

**Public Accounts Committee – Progress with Making Tax Digital (MTD) inquiry
Response from the Low Incomes Tax Reform Group (LITRG)**

1 Introduction

- 1.1 We are pleased to have the opportunity to provide a brief response to the Committee’s inquiry. We fully endorse the points made in the submission from our CIOT colleagues. Our submission therefore focuses specifically on MTD as it affects low-income, unrepresented taxpayers.
- 1.2 When MTD was first announced in 2015 by the then Chancellor of the Exchequer, George Osborne, we were told this would mean “*the death of the annual tax return*”. MTD was therefore always going to be a very ambitious project and, whilst we are generally supportive of HMRC’s desire for businesses to use digital tools as part of the wider digital agenda, as details of the MTD regime have emerged over the last few years it has become clear that it is not an easy aim to achieve.
- 1.3 Although digital capability has undoubtedly increased in the UK since 2015, there are still people who are digitally excluded or who, although able to manage simple digital tasks, find more complex digital tasks challenging. HMRC therefore need to allocate sufficient resource to support those who cannot manage the digital requirements, not just leave them behind.
- 1.4 In response to the initial 2016 consultation on implementing MTD¹, we highlighted our significant concern that much of the detail of the MTD programme was still to be considered and finalised and felt that the April 2018 timetable was totally unrealistic and unachievable. We therefore supported the announcement in 2017 that MTD for income tax would not be implemented until at least 2020.
- 1.5 Unfortunately, the further delay announced in December 2022 was inevitable, despite the previous delay allowing HMRC time to address the various issues. It was very clear that the programme was not going to be deliverable by April 2024. Although we welcomed the further delay, and also the review of the needs of those with turnover under £30,000, we would question whether, without significant changes to the programme, it will ever be successfully delivered and realise all of the benefits initially envisaged.

¹ <https://www.litrg.org.uk/sites/default/files/files/161107-LITRG-response-MTD-business-tax-digital-age-FINAL.pdf>

2 The benefits of MTD

- 2.1 One of the initial consultations on MTD in 2016¹ set out a number of benefits both for businesses and HMRC. For businesses, the consultation stated it would give them the benefit of in-year estimates of income tax and NIC, software would allow businesses greater control and certainty and support would be built into the software to help people get things right, including nudges and prompts to flag up reliefs or allowances that they may be entitled to. It was stated that compliant businesses would see a reduction in unnecessary HMRC interventions. HMRC have also been keen to point out that many businesses should enjoy productivity benefits due to an anticipated reduction in time spent on tasks as a result of digitalisation.
- 2.2 For HMRC, it was stated that MTD would reduce the tax gap and deliver a significant amount to the exchequer each year as a result of savings from more timely and accurate record keeping. HMRC would also have more data to allow for a better understanding of businesses, allowing them to provide support and assistance to those businesses who need it and to more easily identify non-compliant businesses.
- 2.3 Whilst we agree these would be helpful and positive benefits, in some cases we are doubtful about the evidence supporting them and therefore whether MTD will actually realise these benefits and the cost savings set out.
- 2.4 For low-income unrepresented taxpayers, there is likely to be as much confusion about in-year tax estimates as there is benefit. We have concerns about the reliability of any in-year estimates as they may prove to be misleading once the tax position for the relevant tax year is finalised. Significant guidance and support would be needed to help people understand them and their limitations.
- 2.5 In relation to free software, we have repeatedly called for HMRC to commit to producing their own free software which ensures that people have access to suitable software in order to comply with their tax obligations. They have so far resisted the call to do so. We maintain that it is not acceptable for Government to impose legal obligations on businesses that require the compulsory use of third-party software.
- 2.6 In addition, based on what we have seen so far in relation to MTD for VAT and ITSA software, the free software that is offered does not give the benefits initially stated (nudges and prompts about reliefs for example), and it often comes with conditions (it is free only for a period, or it only applies to a limited number of transactions) . This leaves businesses having to navigate a complicated set of options to try and choose the right software for them which can be overwhelming and/or time consuming. We also have concerns about the availability of accessible software.

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https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/545715/Making_Tax_Digital-Bringing_business_tax_into_the_digital_age-consultation.pdf

- 2.7 Given the repeated delays to the programme, the relationship between HMRC and software developers is, unsurprisingly, likely to be strained. This will make delivering suitable free software a challenge.
- 2.8 For low-income unrepresented taxpayers, productivity benefits are unlikely to be significant, if there are any at all and are unlikely to outweigh the added costs and burdens of complying with MTD.
- 2.9 The benefit of reduction in the tax gap and exchequer savings are, in our view, extremely optimistic. We have still not seen any convincing evidence, information or research that shows exactly why keeping records digitally will reduce the numbers of mistakes by the smallest businesses. Some of these mistakes could be corrected with sophisticated software, but software that might identify certain errors¹ is unlikely to be freely available. Further, it is just as easy to make mistakes such as transposition errors or posting the wrong amount of expenses in software as in manual records. In addition, if people have a misunderstanding about a certain part of the system, then it is unlikely software will pick that up. User testing should be carried out with unrepresented taxpayers who have never used digital tools before to get a better understanding of the errors or mistakes that can arise.
- 2.10 We also think there is a risk that some low-income unrepresented taxpayers will find the MTD requirements so onerous that they may well become *less* compliant than they are currently, and new businesses may be deterred from registering with HMRC at all if they think that complying with MTD will be too difficult or burdensome.

3 Support for unrepresented taxpayers

- 3.1 We think the large majority of unrepresented taxpayers have no idea about MTD, what it will mean for them and the timetable for implementation. Raising awareness at the right time remains a challenge, particularly with other potentially complex changes to the tax system for the self-employed on the horizon over the next couple of years such as basis period reform and modification of the cash basis of accounting.
- 3.2 Our CIOT colleagues have raised concerns about the level of capacity within the agent market and that some agents are leaving the market ahead of MTD implementation. This is unsurprising, there will be a significant time commitment needed to enrol taxpayers in MTD and give the ongoing necessary support. It is likely to involve an increase in fees that some smaller businesses are unable to afford and for smaller agents they cannot feasibly charge enough to cover the time they will need in reality to cope with MTD requirements. We think that this will potentially result in an increase in

¹ For example, the initial consultation document, Page 25, gave an example of a small sole trader who was using her accounts information to complete her tax return which included depreciation of her business equipment as an allowable expense. This is not an allowable expense for tax and must be added back in. Within MTD the software would pick this up and prompt her to add it back into her tax calculations thus reducing the error.

the number of unrepresented taxpayers (which could in turn lead to a reduction in compliance/accuracy of submissions).

3.3 The amount of support required for the smallest businesses to comply with MTD will be significant. HMRC's customer services are currently unable to cope satisfactorily with current demand and it is difficult to see how HMRC will be able to provide the necessary support without an increase in resource. We anticipate that HMRC will not only be contacted by those who require digital support but also those who can do some things digitally but lack confidence and so contact HMRC to make sure they have done the task correctly.

3.4 If free software is provided via third parties, rather than HMRC, it is unlikely that the software companies will provide anything other than a basic level of support at most for the products, as compared to the level they will provide for paid products (which is entirely understandable). This means taxpayers will turn to HMRC for help and guidance.

4 What next for MTD?

4.1 We have welcomed the review into the needs of small businesses with turnover under £30,000 in the context of MTD. We understand from HMRC figures that there are around 2.5 million businesses in this cohort, making up the majority of the MTD population. Some of the self-employed individuals will also be claiming universal credit. We hope that the review will fully consider the following areas that we have been raising for some time:

- That the original threshold of £10,000 is too low.
- The need for HMRC to provide free software with sufficient functionality for people using it to realise the benefits of MTD originally outlined.
- Whether it is necessary to mandate people into MTD – we still believe that mandation is unnecessary if MTD will bring the benefits HMRC say it will. People will naturally want to sign-up.
- Whether submission of quarterly updates is an essential part of the process. Those on universal credit (UC) need to make monthly submissions of income and expenses for their UC claims and if they are in scope of MTD they will also need to submit 4 in-year submissions and an end of period statement.ⁱ This means they will need to make 17 different submissions to government in one financial year, which is very onerous for a small business.

4.2 We think that HMRC should publish an updated impact assessment and further detail and research about how exactly MTD will realise the tax gap savings discussed above. Before the programme moves forward at all, there must be clear evidence that the programme proposed will meet the original objectives of MTD for both businesses and HMRC.

4.3 There are still many practical issues to overcome if MTD is going to move forward for any businesses. Any timetable must ensure there can be a full cycle of testing (including an end of year submission) plus time to make changes depending on the pilot results before mandation. Even with the re-phasing of the programme this is looking like it will be a challenge. The numbers of taxpayers in the MTD pilot have been extremely low (in the low hundreds) and as it is very labour intensive for HMRC, taxpayers and software developers, HMRC have so far failed to scale it up to sufficiently test

the service. It is imperative that the pilot must now include sufficient numbers and different types of taxpayers (including unrepresented low income taxpayers) to ensure the system can meet all the needs and so that HMRC have the best possible chance of understanding the support package that will be needed.

- 4.4 We strongly urge HMRC, once a decision is made about businesses with turnover under £30,000, to pause and carry out a further consultation to the future of MTD for all businesses. The digital and economic landscape has changed significantly since MTD was first introduced in 2015 and many challenges have been identified in the work done thus far that require further work if they are to be dealt with or overcome. A consultation would allow for more radical thinking about the future programme.

5 About Us

- 5.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998, LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low-income workers, pensioners, migrants, students, disabled people and carers.
- 5.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.
- 5.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

LITRG
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ⁱ The figures required for Universal Credit are not exactly the same as those required for tax purposes as the rules on what constitutes income is different for UC and some expenses are treated differently for tax purposes.