

House of Lords Economic Affairs Committee
Finance Bill Sub-Committee
Inquiry into Draft Finance Bill 2018
Evidence from Low Incomes Tax Reform Group (LITRG)

- 1 We welcome the opportunity to respond to the recent call for evidence in relation to both HM Revenue & Customs (HMRC) powers and Making Tax Digital for VAT on behalf of low-income and unrepresented taxpayers generally.

- 2 **Executive summary**
 - 2.1 HMRC must have the power to administer and enforce the tax system effectively and fairly, but the powers must be proportionate to be most effective, there must be accessible safeguards in place and there should be independent oversight.
 - 2.2 We consider that the new proposals in clauses 33-34 of Finance Bill 2018 and the proposals around HMRC's civil information powers which are currently the subject of separate consultation are starting to tip the balance of power much more in favour of HMRC.
 - 2.3 We do not support the extension of the time limit for assessing additional tax in offshore cases to 12 years in clauses 33-34 of Finance Bill 2018. We strongly recommend that additional specific safeguards are provided for, in particular, the introduction of a *de minimis* limit to prevent the collection of immaterial amounts of tax, often from elderly low-income taxpayers who have made an innocent error.
 - 2.4 We continue to be concerned about five key areas of the Making Tax Digital for VAT programme, namely the timetable for implementation, software development, the progress of the pilots, support for the digitally excluded and those needing digital assistance, and HMRC's communications strategy.
 - 2.5 We broadly support the new penalty system being introduced by schedules 11 - 13 of Finance Bill 2018 but we recommend some specific amendments which are set out at paragraph 6.2 below.

3 About Us

- 3.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low-income workers, pensioners, migrants, students, disabled people and carers.
- 3.2 The CIOT is a charity and the leading professional body in the UK concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

4 HMRC powers

4.1 Underlying principles in relation to HMRC powers

- 4.1.1 As a fair tax system must underpin a civilised society, the tax gathering authority needs the necessary powers to administer and enforce the system effectively and fairly. However there must also be accessible safeguards in the system which act as natural checks and balances to ensure that any enforcement is proportionate and the circumstances of vulnerable taxpayers are properly considered. Moreover, there should be independent oversight of HMRC's exercise of their powers and the use of the safeguards.
- 4.1.2 In our view, powers are proportionate and effective if they are geared to the situation of the taxpayer and the tax at stake. For example, a £100 penalty may be devastating for a pensioner on a low income, but wholly insignificant for a large corporation. Further, safeguards are accessible if the rights they guarantee are transparent and can easily be exercised at no more than a proportionate cost. Statutory review,¹ which is free, time-limited and optional, is an accessible safeguard; judicial review, which is costly and limited to the High Court, is generally inaccessible to individuals of modest means (ie most taxpayers). Therefore traditional routes of appeal, which provide for independent oversight, should always be in place so that ordinary taxpayers can have recourse to justice.
- 4.1.3 Digital means can and should be used to facilitate the operation of the tax system by enhancing accuracy and reducing cost and inconvenience for both tax authority and taxpayer. HMRC should not need enhanced powers in a digital environment, but they should harness the technology to use their powers more effectively and to enable easier access to safeguards such as to appeals frameworks, for example. Digitisation is not justification for a reduction in safeguards.
- 4.1.4 Nevertheless, viable and easily accessible alternatives to a digital environment must remain available to the substantial minority of taxpayers who are digitally excluded for some reason (eg without an adequate internet connection, coping with disability, lack of digital 'literacy'). Failure to

¹ Statutory review is an internal review process available to taxpayers where they disagree with a decision by HMRC. They can ask HMRC to look again at their decision and it will be reviewed by a different HMRC team who have not been involved in the original decision. The option to appeal to an independent tax tribunal remains open, even if a statutory review is undertaken.

do so will inadvertently encourage involuntary non-compliance as well as causing avoidable distress to those who wish to comply but cannot.

4.2 ***Our experience of HMRC's powers***

- 4.2.1 The most common example of the exercise of HMRC powers we see is in the world of penalties, an area which is now largely automated. It is noteworthy that fewer than half of the decisions considered on statutory review in 2017/18 were upheld in HMRC's favour, the remainder being varied or cancelled. While this reflects well on the impartiality of the review teams, it reflects badly on the quality of the initial decision making. On one hand, that is hardly surprising, because so many penalties are imposed automatically without human intervention. Nevertheless, there are clearly some cases that the taxpayer should never have had to take to statutory review in the first place. Given that it takes confidence, persistence and courage for an unrepresented individual to request a statutory review and/or pursue a case to appeal against the opposition of a well-resourced government department, it would be hardly surprising if most individuals simply acquiesced. In 2017/18, there were only 34,000 applications for statutory review, a small proportion of all appealable decisions by HMRC.²
- 4.2.2 The most conspicuous examples of perceived unfairness show up in the differences in treatment between the represented taxpayer, who can rely on an experienced adviser to spot where safeguards might protect them in an enquiry or investigation, and the unrepresented taxpayer who is far more likely to rely on HMRC's view of a matter to their own detriment. For example, the law on inaccuracy penalties³ states clearly that only a careless or deliberate error attracts a penalty, but no penalty arises where the mistake is neither careless nor deliberate. Yet HMRC not infrequently impose a penalty on the basis that a mistake is careless even if it is in fact innocent (for example, a transposition error). A well-informed or represented taxpayer would be able to question the imposition of such a penalty because they or their adviser would know that innocent mistakes do not give rise to a penalty; an unrepresented taxpayer, on the other hand, would often accept the penalty and not enquire further, however unfair it seemed to him, because he would lack the requisite knowledge of tax law and the system of penalties and how to mitigate them.
- 4.2.3 Together with the clauses in this Finance Bill, new proposals around HMRC's civil information powers raise a concern that the balance of power is tipping much more in favour of HMRC. We consider that the proposed changes do not protect the low-income taxpayer sufficiently against the misuse of the proposed new powers.
- 4.2.4 We look at this further in the context of clauses 33-34 FB 2018 at paragraph 4.4 below. With regard to the extension of civil information powers, the consultation document suggests that the requirement to obtain tribunal approval before HMRC can issue a third-party information notice be removed, on the basis that it stops HMRC from processing these cases in a timely manner. In our view, the arguments set out in the consultation to abolish the requirement to obtain independent tribunal approval are at best weak. LITRG will be responding to the consultation to

² See HMRC's Annual Report and Accounts 2017/18:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/726849/HMRC_Annual_Report_and_Accounts_2017-18_web.pdf

³ Financial penalties imposed where the taxpayer pays too little tax because they have made a mistake in a document they submitted, such as a tax return.

argue against the change on the basis that it is one-sided and disproportionate. The safeguards are as valid now as they were when they were originally introduced; the principles remain the same.

4.3 ***Oversight and governance***

4.3.1 We believe the tax system could operate more effectively overall if there was better oversight of the use of HMRC powers. Therefore it might be helpful to introduce some degree of parliamentary oversight. This could be done by an independent body preparing an annual report on the exercise of HMRC powers for Parliament.

4.3.2 Independent oversight such as from the tax tribunals for example, whether in relation to appeals or as noted above at paragraph 4.2.4 in relation to approving HMRC actions, improves day-to-day governance. In our opinion, governance could also be improved by ensuring that no powers are exercised without providing the taxpayer with full and clear information on the nature of the power, what they are required to do, and their rights – which would include limitations on the extent to which HMRC may exercise the power in question, and any relevant safeguards (eg appeal rights and how to exercise them).

4.4 ***Comments relating to clauses 33-34 Finance Bill 2018***

4.4.1 These clauses provide for the ordinary time limits for assessing tax to be extended in offshore cases from four years (or six years where a taxpayer's under-declaration or other non-compliance has been careless but not deliberate) to twelve years. This moves the balance of power even further in favour of HMRC, and seriously undermines the fundamental right of any honest taxpayer to closure after a reasonable time.

4.4.2 LITRG is among those who have responded to the Government's consultation and subsequent publication of clause 33 in the draft Finance Bill, expressing deep concern over the fairness of the proposals.⁴ In our view, the safeguards in the proposals are inadequate, and in our submission on the draft Finance Bill we have argued that a fairer balance will be provided by introducing:

- (a) a statutory time limit for HMRC to 'reasonably' assimilate information received from overseas under mandatory automatic exchange agreements and make an assessment based on that information;
- (b) the new rules from 2019/20 only, rather than their having effect in relation to tax years as early as 2013/14, as currently proposed;
- (c) a *de minimis*, so that HMRC are prevented from using the new legislation to collect immaterial amounts of tax for which the distress caused to the vulnerable taxpayer does not justify the net gain for the Exchequer.

4.4.3 Judging by the standard 'nudge' letters sent out, HMRC seem to assume that individuals with overseas accounts are wealthy and sophisticated people. In fact, many recipients of these letters are elderly people on low incomes who have small amounts of either taxed interest from foreign bank accounts or foreign pensions. These individuals mostly assume that because tax is usually already deducted at source, the income does not have to be reported to the UK authorities. The

⁴ <https://www.litrg.org.uk/latest-news/submissions/180511-extension-offshore-time-limits>,
<https://www.litrg.org.uk/latest-news/submissions/180830-draft-finance-bill-2018-2019-extension-offshore-time-limits>

tax charity Tax Help for Older People reports that currently approximately 10% of their enquiries relate to this issue each week. In our opinion and experience, the vast majority of low-income taxpayers who have undisclosed liabilities related to offshore investments want to be compliant once aware of the error; the threat of penalties or criminal prosecution is wholly unnecessary. Arguably the Government should be doing more to **support** such taxpayers who are unintentionally non-compliant.

5 Making Tax Digital (MTD) for VAT

5.1 The Committee will be aware that we have previously made submissions⁵ on HMRC's 'Making Tax Digital' programme. We draw upon our experiences of working with self-employed individuals and small businesses, some of whom are VAT registered due to the level of turnover, but nonetheless make very modest profits. This might include businesses such as cafes and corner shops where there is sufficient turnover to be VAT registered but with low margins and so relatively small profits. Some of these traders will also be in receipt of state support such as tax credits or universal credit.

5.2 We have identified five key areas which continue to be of concern to us:

- (a) Timetable – the successful introduction of MTD for VAT in April 2019 is now likely to be a very significant challenge. To date there has been virtually no direct publicity to let businesses know this is being introduced.⁶ In our opinion this leaves insufficient time to enable a business to research and consider options with regard to software and establish new procedures or modify existing procedures for its record keeping, or apply for an exemption if it considers it is eligible for this. HMRC need to be aware that many small businesses will need to move to digital record keeping for the first time and so they may well find the prospect very daunting and intimidating and so will need time to familiarise themselves with what is required, both in terms of the digital record keeping requirements and any system requirements. In addition, for some businesses, the introduction of MTD for VAT at the same time as Brexit happens could mean significant administrative burdens arising at the same time.
- (b) Software – HMRC have published a list of software companies who will be producing MTD for VAT compliant software in due course, however it does not make it clear which companies (if any) have software available now. There is no indication which companies have free software available nor whether any software is industry specific or has any kind of restrictions on its use. (It should be remembered that the provision of free software for the purpose of complying with MTD for VAT was not a requirement that the software companies had to meet as part of their agreement with HMRC, unlike for MTD for income tax.) We understand a digital tool, allowing users to sort the various software offerings according to certain criteria, is

⁵ <https://www.litrg.org.uk/latest-news/submissions/171121-lords-economic-affairs-committee-making-tax-digital-business-%E2%80%93>

<https://www.litrg.org.uk/latest-news/submissions/170306-lords-economic-affairs-committee-inquiry-draft-finance-bill-2017>

⁶ A page of information on MTD for VAT was published on GOV.UK on 17 September but as far as we are aware, this has not yet been brought to the attention of VAT registered businesses.

to be developed. This needs to be available on GOV.UK as soon as possible to help businesses at least narrow down their choices.

It is imperative that reliable, approved software is available in the very near future. Many small businesses will need time to research and plan for implementation, as well as undertake training in some form, particularly if they are completely new to any type of accounting software. There will almost certainly be cost implications too, either for hardware, software or both, as well as costs in terms of time spent by the business owner in getting to grips with this regime, possibly at the expense of additional sales income. We continue to urge HMRC to provide some basic free software that small businesses could choose to use to make the new MTD for VAT process much easier and supportive for them.

- (c) Pilots – our understanding is that the pilot testing of the MTD for VAT regime is still on a very small scale, despite being only a little over six months away from going ‘live’. It is not possible to join the pilots voluntarily at this stage, it is by invitation only. Further, to date, HMRC have not provided any feedback on what has been learned from the pilots and so stakeholders are in the dark as to what changes, if any, are likely to evolve from the pilot process.
- (d) Digital assistance and exemption – HMRC have not yet published any detailed information as to how exemption from MTD for VAT may be obtained. As many individuals and businesses may wish to do that well in advance of April 2019 it is imperative detailed guidance is made available immediately and it is publicised. For those vulnerable taxpayers who are likely to be covered by the exemption, delays in this area will almost certainly be causing unnecessary stress and worry. In the Committee’s 2017 report it was noted that HMRC research found 61% of the self-employed and 31% of micro businesses fell into the digitally excluded or digitally assisted categories. It is not known how many are VAT registered but we would expect it to be a sizeable population.
- (e) Communications – the majority of small self-employed individuals or businesses who are unrepresented are completely unaware of HMRC’s Making Tax Digital programme and the obligation to comply with MTD for VAT from April 2019. This is unacceptable and needs to be rectified as a matter of urgency.

6 Making Tax Digital – the new penalty regime

6.1 We are broadly supportive of the new regime, particularly because it differentiates between deliberate and persistent non-compliers and those who make occasional innocent errors. However we still have a number of concerns on some specific aspects of the proposals which we set out in our earlier submission in respect of the draft Finance Bill clauses.⁷

6.2 Our main issues are as follows:

- (a) As HMRC should be fully aware of a taxpayer’s accumulated penalty points it should not be necessary to allow HMRC a two year window to raise a penalty assessment (paragraph 18, schedule 11 FB 2018). We believe this runs counter to one of the key aims of the new system

⁷ <https://www.litrg.org.uk/latest-news/submissions/180831-draft-finance-bill-2018-2019-penalties-and-interest>

which is to encourage non-compliant taxpayers to become compliant again as quickly as possible. The time frame should be much shorter, perhaps in line with the time limit for awarding penalty points.

- (b) In circumstances where HMRC withdraw a notice to file a tax return, the legislation should provide that HMRC MUST cancel any associated penalties. At the moment, paragraph 23(3) of schedule 11 and paragraph 15(3) of schedule 12 only allow for the possibility of the penalties being cancelled.
- (c) With regard to the late payment penalties introduced by schedule 13 we strongly believe that levying a penalty if tax is still outstanding 15 days after the due date is far too soon in view of the likely sequence of events in this situation being
- HMRC issue the penalty notification;
 - the taxpayer receives the notification and takes time to consider it (including whether it is valid and for the correct amount);
 - the taxpayer takes appropriate action, whether that is arranging for payment, contacting HMRC to propose a time to pay (TTP) agreement, appealing the penalty or seeking advice (whether from a paid adviser or a tax charity) to ascertain the appropriate next step.

6.3 Finally as penalty points will accrue per tax (income tax, VAT, etc) a self-employed individual who is VAT registered and who falls behind with his compliance could have two sets of penalties to keep track of, and so this could quickly become quite complicated. It is vital that taxpayer guidance and correspondence is clear to ensure the regime is transparent, setting out all rights and obligations of both HMRC and taxpayers. For instance, examples setting out potential taxpayer liabilities should include both penalties and interest, and notifications issued to taxpayers should explain how penalties AND interest will be worked out, so that the levels of the second penalty and any late payment interest do not come as nasty surprises.

LITRG

1 October 2018