in time for April 2019. (Paragraph 58)
12. A market in ‘bridging software’ does not seem to have emerged. As there is a greater commercial opportunity for software providers in those businesses who are digitising more substantially, ‘bridging’ customers may be less supported by the larger software providers, and so receive less training and support. (Paragraph 59)
13. Many of the concerns about the software required for Making Tax Digital could be explored and overcome with a longer pilot period. This ought to allow a more developed software market to emerge in 2019. In this context, HMRC’s ‘soft landing’ for digital links is essential. (Paragraph 60)

Taxpayer readiness

14. Although many witnesses supported digital record-keeping in principle, some saw no justification for HMRC to impose digital record-keeping requirements on businesses, especially where it would provide exactly the same information to HMRC as the current system. (Paragraph 63)
15. There was questioning throughout our evidence of whether HMRC should mandate Making Tax Digital at all. It seems unreasonable to make people run their businesses in a different way just to produce the same figures for tax purposes. We have sympathy with the view that HMRC should not impose digital record-keeping requirements purely for tax purposes without compelling reasons, where they hold no benefits for a particular business. (Paragraph 64)
16. A spectrum of business readiness has emerged, from those confident in their readiness, through those trying to prepare but hampered by lack of information, to those still wholly unaware or digitally excluded. It is concerning that a substantial proportion of affected businesses appear to be unaware of what they will be expected to do in five months’ time. (Paragraph 69)
17. Although MTD for VAT-compliant software may be available, there has been insufficient time to establish a competitive, accessible and diverse software market. (Paragraph 76)
18. The lack of HMRC guidance or support for digital product selection means businesses trying to go digital for the first time face considerable challenges. The fast-changing software market and Making Tax Digital for VAT deadline in April 2019 compound the difficulty in making the best long-term choice.

These businesses may not be able to make the right choice in time for April 2019 and would benefit from a longer timetable. They should not have to hope for a discretionary waiver of a penalty from HMRC. (Paragraph 77)

19. Businesses using older software face costs of upgrading purely to meet Making Tax Digital for VAT requirements, since they are already realising efficiencies through their existing software. (Paragraph 78)
20. We recommend that the Government urgently provides a support package for software system selection to businesses going digital for the first time and their agents, independently from the software industry. (Paragraph 79)
21. We recommend that HMRC, as its software selection tool is developed, makes provision for establishing and certifying which software options are compliant with Making Tax Digital for VAT. (Paragraph 80)
22. The lateness in piloting has placed unreasonable burdens on taxpayers by reducing their time to prepare or test new systems. (Paragraph 86)
23. As HMRC is relying heavily on agents to support their business clients, it needs to give agents greater support with matters such as software suitability and be more open to their feedback on the digital challenges their clients are facing. (Paragraph 87)
24. HMRC is alone in its confidence that all one million businesses will be ready for Making Tax Digital for VAT in April 2019. They have underestimated the time for research, planning, training and system changes that some businesses will need. (Paragraph 89)
25. HMRC told us on 16 October that it was “significantly increasing its communications activity” to ensure businesses were ready for April 2019. With less than five months remaining before introduction, it is too late to begin an effective communications campaign. (Paragraph 90)
26. We recommend that HMRC increases the communication and support available to agents, and listens to agents’ concerns. Within that communication strategy, HMRC needs to address how it supports unrepresented taxpayers. (Paragraph 91)
27. Some businesses with complex affairs have been granted a six-month deferral after they complained about the April 2019 deadline. Smaller businesses also need to be heard by HMRC specialists and the case for further categories of deferral should be considered. In addition, specific support in dealing with implementation problems will be needed for unrepresented taxpayers. (Paragraph 92)
28. The evidence presented to us suggests that HMRC, taxpayers and the software market are unprepared for the implementation of Making Tax Digital for VAT in April 2019. (Paragraph 94)
29. We recommend that the Government defers the date for mandating Making Tax Digital for VAT by at least one year, while encouraging businesses to join voluntarily. This will enable further development of a competitive software market and specialist sector products, permit HMRC’s systems to be fully and appropriately tested, and allow taxpayers to prepare fully for implementation of new systems. (Paragraph 95)

30. Deferring the date for Making Tax Digital for VAT will not by itself solve the concerns raised in this report, if HMRC does not start listening to the concerns of businesses and agents. (Paragraph 96)
31. We recommend that HMRC plans a staged transition for businesses to join Making Tax Digital for VAT, and future stages of Making Tax Digital which allows for businesses, not just HMRC, to be fully ready. As part of this, HMRC should provide more information on their plans for Making Tax Digital for Business and Making Tax Digital for corporation tax. This will allow businesses to make informed long-term decisions about their software selection. (Paragraph 97)
32. The absence of a long-term plan for Making Tax Digital and digital data collection is a cause of business uncertainty. While businesses do not need to know precise dates, they do need to understand the future direction of Making Tax Digital. (Paragraph 100)
33. It will be unhelpful for businesses, if they have invested in software for Making Tax Digital for VAT, to find they need to reinvest in alternative software for Making Tax Digital for Business or corporation tax. (Paragraph 101)
34. We recommend that the Government publishes its plan for the long-term development of Making Tax Digital, including key decision points, milestones and dependencies. This will give greater certainty, and the software industry the information it needs to develop software that will work across each different aspect of the Making Tax Digital programme. It will also encourage businesses to choose digitalisation for productivity, efficiency and modernisation reasons rather than just tax compliance. (Paragraph 102)
35. We recommend that the next stage of Making Tax Digital is not implemented until April 2022 at the earliest. At least two years are required to learn and act on lessons from the implementation of Making Tax Digital for VAT, and a further year will be required for the software industry and taxpayers to prepare. (Paragraph 103)

The Making Tax Digital penalty and interest regime

36. We commend the consultation process which underlies these proposals, which was key in achieving broad support. This demonstrates the value of the ‘new approach to tax policy making’ when it is used effectively. (Paragraph 110)
37. The penalties regime could be fairer and better encourage taxpayers to remedy defaults promptly by giving taxpayers a longer grace period before penalties for late payment are applied, and ensuring taxpayers are aware of their exposure sooner. (Paragraph 120)
38. We recommend that the two-stage late payment penalty system is amended to extend the period of grace from 15 to 30 days. (Paragraph 121)
39. We recommend that the Government reduces the two-year time limit for HMRC to assess penalties to no more than one year, so that taxpayers are aware of their exposure sooner. (Paragraph 122)
40. While we support the points-based approach for late filing of penalties we remain concerned that the complexity of the provisions, the transition process and the timescales may be confusing to taxpayers until they become familiar with the new system. (Paragraph 125)

41. The absence of any incentive for HMRC to conclude VAT inquiries promptly risks taxpayers being unfairly disadvantaged by HMRC delays. (Paragraph 129)
42. We recommend the draft legislation is amended to remove the restrictions on repayment interest on VAT. (Paragraph 130)
43. We recommend that HMRC introduces a communication and support programme to ensure that taxpayers have a clear and timely understanding of the new penalty and interest regime, including the transitional provisions. (Paragraph 133)
44. We recommend that HMRC introduces a messaging system to give timely information to taxpayers of penalty points accruing, in order for the new regime to support taxpayers in timely compliance with their tax obligations. (Paragraph 134)

Revisiting the case for Making Tax Digital

45. We support the Government's attempts to modernise HMRC systems and seek efficiencies for taxpayers, but we remain unconvinced that MTD will reduce error and thereby the tax gap. If Making Tax Digital does not deliver the additional tax yield HMRC expects, the argument for mandating Making Tax Digital for VAT in April 2019 is much diminished. (Paragraph 143)
46. Our evidence suggests the costs to businesses of MTD for VAT, both for initial setup and for subsequent operation, will significantly exceed those used in the Government's impact assessment. (Paragraph 156)
47. We recommend that the Government updates the impact assessment to reflect evidence gathered in recent months, including from the pilot. A revised impact assessment should be published alongside the Government's long-term plan for mandating MTD for other taxes. (Paragraph 157)

HMRC's responsiveness to our 2017 report

48. We have been struck with a sense of déjà vu throughout our inquiry. It is disappointing that many of the concerns raised in evidence to this inquiry have repeated issues addressed in our 2017 report. There is considerable frustration amongst taxpayers about HMRC's lack of responsiveness to their concerns. (Paragraph 166)
49. On most issues we raised in 2017 HMRC took no meaningful action. HMRC and businesses are unlikely to have a smooth and efficient transition to digital tax reporting if it is mandated on the current timetable, particularly for businesses implementing any changes necessitated by Brexit at the same time. We believe HMRC's unwillingness to listen and learn lessons will result in difficulties for taxpayers. (Paragraph 167)
50. We have been concerned by HMRC's optimism in its evidence to this inquiry. There seems a failure to appreciate, or at least acknowledge publicly, the extent of the risks to implementation that Making Tax Digital for VAT faces. We recommend that HMRC's Board challenges the Department's current assessment of the risks. (Paragraph 168)
51. It is possible that many of the problems in implementing Making Tax Digital stem from inadequacy of resources devoted to the enterprise. We urge the

Government to take steps to ensure that an adequate budget that is protected by a ring-fence should be available for Making Tax Digital. (Paragraph 169)

52. The Financial Secretary to the Treasury's refusal to give oral evidence during our current inquiry does not convince us that the Treasury is taking seriously the risks of implementation, or the widespread criticism of HMRC's proposals. These issues need serious and prompt attention by ministers. (Paragraph 170)
53. We request that HMRC writes to update the Economic Affairs Committee every six months until the entire MTD programme is rolled out. (Paragraph 171)
54. It is time to take a fresh look at the plans for MTD. The modernisation of the tax system and encouragement to businesses to embrace technology should be a positive move. A different approach is needed to deliver maximum advantage for all. (Paragraph 172)

Making Tax Digital for VAT: Treating Small Businesses Fairly

CHAPTER 1: INTRODUCTION

1. This is the thirteenth report in a series which began in 2003 when the House of Lords Economic Affairs Committee 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; in recognition of the House of Commons' financial privileges, the Sub-Committee does not inquire into rates or incidence of tax.
2. This year the Sub-Committee decided its inquiry should address two areas: progress on the 'Making Tax Digital' programme since the Committee's March 2017 report on *Making Tax Digital for Business*,¹ and developments in the balance of powers and safeguards between Her Majesty's Revenue and Customs and the taxpayer. This report considers the first of these areas.
3. The legislation introducing Making Tax Digital (MTD) was the Finance (No. 2) Act 2017.² The provisions relating to the penalty and interest regime for MTD, which complete the legislative package, were in the draft clauses for the Finance Bill 2018–19, published on 6 July 2018.³ These are considered below, although the provisions are now expected to be included in the 2019–20 Finance Bill.
4. The Economic Affairs Committee usually publishes the report prepared by the Finance Bill Sub-Committee before the Budget and publication of the Finance Bill itself. However, the parliamentary timetable and announcement of an early Budget on 29 October 2018 meant that the report could not be published ahead of the Budget.
5. As in previous years, the Sub-Committee took written and oral evidence from stakeholders, including leading professional and business organisations, academia, accountants, tax advisers and software houses, as well as from HM Treasury (HMT), HM Revenue and Customs (HMRC) and the Office of Tax Simplification (OTS). The Committee thanks all who contributed to our work.
6. The Sub-Committee invited the Financial Secretary to the Treasury, the Rt Hon Mel Stride MP, to give evidence to the inquiry. We were concerned that the Financial Secretary refused to participate.⁴ We hold more serious concerns about the Minister's failure to give evidence on the powers of HMRC, which we will address in our second report of this inquiry. However, we were disappointed that the Minister, who officials told us takes a "close interest" in MTD, was unwilling to discuss the issue with the Sub-Committee. We will continue to pursue constructive solutions to the issues raised by our witnesses in coming months.

1 Economic Affairs Committee, *Draft Finance Bill 2017: Making Tax Digital for Business* (3rd Report, Session 2016–17, HL Paper 137)

2 [Finance \(No.2\) Act 2017](#)

3 [Explanatory notes to the Finance \(No.3\) Bill 2018](#) [HC Bill 282 (2017–19)-EN]

4 Letter from the Rt Hon Mel Stride MP to the Rt Hon Lord Forsyth of Drumlean, 25 October 2018: <https://www.parliament.uk/documents/lords-committees/economic-affairs/251018%20FST%20LEAC%20Letter.pdf>

CHAPTER 2: DEVELOPMENT OF MAKING TAX DIGITAL

7. Our previous inquiry *Making Tax Digital for Business* considered in detail the Government's original MTD proposals.⁵ The MTD for Business proposals were to be mandatory from April 2018 for businesses with annual income greater than £10,000 and were to be extended in due course to corporation tax and VAT reporting.
8. The 2017 report set out the full history and background to the MTD programme. This report considers the policy developments and progress over the last 18 months towards implementation of this significant project.

The 2017 report—key conclusions and recommendations

9. The Committee's report concluded that the Government was right to seek to modernise HMRC systems and encourage businesses to embrace digitalisation and seek efficiencies. It offered a number of challenges to the MTD for Business proposals, as well as recommendations. The Committee found:
 - The suggested impact on the tax gap benefit to the Exchequer, which was HMRC's main driver for mandatory digitalisation, was unproven and little more than guess work. The report recommended HMRC revisit and test, as part of its pilot, the behavioural responses of taxpayers in reducing errors by adopting digital record-keeping and filing.
 - HMRC underestimated the initial and ongoing costs to a diverse range of businesses, which were likely to outweigh benefits; it recommended that HMRC produce a more comprehensive impact assessment, stratified by business type, size and digital capability.
 - Levels of awareness of the significant changes the new mandatory obligations would bring were very low and skills needed to be developed; a comprehensive communications strategy was needed to make taxpayers aware of the changes together with a support and resources strategy to assist businesses in compliance.
 - HMRC underestimated the difficulties faced by the considerable number of people with limited digital skills or inadequate broadband access; the Committee recommended HMRC should work with representative bodies to develop detailed guidance that would work in practice, particularly for those with insufficient broadband access.
 - The pilot programme was too short and limited to yield learning and process-improvement benefits, or to test a full compliance cycle, taxpayer experiences, costs or the impact on error rates and the tax gap. The Committee recommended extending the pilot to early 2019, with a comprehensive scope.
 - Witnesses were almost universally concerned that the timetable was too tight and entailed unjustifiable risks for businesses, HMRC, tax practitioners and the software industry. The Committee recommended deferring all mandation until April 2020 at the earliest.

5 Economic Affairs Committee, *Draft Finance Bill 2017: Making Tax Digital for Business* (3rd Report, Session 2016–17, HL Paper 137)

- The late publication of draft legislation meant that the time for consultation was inadequate and the reliance on secondary legislation reduced the scope for effective parliamentary scrutiny. The Committee recommended 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”.

10. The report welcomed the Chancellor’s announcement in the Spring Budget 2017 of a 12-month delay in mandating the MTD for Business scheme for businesses with annual income below £85,000, although it concluded that the deferral had not gone far enough, nor addressed the many broader challenges.

Policy developments and implementation progress

11. In partial recognition of the concerns on the timescales proposed, the Financial Secretary to the Treasury announced in July 2017 that MTD would apply from April 2019 instead of April 2018. Furthermore, MTD would be restricted to VAT only, until April 2020 at the earliest. As a result, from April 2019 MTD will be mandatory only for VAT-registered businesses with annual taxable turnover over £85,000.
12. An updated impact assessment was published at the time of the Autumn Budget 2017.⁶ Government estimates of the contribution of MTD to the Exchequer by 2022–23 reduced from over £3 billion to just over £1 billion. The assumptions underlying the estimates did not change from those challenged by the Committee. Estimates of the costs to be borne by those businesses mandated from April 2019 were revised to show ongoing net costs (after transition) of £37 million to the estimated 1.2 million businesses affected, confirming our 2017 conclusion that costs would exceed benefits to businesses. Transitional costs were forecast at £131 million, or just over £100 per business.
13. In recognition that spreadsheets were widely used, especially by smaller businesses, HMRC announced in December 2017 that spreadsheets would meet digital record-keeping requirements for VAT. The spreadsheets will have to link through ‘bridging’ software to HMRC’s systems to submit VAT returns digitally.
14. A limited VAT pilot involving a few hundred of the simplest businesses started in April 2018. It began opening on a staged basis to businesses with suitable software in October 2018.
15. HMRC’s detailed requirements for business record-keeping and MTD compliant software were published in July 2018.⁷ While providing useful clarification for some, the challenges of adapting systems in more complex VAT businesses started to emerge.

6 HM Revenue & Customs, *Making Tax Digital: changing the scope and pace: technical note* (1 December 2017): <https://www.gov.uk/government/publications/making-tax-digital-changing-the-scope-and-pace-technical-note/making-tax-digital-for-business> [accessed 14 November 2018]

7 HM Revenue & Customs, *VAT Notice 700/22: Making Tax Digital for VAT* (13 July 2018): <https://www.gov.uk/government/publications/vat-notice-70022-making-tax-digital-for-vat> [accessed 14 November 2018]

16. The draft Finance Bill 2018 was published in July 2018. This included draft clauses to introduce a penalty and interest regime to support compliance with MTD, to be introduced from April 2020.
17. On 16 October 2018, HMRC announced a six-month deferral for some organisations with more complex VAT arrangements, including NHS trusts, local authorities and VAT groups—around 35,000 of the total one million or so mandated from April 2019.⁸
18. **We acknowledge the announcement on 16 October 2018 of the deferral for some of the more complex organisations, and extension of the pilot programmes. We regret that this deferral was given mainly to other public sector bodies and a selection of small organisations with the most complicated tax affairs, and not to the smaller businesses for whom implementation will be most burdensome, and who have the fewest resources to devote to implementation.**

8 Letter from Ruth Stanier OBE, to The Rt Hon Lord Forsyth of Drumlean, 16 October 2018: <https://www.parliament.uk/documents/lords-committees/economic-affairs-finance-bill/draft-finance-bill-2018/161018%20MTD%20for%20VAT%20Letter%20LF%20.pdf>

CHAPTER 3: HMRC'S PREPARATIONS FOR MAKING TAX DIGITAL FOR VAT

19. This chapter considers HMRC's preparations for MTD for VAT since the announcement in July 2017 that MTD would focus on VAT first. It considers five areas: HMRC's understanding of business systems and concerns, the pilot programme, the communication strategy for taxpayers affected, digital exclusion and the long-term strategy.

Understanding business systems and concerns

20. HMRC's preparations should be viewed against the background of widespread concern among external stakeholders that it underestimates the extent of change the introduction of MTD for VAT imposes on many of the businesses affected, as well as the complexity of VAT calculations and processes.
21. HMRC announced a 'soft landing' in July 2018. Businesses would not be penalised for not having digital links between systems for the first year of MTD for VAT (2019–20), although digital record-keeping and digital filing would still be required.
22. Online filing of VAT returns has been mandatory for some years. It is currently possible for businesses to copy the relevant figures from non-digital records and input them—or ask their agents to do so—through a portal on GOV.UK. It is estimated that around 90 per cent of taxpayers do this.⁹ The fact that a large majority of VAT businesses file electronically does not mean that they have fully digital accounting systems supplying those figures. Regardless of whether they do or not, for partially exempt businesses, groups, users of special VAT schemes and others, the entries in their VAT returns do not flow directly from such records. The Confederation of British Industry (CBI) told us:
- “... businesses will be required to have a clear digitally linked audit trail from the transaction records to the VAT return filing—a ‘digital link’ is responsible for an electronic transfer or exchange of data between software programs, products or applications without the involvement or need for manual intervention. Such a requirement represents a very considerable undertaking for businesses in terms of time and cost, given the potential complexity involved.”¹⁰
23. When asked why the deferral for some organisations announced in October 2018 was limited to only a small group, HMRC told us that while the technical functionality would be in place before April 2019, this would not allow enough testing for the more complex requirements of these entities.¹¹ The deferral for this group was expected to have a negligible effect on the tax gap yield.
24. **HMRC's failure to appreciate fully or take account of business and accounting processes early in its project planning, combined with a rushed timetable, is unhelpful. The soft-landing is welcome but does not address all of businesses' concerns.**

9 [Q 11](#) (Frank Haskew)

10 Written evidence from CBI ([DFC0079](#))

11 [Q 43](#) (Ruth Stanier)

25. **We are disappointed that HMRC has not done more to consider the business perspective and challenges in preparing for Making Tax Digital for VAT. A more engaged and collaborative approach will be needed if Making Tax Digital for Business, or Making Tax Digital for corporation tax, is rolled out.**
26. **We recommend that HMRC reviews and learns lessons from its Making Tax Digital for VAT experience. It must fully consider the practicalities affecting underlying business and accounting systems before Making Tax Digital is extended to other taxes.**

Pilot programme

27. The pilot programme for MTD for VAT started in April 2018, only 12 months before the new system is due to be implemented. It began with a very limited number of businesses participating on an invitation-only basis and dealing with only the most straightforward processes. This stage of the programme was completed successfully in October 2018.
28. HMRC will be writing to half a million businesses in the coming weeks inviting them to join the pilot. From early 2019, the remaining nearly 600,000 will be invited to join, including types of business not previously eligible, such as partnerships and those who trade in EU countries. This late admission to the pilot has been criticised by some, who say many partnerships will not even have one VAT quarter to test their systems before the system is mandated, and consider this insufficient for preparation and learning.¹²
29. We are also concerned that the pilot period runs up to 31 March 2019, immediately before the MTD for VAT becomes mandatory. There will be no “pause” to allow the lessons learned in the pilot to be evaluated, particularly from the perspective of taxpayer readiness, and changes made before it is mandatory for most taxpayers. The reliability and performance of the system in dealing with large numbers of VAT traders is unproven.
30. We note with concern that the pilot has made no effort to test HMRC’s assessment of the costs and benefits of Making Tax Digital. HMRC told us “the pilot was really to test whether the system was working on the customer experience side rather than test the effect on tax revenues.”¹³ In written evidence to our 2017 inquiry, the Treasury and HMRC stated one of their aims for the pilot, which at that point planned to test the MTD for Business programme as a whole, as “to provide evidence and early insight into the effects of the policy on those participating in the pilot”. We recommended in that report that the pilot include analysis of the costs to businesses of MTD for Business, and the impact on error rates and the tax gap.¹⁴ HMRC failed to listen to this recommendation, and as a result their estimates remain under criticism, particularly from those representing small businesses.
31. Our evidence showed widespread concern about the lateness of the pilot process relative to the April 2019 deadline.¹⁵

12 Supplementary written evidence from Kevin Ringer ([DFC0095](#))

13 [Q 45](#) (Theresa Middleton)

14 Economic Affairs Committee, *Draft Finance Bill 2017: Making Tax Digital for Business* (3rd Report, Session 2016–17, HL Paper 137)

15 Written evidence from National Farmers’ Union ([DFC0084](#)), Association of Taxation Technicians ([DFC0061](#)), Low Incomes Tax Reform Group ([DFC0067](#)), Institute of Chartered Accountants of Scotland ([DFC0068](#)), Association of Convenience Stores ([DFC0087](#))

32. **The timetable for introducing Making Tax Digital for VAT from piloting to implementation is too rushed and the pilot so far has been too narrow and too late. The expansion of the pilot over the coming weeks is welcome but there is too little time before 1 April 2019 to make up lost ground and respond to implementation issues identified by taxpayers. HMRC’s systems are still unproven at scale.**

Communications and taxpayer support

33. HMRC’s communications so far about MTD for VAT have largely focused on agents. HMRC decided to rely initially on agents to raise awareness of the change amongst their clients.
34. VAT Notice 700/22 was published in July 2018 to give guidance to affected businesses, along with a communications pack for other stakeholders.¹⁶ The notice is not an easy read and there has been criticism that it does not cover all the necessary issues.¹⁷
35. There is widespread concern about the absence of direct communications from HMRC to make taxpayers aware of their obligations and about HMRC’s failure to support small businesses who are unrepresented, digitally excluded or have limited digital skills to meet their new digital obligations. When HMRC writes directly to businesses once the pilot is opened to them, they intend to include advice about the actions the business needs to take to get ready. This will be too late to be helpful. We return to this in chapter 5.
36. HMRC’s performance in this area was compared unfavourably by the Federation of Small Businesses (FSB) with the arrangements made by the Australian tax authority in similar circumstances. In Australia there was a year-long programme of engagement with key stakeholders—workshops, information sessions and webinars, videos, guides and regular newsletters.¹⁸ HMRC’s approach is inconsistent with best practice in change programmes and it underestimates the impact it will have on some taxpayers and their agents.
37. HMRC recently published its own research,¹⁹ undertaken from July–September 2017, on how it might communicate most effectively with affected businesses. It is not clear that it has developed a support package to reflect that research or to communicate with those with no awareness or who may be digitally excluded. Even when HMRC writes to businesses directly, its support material will link to online videos and other digital means,²⁰ which is unhelpful to those who are less digitally enabled and in greater need of support. More generally, witnesses suggested that HMRC does not have sufficient resources to assist businesses to the extent necessary.²¹

16 HM Revenue & Customs, *Making Tax Digital for VAT- stakeholder communications pack*, (18 October 2018): <https://www.gov.uk/government/publications/making-tax-digital-for-business-stakeholder-communications-pack/making-tax-digital-for-business-stakeholder-communications-pack> [accessed 30 October 2018]

17 Written evidence from National Farmers’ Union (DFC0084) and CIOT (DFC0071)

18 Written evidence from FSB (DFC0076)

19 HM Revenue & Customs, *Making Tax Digital: Exploring Transitional Support approaches*, (October 2018): https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/750412/Making_Tax_Digital_ExploringTransitional_Support_Approaches.pdf [accessed 30 October 2018]

20 Q 49 (Theresa Middleton)

21 See written evidence from Institute of Chartered Accountants of Scotland (DFC0068), Chartered Institute of Taxation (DFC0071), Michael C Feltham and Associates (DFC0077) and CBI (DFC0079)

38. **HMRC has not done enough to communicate with taxpayers or agents to support their preparations to meet their Making Tax Digital obligations. HMRC’s dependence on agents to ensure businesses understand their Making Tax Digital for VAT obligations does not recognise the needs of unrepresented taxpayers. It also has the effect of shifting the costs of supporting taxpayers through this significant change, which HMRC should bear, to taxpayers by increasing their compliance costs.**
39. **We recommend that HMRC urgently publishes full details of how its communication and support systems will meet the needs of taxpayers and agents across different levels of digital capability and skills.**

Assisting the digitally excluded

40. A common concern raised with us was that the method of claiming digital exemption or exclusion by reason of age, disability or broadband connection problems had still not been made available, nor was there any clarification of what rules HMRC would apply in practice. For example, how old do taxpayers have to be to qualify for an exemption on ground of age? The lack of information on exemptions and the rules that might be applied to such businesses is a cause of frustration.²² We also heard that HMRC has been unwilling to grant exemptions from using the existing digital portal. As a result, some witnesses were sceptical that HMRC would take account of digital capabilities when granting exemptions.²³ The Low Incomes Tax Reform Group said: “For those vulnerable taxpayers who are likely to be covered by the exemption, delays in this area will almost certainly be causing unnecessary stress and worry”.²⁴
41. We heard from agents about the difficulties they, and their clients, have with broadband connections.²⁵ Many small businesses with inadequate broadband coverage file online at present using workarounds, such as passing information to their agent to file or filing by phone. As Kevin Ringer, a partner in a firm of chartered accountants (writing in a personal capacity), commented, workarounds for online VAT are practical “because they are only required periodically and do not disrupt the business. But MTD is completely different because MTD requires digitisation of all transactions i.e. every day of the year.”²⁶ As HMRC has failed to communicate adequately on this issue—one not dependent on software or pilots—it is not possible to tell whether it has underestimated the additional number of applications for exemptions to replace current workarounds that will no longer suffice and so will not be able to process new claims in time.
42. **We recommend that HMRC develops guidance on the practicalities of claiming digital exemption with the representative bodies and publishes it as a matter of urgency. HMRC should notify taxpayers in writing of its guidance and claims process for digital exemptions when it invites them to join the pilot.**

22 Written evidence from James Smith (Accountant) Ltd ([DFC0039](#)), Kevin Ringer ([DFC0064](#)), NFU ([DFC0084](#))

23 [Private oral evidence taken on 22 October 2018](#) (Session 2017–19) and written evidence from Kevin Ringer ([DFC0064](#))

24 Written evidence from Low Incomes Tax Reform Group ([DFC0067](#))

25 Written evidence from Kevin Ringer ([DFC0064](#))

26 *Ibid.*

CHAPTER 4: THE NEW SOFTWARE MARKET

43. This chapter considers developments in the software market in response to the latest MTD for VAT obligations on businesses. Challenges for business in selecting software providers are discussed in chapter 5.

Software industry

44. The accounting software industry, or at least its market leaders, see MTD for VAT in the context of their broader business of promoting and enabling business efficiency through the use of technology in a commercial environment. Sage cited its survey evidence of administrative savings by businesses moving from paper to digital accounting:

“Our research shows that by moving to digital accounting, businesses can save £17,000 per year, the equivalent to getting 27.6 days a year back to focus on revenue-generating activities.”²⁷

45. Mike Cherry, National Chairman of the Federation of Small Businesses, was not sure his members would agree:

“For those small businesses, many of which are microbusinesses, that are just about able to comply with the VAT regime, which is one of the most costly tax regimes that they have to deal with, this [MTD] is going to take a huge amount of their time away from coping with all the additional problems that they are facing at the moment relating to costs, Brexit and everything else. That seems quite bizarre.”²⁸

Our witnesses supported using digitalisation and technology to promote efficiency and productivity.²⁹ How and when it was best achieved was the challenge the Government had not addressed in its enthusiasm to mandate MTD for VAT.³⁰

46. The accounting software industry has a pivotal role in MTD for VAT in supplying systems to support taxpayer compliance and expects to be a major beneficiary of it. The industry has had to adapt from the wider version of MTD originally envisaged to the narrower version for VAT, including bridging software to accommodate the use of spreadsheets. It has invested in developing its software through the VAT pilot as well as raising business awareness.
47. In the longer term, MTD for VAT is still expected to extend to income tax and corporation tax. To sustain product demand and development, the software industry has asked for clarity on the long-term road map. Although digital record-keeping may be suitable for all taxes, systems will have to work for multiple taxes and suitable lead time is required. Sion Lewis, chief executive officer of IRIS Accountancy Solutions, said:
- “... clearly there is concern about not having access to the longer-term plans for MTD, and it would be incredibly helpful to understand those plans”.³¹

27 Supplementary written evidence from Sage ([DFC0088](#))

28 [Q 17](#) (Mike Cherry)

29 See [Q 15](#) (John Cullinane), written evidence from ICAEW ([DFC0073](#)) and ICAS ([DFC0076](#))

30 See written evidence from Association of Accounting Technicians ([DFC0044](#)), ICAEW ([DFC0073](#)), Kevin Ringer ([DFC0064](#))

31 [Q 24](#) (Sion Lewis)

Development of MTD-compliant software

48. The software market for MTD for VAT compliance falls into three broad categories: the latest versions of comprehensive accounting and tax reporting packages (possibly cloud based); older software licences, sometimes industry-specific; and newly developed ‘bridging software’, to enable spreadsheets to make the digital links to HMRC systems.
49. The larger software providers appear to be confident that the latest versions of their software packages will be ready for the MTD for VAT start date, or are already tested and ready.³²
50. It is not clear whether or how older products will be made ready for MTD for VAT: one provider is offering an MTD for VAT module to add to older products for the first year of mandation, acknowledging that the timescale for business to migrate to new technology may be too short for some.³³ Witnesses told us that older packages with a one-off licence fee would have to be upgraded to the latest version on a subscription package.³⁴
51. HMRC said that specialist sector software, for the agricultural industry or for charities for example, was under development.³⁵ There is, however, no certainty if or when fully developed software for these will be available.
52. The position on bridging software to enable spreadsheet use, particularly by unsophisticated taxpayers and smaller businesses, is not clear. Products are listed on HMRC’s website though unhelpfully they are not labelled as bridging software products. It is also not clear whether the software companies will back the products with education and training support and we note that the continued use of spreadsheets as the main mechanism for MTD compliance runs counter to the leading software providers’ main fully digital market offerings.
53. Witnesses referred to HMRC’s decision that ‘cut and paste’ solutions would not meet MTD for VAT requirements. Some disagreed with HMRC’s conclusion that such approaches did not constitute a digital bridge rather than a manual intervention of the type HMRC is trying to remove as a potential source of errors.³⁶
54. Many larger businesses have bespoke software for their accounting; this software will have to be reviewed individually to assess MTD compliance. Although HMRC was confident that larger businesses would find it relatively easy to meet MTD for VAT obligations, our evidence challenges this. UK Finance said the obligations set out in VAT Notice 700/22, issued in July 2018, failed to consider adequately how VAT applied to financial services businesses and how its requirements could be applied by those using certain partial exemption methodologies. They said, “this is significantly more than our members are currently required to record and will result in additional costs and complexity”.³⁷ UK Finance stated that considerations of cybersecurity, internal compliance, due-diligence and the internal

32 For example, see supplementary written evidence from Sage ([DFC0088](#)).

33 Supplementary written evidence from Sage ([DFC0088](#))

34 Written evidence from ICAEW ([DFC0073](#)), Harrison Riley Accountants ([DFC0016](#)), Christopher Prescott ([DFC0055](#)) and Kevin Ringer ([DFC0064](#))

35 Written evidence from HMRC ([DFC0085](#))

36 For example, written evidence from Sheena Green ([DFC0009](#)).

37 Written evidence from UK Finance ([DFC0066](#))

technological requirements, translated into “a time-consuming and costly exercise”.³⁸ The CBI echoed those concerns.³⁹

55. New software packages need to be accompanied by training and support. They are best introduced by businesses at the end of an accounting period. Concern has been expressed that training and support may not be available and that businesses will be pushed to change at inappropriate times in the rush to the April 2019 deadline.⁴⁰
56. **The software industry is, unsurprisingly, responding to the commercial opportunity of Making Tax Digital for VAT. We have seen no evidence that any free software products will be offered.**
57. **We question the logic of requiring taxpayers to spend additional money to pay their tax. Since a free option has not emerged from the software industry, the Government should consider again the case for providing a basic, free software option.**
58. **Businesses and accountants using the latest versions of mainstream digital accounting software are likely to be well supported for Making Tax Digital for VAT compliance in April 2019. It is not clear that older packages or specialist software will be updated to be compliant with Making Tax Digital for VAT in time for April 2019.**
59. **A market in ‘bridging software’ does not seem to have emerged. As there is a greater commercial opportunity for software providers in those businesses who are digitising more substantially, ‘bridging’ customers may be less supported by the larger software providers, and so receive less training and support.**
60. **Many of the concerns about the software required for Making Tax Digital could be explored and overcome with a longer pilot period. This ought to allow a more developed software market to emerge in 2019. In this context, HMRC’s ‘soft landing’ for digital links is essential.**

38 Written evidence from UK Finance ([DFC0066](#))

39 Written evidence from CBI ([DFC0079](#))

40 Written evidence from P McKelvey & Co ([DFC0003](#)) and Richard Pepper ([DFC0034](#))

CHAPTER 5: TAXPAYER READINESS

61. This chapter considers the readiness of businesses to meet their MTD for VAT obligations in April 2019, in light of HMRC's preparations and software developments. Starting with levels of awareness among the affected businesses, it will then consider the software and implementation choices for different types of taxpayer and what still needs to be done.
62. In our 2017 report we noted that "the readiness of ... businesses for MTD for Business 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 extent of internet connectivity."⁴¹ It might be expected that, due to the passage of time and because MTD for VAT excludes businesses with annual income below £85,000 (which were included in MTD for Business), business readiness would be noticeably higher than in early 2017. However, the evidence we have received suggests that our assessment in 2017 remains valid today.
63. **Although many witnesses supported digital record-keeping in principle, some saw no justification for HMRC to impose digital record-keeping requirements on businesses, especially where it would provide exactly the same information to HMRC as the current system.**
64. **There was questioning throughout our evidence of whether HMRC should mandate Making Tax Digital at all. It seems unreasonable to make people run their businesses in a different way just to produce the same figures for tax purposes. We have sympathy with the view that HMRC should not impose digital record-keeping requirements purely for tax purposes without compelling reasons, where they hold no benefits for a particular business.**

Business awareness and planning

65. Research by the Institute of Chartered Accountants in England and Wales (ICAEW)⁴² in July 2018 revealed that over 40 per cent of businesses due to be affected by MTD for VAT were not aware of it. A survey by OTS⁴³ in October 2018 indicated that the figure not aware of MTD might be slightly lower, at 30 per cent, but both figures constitute a sizeable percentage of those affected.
66. ICAEW's research⁴⁴ revealed that 54 per cent of VAT-registered businesses use accounting software at present, a noticeable increase since its 2016 survey, but the proportion of businesses due to be affected by MTD for VAT using only paper-based records (13 per cent) is unchanged since 2016.⁴⁵ HMRC's

41 Economic Affairs Committee, *Draft Finance Bill 2017: Making Tax Digital for Business* (3rd Report, Session 2016–17, HL Paper 137)

42 Written evidence from ICAEW ([DFC0073](#))

43 [Q 16](#) (Paul Morton)

44 Written evidence from ICAEW ([DFC0073](#))

45 ICAEW, 'MTD awareness and planning: business survey results', September 2018: <https://www.icaew.com/technical/tax/making-tax-digital/mtd-articles/mtd-awareness-and-planning-business-survey-results> [accessed 26 October 2018]

expectation is that a large number of this group will move to software,⁴⁶ but there is no evidence of any move in that direction at the moment.

67. The ICAEW survey found that 34 per cent of businesses aware of MTD expected to rely on their agent to deal with the changes. Another 35 per cent had acquired or would acquire new software. Some presumably were undecided, but 20 per cent had made no preparations. According to the OTS survey,⁴⁷ less than 30 per cent of businesses were confident that they understood what would be required and less than 15 per cent of businesses said they were prepared.
68. The lack of awareness in some businesses in part reflects HMRC's decision, discussed in chapter 3, to communicate primarily with software providers, agent representative bodies and agents. It would not inform taxpayers until they were invited to join the pilot. Many witnesses considered this too late. As Frank Haskew of ICAEW put it, "while some businesses are obviously ready, there is still a mountain to climb in relation to communication and making sure that businesses will be on board for this when it comes in."⁴⁸
69. **A spectrum of business readiness has emerged, from those confident in their readiness, through those trying to prepare but hampered by lack of information, to those still wholly unaware or digitally excluded. It is concerning that a substantial proportion of affected businesses appear to be unaware of what they will be expected to do in five months' time.**

Software selection challenges

70. The first challenge for businesses which do not use the latest software packages and those small businesses intending to adopt digital accounting for the first time may be selecting the most appropriate system for them. Some are concerned that the lack of clarity on the longer-term direction of MTD makes selection more challenging, as they would strongly prefer to move to a system that would be compliant for all taxes.⁴⁹
71. The decision in practice may be made by some businesses because of their accountant's choice, to achieve compatibility of systems, or some may decide to ask their accountants to do more for them. Many may lack the expertise or confidence to inform their choice. Evidence from practitioner bodies and agents suggests businesses are simply not clear on choices.⁵⁰
72. Additional concerns arise because HMRC refuses to 'approve' software products, limiting its involvement to listing products that have passed the technical test to link to HMRC systems. HMRC guidance states: "HMRC does not recommend or endorse any one product or software provider and is not responsible for any problems you have with software".⁵¹ This is as unhelpful as it is unequivocal.

46 [Q 44](#) (Theresa Middleton)

47 [Q 16](#) (Paul Morton)

48 [Q 9](#) (Frank Haskew)

49 Written evidence from ICAS ([DFC0068](#)) and ICAEW ([DFC0073](#))

50 For example, written evidence from ICAS ([DFC0068](#)), Hillier Hopkins ([DFC0070](#)) and David Jeffreys ([DFC0046](#)).

51 HM Revenue & Customs, *Find software suppliers for sending VAT Returns and Income Tax updates*, (24 October 2018): <https://www.gov.uk/guidance/software-for-sending-income-tax-updates#VAT> [accessed 26 October 2018]

73. HMRC has suggested it will make available, perhaps in December 2018, a software selection tool.
74. We heard specific concerns about data retention through software product changes,⁵² responsibility for software problems and what consumer-protection obligations and standards HMRC is requiring of software providers.⁵³
75. HMRC has however offered a ‘soft landing’ on penalties for businesses who cannot meet their digital record-keeping or filing obligations, and “where businesses are doing their best to comply with the law”.⁵⁴ Although we welcome recognition of the challenges businesses face, it is not yet clear how HMRC will apply the soft landing and what burden it might place on smaller businesses.
76. **Although MTD for VAT-compliant software may be available, there has been insufficient time to establish a competitive, accessible and diverse software market.**
77. **The lack of HMRC guidance or support for digital product selection means businesses trying to go digital for the first time face considerable challenges. The fast-changing software market and Making Tax Digital for VAT deadline in April 2019 compound the difficulty in making the best long-term choice. These businesses may not be able to make the right choice in time for April 2019 and would benefit from a longer timetable. They should not have to hope for a discretionary waiver of a penalty from HMRC.**
78. **Businesses using older software face costs of upgrading purely to meet Making Tax Digital for VAT requirements, since they are already realising efficiencies through their existing software.**
79. **We recommend that the Government urgently provides a support package for software system selection to businesses going digital for the first time and their agents, independently from the software industry.**
80. **We recommend that HMRC, as its software selection tool is developed, makes provision for establishing and certifying which software options are compliant with Making Tax Digital for VAT.**

Progress towards implementation

81. Depending on their current readiness, businesses may go through various stages before MTD for VAT compliance is achieved: awareness; understanding; considering digital exclusion; software selection; skills development; training; and implementation and testing. Witnesses noted that this was a “not inconsiderable task”⁵⁵ for some. It is considered particularly unfair on those business owners with less digital skills or training, who currently keep perfectly acceptable manual accounting records.⁵⁶

52 Written evidence from Kevin Ringer (DFC0064)

53 Written evidence from the Federation of Small Businesses (DFC0076)

54 Letter from Ruth Stanier OBE, to The Rt Hon The Lord Forsyth of Drumlean, 16 October 2018: <https://www.parliament.uk/documents/lords-committees/economic-affairs-finance-bill/draft-finance-bill-2018/161018%20MTD%20for%20VAT%20Letter%20LF%20.pdf>

55 Written evidence from Christopher Prescott (DFC0055)

56 For example written evidence (DFC0042), Joe Quinn Tax Ltd (DFC0040), Kevin Ringer (DFC0064).

82. Witnesses suggested that some owners may give up altogether rather than adapt to the disproportionate burden placed on them. One agent quoted a client as saying “If this is made compulsory I will pack up first”.⁵⁷ As John Cullinane of the Chartered Institute of Taxation (CIOT) put it, “elderly business people or advisers might retire early or give up. It is anecdotal and speculative, but quite a significant possibility”.⁵⁸
83. For the 34 per cent in the ICAEW survey who aim to rely on their agent for assistance with changes, there are concerns that agents may not have the requisite capacity. CIOT wrote:

“We are also concerned about the amount of agent help businesses will be able to obtain in the run up to April 2019 ... many of our members will be helping their clients fulfil their Corporation Tax and ITSA filing obligations (December and January deadlines respectively) and so simply will not have the capacity to help businesses transition to MTD until February 2019 or later.”⁵⁹

Regardless of capacity, witnesses said that an agent’s ability to assist with software selection at this stage is hampered by the late availability of software and the expectation they may have to assist with training.⁶⁰

84. Even when businesses have decided to change to digital packages, witnesses stated that the transition takes time and is not necessarily smooth, even with agent support. One agent wrote: “some do pick it up well. However, many struggle. Some make such a mess of it that it is easier to ignore their efforts.”⁶¹
85. Many agents have undertaken a detailed review post-implementation of new systems, which has been illuminating. They cite examples of incorrect settings in software taking time to be found and corrected.⁶² A sensible implementation timescale needs to consider these.
86. **The lateness in piloting has placed unreasonable burdens on taxpayers by reducing their time to prepare or test new systems.**
87. **As HMRC is relying heavily on agents to support their business clients, it needs to give agents greater support with matters such as software suitability and be more open to their feedback on the digital challenges their clients are facing.**
88. Some small businesses are unrepresented or have little agent involvement in their tax affairs. The Low Incomes Tax Reform Group wrote:

“The majority of small self-employed individuals or businesses who are unrepresented are completely unaware of HMRC’s Making Tax Digital programme and the obligation to comply with MTD for VAT from April 2019. This is unacceptable and needs to be rectified as a matter of urgency.”⁶³

57 For example, written evidence from John Stone ([DFC0004](#))

58 [Q 11](#) (John Cullinane)

59 Written evidence from CIOT ([DFC0071](#))

60 Written evidence from Richard Pepper ([DFC0034](#))

61 Written evidence from GBM Accounts Ltd ([DFC0025](#))

62 Written evidence from Christopher Prescott ([DFC0055](#))

63 Written evidence from Low Incomes Tax Reform Group ([DFC0067](#))

This community may be the one least supported or enabled for MTD for VAT. Many may choose to seek agent support, which may raise concerns about affordability.

89. **HMRC is alone in its confidence that all one million businesses will be ready for Making Tax Digital for VAT in April 2019. They have underestimated the time for research, planning, training and system changes that some businesses will need.**
90. **HMRC told us on 16 October that it was “significantly increasing its communications activity”⁶⁴ to ensure businesses were ready for April 2019. With less than five months remaining before introduction, it is too late to begin an effective communications campaign.**
91. **We recommend that HMRC increases the communication and support available to agents, and listens to agents’ concerns. Within that communication strategy, HMRC needs to address how it supports unrepresented taxpayers.**
92. **Some businesses with complex affairs have been granted a six-month deferral after they complained about the April 2019 deadline. Smaller businesses also need to be heard by HMRC specialists and the case for further categories of deferral should be considered. In addition, specific support in dealing with implementation problems will be needed for unrepresented taxpayers.**
93. Another concern relates to Brexit: in particular the uncertainty about its impact on businesses and their VAT reporting. That Brexit happens the same week as MTD for VAT means businesses may have to implement two significant changes at the same time. Witnesses were consistent in thinking that this coincidence created overly onerous burdens on business. This adds to the case for delaying the date for mandating MTD for VAT.⁶⁵
94. **The evidence presented to us suggests that HMRC, taxpayers and the software market are unprepared for the implementation of Making Tax Digital for VAT in April 2019.**
95. **We recommend that the Government defers the date for mandating Making Tax Digital for VAT by at least one year, while encouraging businesses to join voluntarily. This will enable further development of a competitive software market and specialist sector products, permit HMRC’s systems to be fully and appropriately tested, and allow taxpayers to prepare fully for implementation of new systems.**
96. **Deferring the date for Making Tax Digital for VAT will not by itself solve the concerns raised in this report, if HMRC does not start listening to the concerns of businesses and agents.**
97. **We recommend that HMRC plans a staged transition for businesses to join Making Tax Digital for VAT, and future stages of Making Tax**

64 Letter from Ruth Stanier OBE, to The Rt Hon Lord Forsyth of Drumlean, 16 October 2018: <https://www.parliament.uk/documents/lords-committees/economic-affairs-finance-bill/draft-finance-bill-2018/161018%20MTD%20for%20VAT%20Letter%20LF%20.pdf>

65 Written evidence from Low Incomes Tax Reform Group (DFC0067), Institute of Chartered Accountants of Scotland (DFC0068), Hillier Hopkins LLP (DFC0070), Chartered Institute of Taxation (DFC0071), CBI (DFC0079), National Farmers’ Union (NFU) (DFC0084)

Digital which allows for businesses, not just HMRC, to be fully ready. As part of this, HMRC should provide more information on their plans for Making Tax Digital for Business and Making Tax Digital for corporation tax. This will allow businesses to make informed long-term decisions about their software selection.

Long-term strategy for MTD

98. When the Government decided to defer the introduction of MTD for Business and focus on MTD for VAT, it did not cease its pilot or testing, which continued at a slower pace. The Government has not altered its intention to implement MTD for Business for income tax or corporation tax. It is still to announce if, or when, MTD will be mandatory for each tax, or whether MTD for Business might be extended to businesses with annual income below £85,000. The original MTD for Business proposals applied to those with annual income over £10,000. That figure looks untenable, particularly once the Chancellor's 2018 Budget announcement to increase the personal allowance level to £12,500 is enacted.
99. While the delay to MTD for Business gives welcome space to focus on MTD for VAT, if MTD for Business is introduced in April 2020 there would be little time to learn lessons from the implementation of MTD for VAT.
100. **The absence of a long-term plan for Making Tax Digital and digital data collection is a cause of business uncertainty. While businesses do not need to know precise dates, they do need to understand the future direction of Making Tax Digital.**
101. **It will be unhelpful for businesses, if they have invested in software for Making Tax Digital for VAT, to find they need to reinvest in alternative software for Making Tax Digital for business or corporation tax.**
102. **We recommend that the Government publishes its plan for the long-term development of Making Tax Digital, including key decision points, milestones and dependencies. This will give greater certainty, and the software industry the information it needs to develop software that will work across each different aspect of the Making Tax Digital programme. It will also encourage businesses to choose digitalisation for productivity, efficiency and modernisation reasons rather than just tax compliance.**
103. **We recommend that the next stage of Making Tax Digital is not implemented until April 2022 at the earliest. At least two years are required to learn and act on lessons from the implementation of Making Tax Digital for VAT, and a further year will be required for the software industry and taxpayers to prepare.**

CHAPTER 6: THE MAKING TAX DIGITAL PENALTY AND INTEREST REGIME

104. This chapter assesses the Government’s proposed penalty and interest regime which would apply to Making Tax Digital. The regime is provided for in clauses 30–32 of and Schedules 11–13 to the draft Finance Bill 2018–19. In the Budget on 29 October 2018 the Government announced that the clauses would not be included in the 2018–19 Finance Bill; they would be included in the 2019–20 Finance Bill instead. We nevertheless present the evidence we received on these clauses below, to inform the drafting of the provisions for the 2019–20 Finance Bill.

The current penalty and interest regime

105. For income tax late filing penalties start at a fixed £100, increasing by £10 per day for 90 days and then increasing again by £300 or five per cent of the tax due, whichever is the greater, and regardless of whether tax is payable for the year concerned. Late payment of tax is penalised by an additional five per cent of tax due at each of 30 days, six months and 12 months, as well as late payment interest.

106. For corporation tax late filing penalties also start with a fixed £100, increasing by a further £200 at 90 days then a further 10 per cent of the tax due if the return is filed up to a year late, or 20 per cent if later. A third late filing year increases the fixed penalties to £500 and £1,000. There is no late payment penalty—only late payment interest.

107. For VAT there is a combined late return and late payment sanction: the VAT Default Surcharge. Each payment default gives rise to an escalating penalty, from 2–15 per cent, within a 12-month rolling default period on the amount of VAT due, with late returns extending the 12-month default calculation period.

Consultation process

108. The proposed penalties for failure to submit returns and failure to make payments on time have each been developed through three stages of consultation. The key principles in the design of the new regime were simplicity and proportionality. Three models were considered for late returns penalties and a points-based system won most support. The Government announced in December 2017 that it would proceed with the points-based system. The proposals on VAT repayment interest were the subject of a two-stage consultation. Draft clauses for all areas were published on 6 July 2018.

109. The evidence we received demonstrated widespread support for the proposals.⁶⁶ This is a strong example of the benefits of the ‘new approach to tax policy making’.⁶⁷

110. **We commend the consultation process which underlies these proposals, which was key in achieving broad support. This demonstrates the value of the ‘new approach to tax policy making’ when it is used effectively.**

66 [QQ 1–15](#) (CIOT); Written evidence from CIOT ([DFC0071](#)), Association of Taxation Technicians (ATT) ([DFC0061](#)), Low Income Tax Reform Group ([DFC0067](#)), Institute of Chartered Accountants of Scotland ([DFC0068](#))

67 HM Treasury, *Tax policy making: a new approach* (June 2010): https://webarchive.nationalarchives.gov.uk/20130102201052/http://www.hm-treasury.gov.uk/d/junebudget_tax_policy_making.pdf

Draft legislation on penalties

111. Under the points-based approach each failure to submit a return by the due date attracts a point. Points accumulate up to a certain threshold after which penalties are applied to subsequent failures. Points are removed after a period of good compliance or two years. There is a shorter penalty period for deliberately withholding information from HMRC by failing to file at all, which links with the new escalating penalties for late filing.
112. There are different points models for each tax and the points for different filing frequencies (monthly, quarterly etc.) will accrue or be removed at different levels, to ensure proportionality. In order for points to accrue HMRC must notify the taxpayer promptly, so that the failure can be remedied before further points accrue.
113. Late payments will not be penalised for the first 15 days; half a penalty will be charged where payment is made between 16 and 30 days. A full penalty applies thereafter until full payment is made with an additional daily penalty. If a taxpayer contacts HMRC to make payments before the relevant dates, penalties will not be charged.
114. An appeal system, based on providing a reasonable excuse or failure to file or pay, provides a taxpayer safeguard.
115. The Government planned to introduce the new penalties regime in 2020–21 at the earliest, one year after the implementation of MTD for VAT, although the effect of the one-year delay to the Finance Bill clauses is not yet clear. The penalty levels and a final impact assessment have yet to be published. As a result we could not hear evidence on the impact on taxpayers of the complete package nor assess its likely effectiveness.

Impact of the penalty reforms

116. Most witnesses agreed that a points-based system is more proportionate in relating penalties to non-compliant behaviours and differentiating between innocent errors and deliberate or persistent non-compliance.⁶⁸ The Association of Accounting Technicians (AAT) wrote: “This penalty system avoids the imposition of a penalty in circumstances where, in the words of one senior HMRC officer, ‘life just got in the way’ at the same as providing strong encouragement to the willingly non-compliant to avoid repetition of their failure.”⁶⁹ But timely notification of failures is needed to support this.⁷⁰
117. Witnesses held mixed views about aligning penalty regimes across taxes. However even those who welcome it as a simplification are concerned that the legislative provisions for the points-based system are complex,⁷¹ particularly around transition to the new regime, and may be difficult for taxpayers to understand. There was agreement that clear communications from HMRC will be important to prepare taxpayers for the new system.
118. Witnesses raised concerns about the detail of the penalties legislation. First, some witnesses considered the two-year time limit for HMRC to undertake a penalty assessment too long. The Low Incomes Tax Reform Group

68 Written evidence from Low Incomes Tax Reform Group ([DFC0067](#)) and Association of Taxation Technicians ([DFC061](#))

69 Written evidence from Association of Taxation Technicians ([DFC0061](#))

70 [Q 21](#) (Paul Morton)

71 [Q 35](#) (Jason Collins)

(LITRG) said this limit “runs counter to one of the key aims of the new system which is to encourage non-compliant taxpayers to become compliant again as quickly as possible”.⁷² The Association of Taxation Technicians (ATT) said: “Two years seems excessive when all that HMRC’s computer system will have to do will be to tot up the number of penalty points that a taxpayer has accrued.”⁷³

119. Second, witnesses stated that the 15-day limit before a late payment penalty was charged was too short to allow for understandable delays, such as for post and processing, and should be extended to 30 days⁷⁴ Mike Cherry OBE, National Chairman of the Federation of Small Businesses, told us the time limit “presupposes that the business owner would never go on holiday”.⁷⁵ The Association of Accounting Technicians (AAT) said: “It is disappointing to note that, in contrast to the views of the clear majority of respondents to the previous consultation, HMRC is proceeding with an unnecessarily short penalty period ... HMRC should not impose late payment penalties until 30 days have elapsed.” They also regarded the “compromise” solution, involving no penalty in the first 15 days and half the penalty being payable between 16 and 30 days, as introducing “unnecessary complexity”.⁷⁶
120. **The penalties regime could be fairer and better encourage taxpayers to remedy defaults promptly by giving taxpayers a longer grace period before penalties for late payment are applied, and ensuring taxpayers are aware of their exposure sooner.**
121. **We recommend that the two-stage late payment penalty system is amended to extend the period of grace from 15 to 30 days.**
122. **We recommend that the Government reduces the two-year time limit for HMRC to assess penalties to no more than one year, so that taxpayers are aware of their exposure sooner.**
123. The new penalty provisions will be introduced for VAT in 2020–21 at the earliest, the year after MTD for VAT goes live. The ATT found it “disappointing that HMRC is unable to move faster to replace the current discredited provisions”.⁷⁷ CIOT wrote: “this creates confusion for businesses and their agents, and indeed HMRC”⁷⁸ as to which regime applies to which taxes and when.
124. Witnesses also highlighted the importance of effective communication of the new penalty regime. CIOT said: “Clear guidance will be needed, especially around the new penalty points regime for MTD taxes”.⁷⁹ The Institute of Chartered Accountants in England and Wales (ICAEW) stated: “The practical application of the old and new penalty rules needs careful managing, with clear communications to business”.⁸⁰

72 Written evidence from the Low Incomes Tax Reform Group ([DFC0067](#))

73 Written evidence from the Association of Taxation Technicians ([DFC0061](#))

74 Written evidence from the National Farmers’ Union ([DFC0084](#)) and Association of Accounting Technicians ([DFC0044](#))

75 [Q 21](#) (Mike Cherry)

76 Written evidence from the Association of Accounting Technicians ([DFC0044](#))

77 Written evidence from the Association of Taxation Technicians ([DFC0061](#))

78 Written evidence from the Chartered Institute of Taxation ([DFC0071](#))

79 Written evidence from the Chartered Institute of Taxation ([DFC0071](#))

80 Written evidence from the ICAEW ([DFC0073](#))

125. **While we support the points-based approach for late filing of penalties we remain concerned that the complexity of the provisions, the transition process and the timescales may be confusing to taxpayers until they become familiar with the new system.**

VAT default surcharge and repayment supplement, and proposed interest regime

126. At present for VAT, late payments by the taxpayer are included in the VAT default surcharge regime. Interest payments to taxpayers are made according to the VAT repayment supplement rules. These limit interest for the first 30 days. No supplement is payable for periods when a return is under inquiry, even if it is subsequently found to be correct or if there are outstanding VAT returns. The repayment supplement rate is five per cent, to recognise these features and to incentivise HMRC to make timely repayments.
127. The proposed interest regime for VAT would broadly harmonise with that for income tax, with interest payable on tax paid late and on tax overpaid, but at different rates. The different rates for corporation tax quarterly payments would be retained. However, as for VAT repayment supplement, interest would not be paid on VAT repayments where there were outstanding VAT returns, until those returns were submitted. It would also not be paid during the period of a reasonable HMRC enquiry. The date when the interest proposals would take effect has yet to be published.
128. Although broadly aligned with the rules for income tax, the proposals differ in ways which seem difficult to justify. Non-payment of interest on overpayments during VAT enquiries is inconsistent with other taxes and uncommercial. CIOT, while welcoming alignment of the interest regime across taxes, were “concerned that certain measures (such as withdrawal of the Repayment Supplement and no entitlement to repayment interest for periods of enquiry by HMRC) remove the incentive for HMRC to process VAT repayments and undertake enquiries in a timely fashion.”⁸¹
129. **The absence of any incentive for HMRC to conclude VAT inquiries promptly risks taxpayers being unfairly disadvantaged by HMRC delays.**
130. **We recommend the draft legislation is amended to remove the restrictions on repayment interest on VAT.**

Taxpayer awareness

131. Comprehensive information and guidance from HMRC will be required to support taxpayers’ understanding of the proposed changes to penalties and interest. As ICAEW noted, “penalties and sanctions only work as a deterrent if taxpayers are aware of them and understand what is required”.⁸²
132. A recurring theme of our inquiry was that HMRC does not do enough to communicate with taxpayers about changes that affect them. Communication needs to be direct with taxpayers and backed up by accessible guidance. It will not be enough for HMRC to put information on a website or in a VAT brief. Unless taxpayers are fully aware of the regime it will not be a deterrent to non-compliance.

81 Written evidence from the Chartered Institute of Taxation ([DFC0071](#))

82 Written submission from ICAEW ([DFC0073](#))

133. **We recommend that HMRC introduces a communication and support programme to ensure that taxpayers have a clear and timely understanding of the new penalty and interest regime, including the transitional provisions.**
134. **We recommend that HMRC introduces a messaging system to give timely information to taxpayers of penalty points accruing, in order for the new regime to support taxpayers in timely compliance with their tax obligations.**

CHAPTER 7: REVISITING THE CASE FOR MAKING TAX DIGITAL

135. HMRC’s case for MTD is that it will reduce the ‘tax gap’—the difference between the amount of tax that should, in theory, be collected by HMRC, and what is actually collected. In particular, HMRC argue that MTD will reduce the amount of tax not collected due to taxpayer errors and carelessness. HMRC recognised that taxpayers would incur costs in the transition to digital but initially expected that administrative savings realised would outweigh those costs.
136. The Committee’s 2017 report identified widespread scepticism of the tax gap assertions. Most witnesses other than HMRC were unconvinced that MTD would reduce errors and so increase tax yield, and we concluded that the case for this was “not yet proven”. We also concluded that costs for taxpayers were understated and benefits overstated.⁸³
137. As noted in chapter 2, policy changes at the time of the 2017 Budget meant HMRC revised its estimates of by how much MTD would reduce the tax gap. This chapter revisits the case for MTD for VAT and the costs and benefits for businesses in the light of experience and new evidence.

HMRC’s estimates of tax gap reduction

138. HMRC expects MTD for VAT to deliver just over £1 billion from implementation to 2022–23. Theresa Middleton, Director of Making Tax Digital for Business at HMRC, told us this would come from a reduction in manual steps where error could arise—“arithmetic” and “transposition” errors—and reduced risk of lost paperwork due to more timely record-keeping.⁸⁴
139. The methodology originally used by HMRC to calculate the impact on the tax gap assumed digital data capture, software that would use ‘nudges’ and ‘prompts’, and spreadsheets being replaced by integrated bookkeeping and reporting packages. Evidence from software providers suggests that HMRC’s analysis had not adequately considered the fact that none of these benefits are required by MTD for VAT. IRIS Accountancy Solutions said: “HMRC’s plan for MTD to reduce the tax gap caused by errors seems unlikely while spreadsheets are still being used”.⁸⁵ Sage noted, in respect of the revised proposals, that “HMRC could have introduced more measures to reduce errors in the tax system from the start”.⁸⁶ Reducing errors could reduce tax revenue as well as increase it.
140. Nothing has changed in HMRC’s assumptions since our last report, nor is there evidence of further research to evaluate its figures. In its announcement of 1 December 2017 HMRC committed to “review and further test this analysis and our assumptions through ongoing extensive engagement and consultation with businesses, and through further research and analysis”.⁸⁷

83 Economic Affairs Finance Bill Sub-Committee, *Draft Finance Bill 2017: Making Tax Digital for Business* (3rd Report, Session 2016–17, HL Paper 137)

84 [Q 43](#) (Theresa Middleton)

85 Written evidence from IRIS ([DFC0086](#))

86 Written evidence from Sage ([DFC0080](#))

87 HM Revenue & Customs, *Making Tax Digital for Business* (1 December 2017): <https://www.gov.uk/government/publications/making-tax-digital-changing-the-scope-and-pace-technical-note/making-tax-digital-for-business> [accessed 12 November 2018]

141. HMRC is now designing a study to measure the impact on the error rate.⁸⁸ By the time it is published it will be past the implementation it was intended to inform.
142. HMRC told us that the Office for Budget Responsibility has validated its tax gap estimates. Witnesses were however sceptical of the likely tax gap yield. CIOT noted: “We do not believe that MTD will deliver the ‘pot of gold’ HMRC expect it to”.⁸⁹ In our private roundtable with practitioners, it was suggested that taxpayers may simply make “different errors”⁹⁰ when dealing with an unfamiliar new system, as discussed in chapter 4. We do not consider discussions with the OBR, who have no apparatus for contacting businesses or their advisers, provide an adequate substitute for testing directly with taxpayers.
143. **We support the Government’s attempts to modernise HMRC systems and seek efficiencies for taxpayers, but we remain unconvinced that MTD will reduce error and thereby the tax gap. If Making Tax Digital does not deliver the additional tax yield HMRC expects, the argument for mandating Making Tax Digital for VAT in April 2019 is much diminished.**

Taxpayer costs and benefits

144. Costs will arise for taxpayers in transitioning to MTD for VAT—the one-off purchases of hardware, software, familiarisation, advice and training—and on an ongoing basis for software or any additional agent support.
145. HMRC estimate that the average one-off ‘transition’ cost for businesses moving to MTD for VAT will be £109, and that businesses will pay an additional £43 in ongoing costs on average.⁹¹ This estimate was calculated by segmenting businesses along two dimensions. The first dimension divided small, medium and large businesses. The second dimension divided businesses into the following categories:⁹²
- Paper-based moving to MTD software
 - Spreadsheet-based moving to ‘bridging software’
 - Spreadsheet-based moving to MTD software
 - Businesses already using accounting software
 - Businesses outsourcing all VAT work to agents
146. Many witnesses expressed scepticism at HMRC’s average cost assessments.⁹³ The National Farmers’ Union described them as “extremely low”,⁹⁴. Several practitioners challenged the estimates based on the experiences of their

88 [Q 45](#) (Theresa Middleton)

89 Written evidence from CIOT ([DFC0071](#))

90 [Private oral evidence taken on 22 October 2018](#) (Session 2017–19)

91 Written evidence from HMRC ([DFC0085](#))

92 Letter from Ruth Stanier OBE to The Rt Hon Lord Forsyth of Drumlean, 31 October 2018: <https://www.parliament.uk/documents/lords-committees/economic-affairs-finance-bill/draft-finance-bill-2018/8%2031%20Oct%20Stanier%20to%20Chairman%20letter%20.pdf>

93 Written evidence from Association of Convenience Stores ([DFC0087](#)), Chartered Institute of Taxation ([DFC0071](#))

94 Written evidence from National Farmers’ Union ([DFC0084](#))

clients.⁹⁵ For those transitioning from paper records, one suggested costs as high as £2,600 and three days of client time.⁹⁶

147. HMRC expects agents to advise their clients on what software to use and which changes to make. Thirty-four per cent of businesses expect their agents to handle MTD for them,⁹⁷ resulting in increased agents' fees.⁹⁸ Businesses moving to software for the first time will also incur the costs of training and time spent on the transition.
148. HMRC included in its estimates the cost to businesses of software, hardware and agent fees. For ongoing costs, it assumed there would be only software costs. HMRC's March 2017 impact assessment explained its omission of ongoing agents' fees:

“we assumed that, in steady state from 2021–2022, accountants and businesses would be familiar with the necessary [MTD for Business] requirements and processes, and that competition in the agents' market should mean that there would be no overall increase in agents or accountancy fees after the transitional period”.⁹⁹

The December 2017 revised impact assessment retained this assumption. However, some agents thought that clients who struggle with digitalisation would need additional ongoing support. One predicted their clients would see a threefold increase in ongoing agent fees, as would take longer for agents to process accounts using software compared to “mixtures of manual lists and spreadsheets”.¹⁰⁰

149. In a letter on 9 November, HMRC provided further detail on costs.¹⁰¹ This detail was provided late, having originally been promised when HMRC gave oral evidence on 22 October.¹⁰² We consider the analysis lacking in several respects.
150. First, the segmentation set out left many smaller businesses insufficiently represented. The small business segment covered too wide a range of turnovers (from £85,000 to £10 million), and included 1.15 million of the total 1.2 million business population. There is a significant difference, particularly in this context, between businesses with turnovers of £85,000 and £10 million. This segment is not representative of those smaller businesses that will struggle most with the costs of Making Tax Digital for VAT.
151. Second, HMRC repeated their assessment that software costs would be the only ongoing cost for businesses after 2021–22. In justifying their judgement that there will be no ongoing increase to agent fees, they used the same

95 Written evidence from James Smith (Accountants) Ltd ([DFC0039](#)), Kevin Ringer ([DFC0064](#)), Hodgsons Chartered Accountants ([DFC0001](#)) and P McKelvey & Co. ([DFC0003](#))

96 Written evidence from James Smith (Accountants) Ltd ([DFC0039](#))

97 Written evidence from ICAEW ([DFC0073](#))

98 Written evidence from Javes Co. Chartered Certified Accountants ([DFC0033](#)), Kevin Ringer ([DFC0064](#)), National Farmers' Union ([DFC0084](#)), Association of Convenience Stores ([DFC0087](#))

99 HM Revenue & Customs, *Updated Impact Assessment on Making Tax Digital for Business*, (21 March 2017): <https://www.parliament.uk/documents/commons-committees/treasury/Correspondence/HMRC-updated-impact-assessment-MTFfB.pdf> [accessed 12 November 2018]

100 Written evidence from Kevin Ringer ([DFC0064](#))

101 Letter from Ruth Stanier OBE to The Rt Hon Lord Forsyth of Drumlean, 9 November 2018: <https://www.parliament.uk/documents/lords-committees/economic-affairs-finance-bill/draft-finance-bill-2018/8%2031%20Oct%20Stanier%20to%20Chairman%20letter%20.pdf>

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

wording as in their March 2017 impact assessment. We can only infer that this assumption has not been revisited in the intervening period.

152. Third, HMRC assume there will be no additional agents' costs for transition either. This conflicts with the evidence presented above. Elsewhere in its transition costs, HMRC assumes a segment of the small business population will employ an agent to assist with transition. HMRC therefore appears to be expecting agents to provide small businesses with additional support without charging for it. HMRC justifies this assumption by noting that almost all businesses with taxable turnover over £10 million use an agent, who, "due to [the business's] size and agent loyalty" would not charge additional fees. But this represents only 32,500 businesses out of the 1.2 million MTD for VAT population.
153. One accountant submitted an estimate of the one-off transition costs of MTD for VAT for their clients:

Table 1: One practitioner's estimate of transition costs of MTD for VAT for their clients

Cost type	Cloud software users	Desktop software users	Paper records users
Software costs	£0–300	£300–£600	£300–£600
Accounting support	£200	£500–£1,000	£1,000–£2,000
Client time	1–2 hours	2 days	3 days
Total	£100–£500, and 1–2 hours	£800–£1,600, and 2 days	£1,300–£2,600, and 3 days

Source: Written evidence from James Smith, Chartered Accountant (DFC0039)

Several other practitioners provided similar estimates, which represent a significant departure from HMRC's figures.¹⁰³ This may be because many of those giving evidence to our inquiry represented businesses with smaller turnovers, who were not adequately represented in HMRC's segmentation exercise.

154. The benefits to taxpayers adopting digital means for the first time should be balanced against these costs. Witnesses generally supported increased digitalisation and modernisation of the tax system.¹⁰⁴ The AAT observed: "for many in business, any increase in the cost of compliance attributable to MTD is likely to eventually be outweighed by the availability of added value built in as standard to much of the MTD-compliant software".¹⁰⁵

103 Written evidence from Hodgsons Chartered Accountants (DFC0001), Anonymous (DFC0036), Javes Co. Chartered Certified Accountants (DFC0033), Kevin Ringer (DFC0064), (DFC0095),

104 Q 3 (CIOT); Written evidence from FSB (DFC0076)

105 Written evidence from Association of Accounting Technicians (DFC0044)

155. The most generous view of the benefits to businesses of moving to digital was presented by Sage, who put the average efficiency savings for the whole MTD programme at £17,000 per annum.¹⁰⁶
156. **Our evidence suggests the costs to businesses of MTD for VAT, both for initial setup and for subsequent operation, will significantly exceed those used in the Government’s impact assessment.**
157. **We recommend that the Government updates the impact assessment to reflect evidence gathered in recent months, including from the pilot. A revised impact assessment should be published alongside the Government’s long-term plan for mandating MTD for other taxes.**

106 Supplementary written evidence from Sage ([DFC0088](#))

CHAPTER 8: HMRC'S RESPONSIVENESS TO OUR 2017 REPORT

158. We welcomed the deferral of the start date for MTD for a year to April 2019 and the decision to begin the implementation of MTD with VAT, which has the advantage of reducing the number of taxpayers affected. However, many of the conclusions and recommendations in this report repeat those made in our 2017 report. We have had a sense of déjà vu throughout our inquiry.
159. In 2017 we recommended revisiting the impact assessment. HMRC has not revised their original assumptions and their assessment of the costs to businesses lacks credibility. In 2017 we recommended that HMRC reassess the impact of MTD on the tax gap. HMRC still claim a yield which tax professionals regard as unachievable, although they are now designing a study to examine errors.¹⁰⁷
160. In 2017 we recommended an action plan to give early notice to businesses of the changes. Communication has been largely restricted to agents so far. In 2017 we recommended a workable system for claiming digital exclusion. Taxpayers remain unclear about what rules HMRC operate and how to apply.
161. In 2017 we recommended a comprehensive pilot. HMRC's MTD for VAT pilot has focused on testing software.
162. In 2017 we recommended better assessment of the support needed by businesses and plans to deliver that support. The evidence in this inquiry suggests that HMRC still does not appreciate the magnitude of the challenge facing many businesses.
163. Our final conclusion in 2017—that Government had to pay attention to widely held serious concerns—seems to have been ignored.

The impact of Brexit

164. Once it became clear how much resource HMRC needed to put into Brexit, HMRC reviewed its projects and reprioritised them, including aspects of MTD. The opportunity was missed for a more fundamental reappraisal of what could be achieved with MTD in the context of the pressures imposed on HMRC by Brexit preparations and those on taxpayers likely to be affected.
165. HMRC should have concluded that MTD needed to be slowed down, phasing in businesses as happened for Pensions Auto-Enrolment. The reluctance to take this approach may be due to the revenues which HMRC have persuaded the Government will flow from MTD, despite the uncertainty about how much it will actually yield.
166. **We have been struck with a sense of déjà vu throughout our inquiry. It is disappointing that many of the concerns raised in evidence to this inquiry have repeated issues addressed in our 2017 report. There is considerable frustration amongst taxpayers about HMRC's lack of responsiveness to their concerns.**
167. **On most issues we raised in 2017 HMRC took no meaningful action. HMRC and businesses are unlikely to have a smooth and efficient**

107 [Q 45](#) (Theresa Middleton)

transition to digital tax reporting if it is mandated on the current timetable, particularly for businesses implementing any changes necessitated by Brexit at the same time. We believe HMRC's unwillingness to listen and learn lessons will result in difficulties for taxpayers.

168. **We have been concerned by HMRC's optimism in its evidence to this inquiry. There seems a failure to appreciate, or at least acknowledge publicly, the extent of the risks to implementation that Making Tax Digital for VAT faces. We recommend that HMRC's Board challenges the Department's current assessment of the risks.**
169. **It is possible that many of the problems in implementing Making Tax Digital stem from inadequacy of resources devoted to the enterprise. We urge the Government to take steps to ensure that an adequate budget that is protected by a ring-fence should be available for Making Tax Digital.**
170. **The Financial Secretary to the Treasury's refusal to give oral evidence during our current inquiry does not convince us that the Treasury is taking seriously the risks of implementation, or the widespread criticism of HMRC's proposals. These issues need serious and prompt attention by ministers.**
171. **We request that HMRC writes to update the Economic Affairs Committee every six months until the entire MTD programme is rolled out.**
172. **It is time to take a fresh look at the plans for MTD. The modernisation of the tax system and encouragement to businesses to embrace technology should be a positive move. A different approach is needed to deliver maximum advantage for all.**

APPENDIX 1: LIST OF MEMBERS AND DECLARATIONS OF INTEREST

Members

Baroness Drake
 Lord Forsyth of Drumlean (Chairman)
 Viscount Hanworth
 Lord Hollick
 Baroness Kramer
 Lord Lee of Trafford
 Lord Leigh of Hurley
 Baroness Noakes
 Lord Turnbull

Declarations of interest

Baroness Drake
Independent member of the Private Equity Reporting Group (PERG), occasional adviser to the Tax Incentivised Savings Association (TISA)

Lord Forsyth of Drumlean (Chairman)
*Non-executive Director, J & J Denholm Ltd
 Chairman and non-executive Director, Secure Trust Bank plc
 Non-executive Director, Denholm Logistics Group Limited
 Director, Denholm Enterprise Ltd*

Viscount Hanworth
No relevant interests

Lord Hollick
No relevant interests

Baroness Kramer
No relevant interests

Lord Lee of Trafford
*Fellow of the Institute of Chartered Accountants of England and Wales
 Interests in a wide variety of listed companies, as disclosed in the Register of Interests, which may be affected by the MTD proposals.*

Lord Leigh of Hurley
*Fellow of the Institute of Chartered Accountants of England and Wales;
 Associate of the Institute of Tax, Senior Partner of Cavendish Corporate Finance Ltd, Advisory Board of Metro Bank PLC.*

Baroness Noakes
Interests in a wide variety of listed companies, as disclosed in the Register of Interests, which will or may be affected by the MTD proposals. These include Sage Group plc which is a supplier of MTD software.

Lord Turnbull
No relevant interests

A full list of members' interests can be found in the Register of Lords' Interests: <http://www.parliament.uk/mps-lords-and-offices/standards-and-interests/register-of-lords-interests/>

Specialist Advisers

Elsbeth Orcharton

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

Robina Dyall

No relevant interests

The Economic Affairs Committee agreed this report by correspondence:

Baroness Bowles of Berkhamsted

Lord Burns

Lord Darling of Roulanish

Lord Forsyth of Drumlean (Chairman)

Baroness Harding of Winscombe

Lord Kerr of Kinlochard

Baroness Kingsmill

Lord Lamont of Lerwick

Lord Layard

Lord Livermore

Lord Sharkey

Lord Tugendhat

Lord Turnbull

During consideration of the report, no interests relevant to the to the subject matter of the report were declared by Members of the Committee.

APPENDIX 2: LIST OF WITNESSES

Evidence is published online at <https://www.parliament.uk/draft-finance-bill-2018-subcommittee-publications> 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 witnesses marked ** gave oral evidence and did not submit any written evidence. All other witnesses submitted written evidence only.

Oral evidence in chronological order

*	Institute of Chartered Accountants of Scotland	QQ 1–15
*	Chartered Institute of Taxation	
*	Institute of Chartered Accountants in England and Wales	
**	Association of Chartered Certified Accountants Global	
*	Federation of Small Businesses	QQ 16–36
*	IRIS Software Group	
**	Office for Tax Simplification	
**	Law Society of England and Wales	
*	Pinsent Masons LLP	
**	Malcolm Gammie QC	
*	The Low Incomes Tax Reform Group	QQ 37–42
**	WTT Consulting	
*	Keith Gordon FCA CTA	
*	HMRC	QQ 43–57
**	HM Treasury	

Alphabetical list of all witnesses

Akerue Limited	DFC0051
Anonymous witnesses	DFC0002
	DFC0011
	DFC0021
	DFC0032
	DFC0036
	DFC0037
	DFC0042
	DFC0063
	DFC0065
	DFC0082
	DFC0083
	DFC0089

**	Association of Chartered Certified Accountants Global (QQ 1–15)	
	Association for Convenience Stores	DFC0087
	Association of Accounting Technicians	DFC0044
	Association of Taxation Technicians	DFC0061
	Jason B	DFC0008
	Jacobus Bezuidenhout	DFC0053
	BMB Accounting	DFC0018
	British Property Federation	DFC0074
	Catherine Newman Tax Services Ltd	DFC0035
	CBI	DFC0079
*	Chartered Institute of Taxation (QQ 1–15)	DFC0071
	Christopher Prescott	DFC0055
	ContractorCalculator	DFC0038
	Dr Stephen Daly	DFC0043
	DSW Tax Resolution	DFC0078
*	Federation of Small Businesses (QQ 16–36)	DFC0076
	Helen Fernandez	DFC0047
	Fiona Fernie	DFC0075
**	Malcolm Gammie QC (QQ 16–36)	
	Janet Garrell	DFC0053
	GBM Accounts Ltd	DFC0025
	Sheena Green	DFC0009
	Harrison Riley Accountants Ltd	DFC0016
	Richard Hedgecock	DFC0057
*	HMRC (QQ 43–57)	DFC0085
	Herbert Smith Freehills LLP	DFC0090
	Hodgsons Chartered Accountants and Business Advisors	DFC0001
	Hiller Hopkins LLP	DFC0070
**	HM Treasury (QQ 43–57)	
*	Institute of Chartered Accountants of Scotland (ICAS) (QQ 1–15)	DFC0068
	Independent Health Professionals' Association	DFC0093
**	Institute of Chartered Accountants in England and Wales (QQ 1–15)	DFC0073
*	Iris Software Group (QQ 16–36)	DFC0086

	Bev Jackson	DFC0056
	James Smith (Accountant) Ltd	DFC0039
	Javes & Co Chartered Certified Accountants	DFC0033
	Jay Khon	DFC0012
	David Jeffreys	DFC0046
	Joe Quinn Tax Ltd	DFC0040
	John Stone, Chartered Accountant	DFC0004
*	Keith Gordon FCA CTA (QQ 37–42)	DFC0052
**	Law Society of England and Wales (QQ 16–36)	
	Loan Charge Action Group	DFC0060
	Sabina Mangosi	DFC0015
	Martin Marsh	DFC0005
	Michael C Feltham and Associates	DFC0077
	Norman Moore	DFC0029
	David Murphy	DFC0022
	National Farmers' Union	DFC0084
	Oaktree Accountancy (Cockermouth) Limited	DFC0026
**	Office for Tax Simplification (QQ 16–36)	
	Gareth Parris	DFC0020
	Richard Pepper	DFC0034
	P. McKelvey & Co	DFC0003
*	Pinsent Masons LLP (QQ 16–36)	DFC0058
	Dale Rayment	DFC0049
	Robert Randall	DFC0006
	Alfred Redden	DFC0050
	Carly Barnes and Ben Reeves	DFC0094
	Kevin Ringer	DFC0064 DFC0095
	Robert Ogle Chartered Accountant	DFC0041
	Chris Rooks	DFC0014
	Sage	DFC0080 DFC0088
	Serocor Group	DFC0028
	Spencer-Davis & Co	DFC0017
	Dr Andrew Summers	DFC0023
	Tanzania Odyssey	DFC0027
*	The Low Incomes Tax Reform Group (QQ 37–42)	DFC0067

	Today Interiors Ltd	<u>DFC0024</u>
	UK Finance	<u>DFC0066</u>
	Antony Wilson	<u>DFC0010</u>
**	WTT Consulting (<u>QQ 37-42</u>)	

APPENDIX 3: PRIVATE ROUNDTABLE MEETING

The Economic Affairs Finance Bill Sub-Committee hosted a roundtable meeting to discuss the practical impact of Making Tax Digital for VAT and HMRC powers for tax practitioners on Wednesday 17 October 2018. All nine members of the Sub-Committee were in attendance, as were Elspeth Orcharton and Robina Dyall, Specialist Advisers to the Sub-Committee. The session was attended by eight tax practitioners, including chartered accountants, tax advisers, and tax dispute resolution advisers.

The group held a general discussion about the Sub-Committee's two topics of interest for its Draft Finance Bill 2018 inquiry—Making Tax Digital for VAT, and the powers of HMRC.

This note summarises the discussion.

Making Tax Digital for VAT

Implications for clients

One participant raised a concern about rural clients. The vast majority of their clients managed their accounts either entirely using paper records, or using very primitive spreadsheets. Another participant noted that the criteria for exemptions from the Making Tax Digital for VAT regime seemed too harsh. One client had been told, when reporting that they had no access to broadband, to go to a library. On responding that they did not know how to use the system, they were told to ring a customer service line while in the library.

Some clients used industry specialist software that would not be compliant with Making Tax Digital. When asked, the software providers had said they did not have the resources to change their software, designed for businesses' purposes, to meet tax requirements.

Participants considered the costs of Making Tax Digital difficult for many small businesses. One participant noted that in practice, the proposals would not make 'tax' digital, but 'transactions'. If it were simply tax, then accountants could digitise clients' records for them, but Making Tax Digital requires changes to businesses' record-keeping systems. This would be costly and disruptive, particularly for small businesses with low profits. Another participant said that the purpose of records in small businesses was not to pay taxes, but to run the business by recording sales, expenses, and profit.

Expected benefits of Making Tax Digital

Several participants noted that, despite the significant disruption caused by Making Tax Digital for VAT, HMRC would receive the same information from customers using the new 'bridging' software as under the current system. The original vision, and benefits, of Making Tax Digital, had assumed that HMRC would have access to the full audit trail, rather than the same "four numbers" as always. Participants also disputed HMRC's claim that Making Tax Digital would reduce errors, and one said that moving to a software model would just produce "different errors".

Consultation

The mechanisms for consultation with HMRC were criticised. One participant raised the example of an online forum for small agents, in which the HMRC

moderator would often remove threads they did not like. Another noted that in previous years, agents would have contacts in local tax offices. The Working Together scheme, now disbanded, was also acknowledged as a good idea.

The powers of HMRC

Culture

There was general agreement that HMRC has in recent years adopted a “guilty before innocent” approach in its enforcement activity. Investigations would be commenced on the assumption of guilt, with undue onus on the taxpayer to prove innocence.

There was a suggestion that reduced resources had hardened the attitude of HMRC towards taxpayers. One participant, who had previously worked for HMRC, described pressure on staff not to undertake a ‘nil’ inquiry—an inquiry concluding that no tax was due. This raised the question of what staff were to do if their investigation indeed suggested that no tax was due.

One participant said agents were “treated as the enemy”, when in practice they do their best to ensure clients pay the tax that is due. There was frustration with formal consultation documents, which participants said often ignored significant opposition to proposals.

HMRC delays

The Sub-Committee was told by participants that, in their view and under some circumstances, poor customer service from HMRC amounted to an abuse of power. One participant shared an example of a client who, amidst a dispute about an employee benefit trust over a “life-changing” amount of money, did not get a response from HMRC for eight years. During this period, interest was accruing on the disputed debt. A response was only received after a Supreme Court case (*RFC 2012 Plc (in liquidation) (formerly The Rangers Football Club Plc) v Advocate General for Scotland (Scotland) (2017) UKSC 45*) had established liability for employee benefit trust arrangements. Another participant said that the accrual of interest during delays in disputes has been compounded by the abolishment of certificates of tax deposit, which would allow taxpayers to pause the accrual of interest while they disputed amounts of tax owed. One participant also noted the disparity between HMRC’s power to require answers within 30 days, and their tendency to take several months to respond to taxpayer enquiries.

Participants raised further delays in the use of ‘Requirement to Correct’ legislation. While this was passed in November 2017 in the Finance Act (No. 2) 2017, letters requesting information were not issued until the following August. In one case of its use, 42 pieces of information were requested, most of which had already been provided to the inquiry. This increased the costs to the client, whose insurance cap had passed, and incentivised them to settle with HMRC. While they had the resources to continue their challenge, many would not.

Targeting the wrong taxpayers

Several participants thought that HMRC were targeting the wrong taxpayers. One shared an example of a nurse, who ran a cleaning products business in their spare time, who was subjected to an extensive inquiry over a £200 tax bill. The nurse was left “terrified” of HMRC. Another noted an example of a painter-decorator targeted in error for undeclared modelling income, when the correct taxpayer was simply someone with the same name whose mother lived on the same street.

Participants raised HMRC's treatment of contractors. One noted that HMRC often issued statements as if they were law, and another stated that HMRC often had a very different view of what constitutes 'employment' than contractors themselves.

Oversight of HMRC

There was some support for independent oversight of HMRC to tackle these problems. One participant argued that change was only possible if HMRC were subject to some kind of external oversight. Another called for the independent arbitration of tax disputes, noting that internal review was not sufficient. One participant qualified that the number of total disputes was low in their experience. Others responded that the number of transgressions was likely far larger than the number of complaints, since the existing complaints procedure was considered convoluted.

APPENDIX 4: CALL FOR EVIDENCE

The House of Lords Economic Affairs Committee's Finance Bill Sub-Committee, chaired by Lord Forsyth of Drumlean, is investigating the draft Finance Bill 2018. In particular, the Sub-Committee will examine developments in the balance of powers and safeguards between Her Majesty's Revenue and Customs and the taxpayer. The Sub-Committee will also examine progress on the 'Making Tax Digital' programme since the Sub-Committee's March 2017 Report on Making Tax Digital for Business.

The Finance Bill Sub-Committee is appointed annually by the Economic Affairs Committee to consider the draft Finance Bill (though it does not always choose to conduct an inquiry). The Sub-Committee focuses on issues of tax administration, clarification and simplification rather than on rates or incidence of tax.

Evidence sought

The Sub-Committee is seeking evidence to address the following questions:

HMRC powers

- What principles should underlie the design of HMRC powers, and where should the balance be struck between taxpayer and tax authority?
- What principles should govern the development of HMRC powers in a globalised digital information age?
- To what extent, or in what areas, is the existing balance of powers between HMRC and the taxpayer inappropriate or unfair?
- The Sub-Committee would be interested in examples of perceived unfairness, either in areas of policy or instances of enforcement.
- How should HMRC powers be differentiated to reflect the different problems being tackled e.g. careless error, sophisticated tax avoidance, and deliberate tax evasion?
- How are HMRC's powers operating in practice? Are they being used in line with their original policy intent?
- Is there sufficient oversight of HMRC powers, and safeguards against their abuse or misuse? Does the oversight and governance of the powers need to be improved? If so, how?
- What is the right balance of powers and safeguards in the security deposit regime and the assessment of offshore matters, for which amendments are proposed in clauses 33–35 of the draft Finance Bill?

Making Tax Digital for VAT

- What key improvements have occurred, or new concerns have arisen, since the Sub-Committee's report on Making Tax Digital for Business was published in March 2017?
- How prepared are HMRC, businesses (small and large) and software providers for the implementation of Making Tax Digital for VAT in April 2019, and what are the challenges of concurrent preparations for Brexit?
- The Sub-Committee would be interested in hearing about the experiences of individual businesses preparing for implementation, as well as more holistic responses.

- What are the potential costs of Making Tax Digital for VAT for businesses?
- Businesses involved in the pilot programmes are encouraged to contribute their experiences.
- How could the penalty regime and the new VAT interest regime proposed in the draft Finance Bill be improved or simplified?

What are the implications of having different penalty regimes for different taxes?