House of Lords Economic Affairs Committee
Finance Bill Sub-Committee Inquiry

Making Tax Digital - Call for evidence

3 February 2017
About ICAS

1. The following submission has been prepared by the ICAS Tax Board. The ICAS Tax Board, with its five technical Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 board and committee members. In relation to Making Tax Digital, there has also been input from the ICAS Members in Practice Advisory Board and the ICAS Making Tax Digital Steering Group.

2. The Institute of Chartered Accountants of Scotland (‘ICAS’) is the world’s oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

3. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members in the many complex issues and decisions involved in tax and financial system design, and to point out operational practicalities.

Making Tax Digital (MTD): Basis of evidence

4. ICAS’ evidence on Making Tax Digital (MTD) is based on the work of its boards and committees, the governance mechanism for canvassing member input, and the primary ones being the Tax Board, Small Business Taxes Committee, Members in Practice Advisory Board and the MTD Steering Group. Making Tax Digital proposals and members views have also been discussed more widely at member events and with a MTD consultation group.

5. ICAS has 1,040 member firms, with approximately 90% being firms with 1 – 3 principals. Generally, smaller independent practices tend to support the smaller businesses and so our members speak for much of the SME market with owner managed businesses, both under and above the VAT threshold.

6. ICAS members support tax compliance and compliant taxpayer behaviour, make complex tax systems workable for businesses and reduce the risk of unexpected tax costs for all taxpayers.

General comments

7. ICAS is grateful for the opportunity to contribute its views to the Inquiry into Making Tax Digital and the related draft Finance Bill 2017 clauses, as requested in the call for evidence issued by the Economics Affairs Finance Bill Sub Committee (FBSC) on 17 January 2017.

8. ICAS will submit its evidence in two tranches, as requested, with the first tranche addressing the following two questions:
   - Question 1: Evidence underlying the case for the Making Tax Digital proposals and their suggested impact, and
   - Question 2: Evidence base for mandatory digital reporting, in particular the potential impact in the ‘tax gap’ and for HMRC resources.

9. The remaining four questions in the call for evidence will be addressed in our second submission, which will be submitted by 15 February 2017.

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

11. ICAS has called for:
   - stronger risk management of this vast project by introducing Making Tax Digital on a phased basis starting with larger businesses
12. A project on this scale needs careful risk management to maximise both its success and acceptance by users. For instance, RTI was introduced with the largest employers that had dedicated payroll staff who could identify and assist in ironing out any difficulties with the system, before it was cascaded down to smaller businesses. A similar approach is recommended here.

13. Use of MTD should be voluntary. Whenever a secure, user-friendly digital solution addresses a tedious chore, it should attract willing users among businesses and individuals alike. Also, if a voluntary approach is adopted, those creating the new system face the invigorating challenge of making it attractive and easy for users. To achieve this, they are likely to set realistic goals, aiming initially at those most likely to become enthusiastic early adopters. By trailblazing the system in this way, they should create a natural following among others eager to experience the advantages they might otherwise miss. This would also focus attention on addressing HMRC service standards for taxpayers and businesses.

14. Should mandation remain in place, the threshold of £10,000 that was proposed is far too low and should be significantly increased. We suggest that the threshold should align with the current VAT threshold of £83,000. As the Treasury Select Committee noted in its report on Making Tax Digital a threshold set at £10,000 would catch many businesses whose profits are far less than the personal allowance and do not pay any tax – which would “palpably be absurd”. Aligning the threshold for MTD with the VAT threshold would also be a simplifying approach.

15. We agree with the Treasury Select Committee’s recommendation that comprehensive pilots of the proposed system are essential and that these pilots should reflect the role of agents in tax. The pilots should cover the entire reporting cycle ie four quarterly updates and an end of year reconciliation. The results should be evaluated - and amendments to the regime implemented before a full rollout.

16. In summary, we have significant reservations about the timescale and the mandatory approach and particularly so for small and medium enterprises. To describe MTD as a reform of tax compliance obscures the reality that it is a colossal IT and change management project affecting some 5.4 million businesses and many more taxpayers.

Specific questions in the inquiry

Question 1: Evidence underlying the case for the Making Tax Digital Proposals and their suggested impact

17. HMRC has indicated that Making Tax Digital will help it meet its target of ‘putting customers at the heart of all we do’? It will also assist with HMRC cost cutting and it is debatable whether this does put the individual taxpayer at the heart of HMRC activity. We note that there has not been a wider public debate about HMRC cost cutting and whether the costs of tax administration should sit with individual taxpayers rather than through public funds.

18. The National Audit Office review of a previous HMRC service delivery change estimated that for every £1 reduction in HMRC’s annual telephone transaction costs there has been approximately a £4 increase in the time and money cost to customers.

2. National Audit Office report: The quality of service for personal taxpayers
19. Savings to HMRC may not equate to savings for taxpayers. ‘HMRC believes it was over-optimistic about the scale of change its staff could take.’

20. The vision of MTD should potentially empower taxpayers, reduce data handling costs, and provide a new range of services for both taxpayers and their agents. It may be attractive in the longer term but, at this stage, it is “before its time” in requiring mandatory adoption at an early stage in the technological evolution (not all the software has yet been developed), and which may well become de rigeur with the passage of time.

21. Our members note that there remain a number of unresolved issues with RTI, the ‘Real Time Information’ digital filing of PAYE, such as reconciling employer and HMRC figures. On the back of this, members ask if mandatory filing by virtually all self-assessing taxpayers, who will generally have less experience of working with HMRC digital systems, will lead to unresolved issues and complaints.

22. MTD impacts a very diverse range of people and businesses. The proposed changes to the tax system are complex and hard to quantify. We are moving in uncharted waters and the behavioural impact of digital transformation is at best uncertain. As a default, ‘monopoly supplier’, it behoves HMRC to move with caution if benefit to the taxpayer is really to be ‘at the heart of all we do.’

One size fits all

23. Making Tax Digital is something of a misnomer. The key business impact of MTD is making accounting digital. Specifically, it attempts to harness the power of cloud accounting to tax administration. This is a laudable aim, but the distance to be travelled by the average business to achieve it should not be underestimated. We welcome HMRC’s announcement that businesses will be able to continue using spreadsheets rather than having to use digital accounting packages, as this should lessen the impact of the change. Nevertheless, we await the detail around this and hope the thresholds will be set at a suitably high level and not simply the smallest of micro businesses.

24. MTD mandates quarterly updates for all businesses with gross income over a threshold still to be decided but initially suggested at £10,000 or over. The scope of this ‘one size fits all’ approach is breathtaking. It would cover businesses with turnover of many millions of pounds and businesses with profits well below the tax threshold. It must be asked if this is appropriate, proportionate or realistic.

25. Businesses with turnover of under £1.5 million would not routinely be expected to need quarterly accounting. The smallest businesses are more regularly run from a knowledge of the bank balance and a full order book.

26. Phased introduction of MTD, starting with larger businesses, would more effectively achieve the desired goal of an efficient digital administration.

27. Comments from ICAS practitioners have included:
   - “MTD will only stifle small business with more red tape and more cost – possibly considerable cost which some micro-businesses will not be able to afford or survive”
   - “cloud accounting is going to be essential to MTD”
   - “The priority of HMRC should be to raise its own level of efficiency before expecting SME’s to comply with this very onerous burden. Their present level of performance is unacceptable.”
   - “unless clients have a basic understanding of book-keeping it is extremely dangerous to let them loose on computerised book-keeping, as I know from experience.”

28. For some business sectors quarterly digital updates do not line up well with the overall objectives of cost saving and certainty around tax liabilities. The two examples given here are illustrative rather than exhaustive.

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3 The net profit percentage of SMEs varies widely depending on business sector. With the tax-free personal allowance at £11,000 (2016-17), gross income could be well over £20,000 in some sectors without any tax liability.
• **Farming:** The nature of farming means that quarterly updates are unlikely to provide either meaningful business management information or figures from which tax liability can be accurately estimated.

• **Rural business and low income self-employment:** Looking more widely at rural businesses, many individuals are self-employed as rural employment opportunities can be limited. Businesses may be carried out on a small scale, with significant turnover, but low profits. For many businesses, here the aim is to break even and cover essential private living expenses. Cloud accounting, if feasible, would be akin to using a Rolls-Royce for a journey which could be done by bicycle.

**Question 2: Evidence base for mandatory digital reporting, in particular the potential impact in the ‘tax gap’ and for HMRC resources**

29. HMRC’s case for a reduction in the tax gap following MTD is apparently based on the view that MTD will lead to better business records, which in turn should lead to improved compliance and potentially a reduction in the tax gap. We have not seen any detailed documentation that supports this case.

30. We support the goal of better business records. The possibilities offered by digitalisation of records are welcomed and to be encouraged.

31. But for small business, particularly those with a single owner manager, the challenge in terms of available time, and the costs of maintaining real-time digital records and making quarterly tax submissions is immense. We recognise that HMRC has partially addressed this by agreeing to the use of spreadsheets by smaller businesses.

32. Imperfections in software and broadband coverage and with differing skillsets and costs adds to the difficulties around mandatory imposition of quarterly digital updates.

33. The proposals may tackle the tax gap, or they may create a danger of currently compliant businesses moving into the shadow economy. The Treasury Select Committee report noted that the UK tax system depends on trust and goodwill between HMRC and taxpayers. This keeps the tax gap down but rushed and badly implemented MTD could jeopardise it.

34. The Treasury Select Committee in its recent report also recognised the importance of costs and administrative burdens for very small businesses and the consequent risk that many may go out of business or move into the hidden economy. This could undermine the revenue the Government expects to raise from MTD. Revenue estimates might in any case not be realistic because, as the accountancy bodies argued in evidence, and the Committee concluded: "It is plausible to suppose that, in so far as MTD results in fewer customer errors, those errors will have been as much in the exchequer's favour (such as forgetting to record deductible expenses) as they have been in favour of the individual taxpayers."

35. It takes time for business owners to change accounting and administrative systems. Training and support is needed to ensure accuracy. It is not an overnight transition, and the journey is longer for existing businesses. To minimise disruption, businesses may opt for transition at their accounting year-end. This means a significant lead time. Even with the concession for the use of spreadsheets, business owners will still need to work with compatible software to submit quarterly returns.

36. Effective stage transition to MTD compliant digital records would be best spread over 3-5 years.

37. Evidence from firms in practice, including those involved in insolvency and winding up failed businesses, is that a significant part of the tax gap is attributable to businesses which are operating altogether outside the tax system.

38. More joined up working, for example between HMRC and local authorities, would start to tackle the issue of unregistered businesses. It is suggested that this would be a better focus of resources that increasing regulation of already compliant businesses.
More haste, less speed

39. We have expressed concerns about digital accounting packages, and particularly those that are based around scanning invoices. The backbone of accurate business records is the bank data feed. This is the spine onto which the other appendages fit. MTD options such as scanned invoices, while attractive, are an add-on: unless the invoices are matched to a payment method and cash and bank balances reconciled, the data has no integrity from an accounting point of view.

40. Technology here is still in its infancy. The MTD consultation ‘Bringing business into the digital age’ appears to assume that scanning invoices will mean more reliable business records. Without matching invoices to accurate bank data feeds this is not so.

41. It will take time for the technology to bed in and for businesses and their advisers to come to workable arrangements that take account of the skill sets of the business owner, costs, business needs and available technology.

42. There are significant data security issues to be resolved, including that of liability for losses arising from data security breaches where accounting software is linked to both HMRC and bank data.

43. A fully functioning market in appropriate software is essential and needs to include adequate free software for smaller and less complex businesses. In our view, the Government needs to set out how this will be accomplished. Cyber-security risks also need to be addressed.

44. People have no choice about complying with their tax obligations - if that includes being forced to submit quarterly digital returns then they should be able to rely on a basic and secure product to enable them to do so. It is unacceptable to expect small businesses and individuals, with little or no digital expertise, to check third party software security - HMRC should be responsible for providing (or making the third parties provide) something secure. If something goes wrong HMRC should be liable.

45. Rushing this process risks self-submission of high volumes of low quality data; which will be of little, if any, benefit in tackling the tax gap.

46. Tax, and online filing is complex. Taxpayers can underestimate the difficulty of making accurate returns. This is well illustrated by the Tribunal case of Mr John Graham. “He believed genuinely, he insisted, that he could complete the Return accurately himself”4 Yet, he received a penalty for submitting an incorrect return. HMRC has a responsibility not to understate the difficulty of MTD, lest taxpayers are misled.

47. There is a significant number of taxpayers who do not wish to interact more frequently with HMRC. They avoid contact with HMRC and are unlikely to respond to HMRC surveys or contact. Agents can facilitate their inclusion with the tax system, but MTD risks marginalising them by requiring the taxpayer personally to take in tasks formerly undertaken by their agent: such as opening and operating a digital tax account and making quarterly submissions.

HMRC resources

48. HMRC has experienced dramatic change in the years since the Inland Revenue and Customs and Excise were merged. This has been picked up in a number of recent NAO reports5: there have been challenging reductions in staffing, there are ambitious location/office reorganisations proposed but with full implementation to be delayed, and now a digital revolution is promised. Tax compliance may also be affected by Brexit and the need to revisit VAT and Customs Duties. It is questionable in our view, whether an enforced digital programme for all taxpayers is sensible including those who may or may

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not benefit or whether it would be better targeted at those who wish to use it and to enable it to evolve from there.
Appendix

The ICAS strategy regarding Making Tax Digital, published June 2016

ICAS responses to HMRC consultation documents

- Bringing business tax into the digital age
- Simplifying tax for unincorporated businesses
- Simplified cash basis for unincorporated property businesses
- Voluntary pay as you go
- Tax administration
- Transforming the tax system through the better use of information

ICAS Commentary and other resources

- Making Tax Digital: Let's hope HMRC will listen
- Making Tax Digital: Bringing business tax into digital age
- Making Tax Digital: Compliance and administration
- Making Tax Digital: Interfacing with HMRC in real time - all the time
- Making Tax Digital: Why did the Titanic sink?
- Making Tax Digital: Pay as you go
- Making Tax Digital: Cash accounting for landlords - do you need an accountant?
- Making Tax Digital: Cash accounting
- Making Tax Digital: How will it impact your practice?
- Making Tax Digital: Fact or fiction?
- Making Tax Digital: Complications and risks
- Making Tax Digital: A business burden too far?
- HMRC launches Making Tax Digital consultation
- Making Tax Digital: The view from ICAS
- Crofter meets HMRC four times a year in new digital tax world
- Making Tax Digital: Will GOV.UK Verify work?