Low Incomes Tax Reform Group

A voice for the unrepresented

Making Tax Digital: Bringing business tax into the digital age
HM Revenue & Customs (HMRC) consultation document
Response from the Low Incomes Tax Reform Group (LITRG)

1 Introduction

1.1 LITRG welcomes the opportunity to comment on the Making Tax Digital (MTD) consultations issued on 15 August 2016.

1.2 This consultation response should be read in conjunction with our responses to the other consultations on MTD.

1.3 We begin though with some general comments on the MTD policy.

2 Making Tax Digital programme

2.1 We generally support the HMRC digital strategy and recognise that many benefits may be possible in the digital world. We are though hugely concerned that much of the detail of the MTD programme is still to be considered and finalised, and as a result implementation of MTD for unincorporated businesses from April 2018 is totally unrealistic and unachievable in the timescale.

2.2 The current timetable does not allow sufficient time for:

- HMRC to properly publicise and educate the public about MTD;
- businesses to prepare for these very significant changes, both in terms of practical impacts and the additional costs which will result;
- the software – which is crucial to the success of MTD – to be anything like fully developed and tested.

2.3 We strongly urge HMRC to delay the commencement of MTD until the design has been completed and fully tested. This should substantially reduce the massive risk of the project going seriously wrong with the damage done to HMRC reputation but also the inevitable 'teething problems' that will without doubt occur. A more relaxed introduction will therefore lessen the chances of the public quickly losing faith in the system, reduce the chance of naturally compliant taxpayers making mistakes due to having to rush into unfamiliar territory, and protect HMRC from reputational damage.

2.4 We do not support the principle of mandating MTD and are wholly opposed to this approach. If we compare it to self assessment (SA) online filing which has been very successful without being mandatory, we can see that if a product is good and beneficial, taxpayers will naturally migrate to it. Mandation is very likely to have the opposite effect to that which it is intended to foster: instead of increasing tax receipts, it may act as a disincentive to businesses to trade legitimately and encourage some into the hidden economy.

2.5 Many businesses with low incomes will find it extremely difficult to comply with the requirements of MTD for a number of reasons, being cost, extra administrative time, lack of IT knowledge, and lack of financial literacy. To make the system work as smoothly as possible, we would strongly recommend that the exemption level is raised very substantially above the proposed limit of £10,000 annual turnover. In our view we consider that the exemption limit should initially be set at an amount equivalent to the current VAT registration threshold. This should at least mean that MTD for business will be more successful from the outset as potentially problematic traders will be below the exemption limit. In turn, fewer resources will be required to provide digital and perhaps financial support to those who will need assistance. This should result in a much smaller group than would otherwise be the case. But if MTD is as good as HMRC promise, traders will almost certainly wish to join it voluntarily.

2.6 The success of the MTD programme depends heavily on the use of good software. It is the responsibility of Government to provide free software where it is a requirement to have software to be able to comply with legal obligations. In respect of MTD HMRC should ideally provide good, free software to small businesses. Relying on commercial businesses to make free software available is, in our view, fraught with very significant problems and is wholly unsatisfactory. Free software provided from commercial sources will have only limited functionality, thus those unable to afford upgraded packages could be excluded from many of the purported benefits of MTD and free software providers will constantly be bombarding their customers with update requests.

2.7 Finally, there will always be some taxpayers who are digitally excluded for a variety of reasons such as lack of broadband due to remote location, or age, or disability. The service and support available to this group of taxpayers must be of at least the same level as that available to digitally enabled taxpayers. Regretfully, the detail of what this support will likely be has not yet been made clear.

3 Bringing business tax into the digital age: Executive summary

3.1 We are hugely concerned that the MTD for Business programme is over-reliant on software where HMRC have no control to make the system run smoothly and efficiently. There is also an assumption that free software will deliver the full range of purported benefits from MTD and it seems inevitable that this will prove to be a grossly inaccurate assumption. It must not be the case that those who are reliant on free software have a much worse experience when it comes to complying with their MTD obligations when compared to their counterparts who are using paid-for versions of commercial software. In our view HMRC should develop free software that is 'fit for purpose' and should not rely on the commercial market to do this.

3.2 Should HMRC proceed with the commercial provision of software only, they must provide an independent guide to the software products available. Furthermore, HMRC should develop an online tool capable of listing the free software products most suitable. HMRC must also ensure that all software is designed so that it is compatible with systems which aid those with disabilities such as screen readers, and voice recognition software.

3.3 A comprehensive and extensive communications programme is urgently required to make taxpayers aware of MTD. We recommend that HMRC consult on their communication strategy as a matter of urgency as millions of taxpayers are unaware of MTD. In this, it will be crucial that HMRC pay special attention to ensuring that people are aware of the exemptions from MTD as these proposals develop. Ideally there should be a factsheet produced on this area and made widely available and should be sent to all taxpayers as soon as possible.

3.4 HMRC must find a way to reassure taxpayers that both HMRC's systems and the software they are obliged to use are safe and secure to allay one of the major fears prevalent in the digital environment.

3.5 The proposed level of turnover of £10,000 or less to qualify for complete exemption from MTD is far too low. We recommend that businesses with a turnover of up to an amount equivalent to the current VAT registration limit, as determined by the figures on the previous year's tax return, be exempt from complying with MTD. This should give a greater chance of the successful implementation of MTD, and encourage 'buy-in' from businesses. Once MTD is running smoothly, consideration could be given to a phased reduction of this threshold over time to bring more businesses within the scope of MTD, provided there is evidence to support a wider rollout. Mandation should never go below a level within which many low-income and vulnerable taxpayers will fall, and we suggest that half the VAT threshold be taken as the lowest possible level for mandation. If the MTD systems are as good as promised, even many within this threshold are likely to comply voluntarily – as evidenced by the success of SA online.

3.6 Provided the level of general exemption from MTD is set at an appropriate level, there will be less need for financial support to be provided by Government. We would be pleased to meet with HMRC to discuss the possible options regarding the provision of financial support once the exemption level has been finalised.

3.7 In addition to the general exemption from MTD we propose a number of specific exemptions for various groups, including those with irregular income, those with good records but not in the prescribed form, those renting out property to help pay for residential care, some carers, and universal credit (UC) claimants (until the rules on calculating self-employed income using the cash basis for income tax and UC are fully aligned and until there can be a single report of income to satisfy both the Department for Work and Pensions (DWP) and HMRC requirements). We also propose time-limited exemptions for businesses in financial difficulties and those about to retire, and short term temporary exemptions for 'time to comply'.

3.8 The process to claim exemption should be simple and straightforward, and all exemptions must be written into statute and carry a full right of appeal to the tax tribunal.

3.9 There is no doubt that considerable further work is necessary before deciding how allowances and reliefs should be claimed by businesses in each accounting period. The current proposals will almost certainly mean either significant extra work each update period to claim the appropriate proportion of allowances and reliefs, or otherwise paying the incorrect amount of tax if Voluntary Pay as You Go is opted for. Based on current proposals, we recommend that small, if not all, business should be able to claim allowances and reliefs in a final (end of year) submission. We also recommend that there should be more flexibility in the periods between updates to better accommodate seasonal businesses.

3.10 We strongly recommend that the deadline for filing the end of year submission should be ten months after the end of the period. We suggest the end of year process should form part of the final update for the accounting period. We recommend a filing deadline of one month and seven days for all updates other than the final period update.

3.11 We trust HMRC will take heed of the lessons that emerged from the Real Time Information (RTI) implementation and ensure that MTD is introduced in appropriate phases. The actual impacts of MTD must be closely monitored such that HMRC and Government are prepared to respond with further relaxations and extension of timescales if the forecast benefits are slower to realise than anticipated.

4 Chapter 2. Acquiring Digital Tools

4.1 ***Question 1: What are the challenges for businesses that currently keep their records on paper or simple spreadsheets in moving to an integrated software package for record keeping, and what further measures or support would help businesses to meet these challenges?***

4.1.1 Many self-employed businesses, and particularly those on low incomes, keep paper based or spreadsheet based business records. This is most likely because their tax affairs are often relatively straightforward, they may only have a few transactions a month to process, and/or many may well have been in business for some years and will have developed a system that they are comfortable with.

4.1.2 These systems will generally be quite simple to understand and therefore easy to operate on a day-to-day basis, and so the business owner will have confidence in being able to maintain them and – very importantly – confidence that they will be able to spot and correct any mistakes that may arise from time to time (for example inconsistencies from inadvertently entering incorrect data). It is also likely that the arrangements will be based around the time and availability of the self-employed person. A builder who works long hours in the summer may quickly put all his receipts in a folder, and then spend some time entering those receipts onto his spreadsheet when work is quieter in the winter months.

4.1.3 Whatever method is being used, these business records will, in most cases, meet the existing recording keeping requirements for tax purposes.

4.1.4 Therefore, some of the main challenges that will arise in trying to move these businesses to an integrated software package for record keeping will be:

a) *educating them as to why they need to change a system that they perceive to be adequate for their business needs.*

   Much of the commercial software will be too sophisticated for the needs of the (small) business and so there will be a fear of making an error. Conversely, there is a danger that any 'free' software will not be sophisticated enough to be of real benefit if it is to replace an existing system which is perceived to be working well. For example, free software may not have the necessary 'add-ons' which allow receipts and invoices to be scanned and/or automatically posted (or it may have a scanning facility but no text recognition), or it may not allow for a package to be 'synced' with a mobile phone app.

   One of the perceived wider benefits of digital record keeping outlined in paragraph 2.6 of the consultation (that a taxpayer can 'see a complete financial picture of their tax affairs in one place, in real time, where they can interact digitally at any time and manage all of their liabilities and entitlements') may well not be persuasive for many small businesses.

b) *the need for a significant investment of time by the business to set up and learn a new record keeping system, which will mean substantial time away from the running of the business itself.*

   There will need to be good IT support available from both HMRC and the software providers to help with any teething problems the business may have when setting up and using the system. This might include resources such as helplines and webchat. This will need to be the case even if it is free software. In view of the current implementation timetable for MTD, businesses may well feel they will be under pressure due to having to learn and implement new systems in time to meet the deadline of joining the MTD programme. (This could be alleviated to some degree by delaying implementation – see section 2 above.)

c) *the requirement to keep records completely up to date in real time (within a maximum window of three months) may be difficult for some businesses who have particular time constraints at specific times of the year*.

   For example, small retail businesses may be extremely busy in November and December with Christmas purchases and then also in January with the traditional 'New Year sales'. This type of trading pattern may make real time reporting difficult on occasion, as it gives limited scope for 'catching up' with data entry at quieter periods of the business cycle. Therefore, these businesses may struggle to see how updating HMRC on at least a quarterly basis will give them enough flexibility to fit around the peaks and troughs of their business activity. (See paragraph 7.4.1 below for further discussion on this.)

d) *the costs of making new or increased investment in software, hardware and maybe staff, as appropriate to each business, for little perceived benefit.*

e) *the need for training on basic computer skills and operating techniques for those with paper based records who do not already use computers within their business.*

This would include understanding areas such as online security, anti- virus software, how to manage automatic software updates to operating systems, troubleshooting techniques, as well as automatic programme updates.

f) *dealing with concerns about provision, reliability and/or cost of broadband internet services in their locality.*

4.1.5 In view of these challenges, we do not believe it should be mandatory for a business which already maintains adequate records to move to keeping digital records in the prescribed form being proposed.

4.1.6 We discuss this further in paragraphs 9.10.2 – 9.10.11 below where we respond to question 38 in Chapter 7, 'Exemptions'.

4.2 ***Question 2: What information and guidance would you find helpful in choosing the appropriate software for your business?***

4.2.1 To help assess the suitability of any software for a particular business, the following details would be very useful in relation to the different types of software product:

a) a summary of the software's functionality, written in simple language so that it can be easily understood by non-IT specialists. This should include a clear explanation of how the software interacts with the digital tax account. It should also clearly state any limitations of the software for example, if it does not automatically post scanned receipts, so these must be posted manually each time;

b) the capability of the hardware necessary to run the system effectively, for example, amount of memory needed, type of operating system required, type of smartphone required (for example, details of whether the software is available for, and may be synced across, different formats – such as an iPhone app to a Windows PC);

c) whether there is a limit to the number of devices on which an individual or business can run the software, and across which data may be synced;

d) the terms of the licence (scope of licence, renewal terms) and pricing structure, making it clear what features are standard and what are add-on features for which there is an additional charge;

e) details of the kind of technical support (such as telephone helpline and any costs for this, online support, hours of availability) that will be provided by software company;

f) an example of what the output from the software would look like;

g) an explanation of what access agents could have to the information contained in the software and how they might interact with the software and data;

h) details of how the software will be updated and how often updates to the system are expected;

i) details of how and where data will be stored, and whether there is any cap on storage capacity;

j) clear and simple explanation of the security features of the software and the data held within it.

4.2.2 It would be helpful for HMRC to develop an online tool which could provide a list of the free software products most suitable for a particular business once the answers to a series of relevant questions has been entered.

4.3 ***Question 3: What types of business should a free software product cater for? What functionality would be necessary in a free software product?***

4.3.1 We note that the Government is committed to ensuring there is free software available for businesses with the simplest affairs (paragraphs 2.21 and 3.2 of the consultation). The free software offering will be critical in making MTD a success for the small businesses and we firmly believe it is HMRC's responsibility to provide good quality free software that is adequate to comply with the new requirements. HMRC should therefore reconsider the statement at 2.22 of the consultation: 'HMRC has no plans to offer its own free software product'.

4.3.2 Larger businesses, particularly those that are incorporated, and many businesses that are VAT registered are those most likely already to have existing commercial accounting software and so they would be unlikely to choose to revert to free more basic software in any event. Therefore, free software providing simple record keeping functionality should be available to those most in need of it. We would expect this to be smaller self-employed non-VAT registered businesses and landlords, who currently do not use digital tools for record keeping at all or perhaps use a simple spreadsheet. It would no doubt be helpful if the software could incorporate some tools which were spreadsheet-based or linked to spreadsheets in some way as many people would then find this type of software fairly easy to use.

4.3.3 Bearing in mind that being VAT registered is indicative of reasonable turnover, but not necessarily reasonable profits, it should be noted that some VAT registered businesses will not have commercial software, and they may not be able to afford to replace an existing records system with sophisticated digital record keeping software. So they too may need to use free software. HMRC's assumption that free software should be available only to those 'with the simplest affairs' is therefore incorrect.

4.3.4 While it remains our view that those smaller businesses already keeping adequate records should not be obliged to move to digital tools (see paragraph 9.10.11 below), free software via computer or smartphone app which is easy to understand and to use is likely to be attractive for businesses whose record keeping is less rigorous. They may therefore move to it voluntarily, even if not mandated to do so.

4.3.5 As stated at 4.3.1 above, we believe it is HMRC's responsibility to provide good quality free software. Any free software from the commercial sector is likely to be very elementary and therefore probably of limited use. Also, there must be some uncertainty as to whether it can be guaranteed to remain free indefinitely. It is likely that a commercial supplier will use the free software to generate contacts to whom they can potentially sell more sophisticated – and useful – software in due course and in our experience this can lead to free software users being bombarded with marketing calls in an attempt to get them to move to paid products. This is not acceptable and should not be part of the free software offering. Similarly, free software users should not be bombarded by advertisements and pop-ups pushing in-app purchases – the traditional means of 'paying for' free software.

4.3.6 We have made some comments regarding the functionality of free software at paragraphs 5.3-5.6 below in the context of digital record keeping generally. As a minimum, the free software needs to ensure that the user can comply with their legal obligations and also that they do not receive a lesser service in terms of prompts and nudges and assistance compared to their counterparts who are able to pay. It will need to be able to function on all operating systems and devices, be easy to use and be updated as necessary. It will also need to be designed so that it works well on systems which aid those with disabilities such as screen readers and voice recognition software. Although we recommend that there are exemptions from MTD for people with disabilities and for other reasons (see later, in answer to question 34), this does not mean that they should be excluded from MTD as a result of software being inaccessible, if they would otherwise wish to use it.

4.3.7 We would add here that any free software should include a facility to print the quarterly updates submitted and also any supporting data/workings, and to allow data to be saved to a separate area independent of the programme itself, eg hard drive, memory stick, cloud storage. Presumably, there will also be some form of filing reference number, as there is with SA online, when a quarterly update is made – the software should also prompt the user either to print out or save this as it will be essential in the event of any dispute with HMRC as to the update being received. Again, as with SA online, any 'test filing' should be clearly differentiated from a live filing, to avoid confusion such that the taxpayer believes they have made a submission to HMRC but in fact have only performed a test.

4.3.8 As many users of free software may be required to report their self-employed income to DWP on a monthly basis for UC purposes, there should also be a facility within the software to be able to extract the relevant data required by DWP and submit this directly. We have recommended below that until such time it is possible to do so, and that the data required by HMRC and DWP is aligned (by, for example, removing any remaining differences in the cash basis used by each Department), UC claimants be specifically exempted from MTD.

4.4 ***Question 4: What level of financial support might it be reasonable for the government to provide towards investing in new IT, software or training, to whom should such support be aimed, and what is the most appropriate form for delivering such support?***

4.4.1 It must always be remembered that any financial support provided by Government comes from the public purse and therefore from other taxpayers. Consequently, it must be reserved for those individuals most in need of it. Should mandatory digital recordkeeping be introduced as currently proposed there will be a very significant number of businesses who will need to invest in equipment and training purely to comply with MTD, and most will not have planned to do so as they are unaware of the proposals. Therefore, there is a strong argument to say that as the Government is forcing businesses to incur these costs, it must be reasonable for them to meet the expense for those on low incomes who otherwise cannot afford the outlay that will be required.

4.4.2 The qualifying expenditure would need to be carefully defined but it should include hardware, including laptops, smartphone, printer, screen, as well as software, and perhaps training costs too. As many small businesses might find themselves unable to fund the purchase of new equipment upfront, there would need to be a system whereby individuals can obtain some kind of grant to cover the expense as an alternative to obtaining a refund of the amount paid.

4.4.3 However as explained at paragraph 2.5 and discussed further at paragraphs 9.7.8-9.7.16 we believe that exemption from MTD should apply, at least initially, to all businesses whose turnover is below the current VAT threshold and that mandation should not be rolled out even in future to anyone with a turnover below half that amount. If this was to be implemented, it is likely that there would be a much smaller need for direct financial support from Government, as businesses with the lowest incomes would be exempt.

4.4.4 Therefore, as there is a direct correlation between the entry level for MTD and the number and type of businesses who might need financial help, it is difficult to offer constructive suggestions until the level of the exemption has been finalised. Once this has been done, we would be very happy to have a meeting with representatives from HMRC to discuss possible ways of offering financial support to those who need it. We would add that should any self-employed individual claiming either UC or tax credits come within the scope of MTD, then they should be entitled to some financial assistance on the introduction of MTD.

4.4.5 In any event, to help businesses plan ahead, it is vital that HMRC publicise the need for this investment in digital technology and launch any scheme offering financial support as soon as possible. Any expenditure can then be factored into appropriate business strategy over the coming 12-18 months, or preferably a longer period if our recommendation at 2.3 above is acted upon and mandation of MTD is delayed.

4.5 ***Question 5: What other forms of support would help to make the transition to Making Tax Digital easier?***

4.5.1 As MTD is such a major change for many small businesses, we envisage that many will need significant amounts of support over several years while the system beds in. HMRC should run face-to-face training workshops and other 'Customer Events' to publicise the changes and the new requirements well in advance of any obligations beginning under the MTD programme. There will also need to be a well-resourced media campaign covering print media, TV and social media. Those most likely to struggle with MTD and need help will likely be those who are less digitally capable, so HMRC must not rely solely on digital support methods. It will also be necessary to set aside additional funding for voluntary sector organisations who may find themselves having to provide support to the less digitally capable and the digitally excluded.

4.5.2 In addition, we strongly recommend that there should be a 'light touch' approach when it comes to applying penalties while everyone gets used to the new regime. We hope that penalties will not be charged for at least the first three years of MTD, as was the case when RTI was introduced for the most vulnerable businesses. We discuss this further in our response to the consultation document 'Making Tax Digital: Tax administration'.

4.6 ***Question 6: What facilities would make it easier and more secure for businesses to enrol for Making Tax Digital and use software regularly?***

4.6.1 One of the biggest deterrents to fully engaging with digital for some people is the fear over security of data while engaging online. MTD as proposed means that HMRC will be insisting that most businesses interact digitally with them, so we would like to see HMRC assessing the security of the various software packages that will be available to use and rating them all (maybe a 1-5 star system, where 1 indicates weak security and 5 indicates strong security for example) or perhaps giving a kitemark to confirm a certain standard of security. This would then give users some peace of mind as to the level of security they can expect, and it would almost certainly also have the effect of generally driving up security standards in all products.

4.6.2 Also, better and more reliable mobile phone coverage and faster broadband speeds would make the whole digital experience much easier for most.

5 Chapter 3. Digital record keeping

5.1 We have not addressed each of the questions raised in this section of the consultation document as most are very software specific and we do not wish to make any comment in relation to the detail of software packages. However we have made some general points below on digital record keeping in the context of low income self-employed businesses. These mainly relate to question 7 about the practicalities of using digital tools.

5.2 ***Question 7: Do you have any comments about the practicalities of keeping evidence of transactions and trading when using digital tools?***

5.2.1 In answer to question 39 below, we raise concerns about the practicalities of using software to keep records digitally, and how that fits with the requirements of MTD. Also relevant to that question are our comments above (paragraph 4.1.4(c)) that it is impracticable for those traders, who use periods of lower activity to catch up on record keeping from periods of peak activity, to keep records updated in real time.

5.2.2 Chapter 3 describes the various ways that software can be used to make digital record keeping straightforward. It stands to reason that the more sophisticated the software in terms of the functionality it offers, the more expensive it will be. The consultation does make reference at both paragraphs 2.21 and 3.2 that for businesses with the simplest affairs, the software will be free. However, the consultation does not give any indication whatsoever as to what the 'simplest affairs' might actually be. We therefore require clarification of what type of business HMRC are envisaging making free software available to.

5.2.3 In respect of the software itself, our concern is whether the free versions will have the level of sophistication that HMRC are expecting most people to have access to, to make the digital record keeping side of MTD successful without creating too much additional work for the business. For example, is free software likely to have the facility to scan paper receipts and invoices into the software, recognise the text and automatically post them to the appropriate place (as per paragraph 3.5)? And will it allow the trader to issue their own invoices and receipts from it (paragraph 3.8)? It is imperative that those who rely on the free software do not get a lesser service which makes their compliance with MTD more difficult than for those who use paid-for commercial software. For example, we would expect that the nudges and prompts which are referred to at various points in the consultation documents should be available to users of the free software packages as well as those using paid-for commercial software products.

5.2.4 Clearly a software system which contains digital copies of all relevant paperwork means 'all the eggs are in one basket' unless the hard copies of the documents are also retained. For larger businesses with IT support this may not be an issue, but for small businesses who may suffer IT glitches that they cannot resolve it gives rise to many issues around backing up digital records and general IT safety protocols (such as preventing viruses) which many will not be familiar with.

5.2.5 For a business keeping their data on their smartphone, what happens if they lose their phone, which is not an unusual occurrence by any means – would all their business records be lost too? This would presumably depend on where the data is stored – on the phone itself, on cloud storage and when data stored on the device was last synced with the cloud. How would back up copies be accessed? Another aspect is when phones are replaced or upgraded, which again, is a frequent occurrence. How does the data get transferred to a new phone? If the old data is stored on the old phone how easily is this retrieved and saved elsewhere? These are not easy concepts for people who are not familiar with digital interactions to get to grips with.

5.2.6 There may also be issues to consider where a taxpayer wants to change from one record keeping system to another, perhaps because the one they were using was initially free but has become a paid-for service after a period of time. How easy will it be to transfer data and previous years' information?

5.2.7 We note that it has been acknowledged at paragraph 7.8 of the consultation that software may not be available for some business types. We would concur with this (for example for foster carers) and discuss this further at paragraph 9.10.12 of this response.

5.2.8 We note there are suggestions regarding the income and expenses categories that should be available in the software. Many small businesses are able to complete the ‘3 line accounts’ part of the current tax return and so may not be used to categorising their expenses into anything other than ‘allowable’ and ‘not allowable’, we trust any new software will accommodate a similar simple categorisation for appropriate businesses (assuming of course this will provide sufficient information for the quarterly updates to be completed correctly – see section 7 below).

5.3 ***Questions 8 to 12.***

5.3.1 We have no comments to make on these.

5.4 ***Question 13: What prompts and nudges would be most useful to businesses?***

5.4.1 In our responses to the separate consultations on ‘Simplifying tax for unincorporated businesses’ and ‘Simplified cash basis for unincorporated businesses’, we point out that nudges and prompts will need to include flagging up the differences in treatment between the cash and accruals bases, in order to help people understand which might be the best method for them.

5.4.2 In our response to ‘Transforming the tax system through the better use of information’, we say that HMRC’s systems must signpost users to claims that they can make not necessarily to do with their business. For example, personal entitlements that may potentially be due but not yet claimed such as the marriage allowance, married couple’s allowance or blind person’s allowance. As HMRC can usually tell which taxpayers are married, they could flag this up, clearly setting out how allowances might be claimed for the current and previous years. This could also be extended to include flagging up potential entitlement to working tax credit, child tax credit and child benefit and a range of DWP benefits.

5.4.3 It is suggested at paragraph 5.22 of the consultation that businesses could receive prompts and nudges from HMRC at the point an update is made to identify possible inconsistencies or ‘unusual features’ before an update is finalised, thereby allowing for revisions or corrections to be made before the update is submitted. We would stress that it is vital such prompts and nudges are available in all software, including free software, to ensure that a similar MTD experience is available to all.

6 Chapter 4. Establishing taxable profit

6.1 ***Question 14: Do you agree that businesses should have the choice as to when to record accounting (& tax) adjustments?***

Question 15: Do you agree that business should have the flexibility to reflect reliefs and allowances when they choose?

6.1.1 We take these two questions together.

6.1.2 Broadly speaking, we support businesses having choice, provided there is sufficiently detailed guidance to enable them to make an informed choice. However, this needs to be balanced with the fact that offering choice can often cause confusion.

6.1.3 It has been acknowledged that if relevant accounting and tax adjustments are not made each time a quarterly update is submitted then the 'real time' tax position shown in the digital tax account will be necessarily estimated. Therefore, this will give a potentially inaccurate and misleading impression of the tax position. This will be very confusing for the taxpayer, especially if they choose to make payments under the VPAYG proposals, as they would be then likely to find they have overpaid tax. We discuss this further in our response to the consultation 'Making Tax Digital: Voluntary pay as you go'. This seems to be at odds with one of the main principles governing the MTD programme. In these circumstances, it will need to be made very clear to the taxpayer that the tax position is only a broad estimate of the anticipated tax liability for the accounting year. Systems will need to flag up that adjustments, reliefs and allowances either have or have not been included and what impact this might have on any estimated tax payment made via VPAYG.

6.1.4 Some unrepresented low income businesses that will be within the scope of MTD are likely to be using the 'cash basis', so the accounting adjustments necessary at a year end are likely to be negligible. Therefore, provided the tax adjustments are dealt with by the software, their taxable profit will hopefully be largely in line with the quarterly updates. This means that it is vital the free software that is to be available to those 'with the simplest affairs' can deal with the tax adjustments accurately and reliably and is easy to use.

6.1.5 But this could still be a step too far for many self-employed low income workers who may be skilled in a variety of ways but who are not financially literate and so are probably not aware of the reliefs and allowances to which they might be entitled. They run the risk of making innocent errors in their quarterly updates which will then automatically feed into their annual accounts and subsequently into the calculation of their taxable profit. There will need to be clear guidance, maybe via pop-ups with prompts, when both the quarterly updates and the End of Year declaration are completed to try to ensure allowances and reliefs are not under-claimed. HMRC must also offer some assurance that, if such errors are picked up in a subsequent enquiry, they will treat people very sympathetically in the early years of MTD. We anticipate that some from this group who have previously managed their affairs themselves may decide to bear the cost of engaging an adviser to deal with the requirements of MTD.

6.1.6 Those who already engage an adviser to help with the annual process of preparing accounts and tax returns for the tax year will generally rely on them to claim appropriate allowances and reliefs. They may also lack the confidence to deal with the quarterly updates themselves and so incur substantially more in fees to give them peace of mind that they are complying with their obligations. Alternatively, to avoid incurring further fees which they cannot afford, they may make assumptions when preparing quarterly updates which prove incorrect. This in turn will produce inaccurate final accounts which will need to be revised, thereby increasing professional time spent on the End of Year process and so still increasing fees.

6.1.7 There are of course many businesses that cannot use the cash basis and so are compelled to use accruals accounting, whatever the level of their turnover, and there are non-tax considerations such as bank (where business loans are required) or shareholder preferences that may also influence the choice of accounting basis. Larger businesses with computerised systems already in place may decide they would prefer accurate tax forecasts and so be prepared to effectively produce full accounts each quarter, inevitably with the help of their advisers which will push up accountancy fees significantly. But allowing choice over when to claim allowances and reliefs could well lead to confusion, misunderstanding and error and therefore we recommend that the default for most businesses would be to claim allowances and reliefs as part of the End of Year process. This would then simplify the software requirements and not put those who use free software at a disadvantage, assuming free software will not be able to offer the option of projecting the effect of an anticipated claim on the taxable profit in a quarterly update, which is acknowledged at paragraph 4.34 of the consultation.

6.1.8 We note the suggestion at paragraph 4.35 of the consultation that records of accumulated trading losses will be maintained by HMRC and that the software will then outline options for utilising the loss for tax purposes. We have strong reservations about free software being able to offer this option and would very much doubt it will be sophisticated enough to cope with the very complex rules relating to loss relief. This highlights a theme running throughout the MTD for Business programme, which is an apparent over-reliance on software over which HMRC have no control to make the system run smoothly and efficiently. There is also an apparent assumption that free software will deliver the same benefits as that which others pay for, which seems inevitably incorrect as commercial software companies will need to keep some things back in order to promote and sell the paid-for versions that will effectively subsidise those that are free. It must not be the case that those who are reliant on free software have a much worse experience when it comes to complying with MTD when compared to their counterparts who are using commercial software.

6.2 ***Question 16: What do you consider is the most appropriate approach to reflecting the effect of the personal allowance on an individual's taxable business profit?***

6.2.1 It would seem sensible to spread the personal allowance over the tax year, which would be similar to allowances given under the Pay As You Earn (PAYE) system. However, it may be more difficult to establish how much allowance will be available to set against self-employed or rental income at the start of a tax year if the taxpayer has other sources of income so due consideration will need to be given as to how to establish exactly what the allowance will be.

6.2.2 Also, the consultation does not say how the allowance will be factored into the tax estimates arising from the quarterly updates. Presumably for those businesses with an accounting year broadly the same as the tax year (so a 31 March or 5 April year- end), 25% of the available personal allowance will be given in each quarter's estimate? But how will the tax-free allowance be calculated for each quarter for those businesses whose accounting periods do not coincide with the tax year?

6.2.3 We would stress again that the digital tax accounts must make it very clear that the tax figures generated from the quarterly updates are estimates and so may prove to be either too low or too high. Ideally they should list the reasons why the tax is estimated and so might change (for example, self-employed profit not finalised, or possible use of losses). There is a risk that while MTD may encourage people to save for their tax during the year, it may also result in people spending their 'tax savings' if they over-rely on estimated tax figures in their digital tax accounts which then prove to be too low.

6.3 ***Question 17: Is this the right treatment of partnerships? Are there any additional partnership issues that need to be considered?***

6.3.1 The requirement for a nominated partner to comply with MTD on behalf of the partnership is broadly consistent with the current rules for partnerships in terms of having responsibility for filing the partnership return and so is a reasonable approach to take. However, there must be a process which allows individual partners to challenge their allocation of profit if they disagree with the (pre-populated) figure shown in their digital tax account.

6.3.2 The responsibility of being a nominated partner is an onerous one and therefore it should not be the case that the nominated partner is solely exposed to any penalties for partnership non-compliance in due course, otherwise there may be a reluctance to become a nominated partner in the first instance. Conversely, what will the penalty position be if the nominated partner fails to provide the information on time and the other partners cannot provide the information and so finalise their own tax position on time? We have made this point at paragraph 13.2 of our response to the 'MTD: Tax administration' consultation.

6.4 ***Question 18: Is this the right treatment of individuals who receive income from property, let jointly?***

6.4.1 While the approach suggested in relation to joint owners (that one owner would be the 'nominated individual' and required to fulfil MTD obligations for all those with an interest in the property) would seem to be reasonable in many cases, it appears to be contradictory to the proposals in the consultation document 'Making Tax Digital: simplified cash basis for property businesses'. That document suggests that each individual owner would be entitled to make their own claim to use the cash basis if they wanted to. This means that information provided by a 'nominated individual' on a different basis may therefore not be correct for the other owners.

6.4.2 There would also need to be a means of overriding the 'nominated individual' arrangement for jointly let properties in certain circumstances, such as a couple that was in the process of separating. If the situation between them is acrimonious, each must be able to provide their own information to HMRC rather than one forced to rely on the other 'nominated' partner to make the report. Equally, as in answer to question 17 above, the penalty regime must be lenient on those who are not the nominated individual and therefore might not have the information available to supply MTD figures if the nominated person fails in their duty to do so.

6.4.3 The position regarding joint owners must be clarified as soon as possible.

6.5 ***Question 19: Is this the right treatment of subcontractors within the Construction Industry Scheme? Are there any other CIS issues that need to be considered?***

6.5.1 The proposal for contractors' CIS returns to feed directly into subcontractors' digital tax accounts should, in theory, be a reasonable approach to take with contractors and subcontractors. However there is a consistent misunderstanding around many areas of the CIS scheme (for example net and gross payments, the rate of tax deducted, and how materials are treated under CIS) so it is inevitable that frequent apparent discrepancies will arise within this business sector. It will be imperative that there are warnings to remind subcontractors to check the pre-populated information generated from main contractor records, and to provide a facility to easily challenge the figures if necessary, together with detailed guidance as to how to do this. It will be necessary to provide very good support via a telephone helpline as well as digital methods to give this scheme the best possible chance of success.

6.5.2 HMRC also need to bear in mind that a significant number of taxpayers who come within CIS will be young, maybe migrants, and may have lower levels of literacy and education. We are concerned that many will simply not be able to understand and/or access an online system, and so will be driven to using CIS tax refund agents not all of whom are entirely scrupulous.

7 Chapter 5: Providing HMRC with updates

7.1 ***Question 20: Do you have views on how detailed the summary data in the updates should be, and whether the level of summary data should be different depending on the size of the business?***

7.1.1 We note it has been agreed that 'summary data' will be provided in the update sent to HMRC at least quarterly. Paragraph 5.8 of the consultation states that 'other data entries needed to reach an estimate of tax and NICs payable, such as reliefs, allowances and tax adjustments would also form part of the data update to HMRC'. However, the proposal at chapter 4 (Taxable profits) is that a business will be able to choose when data such as accounting and tax adjustments, reliefs and allowances are claimed and therefore they will not necessarily feature in every quarterly update. In fact, we are recommending that these types of adjustments are likely to be done as part of the End of Year process (see paragraph 6.1.7 above). This contradiction in the consultation document seems to highlight a lack of clarity around the design of MTD even at this stage, which is disappointing.

7.1.2 As the updates process is due to be used for both income tax and VAT purposes eventually, it would seem sensible to standardise the dataset for the two types of returns, as suggested in paragraph 5.10 of the consultation. However, HMRC have given no indication to date that the data currently provided in a VAT return is 'not fit for purpose' and therefore it is hard to see what justification there is for insisting that expenses are categorised for both quarterly MTD updates and VAT returns in future.

7.1.3 A more appropriate approach might be to tailor MTD summary data requirements to the current VAT requirement so that summary data is actually just that – the total business income in the update period and the total (and so uncategorised) expenses in the update period. The breakdown of the total expenditure in the accounting period can then be provided as part of the End of Year process.

7.1.4 For businesses that are not VAT registered, this is analogous to using '3 line accounts' for SA purposes. At the very least we would definitely like to see this '3 line accounts' simplification carried into MTD and implemented for this group of taxpayers.

7.2 ***Question 21: Do you have any comments on the categorisation of summary data in the updates?***

7.2.1 See our answer to question 20. We think that '3 line accounts' reporting of data is adequate for most of those we seek to represent and as such believe that no further categorisation of summary data should be necessary.

7.3 ***Question 22: Do you have any views on what VAT data the updates should contain? Do you have any views on the advantages or disadvantages of including VAT scheme data in the updates? If so, which schemes and which data should be included in the updates?***

7.3.1 We have no detailed comments to make on the VAT aspects raised in the context of the content of the quarterly updates.

7.4 ***Question 23: What flexibility around update cycles would be useful?***

7.4.1 We note it is acknowledged that some non VAT registered seasonal businesses may want some flexibility around completing their updates, and this is a point we have raised at paragraph 4.1.4(c) above. However, flexibility will not be achieved if the maximum period between updates is three months. We recommend that there should be an option for a seasonal business to apply for a dispensation to file updates at more suitable intervals to fit with the trade and that HMRC should be obliged to agree to any proposals unless there is evidence which shows it is an unreasonable claim.

7.5 ***Question 24: Do you agree businesses should be allowed one month to submit their update? Would any problems be caused for VAT registered businesses by standardising the time limit for updates for all taxes?***

7.5.1 We agree that a standard time limit for uploading updates across all taxes (as outlined in paragraph 5.21 of the consultation) would be desirable as it will be consistent and therefore less confusing and burdensome than multiple deadlines. VAT registered businesses will be very familiar with the current time limit of one month and seven days after the quarter end to file VAT returns; it would therefore be sensible to align the time limit for MTD updates with this, rather than introduce a new time limit of one month from the quarter end for MTD updates and eventually align VAT returns with that. The introduction of MTD should not put more pressure on businesses by increasing the time needed to deal with obligatory compliance matters.

7.5.2 Consideration should also be given to aligning the time limit for reporting for UC with this too, and we reiterate that we have recommended below that UC claimants be specifically exempt from MTD. This is strongly recommended until a time when a single, aligned report can be made to government that fulfils both DWP and HMRC requirements.

7.6 ***Question 25: What method of deriving a business's start date for providing updates under Making Tax Digital would be most straightforward for businesses?***

7.6.1 We think that the introduction of MTD should be done in the most straightforward way possible. Therefore, we believe option 1 outlined in paragraph 5.29 of the consultation document is the best option. Based on the start date for MTD as currently proposed for this purpose, this means a business 'joins' MTD with effect from the first accounting period beginning after 5 April 2018, (provided the accounting date is after 5 April 2019) and the first quarterly reporting obligation would arise three months after the start of this accounting period provided the business was not exempt. However, we would stress that we believe there should be a delay in implementation of MTD as explained at paragraph 2.3 above.

7.6.2 We note the proposed modification of quarterly reporting periods for those businesses with a year- end between 1 and 5 April explained in paragraphs 5.32-5.34 of the consultation and agree this is a reasonable approach to ensure that quarterly update periods fall at month end.

7.6.3 Under option 2 businesses would have part of their accounting period outside MTD and part within MTD when they first 'join' MTD. This would be very confusing for many businesses and so could generate negative feedback about MTD before it has a chance to work.

7.6.4 For VAT registered businesses it should be possible to align MTD update periods with VAT quarters for simplicity. If the VAT quarters are not aligned to the accounting period this may mean additional MTD updates will be required in the first accounting period, however as VAT comes within the scope of MTD 12 months after MTD for income tax, this transitional period will be short anyway. Again, if aligning return periods becomes too difficult, negative feedback will arise in relation to the MTD regime which will be detrimental to the project.

7.6.5 Self-employed individuals who claim UC may want to align MTD update periods with UC reporting periods. Though again we stress that we have recommended below that UC claimants be specifically exempt from MTD until a single, aligned report can be made to government that fulfil both DWP and HMRC requirements.

7.7 ***Question 26: Do you wish to make any comments about the operation of 'in-year' amendments to updates for the purposes of profits taxes or VAT?***

7.7.1 We agree that it may be necessary for updates to be amended from time to time, so it is important that any amendment process is as straightforward as possible. As each update in an accounting period adds to the previous updates to give a cumulative position for the business for the accounting period, it would seem sensible for amendments to MTD updates to be dealt with in a similar way to corrections to VAT returns, whereby any amendment is made in the next update so that the cumulative position is corrected once the later update is filed.

7.7.2 As for VAT, there would need to be a limit above which the amendment must be dealt with via a 'stand- alone' corrective process. However, provided the limit is set relatively high, the significant part of innocent errors that need to be corrected would be dealt with in the subsequent update and only a small number would need to be dealt with using a stand-alone procedure.

8 Chapter 6: 'End of Year' Activity

8.1 ***Question 27: Do you agree that the process of finalising the regular updates should be separate to the regular updates?***

8.1.1 For most low income self-employed businesses who will be on the cash basis, there will be little additional work to do to complete the End of Year Activity, as defined. Therefore, it will be most straightforward for this group to finalise the accounts via the final quarterly update rather than having to do yet another activity, provided a reasonable timeframe is put in place to allow time to consult advisers.

8.1.2 In view of this, it may not be appropriate to take the 'one size fits all' approach and those on the cash basis should perhaps have a different finalisation process to other businesses. But if so, it will be necessary to clarify when a business must decide on what basis it will be preparing its accounts. For example, for a business that is on the cash basis, if it looks like losses might be sustained as the business gets towards the end of its accounting period, it might prefer to move to the accruals basis to be able to claim the benefit of loss relief.

8.1.3 Further consideration needs to be given to these proposals and the interaction with the proposals made in the consultation document 'Making Tax Digital: Simplifying tax for unincorporated businesses' (see our separate response to that consultation).

8.2 ***Question 28: Do you agree that businesses should have nine months to complete any End of Year activity?***

8.2.1 As a significant number of businesses have a 31 March or 5 April year end, a nine month time scale for finalising the End of Year Activity would give a workflow peak at the end of December, when many people including professional advisers and HMRC staff are on leave, so effectively it means a deadline of say 22 December. For this reason, we strongly object to a nine month time frame for completion of the end of year activity.

8.2.2 As the SA deadline of 31 January is now very well known among the various business communities we would recommend a ten month time period for completion of the End of Year declaration.

9 Chapter 7: Exemptions

9.1 ***Question 29: What criteria should be applied in determining whether to exempt a particular business or business type from the requirements of MTD?***

9.1.1 Please note that our reply to this question should be taken together with our answer to question 38 (additional exempt groups).

Regularity of income

9.1.2 In the paragraphs preceding this question, the consultation refers to businesses which have certain characteristics which may not make them well suited to the requirements of MTD. One criterion that might be considered is regularity of income – for example, those who receive irregular sums such as authors and artists might have little to keep records of on a regular basis and in turn little to report. Their businesses will therefore not enjoy much in the way of the anticipated 'benefits' of MTD. We therefore recommend there is an exemption for businesses such as authors and artists which can show that their income is very irregular.

The need to consider the likelihood of free, comprehensive software being available

9.1.3 A key consideration here is that software developers are unlikely to provide free packages to comply with MTD for those operating in 'niche' areas. For example, shared lives carers (such as foster carers) calculate their profits and tax position in accordance with a special set of rules. Although their 'turnover' from such activities may take them well above the exemption if this is taken forward at its proposed level of £10,000, they are not likely to be able to easily afford bespoke software to comply with MTD assuming it is available. We therefore recommend that, irrespective of there being a 'financial exemption' level, there is a specific exemption for those claiming qualifying care relief.

9.2 ***Question 30: Should charities be exempt from the requirements to maintain digital records and to update HMRC at least quarterly?***

9.2.1 While LITRG does not aim to represent charities, we would nevertheless note that small charities or local associations might be run by unrepresented trustees. We understand also that many charities and community groups have their accounts done on a *pro bono* basis and this is less likely to continue if the compliance requirements become more complicated for them. We therefore believe that an exemption for charities would be welcome.

9.3 ***Question 31: Should trading subsidiaries of charities be exempt from the requirement to maintain digital records and to update HMRC at least quarterly?***

9.3.1 We have nothing to add to our answer to question 30.

9.4 ***Question 32: Should CASCs be exempt from the requirement to maintain digital records and to update HMRC at least quarterly?***

9.4.1 CASCs may well be small, local organisations run by the unrepresented. An exemption for them would therefore be welcome.

9.4.2 Furthermore, we recommend that consideration is given to there being an exemption for incorporated and unincorporated mutual trading bodies, for example residents' service operations in housing communities which share characteristics of charities and CASCs and are often run by volunteers.

9.5 ***Question 33: Should businesses within the insolvency process be included within the scope of the requirement to maintain digital records and to update HMRC at least quarterly; and are any special arrangements required for this group?***

Insolvency

9.5.1 We are not directly involved with insolvencies, but we think the question is rather confusing, because we would have thought it likely to be the insolvency practitioner or trustee in bankruptcy who would be responsible for reporting to HMRC rather than the 'business'. So should not the question be: 'Should insolvency practitioners and trustees in bankruptcy be outside the scope of MTD?'

Businesses that are not insolvent but which are in financial difficulty

9.5.2 We would however observe that there may be businesses skirting the edges of insolvency and if a business is struggling financially, they might have difficulty in meeting the requirements of MTD. For instance, attention might be diverted to trying to turn a business around, to get it out of debt; or the proprietor might not be able to afford a continuing broadband subscription, or indeed software or hardware costs, to enable compliance.

9.5.3 Would HMRC's proposed financial support be available to such businesses to help them remain compliant with MTD? Even if that is the case, it might not be the best use of public funds if ultimately the business fails. We therefore recommend that there is a time-limited exemption or relaxation of the rules for businesses that are in financial difficulty (see for example our suggestion for 'time to comply' under question 37, or allowing a business to telephone HMRC with quarterly figures temporarily, until the business is back online).

9.5.4 Further, we recommend that any exemptions from MTD compliance are written into the statute and carry a full right of appeal, rather than being left to HMRC concession or guidance.

9.6 ***Question 34: Which businesses should be included within a consistent definition of persons 'unable to engage digitally'?***

9.6.1 Firstly, we would strongly point out that many of those unable to engage digitally are likely to fall out of the scope of MTD mandation if the financial threshold for exemption discussed under question 35 below were much higher than the £10,000 turnover currently suggested. By getting that threshold right, HMRC will be relieved of the burden of providing financial assistance and other forms of support to enable people to comply as discussed at paragraph 4.4.3 above – provided of course that alternative channels remain, and that these are equally as good as the digital channels.

9.6.2 We welcome the VAT Regulations being used as a starting point for the definition of persons unable to engage digitally. These are noted in para 7.21 of the consultation document as follows:

> "two particular groups are exempted from the general requirement to file VAT returns online on the basis of their inability to do so:
>
> - a person who the Commissioners are satisfied is a practising member of a religious society or order whose beliefs are incompatible with the use of electronic communications; and
> - persons for whom online filing is not reasonably practicable for reasons of disability, age, remoteness of location, or any other reason."

9.6.3 It should be well recognised that those who are unable to comply for financial reasons will almost always be included within the 'any other reason' category. Even with direct financial support from HMRC (dealt with separately), there may be those for whom compliance still poses an unreasonable or excessive burden. For instance, it may be that timing of financial support on offer is not suited to their needs (if, say, that support was not in the form of up-front payment, but by reimbursement or reward at a later date, but the taxpayer was unable to afford the initial outlay awaiting reimbursement).

9.6.4 That of course may be a point about the design of a financial support scheme, rather than about an exemption, but financial difficulty could still present a barrier to compliance in some cases. For example, there will be those who have an adverse credit rating who cannot get a mobile phone or broadband contract and so might struggle with the ongoing demands of MTD, even if HMRC support were on offer.

9.6.5 It may be that the second limb of the above definition from the VAT Regulations is adequate if financial problems are included within the scope of the term "any other reason". However, as financial insufficiency is rarely considered acceptable, for example as a reasonable excuse for late payment of tax, it would be preferable if the law were to be clear that this ought to be considered in some cases (without individuals having to engage in complex arguments over the possibility that there may be a breach to their human rights or an 'individual or excessive burden').

9.6.6 We therefore recommend that HMRC use the VAT Regulations as a starting point for MTD exemptions, but these should be qualified such that financial difficulty can be expressly considered amongst the reasons for non-compliance.

9.6.7 We also recommend that the process for claiming these exemptions should not be onerous. HMRC should follow the Charter in trusting taxpayers as honest and allowing them to be the best judge of their capabilities; so, if they say they are unable to cope with MTD and provide a valid reason, we do not believe there should be a significant burden of proof on the taxpayer to evidence this.

9.6.8 We recommend that HMRC carefully consider the valid security fears within the scope of 'any other reason' for claiming exemption from MTD. There are already large numbers of scams –

for example using tax refunds – as a means of extracting personal data and bank account details from people. It is not unlikely that MTD will spawn a whole new spectrum of such scams. If a person has been a victim of online fraud, it is likely they would be justified in seeking exemption from MTD for 'any other reason' – that is, the valid fear that something similar could happen to them again.

Single or multiple barriers to engagement with MTD?

9.6.9 One point we would like to reinforce is that HMRC must not take the attitude when considering exemptions within the existing VAT definition (or similarly, when MTD rules are finalised), that someone must have multiple barriers to engagement. We are concerned that HMRC might adopt examples in their guidance to staff making decisions about the application of the exemptions such as that in Fig 7.1 of the consultation document – 'Jas'.

9.6.10 That example, while perfectly plausible, illustrates someone as having physical barriers to engagement, no local support and living in a rural location. His physical disabilities alone, or his remoteness of location and poor access to broadband would be adequate for him to claim the exemption outlined in the VAT legislation. HMRC therefore must not impose, through guidance, a higher hurdle than that which the law requires.

9.6.11 We therefore recommend that HMRC makes it clear in guidance on the exemptions that any one factor may be sufficient for the exemption to apply, and that individuals need not have multiple barriers to compliance so that they qualify. Further, HMRC must make this clear in their communications to the public – example scenarios must not be framed such that they deter people from applying for exemption.

Definition of 'person'

9.6.12 Answering a slightly different question than that posed, we feel it is worth pointing out a section of the judgment in the case of *LH Bishop Electric Co Ltd and others* [2013] UKFTT 522 (TC)[1] on the nature of what is a person for the purposes of considering human rights provisions.

9.6.13 As can readily be seen from the title of the case, the lead-named appellant was a company appealing against an HMRC notice to file VAT returns online. The company's main director, Mr Bishop, had various personal disabilities and his appeal grounds centred on his personal ability to comply with the notice.

9.6.14 While HMRC argued in the hearing that companies can have no human rights, the Tribunal disagreed:

> "563. In conclusion, I consider that it is irrelevant to the first and fourth appellant's case that they are incorporated companies: they have the same human rights as their

[1] See http://www.bailii.org/cgi-bin/format.cgi?doc=/uk/cases/UKFTT/TC/2013/TC02910.html&query=(LH)+AND+(Bishop)+AND+(Electric)+AND+(Co)+AND+(Ltd)

owners would have had had they chosen to conduct their business without incorporation."

9.6.15 In the paragraphs preceding this conclusion,[2] the judgment discusses in detail how a corporate body may be looked through to a degree where it is a small company, effectively the "alter ego" of its proprietor(s).

9.6.16 When framing the MTD exemptions for persons unable to engage digitally, we therefore recommend that HMRC and Parliament bear in mind that they should apply equally to corporate bodies in cases where small companies are effectively the 'alter ego' of their proprietor(s).

Right of appeal against an HMRC decision not to allow exemption

9.6.17 Not mentioned in this section of the consultation document is that under the primary VAT Act (VATA 1994, section 83(zc)) there is the ability to appeal against an HMRC decision not to allow the exemption. We recommend that the tax tribunal continues to have the final say on exemptions for persons unable to engage digitally – that is, there must be a right to appeal an HMRC decision not to allow exemption from MTD.

Transparency, availability and communication of exemptions

9.6.18 A further essential point, although not directly in answer to this question, is that the exemptions must be made known to taxpayers[3] – and not just digitally. Any communications sent to taxpayers relating to the MTD reforms, and promotion of MTD via the media should make it very clear that there are exemptions and make it very easy to find out about them in full. Ideally, we recommend a factsheet containing the exemptions is sent to all taxpayers at the time the reforms are introduced, and to new businesses when they register with HMRC.

9.6.19 We recommend that HMRC consult on communication strategy in full, with special attention to ensuring that people are aware of the exemptions, as these proposals develop.

9.6.20 Finally, we recommend that HMRC instate a clear and easy process for claiming exemption due to being unable to engage digitally. We understand that there is still some difficulty in finding out about and accessing the exemptions in place for VAT.

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[2] Ibid. See the section headed 'Do companies have human rights?' (paragraphs 539-563 of the judgment).

[3] The First-tier Tax Tribunal in the case of *LH Bishop Electric Co Ltd and others* [2013] UKFTT 522 (TC) was critical of HMRC's telephone filing facility which it had introduced as a concession to the then strict requirements of the legislation for online filing of VAT returns, on the basis that HMRC did not publish details of it. The exempt categories, now written into the law are published on GOV.UK: https://www.gov.uk/vat-returns/send-your-return

9.7 ***Question 35: Do you agree that £10,000 annual income is an appropriate threshold for exempting businesses from Making Tax Digital? Do you have any other comments on how the exemption should operate?***

9.7.1 We take the two sub-questions to question 35 in reverse order as, in part, it seems logical to consider how the exemption might operate, and raise wider queries on what figure it should be based upon, before considering the actual amount.

Operation of the exemption

9.7.2 There is a need to determine what is meant by 'annual income'. In the consultation document, it appears that this is interpreted as turnover rather than profit. This raises a question as to whether turnover is the appropriate measure, or whether profit is more suitable.

9.7.3 This 'turnover versus profit' is a question to which we ourselves see no straightforward answer, as there are advantages to both. Profit is a better indicator of whether compliance with MTD requirements is affordable, but sales information (turnover) is more likely to be a readily accessible figure than profits; and a threshold based on turnover ties into both the VAT threshold and the cash basis threshold.

9.7.4 A profits basis would, however, be possible to set if the threshold were backwards-looking, that is based upon the last complete year's figures. It is unfortunate that the basis for judging the threshold is not discussed at all in the consultation document, as this presents an area of complexity. The following questions need consideration:

- On which year's figures is the exemption threshold to be gauged – is it to be on the last complete year, or assessable on an ongoing basis, or a mixture of the two (as, for example, with the VAT registration threshold where there are both historic and future tests to be considered)?
- If a business is within the exemption, at whatever level it eventually set, at what point do they enter MTD if they exceed the limit?
- Will there be any penalty for failure to join MTD at the appropriate date?
- Once 'in' the MTD system, what happens if the business dips below the exemption threshold again? Do they come out of MTD? If so, from what point? Is it immediate, or must the business be below the exemption limit for, say, two years in a row before coming out? Will there be a 'higher hurdle' imposed for coming out of MTD, as for example there is for VAT deregistration? There is a danger of the system becoming over-complicated if taxpayers switch in and out, but equally there must be some means of a taxpayer being able to opt out if they fall below the exempt amount and expect to stay below that level.
- There is also the issue of what happens with joint income; is the exemption gauged by reference to the income source or the taxpayer? For example, would joint rental

income of £18,000 shared between two people mean they need to do quarterly reporting? Or because the half share is below, are they exempt from MTD?

9.7.5 On balance, we recommend that – with exceptions for new business which would require a forecast or some grace period to establish turnover and profitability – the MTD exemption threshold is measured by reference to final figures for the previous year. Entry into MTD would then effectively be deferred for a full tax year once a business exceeds the exemption if HMRC allow for the figures to be finalised for a year which show entry into MTD is required, and then allow the business to join MTD from the start of the following tax year. This will be necessary because MTD-exempt businesses may not be tracking quarterly figures so may not know until after they have completed a return for the year that they have breached the MTD exemption limit.

Example – entry into MTD

9.7.6 Let us assume that the exemption is set at £10,000 turnover as proposed (a figure we suggest is far too small, as explained below). Roger has turnover in 2019/20 of £9,000, then it goes up to £11,000 in 2020/21. Roger is not within the MTD regime in 2019/20 or 2020/21 and only realises his turnover has exceeded the threshold when he finalises his 2020/21 tax return in January 2022. Presumably he would then enter the MTD regime from 6 April 2022? But what would happen if his turnover has dropped again, such that he anticipates his final figure for 2021/22 to be £9,500, say?

9.7.7 Scenarios such as these require detailed working through, and simple explanation to taxpayers. We assume that Roger in this scenario would be sent a notice by HMRC that he must comply with MTD with effect from the appropriate date?

The threshold level

9.7.8 Turnover of £10,000 is far too low, when considering the abilities of the low-income population to comply with the MTD proposals. It is also out of step if one considers that the personal allowance for income tax is £11,000 and pledges have previously been made to increase it to £12,500. But from a practical perspective a turnover of £12,500 would still be too low.

9.7.9 Even a *profits* base of £10,000 would bring into scope many of those on the lowest incomes, among them many people trying to get into self-employed work and away from reliance on benefits, together with many people who might have disabilities but for whom self-employed work is an attractive alternative to employment and who might have been actively encouraged into that form of work by other arms of Government.

9.7.10 Indeed, generally £10,000 seems further out of step with other Government proposals – for example, UC's Minimum Income Floor for the self-employed is usually 35 hours a week at National Minimum Wage/National Living Wage. Thus, £7.20 an hour for 35 hours a week working 48 weeks of the year gives annual income of over £12,000; so, at a £10,000 threshold level (even if it were based on profit), MTD would catch many of the most vulnerable low-income self-employed.

9.7.11 While raising potential 'fairness' issues in terms of not recognising profitability and therefore the ability to meet costs of compliance with MTD (which may or may not be addressed by financial support schemes to be offered), we would on balance recommend that, for simplicity, the threshold is set using turnover. As noted above, this figure should be gauged on a backward-looking basis.

9.7.12 Initially, we recommend that the exemption level should be set at an amount equivalent to the current VAT threshold, given that this is already a recognisable figure for businesses. In arriving at this proposal, we considered concerns that linking the MTD threshold directly to the VAT threshold would subject it to uncertainty on the future of VAT due to 'Brexit'. On the plus side the VAT threshold is index-linked every year, so linking MTD to it would mean that the exemption should remain at a relevant level for the future. Concerns over Brexit could be addressed by giving MTD its own threshold separately from the VAT threshold, but equivalent in amount to the current VAT threshold.

9.7.13 HMRC might view a level equivalent to the VAT threshold as too great a departure from the £10,000 suggested in the consultation document. Indeed, it might be that this is too high a figure for the longer term. What is does allow is time to adapt to wholesale changes in the administration of the tax system. And, if the software and HMRC systems live up to the high expectations that HMRC have set for themselves, it gives a chance for 'early adopters' even within the exemption limits to move across to the new regime voluntarily. The adoption of SA online filing, even without mandation, is evidence that this is likely to happen if the systems make it easier to deal with tax.

9.7.14 Furthermore, setting the initial exemption at an amount equivalent to the VAT threshold will enable any initial issues in the system to be resolved by working with businesses that are familiar with record keeping of a sufficient standard to submit VAT returns.

9.7.15 Once the actual impact of MTD has been fully assessed at this level, it may be possible to consider further progressive introduction of the regime with the threshold reducing over a period of years. We would recommend, however, that any proposals to phase the introduction be the subject of separate future consultation, once the initial results of MTD at our proposed level have been seen and HMRC can then present evidence to support a wider roll out.

9.7.16 The separate charity TaxAid, in its own response to this consultation, sets out detailed reasoning as to why they similarly view that (at least initially) that the MTD exemption threshold should be set at the VAT threshold as a minimum, and that they have gone on to explain why they view that it should never be reduced to below 50% of the VAT threshold. We fully support and reiterate this recommendation by TaxAid, and the reasons behind it.

The Access to Work scheme, and other grants – a further point of detail

9.7.17 If the exemption from MTD is set using a turnover figure, whether this be the suggested £10,000 or some higher figure, we recommend that the turnover figure should expressly exclude any payments received under the Access to Work scheme[4] which help cover

[4] See https://www.gov.uk/access-to-work/overview

additional costs associated with a disability (such as costs of equipment, or to pay a support worker). These payments may be considered as 'income' or 'turnover' but aim to be cost neutral in terms of covering only the additional expenses to put a disabled person on a level playing field with others.

9.8 ***Question 36: Should the smallest unincorporated businesses that are not exempt have an extra year to prepare for Making Tax Digital? How should eligibility for this group be defined?***

9.8.1 An extra year is the absolute minimum that the smallest businesses should have before they are required to join MTD. But, as previously commented, we think that the timescale for these reforms is far too short and that MTD should be phased in over a much longer period of years (see section 2 above).

9.8.2 We recommend that MTD is phased in by initially setting the exemption figure at turnover equivalent to the VAT threshold. This could then be reduced over time, but never to below less than half the VAT threshold. We do not set out a timescale for such progressive mandation of MTD, as we recommend that HMRC should first have to demonstrate, with evidence and independent research, that MTD is working well for those with higher incomes and have fully tested it with those on lower incomes (and not only with keen 'early adopters').

Incorporated businesses

9.8.3 To answer a slightly different question than that posed, we pointed out in answer to question 34 above that an incorporated business can effectively be the 'alter ego' of its proprietor(s). Therefore, HMRC should ensure that small incorporated business have the benefit of any exemptions, extended timescales, or relaxation of penalties as those which are unincorporated.

9.9 ***Question 37: Do you agree that the principles set out in Fig. 7.3 are the right ones to use in determining eligibility for an exemption? Are there any additional principles which should apply?***

9.9.1 We largely agree with the principles set out in Fig 7.3. One qualification is, however, that previous behaviour will not always give an accurate guide to future behaviour.

9.9.2 For instance, in cases where someone has a condition (either physical or mental) that is fluctuating, intermittent or progressive, their past behaviour will not be indicative of future compliance.

9.9.3 There may also be cases where someone needs to claim an exemption when hitherto they were able to comply. For example, someone may be getting older and feel they are unable to cope with keeping up to date with new systems as time passes and their old computer breaks down or ceases to be supported in terms of updates. This is not hard to envisage in a world where, for example, many past versions of the iPhone are now unsupported and obsolete, even though the first one only became available less than ten years ago![5] Or a person may simply not be able to afford an upgrade in such circumstances, unless there is ongoing means of financial support.

9.9.4 Another common example is likely to be bereavement, where a surviving spouse or partner does not have digital capabilities.

9.9.5 To take account of many kinds of changes in circumstances, we therefore recommend that HMRC should be open to an application at any time for exemption under the 'VAT style' provisions discussed under question 34 above.

'Time to comply'

9.9.6 One might also envisage scenarios where someone needs to make a 'time to comply' arrangement, rather than incur a penalty and apply for reasonable excuse for their failure. This might be for example if they need time to replace a computer that has succumbed to a virus. HMRC should have a simple process for this.

9.9.7 The consultation also refers to the UK Government's commitment to the availability of broadband across the country as justification for why it is believed that MTD will be a success (for example, para 2.11 which refers to the Government's support for all having access to 'basic broadband of 2Mbps for all, which HMRC consider is a speed sufficient to send an update'). What must not be forgotten is that there may be some people who are temporarily abroad and out of range of broadband – for example a migrant to the UK who is self-employed, but who has temporarily returned to their home country for a family emergency – who may usually be able to comply, but not be able to at the time their report is due. This is obviously easier to manage and work around for an annual tax return than it is for more frequent reports. There therefore must be a concession, and the ability to apply in advance for a deferment – perhaps until they return to the UK.

9.9.8 We recommend that HMRC must have clear processes for anyone temporarily unable to comply with MTD, which should include the ability to apply for short term extension of a deadline or deferment of a filing obligation. We have also included this recommendation in our response to the 'Making Tax Digital: Tax Administration' consultation.

9.10 ***Question 38: Which additional groups (if any) should be exempt from the requirements to maintain digital records and to update HMRC at least quarterly?***

UC claimants

9.10.1 Much work needs to be undertaken on alignment of DWP and HMRC systems if any claimants of UC are to be brought into MTD. Setting the threshold at a much higher level than the £10,000 suggested would of course take many of these problems out of the equation. However, it is **unacceptable** for HMRC and DWP to have different rules for the calculation of business income for low-income people, together with different reporting

[5] See for example http://www.telegraph.co.uk/technology/2016/02/25/apples-iphone-a-definitive-history-in-pictures/

cycles, accounting methods, IT systems and using different terminology in guidance. Alignment of HMRC and DWP systems must be achieved before there is any question of UC claimants being brought into MTD; that is, we recommend that UC claimants are specifically exempt from MTD until at least the cash bases for tax and UC are fully aligned and that claimants are subject only to a single reporting requirement for both.

Taxpayers who are already keeping good, perhaps even digital, records

9.10.2 While our key focus in responding to this consultation is on the exemptions available for those unable to engage digitally, we do wish to raise some points referring to some who *may* be able to engage digitally but who we do not feel should be so mandated (or at least, not immediately when MTD is introduced).

9.10.3 Para 2.12 of the consultation document says:

> "HMRC is exploring, with specialists, the role of spreadsheets in business record keeping and their ability to meet the requirements and benefits of MTD compatible software. We are interested in the views of businesses on how spreadsheets could meet the requirements of MTD as set out in subsequent chapters of this consultation."

9.10.4 The alternative to making those keeping contemporaneous spreadsheet records of data comply with MTD quarterly reporting is to exempt them from the process and allow them to continue with annual filing.

9.10.5 Careful consideration also needs to be given to diligent keepers of paper books and records, and those who may be running perfectly adequate and accurate, but out of date, software that is unlikely to be brought into line with MTD requirements (or indeed who has hardware which is perfectly adequate for their requirements and is familiar to them but which will not support MTD-compatible software).

9.10.6 Forcing these people to use software or convert to new, MTD-compatible software runs the risk of turning compliant taxpayers to non-compliant ones. Such people may see little or no benefit to them in joining MTD and indeed there may be overall negative effects, such as errors being made in switching systems, or in familiarisation with new processes. This would achieve the exact opposite of MTD's aims of increasing accuracy and compliance.

9.10.7 The difficulty in defining this population is the question of how one proves that they are maintaining good, contemporaneous records. Many of those concerned may drop out of the scope of MTD if the exemption threshold is set at an adequate level. A separate exemption to be claimed for those keeping other good records would likely have to be by means of self-certification, perhaps accompanied by an example extract of such records. The taxpayer could sign a declaration to say in what format they will be keeping prescribed records if not using MTD software.

9.10.8 If good records are already being maintained, the Exchequer will gain little by mandating digital record-keeping and in fact losses are risked as explained above. If the key target population for MTD is those who are not keeping good records, the bulk of the perceived benefits (assuming the software delivers what is promised) will be achieved by bringing the non-compliant into the regime first and either exempt those already keeping good records or by giving them longer to join MTD.

9.10.9 An alternative to full-blown MTD for this group, but stopping short of full exemption, would be to allow them to telephone in their summary figures once a quarter, as the digitally excluded VAT filers are already allowed to do, at which point the officer who takes the call can input the figures straight on to HMRC's back-end systems. This would be a form of assisted digital which is already working well for VAT.

9.10.10 The other alternative to telephoning in figures, for those who may be online, is to allow them to enter their quarterly figures manually into their digital tax account (for example, by logging in to their personal tax account). This would be a half-way house for MTD, by respecting the fact that these businesses are already keeping good records but on a system which is not compliant with MTD to 'sync' directly with HMRC systems. Indeed, for those keeping records on spreadsheets, it would recognise that they are already using a 'digital' format but without being prescriptive as to the exact software.

9.10.11 In summary, we recommend that those keeping spreadsheet records, good paper records, or digital records but on software which will not be compatible with MTD should be exempt from MTD quarterly reporting unless a straightforward means of manually reporting quarterly figures online or by telephone can be found.

Shared lives carers (those eligible for 'qualifying care relief)

9.10.12 As noted under question 29 above, those working in 'niche' areas such as shared lives carers might find it hard to obtain free, bespoke software to cater for their needs under MTD. We suggest a specific exemption for them, particularly as providing care is a round-the-clock job which may mean that MTD does not lend itself to those so engaged. For instance, one can hardly ignore the needs of foster children while updating one's MTD app; therefore carers might only have particular times during which they can update their records.

People nearing retirement

9.10.13 There is little point in moving businesses into the MTD regime in the next couple of years if they are planning to retire and cease trade in the not-too-distant future. This would involve them in costs and systems changes (and potentially cost the general taxpayer money if the person were eligible for financial support to do so) for nil or very little in the way of return – either to the Exchequer or the individual.

9.10.14 We recommend the Government cater for such businesses with a time-limited exemption and would suggest that anyone planning to retire within, say, five years of MTD being introduced should be able to claim to come within it. This exemption would have a built in 'sunset' of 2023, ie five years from the start of MTD in 2018. While it might be argued that such an exemption could be open to abuse, it would offer limited opportunity to avoid compliance with MTD, as if retirement had not taken place by the time the exemption expires in 2023, the business would in any case be forced to join the regime at that point.

9.10.15 Indeed, those who are digitally capable may not choose to avail themselves of this exemption, so may voluntarily comply.

9.10.16 If a specific exemption is not taken forward for this group of people, HMRC must be willing to consider applications made on the basis of age as described previously.

Those who let out their own home due to requiring residential care

9.10.17 The proposals include mandatory compliance with MTD for those who let out property with income of over £10,000 a year. If looking at gross rents, this figure caters for a single letting of £833 per calendar month. This is arguably not a substantial amount, particularly in certain areas of the country where rental values might be higher than others.

9.10.18 We recommend that there should be a specific exemption from MTD for those people, perhaps of advancing age, who rent out their own home to help pay for residential care fees. These people may fall within the MTD exemptions discussed under question 34 (due to age, disability etc), but it would be easier for them (or trusted helpers/friends and family) to deal with the consequent tax reporting obligations if there is a specific exemption.

10 Chapter 8. Initial Assessment of Impacts

10.1 ***Question 39: Do you believe that there is the opportunity for MTD to create savings for your business? What percentage time reductions would you see from the following?***

- ***a) Targeted software tax guidance (prompts and nudges to get information right first time).***
- ***b) Gathering, collating and inputting data***
- ***c) Reporting obligations through providing regular updates.***
- ***d) Any other potential savings not covered above.***

General points

10.1.1 Potential savings from MTD are reliant upon availability of good, free software that incorporates functionality that makes it easy to record transactions. For example, the ability to take a photo of a receipt for storage in accounts is of limited benefit if the software does not incorporate text-recognition such that the user then must input the details of the retailer, amount spent manually. We therefore recommend that HMRC insist that software developers offer text-recognition functionality as a minimum standard in free software.

10.1.2 We also express caution that the ease of use of such software may be over-stated, especially in the early years of gaining familiarity with it and setting it up (for example with appropriate headings to analyse expenses for particular trades). It is all very well to say that a person can photograph their receipt immediately after a purchase, but equally as easy to see the impracticalities and hurdles to so doing.

10.1.3 For example, how does one photograph and upload a fuel receipt in real time when there is a queue to use the pump and those waiting behind are impatient for you to move? Is there a risk that, feeling under pressure to comply, some might be tempted to use their app to do so while driving? And how does a childminder update their app contemporaneously while looking after those in their charge? Inevitably there will still be very many instances in which receipts and invoices will be thrown in a pile to be caught up on later, so the perceived benefit of reducing forgotten expenses may not materialise in full.

10.1.4 The free software also needs to cater adequately for other seemingly minor complexities such as having to return a purchase and obtaining a refund or credit note. If it does not do so, or users are bombarded with 'in-app purchases' such that they are compelled to upgrade to make the software fully functional, this will substantially diminish the benefits of MTD. The great difficulty is that, in answering this and the questions below about savings, people need to make assumptions about the usability of the promised software and the likely level of functionality included in free software so as to gauge the likely outcome. HMRC and Government should therefore be mindful that suggested impacts are only estimated and the full extent will not be known until people start to join MTD.

10.1.5 For this reason, relaxation of penalties (as referred to in the 'MTD: Tax Administration' consultation and discussed in our response thereto), appropriate exemptions and wide-ranging support will be essential to minimise transitional costs and impacts. We also recommend that the actual impacts are closely monitored such that HMRC and Government are prepared to respond with further relaxations and extension of timescales if the forecast benefits are slower to realise than anticipated.

Consultation with businesses themselves

10.1.6 As it is probable that many businesses will not have the time to respond in detail to these consultations, even if they are aware of their existence, HMRC will need to continue to take time to reach out to businesses to find out from them directly the anticipated impacts. We therefore recommend that consultation on impacts is not a one-off exercise, but must be monitored on an ongoing basis until MTD is fully embedded.

10.1.7 If there is a lack of direct response from businesses to this consultation, this must not be taken as an indication that businesses think there is no cost or other likely impact to them.

Timescale for implementation

10.1.8 We believe that HMRC must give serious consideration to the fact that April 2018 is far too short a timescale for starting to roll out MTD. It may be that some businesses will be very negative about MTD and its associated costs (believing that it will cost them money rather than make savings), but this may be as a reaction to the timescale in which it is to be introduced and by which they will be expected to have evaluated new software options, make the transition, introduce and embed new routines or processes in the way they do business and so forth. Some might take the view that if they had longer to make the transition, the cost would not be so great as it could be built in more slowly as a natural development to the way they do business.

10.2 ***Question 40: Do you think there are different business sectors or sizes likely to benefit more from MTD? If so, what would these be?***

10.2.1 We think that many small businesses may welcome MTD if the software works well and it does truly deliver a slicker and simpler means of dealing with taxes.

10.2.2 But it must be approached with caution, particularly for those who will need bespoke software to deal with specialist tax regimes, such as shared lives carers. While those involved in that sector might find that digital record keeping could be of assistance to them, it will not be so if it comes at a financial cost in terms of hardware, software or additional fees of an agent – especially if ultimately their taxable income is below the personal allowance. It could simply mean a lot of regular work (distracting them from the job of caring) for no return, which is why we have suggested an exemption (see our answer to question 38 above).

10.2.3 Many small businesses, however, will not benefit from MTD as some use no software and some that do only use spreadsheets. As far as they are concerned, this will be added time and cost to prepare the same records. Far from making people more independent in their dealings with HMRC, it may in fact make them *more* reliant on agents.

10.2.4 ***Question 41: What costs might you expect your business to incur in moving to the new regime? Please provide details of the costs for:***

a) Time spent in your business familiarising with the new processes and conversion to these new processes.

b) Software expenditure costs (new or upgrading software).

c) Hardware expenditure costs (purchase of a computer, tablet device, etc).

d) Any other costs which are not covered above.

10.2.5 A significant cost is likely to be learning or being taught to use the new software and ironing out implementation issues. Importantly, these impacts are likely to be as great in terms of the time and effort required for compliance as they are in terms of financial impact. Time is not something which many small business people have a surplus of.

10.2.6 This indeed has been shown with the implementation of the RTI programme for PAYE. HMRC-commissioned research recently published indeed indicates many key points in terms of the impact of RTI, for example:

> 'There is no shortage of information to educate micro-employers about their duties but the investment required to make best use of the available resources (either in terms of time spent self-educating, or money spent on an advisor or premium software) can cause difficulties for those where time and/or available money is scarce.'[6]

[6] See 'Managing Pay As You Earn in real time: challenges faced by micro-employers' – Key findings, point 9 (page 6): https://www.gov.uk/government/publications/managing-pay-as-you-earn-in-real-time-challenges-faced-by-micro-employers

10.2.7 This clearly illustrates that even though guidance is available, businesses still struggle with having the time to comply with the requirements of RTI. Their first priority is to deal with the day to day running of their business.

10.2.8 It is not difficult to conclude that the record keeping requirements proposed under MTD together with quarterly reporting may form even lower priority for business than paying their staff and consequent reporting.

10.2.9 The requirement to spend time on what appears effectively to be 'real time' record keeping rather than allowing businesses to do their bookkeeping at a time to suit them appears to significantly underestimate the impact on business. This is that time spent in complying will translate directly into lost income for the lowest paid who may already be working every hour possible.

10.2.10 We recommend that HMRC learn from RTI experiences and ensure that MTD is introduced in appropriate phases. We have recommended in our response to the 'Making Tax Digital: Tax Administration' consultation that penalties for MTD failures are similar to those used when implementing RTI in that there should be relaxations for at least three years following introduction.

10.3 ***Question 42: Do you expect that your business will incur additional on-going costs as a result of these changes? Please provide the details of the additional costs or time for:***

- ***a) Additional support from your accountant or tax agent.***
- ***b) Additional time spent gathering, collating and inputting data.***
- ***c) Additional time reporting obligations through providing regular updates and any end of year activity.***
- ***d) Any other costs or time spent not covered above.***

10.3.1 Smaller businesses may not be able to afford to rely on agents to assist with quarterly reports plus finalising matters at the end of year, and may indeed not be able to engage assistance from an agent if the digital record keeping requirement is framed such that HMRC expect near 'real time' capture of data.

10.3.2 Those who do have agents are likely to incur more fees as there could be more for the agent to sort out at the year end if the client has tried to do quarterly reports themselves and has made mistakes.

10.4 ***Question 43: Will particular businesses (e.g. partnerships) experience more difficulty in adapting to the changes? If so, please provide details, including any additional one-off costs or ongoing costs.***

Partnerships

10.4.1 The proposals could mean that some partnerships may have to reconsider who is their nominated partner with HMRC. It may not be appropriate to have the same person as was nominated for SA, for example if there is more to do on regular record keeping.

10.4.2 Also, given that there is no free HMRC software currently for preparing and submitting partnership tax returns, many small partnerships still complete paper tax returns. Under the mandatory MTD regime, there must be a free software option for small partnerships.

Businesses that make annual adjustments

10.4.3 Businesses that make annual adjustments may find they have more difficulty, such as childminders who can prepare working at home expenses looking at the number of hours worked and using personal bills such as gas and electricity.

10.5 ***Question 44: If you are an agent, please provide details of how these changes will impact on your own business, including details of any one-off and ongoing costs or savings. How do you perceive that these changes might affect your clients?***

10.5.1 LITRG is not a tax agent, but we do provide guidance to the public on tax matters on our websites: www.litrg.org.uk, www.taxguideforstudents.org.uk and www.disabilitytaxguide.org.uk. The MTD changes will involve us in significant one-off costs in changing our guidance, and we anticipate – at least in the short term – that enquiries to our website (although we do not provide an advice service, people often contact us seeking help) will increase as a result of such significant wholesale changes in the administration of tax.

10.5.2 In the assessment of impacts, it should be noted that third sector organisations will have changes to make. Those organisations that advise and assist the public directly will have different and no doubt substantial costs compared to those we have described.

10.5.3 In terms of the impact on paid agents, LITRG is not providing any response. LITRG is a committee of the Chartered Institute of Taxation (CIOT) and we refer to the CIOT's response here which draws on responses to a member survey conducted by it and the Association of Taxation Technicians (ATT).

LITRG
7 November 2016