

**Digital record keeping and reporting for income tax, etc.
Finance Bill 2017-2019, clauses 60-62, and schedule 14
Briefing from the Low Incomes Tax Reform Group (LITRG)**

1 Introduction and Summary

- 1.1 Clauses 60-61 and schedule 14 of this Finance Bill provide the legislation to implement some of the key tenets of the Government's 'Making Tax Digital' (MTD) regime. Clause 62 amends VAT legislation for MTD requirements.
- 1.2 We are generally supportive of HM Revenue & Customs' (HMRC) digital strategy and recognise that there are potentially significant benefits for many taxpayers. However, we do not want to see a system rushed in without sufficient testing, which does not cater adequately for those who are less digitally capable or digitally excluded, and which imposes unrealistic obligations on businesses as a result of mandatory compliance.
- 1.3 The Ministerial statement on 13 July, announcing changes to the timetable for the implementation of MTD, is welcome and we hope the extra time will allow for full consideration of some of the key issues discussed below.

2 Specific proposals

We recommend two specific changes to the draft legislation, as follows:

- 2.1 that clause 12 of schedule A1 be withdrawn and considered more fully in the context of the recent consultations on penalties for late submission and late filing under the MTD regime. (This clause allows for a penalty of up to £3,000 to be charged for failing to comply with the record keeping requirements). See further para 4.2 to 4.5 below;

- 2.2 that clause 16 (2) be amended to include some wording similar to ‘or such other period as may be allowed by an Officer of HM Revenue and Customs or on appeal by the First Tier Tribunal’ to allow for late appeals in circumstances where an appeal cannot be made within the 30 day period currently stated. See further para 4.6 below.

3 General comments

- 3.1 The clauses and schedule under consideration here cover the main areas of MTD for business: the types of businesses within and outside the scope of MTD, the requirement to submit periodic updates and End of Year statements, digital record keeping requirements, specific exemption for those who are digitally excluded, and appeals.
- 3.2 However, the provisions covering all but the first and last of these areas are enabling provisions only, which thereby relegate the principles relating to crucial aspects of the new system to regulations. We are extremely disappointed and hugely concerned by this approach as it inevitably means very important aspects of the MTD programme will be subject to minimal parliamentary scrutiny. As these are fundamental parts of the MTD for business regime, we firmly believe they merit inclusion in primary not secondary legislation.
- 3.3 As the secondary legislation will be subject to the negative resolution procedure, and not the affirmative procedure, we remain concerned that this approach enables the principles of MTD to become law on the nod, as it were, without proper scrutiny or substantial debate, which is worrying. We would strongly urge reconsideration of this approach for both income tax and VAT, with a view to incorporating more of the key principles of the MTD programme in primary legislation.
- 3.4 As a consequence of this legislation, most of our concerns – and those of many of our professional colleagues – remain to be addressed by regulations. This means we do not yet know how onerous, both in terms of time and money, complying with MTD will be. We fear that 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. In the consultation documents issued in August 2016, HMRC stated they may provide financial support, but this does not appear to have been brought into legislation at this stage. It would be helpful to have clarity sooner rather than later around whether any financial support will be offered and in what circumstances. Some of the costs that will inevitably be incurred by those on low incomes will be disproportionate to the size of their businesses and prohibitive to them, even if in absolute terms they may not seem so.
- 3.5 The periodic updates required under the MTD for Business programme are not compatible with the reporting of business income under universal credit (UC) rules. This means that a UC claimant who is self-employed will be required to make 12 monthly declarations for UC **in addition to** their periodic updates and End of Year declaration for MTD. As the basis of calculating the profit for both income tax and UC is not the same, there is already

complication and confusion inherent in the system for claimants. Therefore we believe this further inconsistency between income tax and UC introduces unacceptable levels of 'red tape' for a small business making low profits. The updates for MTD and the reporting for UC need to be aligned as a matter of urgency, and we believe that UC claimants should be exempt from complying with MTD until this is the case.

- 3.6 HMRC are keen to point out that free software will be available for the smallest more straightforward businesses, but we anticipate that this will have very limited functionality. Also, our understanding is that most commercial suppliers see this as a potential 'hook' to generate more fee paying business in due course. Clearly it will not be satisfactory for those small businesses which cannot or do not intend to develop into larger businesses to have to pay for software because the 'free' software is unsuitable.
- 3.7 We strongly believe HMRC should reverse their decision not to produce their own free software and agree to invest in providing a basic package, which small businesses and landlords can use without having to incur extra expense or make do with an inferior commercial product. This will be even more pertinent for MTD for VAT, as many small businesses currently use spreadsheets together with the HMRC online portal to complete their quarterly VAT returns, and so they will be in need of MTD compliant software. This must be available quickly, and sufficiently in advance of April 2019, to enable traders to be able to get used to any new systems and to get fully trained in their use.
- 3.8 One of the main benefits of the deferred introduction of MTD for Business is that the full cycle of quarterly updates, end of year declarations and interaction with declarations in relation to other sources of income for a tax year can be properly tested and any glitches ironed out before mandation. Ideally, the development of good, easy-to-use systems will mean taxpayers naturally migrate to them, as happened with Self Assessment Online, and ultimately mandation may then prove to be unnecessary.
- 3.9 The extra time should also be used to develop robust and effective digital assistance programmes for those in need of support, and adequate alternatives for those who are digitally excluded. No additional costs should be incurred by users in circumstances where a disability requires additional support, whether technological or otherwise. These essential aspects of the Making Tax Digital programme have not been properly addressed to date.
- 3.10 It is crucial that a good communications strategy is launched immediately by Government as the MTD programme brings in a monumental change for most small businesses, most of whom remain blissfully unaware of its imminent arrival. They need as much notice as possible of what will be expected of them so they can prepare themselves as best they can for compliance. It might be helpful here for HMRC to draw on the experience of The Pensions Regulator, which has tracked carefully employers' awareness of their duties under auto enrolment.¹ This indicates how challenging it can be to make small and micro

¹ See research published: <http://www.thepensionsregulator.gov.uk/doc-library/research-analysis.aspx#s16192>

businesses aware of forthcoming changes in rules, much less ensure they have a full understanding of what future obligations will be. Extensive guidance will therefore need to be made available in a variety of formats, including non-digital ones, to support taxpayers in complying with MTD.

4 Comments on specific aspects of legislation

- 4.1 We are pleased to note that part 3 of the new schedule A1 to the Taxes Management Act 1970 enables regulations to be laid which exempt individuals and/or partners who are digitally excluded from the scope of these provisions (and that digitally excluded includes those where **for any reason** it is not reasonably practicable for them to use electronic communications or records). This part also allows regulations to be made for exemptions on other grounds. We trust that this gives scope to exempt many other businesses where compliance with MTD would be extremely difficult and would almost certainly cause a great deal of stress and anxiety. We suggested some specific exemptions in our response to the original consultation document 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; and some carers. We also proposed time-limited exemptions for businesses in financial difficulties and those nearing retirement, and short term temporary exemptions for ‘time to comply’. For more information on these suggested exemptions, please see our full consultation response.¹
- 4.2 One of the few clauses in schedule A1 which is other than an enabling provision is paragraph 12 which imposes a penalty of up to £3,000 for failing to comply with the record keeping requirements as set out in the regulations. This is aligned with the existing penalty for inadequate recordkeeping in s12B(5) TMA 1970 and we welcome that both penalties cannot be applied to the same failure.
- 4.3 We note the paragraph allows for a penalty to be applied where there is a failure to comply with the regulations for any period. We trust the regulations will clarify what ‘a period’ will be in this context. We trust they will not allow for a penalty to be applied for a periodic (for example, quarterly) reporting period. It would be excessive for four different penalties to be incurred for a record keeping failure which affected four quarterly returns – or maybe more – in an accounting period.
- 4.4 In this regard, it is noteworthy that the existing provisions for inadequate recordkeeping are little used by HMRC – most likely because HMRC tend only to find out about failures in the event of a compliance check. If, during a compliance check, recordkeeping failures are found to give rise to an understatement of tax, the penalty that then tends to arise is one of having

¹ <http://www.litrg.org.uk/sites/default/files/files/161107-LITRG-response-MTD-business-tax-digital-age-FINAL.pdf>, sections 9.9 and 9.10

filed an inaccurate return. HMRC do not tend to penalise the record keeping failures themselves.

- 4.5 However, with HMRC receiving regular summary data from taxpayers under MTD, it is easy to foresee that penalising record keeping failures could become more commonplace. We therefore think the Government should remove paragraph 12 to allow for proper consultation on the merits and demerits of such a clause, particularly in view of HMRC's consultation on penalties for late submission and late payment in the context of MTD earlier this year (to which any response has yet to be issued).¹
- 4.6 We are pleased to note that part 4 of the proposed schedule A1 TMA 1970 sets out the right of appeal against any decision by the Commissioners or by an officer of HMRC, within 30 days of notification of the decision. However we recommend that para 16(2) be amended to say 'or such other period as may be allowed by an officer of Revenue and Customs or on appeal by the First-tier Tribunal' to allow for late appeals in circumstances where an appeal cannot be made within the 30 day period
- 4.7 Schedule 14, introduced by clause 61, covers the changes required to the TMA 1970 to introduce the MTD process. For example, it allows a digital declaration via a prescribed method (which will presumably be the personal tax account in due course) as a means to abolish the tax return as has been publicly stated, and which is the ultimate goal of the digital project.

5 About Us

- 5.1 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.
- 5.2 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.
- 5.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the

¹ <https://www.gov.uk/government/consultations/making-tax-digital-sanctions-for-late-submission-and-late-payment>

administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

LITRG

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