Low Incomes Tax Reform Group

A voice for the unrepresented

Making Tax Digital: discussion paper on simpler payments
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 LITRG welcomes the opportunity to comment on this discussion paper issued by HM Revenue & Customs (HMRC). While we support HMRC's efforts to develop ways in which taxpayers can interact with them digitally if they so choose,[1] we believe there are serious fundamental flaws in the Making Tax Digital program as it is currently proposed and would strongly urge HMRC to reconsider their strategy very carefully.

1.2 Taxpayers should be able to understand their tax obligations, in particular how much to pay and when, so they need to be clear as to what taxes they are paying each time they make a payment. Aligning the payment of several taxes will not achieve this. Offsetting overpayments of tax in one area against other outstanding liabilities should happen as a matter of course if simply requested by the taxpayer.

1.3 Self assessment tax payments for unincorporated businesses should not be changed without a major review of the basis of taxation of such businesses for income tax purposes and the

[1] See LITRG press releases:

http://www.litrg.org.uk/latest-news/news/151209-digital-tax-account-charity-urges-hmrc-respect-rights-digitally-excluded

http://www.litrg.org.uk/latest-news/news/160114-press-release-tax-professionals-issue-warning-about-move-quarterly-tax impact any changes will have on them. This effectively amounts to a potential overhaul of the entire system of self assessment, which should not be embarked upon as a side effect of the Digital Program.

1.4 Tax payments should not be based on information reported in quarterly updates as they will very likely be inaccurate and are most unlikely to reflect a 'real time' tax payment. Also the obligation to make any kind of quarterly return will impose yet another administrative burden on small businesses which will cause an unnecessary diversion of time and energy away from the running of the business itself. We find this totally unacceptable.

2 About Us

2.1 The 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.

2.2 LITRG works extensively with HMRC and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 General comments

3.1 The paper states that the Government's intention for the Making Tax Digital Program is to transform the tax system so it operates much more closely to 'real time', and that by reporting information closer to real time, "businesses will find it easier to understand how much tax they owe, giving them far more certainty over their tax position and helping them to budget accordingly."

3.2 However this seems to be at odds with HMRC research[1] published in September 2015 where some of the key findings were:

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[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/457624/R398_Reporting_Cycles.pdf

- Overall, SMEs felt their business and tax cycles fitted together well.
- Approaches to payment and reporting varied by SME size and turnover, complexity, cash flow, financial confidence and degree of organisation.
- Frequent payment was valued for managing cash flow, though practical implementation raised some concerns.
- More frequent reporting held little initial appeal, being associated with administrative burden and seen as 'controlling' by simple businesses.

3.3 More specifically, the Executive Summary from the report states:

- As SMEs were broadly satisfied with the way their tax and business cycles fitted together, most struggled to think how they could be better integrated.
- Reactions towards more frequent reporting were predominantly negative, due to associations with administrative burden and the sense it was for HMRC, rather than the business. Most saw no or few obvious benefits.

3.4 In view of the above conclusions from HMRC research, which is consistent with our own anecdotal evidence, it is difficult to see why HMRC intend to press ahead with the Making Tax Digital program in its current form. While we support HMRC's efforts to develop ways in which taxpayers can interact with them digitally if they so choose[1] we believe there are some fundamental flaws in the system as it is currently proposed, in particular the requirement for businesses and some individual taxpayers such as landlords to report information quarterly and a compulsion to maintain digital records.

3.5 We are also concerned with the one-size-fits-all approach that this program is advocating in respect of SME's. The aforementioned research identified several types of SME business with very different needs and therefore more detailed consideration should be given to tailoring a digital program to the different types of SME business to meet these varying needs more closely.

3.6 Sufficient provision also needs to be made for the digitally excluded to comply with their tax obligations, which we believe make up a very significant sector of taxpayers across all ages.

[1] See LITRG press releases

http://www.litrg.org.uk/latest-news/news/151209-digital-tax-account-charity-urges-hmrc-respect-rights-digitally-excluded

http://www.litrg.org.uk/latest-news/news/160114-press-release-tax-professionals-issue-warning-about-move-quarterly-tax

4 Simplifying Payments

4.1 We do not agree that the different payment systems currently in place "are confusing for taxpayers and lead to error". We believe that most taxpayers understand when their tax payments become due, whether they are payments of VAT, CT or ITSA. There needs to be a transparent system so that taxpayers are clear as to what taxes they are paying when they make a tax payment and one single payment covering various taxes would not achieve this clarity.

4.2 Some taxpayers find it confusing that their self assessment payments also mop up class 4 National Insurance contributions (NIC) and capital gains tax (CGT) due and so further alignment of other taxes would cause additional confusion.

4.3 However, we strongly support the option to offset overpayments in one area against liabilities in another and believe this facility should be easily available as soon as possible in any event. But this should be achievable by improving HMRC's administrative processes, without the need to change payment dates for taxes.

5 Self assessment and unincorporated businesses

5.1 We agree there is some complexity within the self assessment tax system which makes the tax position of an unincorporated business sometimes difficult to understand, however this is as a direct consequence of the basis period rules which determine taxable profits in a tax year. These rules can be complicated and give rise to some profits being taxed twice in the early years of the business which is compensated for by overlap profits.[1] It is generally accepted that this is not really a satisfactory way to tax profits but to simplify this it would be necessary to have a compulsory tax year basis period for all businesses. This would be a major change in the income tax rules governing unincorporated businesses and should be consulted on separately as it must be well thought out and would inevitably involve complex transitional rules.

5.2 The current basis period rules is one of the reasons why any form of quarterly reporting of 'real time' profits (however they are calculated for this purpose) for unincorporated businesses whose accounting year end is not 31 March or 5 April will NOT bear any resemblance to the profits on which their self assessment tax bill would be based. Therefore any payment based on the quarterly return would not amount to paying tax in 'real time' for many unincorporated businesses.

[1] Overlap relief can be claimed by unincorporated businesses with overlap profits usually on cessation of trade or on change of accounting date. It is a complex relief and its value is eroded over time in real terms.

5.3 In any event, the obligation to make any kind of quarterly return will impose yet another administrative burden on small businesses, causing an unnecessary diversion of time and energy away from the running of the business itself which in our view is unacceptable.

6 More regular payments

6.1 Currently payments on account of ITSA liabilities are made twice per year where the conditions requiring such payments are met. We accept that the payments on account are not based on up-to-date data initially as they are fixed by the tax position of the taxpayer for the previous tax year. However the payments can be reduced by making an appropriate claim so that they are in line with the anticipated tax position for the tax year to which they relate so the current system does allow for some adjustment to interim payments to reflect the anticipated 'real time' position.

6.2 If the objective is to make more frequent payments of tax due on 'real time' profits then aside from the issues for the self employed explained in paragraph 5 above, unless the quarterly reporting reflects taxable profits for the quarter this will not be achieved. If the cash basis is not being used[1] then taxable profits would need to reflect stock, WIP, capital expenditure and other adjustments made to accounting profits which would almost certainly require input and work from an accountant and so increase – not decrease – the cost to business of complying with this measure. It will also involve the business management team in more time dealing with compliance matters rather than running their business.

6.3 Therefore if the quarterly data reported is anything other than taxable profits, any payment based on it is arguably no more accurate than the current payments on account system and therefore there would be little point in introducing such a measure.

6.4 However for those taxpayers who would prefer to make more frequent payments, an option could be introduced whereby payments on account could be made in four equal instalments rather than two as currently. We would only support such a proposal if it was a voluntary measure.

6.5 Taxpayers can of course currently make more regular payments using the Budget Payment Plan[2] option offered by HMRC, whereby regular payments are made by direct debit, usually weekly or monthly. This could perhaps be expanded to provide businesses with more flexibility so that they could make payments whenever they wish to in advance of a liability becoming due. This would enable them to build up funds with HMRC on an ad hoc basis to suit their business cashflow and use them to settle the liabilities as they arise. Again, this can

[1] ie business is using the accruals basis.

[2] https://www.gov.uk/pay-self-assessment-tax-bill/budget-payment-plan

be achieved by modifying an existing scheme and does not require wholesale reform of the tax system.

6.6 It should also be noted that not all businesses in HMRC's recent research supported more frequent payment as the Executive Summary points out:

> *"Many SMEs could see that paying smaller amounts more frequently could enable them to better plan their finances and avoid 'shocks', especially for taxes paid annually (e.g. CT). Additionally, some felt it fit with their current activities, for both tax and other payments (eg utilities bills).However, for others who 'dipped' into money set aside during quieter periods, paying more frequently would lose this flexibility. Some also felt they would lose out on interest accrued on the money they set aside."*

6.7 Finally, it is not clear what the current proposals are for collecting underpaid tax from PAYE taxpayers with secondary income of less than £10,000, and so this raises several questions. We note this group of taxpayers will be expected to update their details via their digital tax accounts (DTA) which will be prepopulated with data already held by HMRC if appropriate. The DTA should then automatically show whether there is an anticipated underpayment or overpayment of tax – but how will the underpayments or overpayments be dealt with? Will there be a facility to make an immediate payment to clear any underpayment which shows on the account at any particular time? Or will the underpayments be collected via a simple assessment? How will the simple assessments take account of any interim payments a taxpayer may have made?

6.8 Also, as mistakes may occur with any prepopulation task we would expect to see clear guidance given to taxpayers when they access their DTA that they must check any prepopulated data against their own records so they can be sure it is correct.

6.9 We are concerned that HMRC's expectation as to how often individuals will check their DTA is unrealistic – what will happen if a DTA is not accessed for several months? Will an electronic reminder be sent to the taxpayer? Or perhaps a letter will be sent?

6.10 We would welcome the publication of more detail on how the DTA will work in practice for this section of taxpayers.[1]

LITRG
25 February 2016

[1] Some of these points may be addressed in the forthcoming webinars explaining the digital tax accounts in more detail.