

**Lords Economic Affairs Committee  
Finance Bill Sub-Committee  
Inquiry into the draft Finance Bill 2017  
Evidence from the Low Incomes Tax Reform Group**

- 1 We welcome the opportunity to provide written evidence to this Inquiry into the Finance Bill draft clauses on digital reporting and record-keeping for businesses chargeable to income tax. In this submission we refer to HMRC's programme 'Making Tax Digital for Business' by its acronym of 'MTD'.

**2 Summary**

- 2.1 In common with most other respondents to HM Revenue & Customs' (HMRC) consultation on MTD launched during August 2016, we believe the proposed exemption threshold of £10,000 turnover is far too low. We favour the current VAT threshold; businesses with turnovers below that should not be mandated but enabled to opt into MTD.
- 2.2 We support HMRC's proposal to exempt those for whom it is not reasonably practicable to use electronic communications or to keep electronic records for any reason, including age, disability or location, and await further details of how the exemption will be implemented and administered. But we are concerned about the possibility of additional cost being incurred by disabled people for whom assistive technology can help overcome their disability, and urge HMRC to provide sufficient financial help to ensure that they do not suffer unlawful discrimination.
- 2.3 We believe the timetable is far too short to enable the smallest businesses to prepare for implementation, or for HMRC to put in place any major changes indicated by the pilots given that the pilots will not allow for one full MTD cycle. There are still too many unknowns. Free software might help the smallest businesses if the specification is right, but those who will

rely on it must not have a worse experience than those who can afford to use paid-for versions of commercial software. It is still our belief that HMRC should develop free software that is fit for purpose and should not rely on the commercial market.

- 2.4 The proposed extensions to the cash basis and reform of the basis period rules may achieve some simplicity, but at the expense of a less convenient tax regime particularly as regards set-off of trading losses. Nobody should be encouraged to adopt cash accounting for the sole reason that it will make compliance with MTD easier for them, particularly when accruals accounting is the only way to understand whether a business is profitable and how it is doing generally. In particular, universal credit claimants should not be expected to understand and apply two different forms of cash basis – one for HMRC for tax, the other for the Department for Work and Pensions (DWP) for benefit purposes.
- 2.5 We welcome the Government's constructive response to the consultation on their proposed penalties model and look forward to further consultative engagement.

### **3 The scope of the exemptions and measures to help the digitally excluded**

#### **3.1 *The exemptions***

- 3.1.1 In their response to the consultation in January 2017, HMRC said that they would consider further the initial exemption threshold, currently proposed at £10,000 turnover (or 'income' in HMRC terminology).
- 3.1.2 During the consultation, the professional bodies, tax charities and the House of Commons Treasury Select Committee were fairly unanimous that the proposed £10,000 threshold was far too low, and would result in the smallest businesses bearing an administrative burden out of all proportion to the time and attention they should devote to their business.
- 3.1.3 Nearly all respondents favoured the VAT threshold (£83,000 turnover) as a more appropriate point of entry. That would ensure that, at least initially, the majority of businesses within the MTD programme would already be accustomed to quarterly digital reporting to HMRC and the numbers of businesses would be more manageable for such a major change – one million rather than four. Businesses below that threshold, while exempt, could opt in to MTD – and if the IT systems worked well and were easy to use, very many probably would.
- 3.1.4 To set the threshold any lower than around £83,000 would bring universal credit claimants into scope. For them MTD would be a particularly onerous administrative burden, coming on top of their obligation to report monthly to the DWP using a different cash basis of accounting from that devised by HMRC. Nobody should reasonably be expected to understand and apply two different bases of accounting together with two forms of regular reporting, which was why we recommended in our response that universal credit claimants should be exempt from MTD until such time as a combined system of reporting can be developed.

### 3.2 ***The digital excluded***

- 3.2.1 The draft legislation (clause 12) provides an exemption from digital reporting and record-keeping obligations for those individuals and members of partnerships who are defined as ‘digitally excluded’: that is, a practising member of a religious society or order whose beliefs are incompatible with using electronic communications or keeping electronic records; or if for any reason (including age, disability or location) it is not reasonably practicable for the person or partner to use electronic communications or to keep electronic records.
- 3.2.2 The second limb of that definition reflects the VAT regulations on exemption from online filing, as amended following the First-tier Tribunal case of *LH Bishop Electrical Co Ltd and others v HMRC Commissioners* [2013] UKFTT 522 (TC) (*Bishop*). In *Bishop* it was held that the VAT regulations requiring the appellants to file their VAT returns online discriminated unlawfully against the appellants, all of whom were of an age that made it difficult for them to acquire computer skills, two of whom had a disability that made it painful for them to use computers, and one lived in a location where internet access was absent or unreliable. It was recognised that digital exclusion may be caused by other factors too. After the hearing, HMRC consulted carefully on amendments to the regulations and the result has proved broadly satisfactory.
- 3.2.3 We are therefore supportive of the broad definition of digital exclusion set out in the draft primary legislation. The precise terms of the exemption are to be set out in regulations which have yet to be published. In our view the regulations must ensure:
- that the alternative channels available for reporting business results are as accessible for the digitally excluded as the digital channels will be for the digitally competent;
  - that the digitally excluded are given as much information about their obligations and entitlements as their digitally competent counterparts, and as good a service;
  - that the alternative channels are well publicised and not kept secret;<sup>1</sup>
  - that there are proper appeal rights to the First-tier Tribunal against any refusal of an application for exemption on grounds of digital exclusion, or any grant of such an application subject to conditions that the taxpayer might find unacceptable.

### 3.3 ***Assistive technology – extra cost***

- 3.3.1 While exemption is appropriate for certain disabilities, there are others for which digital communication is a lifeline but who need various forms of assistive technology to make the

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<sup>1</sup> In *Bishop* it was held that HMRC could not rely on the concession of telephone filing as it was not made public, and those who might benefit from it could only find out about it if they happened to hear about it from a contact centre or were offered it as part of an offer of settlement in the course of litigation, as happened with the three appellants.

internet accessible. While HMRC have set up a working group to look at what forms of assistive technology will be necessary to enable people with disabilities to comply with the requirements of MTD, it is unclear how the Government proposes this should be funded. If disabled business owners had to incur a greater cost to comply with MTD which they would not have had to incur but for their disability, that would constitute unlawful discrimination. Consequently HMRC would be in breach of their public sector equality duty if they did not seek to eliminate that extra cost.

3.3.2 The *Summary of Impacts*,<sup>1</sup> under *Equalities Impact*, states as follows:

“HMRC doesn’t have evidence to suggest this measure will have a significant or disproportionate impact on groups with legally protected characteristics, as recognised in the Equality Act 2010.

“The government recognises that many people with disabilities use digital technology and are able to interact online using assistive technology. HMRC will ensure that available software will be compatible with forms of assistive technology and that those that are willing to operate MTDfB [Making Tax Digital for Business] are able to do so.”

3.3.3 That says nothing about how the extra cost would be met where a person’s disability does not make them ‘digitally excluded’.

#### **4 Robustness of the proposed timetable from the perspective of the smallest businesses**

4.1 Most of the public have little or no idea what MTD is, what it involves, or how it will affect them. There has been a complete failure of publicity to date, and given the huge scale of the programme (an estimated four million businesses), this will make a smooth start in April 2018 very difficult if not impossible.

4.2 During the period of 13 to 14 months between now and April 2018, those businesses that are unused to transacting digitally will have to invest in appropriate software, some will have to buy hardware, and even those which are comfortable with technology will have to invest in or update their existing software to make it compatible with HMRC’s systems. Yet we still do not know precisely what software will be required, nor do we know whether the £10,000 turnover figure will stand or be increased to something more realistic, nor which businesses will have the benefit of a deferred start date. There are still too many unknowns for anyone to be able to prepare.

4.3 The proposed pilots will be important so long as many diverse businesses are involved and the results shared with an implementation group comprising tax and software experts from outside HMRC as well as inside – as was the case with the implementation of self-

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<sup>1</sup> <https://www.gov.uk/government/publications/digital-reporting-and-record-keeping-for-business-income-tax/making-tax-digital-for-business>

assessment. But the time allowed for them is too short – it does not even comprise a full cycle of reporting (four quarterly reports and an end-of-year declaration). Moreover, we understand that the reporting software will not be ready at the start of the pilot so in the first two quarters only the record-keeping will be tested, not the reporting to HMRC. It is essential that HMRC have funds set aside for any necessary changes, and give themselves sufficient time to implement them. For example, if a problem becomes apparent in the second quarter of the pilots, there may be insufficient time to make any substantial changes before implementation date.

- 4.4 We understand that free software will be available to the smallest businesses, but repeat our earlier concerns that those who will rely on it must not have a worse experience than those who can afford to use paid-for versions of commercial software. We are not confident that HMRC's current specifications will allow users to benefit from the full range of possibilities that MTD will offer. It is still our belief that HMRC should develop software that is fit for purpose and should not rely on the commercial market to deliver this, particularly as any commercial model involving an element of free software is likely to attach terms and conditions to the use of the free product that may be unsuitable for those most likely to need it.
- 4.5 Deferring penalties for 12 months may in practice allow for a breathing space of one year to get used to the systems. Nevertheless, the smallest businesses were allowed three years' period of grace under RTI before penalties were charged, and MTD is a vastly bigger and more complex change.
- 4.6 Without an intensive programme of communication and education in the new process, the changes of the majority of the smallest businesses being sufficiently familiar with it to ensure a smooth start in April 2018 are slim indeed.
- 4.7 Furthermore, without even testing a full cycle of MTD in the pilot scheme, HMRC risk having to make changes to the 'live' system from April 2018. This in turn risks causing serious confusion to taxpayers as they move to the new way of working, and a demand for individual support that HMRC is unlikely to be able to manage.

## **5 Adequacy of the proposed measures to simplify the calculation of taxable profits and basis periods and the timing of their introduction**

- 5.1 Small businesses may initially be attracted to the apparent simplicity of the cash basis, and the proposed reform of the basis periods may be an added superficial attraction. Nevertheless, sooner or later the tax disadvantages become apparent – for example, the inability to set losses off against other, non-trading income. For the smallest businesses, without year-end adjustments, there may be no difference between presenting their results on a cash basis from the accruals basis, in which case there is no need for them to opt for the cash basis – indeed there could be positive drawbacks.

- 5.2 Whether or not the cash basis is advantageous in terms of simplicity, it is not necessarily the best way to understand how a business is doing. Businesses should not be nudged towards the cash basis simply in order to make digital reporting to HMRC easier.
- 5.3 More importantly, those businesses with low or modest profits who are claiming tax credits now may soon be claiming universal credit which also works on a cash basis, but a different one from tax. While accounting for tax and tax credits purposes are well aligned, there will be wide divergences between the cash basis of accounting for tax and for universal credit. These differences – annual for tax, monthly for universal credit; different, and very limited, loss carry-forward for universal credit; minimum income floor in universal credit – will mean that small and growing businesses will have to understand and apply two different cash bases of accounting, and it is unreasonable to expect anyone to do that. It is unfortunate that HMRC and DWP between them could not have simplified things for the customer by aligning the two bases, allowing the business proprietor to do just one set of accounts for both departments, then get on with running their business.
- 5.4 It is no answer to the problem of accounting for tax and universal credit to say that businesses can opt for monthly basis periods, because there remain the differences in treatment of losses and in the minimum income floor in universal credit.
- 5.5 Businesses are being encouraged to use the cash basis as it is easier to record things in real time, as HMRC require. But a cash basis is not appropriate for all businesses (eg farming, creative artists) – and will the banks and lending institutions accept accounts drawn up on this basis? If (as seems likely) not, there will be a third set of accounts to be drawn up for the lenders.
- 5.6 It would have been helpful to know what the MTD quarterly reporting threshold will be – then we might have a better idea of whether a move to the cash basis would help small businesses deal with MTD.
- 5.7 A few years ago HMRC carried out a ‘Business Records Check’ programme in the hope of improving accuracy of small businesses’ returns by checking they were keeping proper business records. The programme was halted and since then we have been awaiting HMRC’s report. It is unfortunate that the report has not yet been made available as it would doubtless be helpful in identifying what errors small businesses typically make, and whether a change to the cash basis might help correct them.
- 5.8 As for the timing of the changes, the new cash basis thresholds take effect in 2017/18 so there is no time for any education or publicity if small businesses are considering what records to keep in the new tax year. Besides, the sheer complexity of bringing in changes to the cash basis threshold, changes to the basis period rules and changes to the way records are to be kept and results reported to HMRC, all at the same time, is exceptionally daunting. Ideally, the accounting changes would have been introduced first, and the new record-keeping and reporting requirements brought in subsequently to fit around them.

## **6 Consequential revisions to the penalty regime**

6.1 The Government consulted openly on the proposed penalty regime and their response to consultation shows that they have taken account of many of the points raised. For example:

- They are taking time to consult further about the design of the proposed penalty points system in view of the divergent opinions expressed on the alternative models explored in the consultation.
- They have recognised the merit of a right of appeal against penalty points as they accrue, rather than having to wait until sufficient points have accrued for a penalty to be charged and only allowing a right of appeal against the penalty.
- They recognise the need for a 'soft landing', have committed to a penalty-free period of at least 12 months, and agreed to consider representations that it should be longer. (In our view the initial penalty-free period should be at least three years for the smallest businesses, as it was for RTI.)

6.2 We look forward to further constructive consultation on these matters, and shall also respond to proposals about inaccuracy penalties when they are published in the spring. Our overriding concern will be to ensure that penalty systems are designed with the perspective of the smallest businesses in mind as they are likely to struggle the most with adapting to new technology and discharging their administrative burdens.

LITRG

15 February 2017