House of Lords Economic Affairs sub-Committee

Making Tax Digital - Call for evidence

15 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.

General comments

4. 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.

5. ICAS is submitting its evidence in two tranches, as requested, and the first tranche was submitted on 3 February 2017 to address 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.

6. The remaining four questions in the call for evidence are addressed in this submission.

7. 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.

8. The Finance Bill 2017 draft clauses, which were published on 31 January 2017, are very brief and have surprisingly little detail making it difficult to provide further comment on the proposals.

9. We are concerned that the MTD project is going ahead on the current timescale but without the overall legislative detail being available yet. With tax administration, the detail is vital. The lack of clarity is also concerning because administrative duties and powers are at the core of any tax system – they are central to effective tax assessment and collection.

10. The draft Finance Bill clauses that have been published are mainly enabling legislation, delegating much of the detail to regulations that will be issued at a later date. ICAS does not support the extensive use of secondary legislation, particularly when this relates to something as fundamental to business and the economy as MTD with its onerous and mandatory new reporting requirements. The granting of powers, duties and functions are an important exercise of Parliament’s duties; these should be exercised through primary legislation so that there is consideration by Parliament before they are granted.

11. Our sense is that the MTD legislation is being developed on an 'agile' basis, along with the technology to implement it. We are concerned that all the parts may not ultimately join up to one coherent whole. This call for evidence only relates to Making Tax Digital for...
Business but this is only part of the picture. It is not yet clear how business or property income will be integrated with an individual’s other taxable income and brought into the end of year processes for arriving at an individual’s overall income tax liability.

12. In summary, we are disappointed at the lack of detail in the draft Finance Bill clauses and we continue to have significant reservations about the timescale and the mandatory approach and particularly so for small and medium enterprises. We are also concerned that insufficient attention is being given to ensuring that Making Tax Digital for business is integrated with other aspects of Making Tax Digital for non-business income and with the processes for arriving at an overall income tax liability for a year.

**Question 3: Scope of the exemptions and measures to help the digitally excluded**

13. The digitally excluded, in our view, may include those who have physical or mental conditions such that using digital facilities causes difficulties. It may also include those who cannot access digital facilities, because internet connections are not available, whether by virtue of their geographical location, financial circumstances, or other reasons.

14. We are pleased to see in the draft Finance Bill clauses that there is recognition that there need to be exemptions and reliefs for those who are digitally excluded. Nevertheless, the measures so far are at the minimalist end of provision.

15. Exemption from mandatory digital is to be restricted to:

- a person who is a practising member of a religious society or order whose beliefs are incompatible with the use of electronic communications; and
- persons for whom MTDfB is not reasonably practicable for reasons of disability, age, remoteness of location, or any other reason.

For partnerships, all partners need to qualify under one of these headings.

16. ICAS participates in an HMRC hosted Assisted Digital Working Group (ADWG). Much of the focus of this group to date has been on how those who do not currently use digital facilities can be assisted to do so, rather than recognising that there are taxpayers who need other ways of interacting with HMRC and discussing how those alternative methods might work.

17. It has also been raised in this forum (ADWG) that some individuals who might qualify for exemption due to problems using software or mobile phones, do not necessarily want to take up the exemption; they want HMRC to ensure that the technology for MTD works for users of assistive technology. There are particular concerns arising from HMRC’s use of third party software providers; HMRC needs to ensure that they are required to provide software which works with all types of assistive technology.

18. There are also significant numbers 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 excluding them by requiring the taxpayer personally to undertake tasks formerly undertaken by their agent, such as opening and operating a digital tax account. It is hard to see how the current proposals for the operation of MTD and the ongoing exclusion of agents from their clients’ PTAs can be reconciled with the taxpayer’s right under ‘Your Charter’ to appoint an agent and to have HMRC deal with that agent.

19. In relation to broadband access, we are not convinced that the following statement in the HMRC response document provides a realistic solution within the necessary timescales. ‘The Digital Economy Bill, published in July 2016, includes proposals that will give every household and business a new legal right to request an affordable broadband connection from a designated provider, no matter where they live, up to a reasonable cost threshold’. By contrast, Highlands and Island Enterprise aims ‘to deliver access to fibre based services to around 86% of premises in the Highlands and Islands’. Significant areas of the UK, and of rural Scotland particularly, do not currently have the required

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1 ‘Bringing business tax into the digital age’, paragraph 8
2 See [http://www.hie.co.uk/regional-information/digital-highlands-and-islands/can-i-get-it.html](http://www.hie.co.uk/regional-information/digital-highlands-and-islands/can-i-get-it.html)
mobile phone and broadband connectivity to support MTD1B, with much of it predicated on the availability of cloud accounting.

Question 4: Robustness of the proposed timetable from the perspective of each of the groups affected, including software industry, different taxpayer groups (such as small business and landlords), intermediaries and HMRC

20. MTD is a revolution the magnitude of which is hard to overstate. It is a colossal IT and change management project affecting 5.4 million businesses, and many more taxpayers. The way taxpayers interact with HMRC is being completely redesigned, from the way businesses maintain records to the prominence they give to their tax affairs, and a new approach will be required by many.

21. In reflecting on this request for evidence we have focused on the role of the agent.

22. 70% of small and medium enterprises (SMEs) have a tax agent\(^3\). 40% of taxpayers do not want direct contact with HMRC. The positive influence of professionally qualified agents on taxpayers is immense. They are uniquely placed to facilitate change.

23. As we have noted from the outset, there is inadequate consideration by HMRC of the role of the tax agent in MTD, and we remain very concerned about the simplistic messaging around ‘Making Tax Easier’ or ‘the death of the tax return’. Such messages suggest an agent is unnecessary; they also lead to difficulties in fee discussions with clients – why would anyone pay, or pay much, for something that is simple and easy to do? At the same time, we would expect the workload, and hence fees, to increase around MTD compliance particularly in the initial transition years. HMRC used similar messaging around making Real Time Information returns and submissions easier, and, also intimated that employers would save money. HMRC should avoid such messaging and have a greater empathy with the needs of business.

24. Professional accountants and tax agents are a powerful asset to have on board when considering change on such a scale as the MTD project. They are involved in the daily life of business. They help businesses to be efficient and profitable. They advise on book keeping and major business decisions. They help businesses calculate and pay the right amount of tax at the right time and encourage compliance.

25. We remain very concerned about the negative messages about tax agents which are being suggested by publicity around MTD, and the ongoing exclusion of agents from viewing their clients’ online accounts. As noted above it is hard to reconcile the current approach to implementing MTD with the taxpayer’s right under ‘Your Charter’ to appoint an agent and to have HMRC deal with that agent. HMRC’s current approach to MTD could also prove detrimental to the relationships HMRC has with SME businesses and to their co-operation with the tax system.

26. Regardless of the timescale for implementing this project, the development of agent services consistently runs behind the development of the business and personal tax accounts. This is causing major problems for agents and it needs to be addressed urgently. We believe agents are vital to implementation and every effort should be made to work with agents and ensure that they can assist their clients in dealing with the huge challenge of MTD.

27. We consider that the timetable for the introduction of MTD is unrealistic. Whilst HMRC has now agreed to pilot the process, this pilot cannot in fact cover the whole cycle (four quarterly returns and the end of year process) because there is already insufficient time before April 2018. Currently agents and clients do not even know which businesses will be within MTD from April 2018 because the threshold and/or any deferrals have not been announced. As noted in our previous submission the proposed figure of £10,000 is far too low and we support a threshold aligned with the VAT threshold (currently £83,000). Tax agents need to be talking to and preparing their clients now, if MTD is to begin in April 2018. They cannot do this until they know which clients will be affected so the threshold figure is vital.

\(^3\) HMRC Agent Strategy Team, Talking Points; 23 October 2015
28. We also have serious reservations about whether the software companies will be able to deliver their free software in time for the start of MTD, never mind the start of the beta testing trial period. Our members also question whether the software companies will deliver truly free software at all; why would they? There is no business case for providing free software and support services for users, so the risk is that any ‘free’ software will be so basic that most businesses will be forced to pay for a better product which actually meets their needs. In addition to poor functionality, there is also a risk that ‘free’ software will have inadequate security because the providers will wish to keep their costs to a minimum.

29. From our members’ knowledge of the SME market, many SMEs are not, and will not, be ready for starting MTD in the timescale that is currently proposed. Many of them still keep simple spreadsheet records and/or manual records. Whilst we welcome the recent announcement that spreadsheets can still be used for MTD there are currently no details about how this will work so it is impossible to assess how far this will assist SMEs.

**Question 5: Adequacy of the proposals to simplify the calculation of taxable profits and basis periods and the timing of their introduction**

30. In the initial consultations last autumn, it was originally envisaged that there would be three levels of accounting for tax depending on the size of the business:

- Cash accounting;
- HMRC ‘GAAP light’; and
- Full GAAP.

HMRC ‘GAAP light’ would be an option for larger unincorporated businesses to use GAAP accounts but without certain accounting adjustments such as for closing stock or bad debt provisions. For businesses that needed full accounts there would be the accounting options of FRS 102 UK GAAP accounts or for the micro business FRS 105 accounts.

**Cash accounting**

31. We support cash accounting for the smallest businesses, both trading and property businesses.

**HMRC GAAP light**

32. ICAS is concerned that MTD proposes that full accounts may be dispensed with for many larger unincorporated businesses, and this matter has yet to be resolved. This was proposed in the initial consultation on the basis of simplification to facilitate MTD. Accounts are not simply about tax. They are about profitability. There is a need for accurate information for business decision making, lending and creditor decisions, as well as for business sale and succession planning.

**Simplification**

33. We believe it is a mistake to view the proposed changes in tax-only terms and that whilst cash accounting may be a useful simplification for micro businesses, it is not appropriate for more substantial businesses. Without full accounts, there is a danger that far too many businesses will have a lack of understanding, and hence control, over their affairs. HMRC is not demonstrating an understanding of business and its day to day requirements by concentrating on only the tax aspects and the unintended consequences of so doing must be considered.

**The draft legislation**

34. The draft legislation is minimalist and does not provide much detail around the Making Tax Digital requirements either in terms of simplifying the underlying tax provisions, or in providing the administrative requirements. It is mainly enabling powers so that measures may be introduced in secondary legislation.

35. With tax administration, the detail is vital but the original consultation on tax administration was somewhat elusive and this remains the position. The lack of clarity is also
concerning because the powers and administrative duties are at the core of any tax system – they are central to effective tax assessment and collection.

36. In terms of principle, ICAS does not support the extensive use of secondary legislation, particularly when this relates to something as fundamental to business and the economy as MTD with its onerous and mandatory new reporting requirements. The granting of powers, duties and functions are an important exercise of Parliament’s duties, and these should be exercised through primary legislation so that there is consideration by Parliament before they are granted.

Interaction of MTDfB and personal tax

37. In addition to the lack of details on how Making Tax Digital will operate there is also a significant and worrying lack of detail on how trading or property income will be tied to the fiscal year, to other sources of income, to the personal allowance and to the appropriate rates and bands. In part this depends on how basis periods will work; without knowing this MTDfB cannot be married up to the fiscal year. The consultation responses note that further consideration needs to be given to basis periods; this needs to be addressed urgently.

38. Our sense is that MTD legislation is being developed on an ‘agile’ basis, along with the technology to implement it. We are concerned that all the parts may not ultimately join up to one coherent whole. This approach also makes it very difficult for agents and their clients – and businesses generally – to prepare. As noted above there is already insufficient time for a full pilot of the entire MTD process for businesses.

39. Further detail is required around compliance and enquiry powers, taxpayer safeguards, penalties, and the personal tax accounts.

40. Making Tax Digital for Business is only part of the picture. As noted in paragraph 37 above, it is not yet clear how business or property income will be integrated with an individual’s other taxable income and brought into the end of year process for arriving at an individual’s overall income tax liability. We raised numerous questions about the interaction between self-assessment, simple assessment and the Personal Tax Account in our response to the consultation “Making Tax Digital: Transforming the tax system through better use of information”. We also asked about the interaction between the proposed processes for business income and the processes for other types of taxable income. The response document did not address these questions which fuels our concern, highlighted above, about the lack of a coherent approach to MTD.

Question 6: Consequential revisions to the penalty regime

41. Further consultation documents are to be issued regarding late submission penalties and late payment penalty interest so we have not commented on this in detail here. Time and careful consideration is needed to adequately design a penalties system that balances all the requirements of fairness, encourages compliance, provides enforcement, but at the same time is not unduly onerous. In broad terms, a penalty points system has its attractions and we look forward to contributing to the next set of consultations on this topic.

42. Consideration should also be given to retaining separate systems for different regimes; there is a fundamental difference between VAT and PAYE where the business is effectively a tax collector, and for Income Tax which is based on the business’s profits.

43. Penalties for quarterly returns also need careful thought: to add penalties essentially for not writing up records up at the time seems unfair and potentially counterproductive. Contemporaneous does not mean accurate: there are many other factors involved.

44. We acknowledge the announcement that there will be a delay for late submission penalties of at least 12 months. We do not think this is sufficient. The UK tax system depends on the goodwill and active co-operation of the majority of taxpayers. Fair systems encourage compliance. Use of MTD should be voluntary for at least the first five years and, even then, phased in starting with large business first. The imposition of
penalties on the smallest businesses for burdensome quarterly filing obligations seems retrogressive.