Think Ahead ACCA

The 2017 Finance Bill inquiry ACCA's written evidence to the Economic Affairs Committee Finance Bill Subcommittee

About ACCA

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ACCA has 188,000 members and 480,000 students in 178 countries, with approximately 75,000 members and over 70,000 students in the UK, and works to help them to develop successful careers in accounting and business, with the skills required by employers. We work through a network of 100 offices and centres and more than 7,400 Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote appropriate regulation of accounting and conduct relevant research to ensure accountancy continues to grow in reputation and influence.

The expertise of our senior members and in-house technical experts allows ACCA to provide informed opinion on a range of financial, regulatory, public sector and business areas, including: taxation (business and personal); small business; pensions; education; and corporate governance and corporate social responsibility.

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Topic 1: The evidence underlying the case for the Making Tax Digital proposals and their suggested impact. The FBSC would be interested in statistical and other evidence, including that drawn from the experience of other tax jurisdictions, relevant to an assessment of the potential impacts of these proposals on businesses, landlords and other taxpayers;

1. As businesses which themselves advise and assist other in their tax affairs, many of our members will be affected by MTD on two fronts. The analysis set out at paragraphs 3 to 8 below is drawn directly from material submitted by a member to HMRC in response to the MTD consultations of August 2016.

2. In addition to qualitative evidence on the ability of clients to cope with the requirements of MTD, the member has considered the practicalities for HMRC of their proposals, and the likely impact on the firm in which our member is a partner, in terms of additional hours of support time, and the economic cost of that non-productive activity.

3. “We are very proactive with IT having been filing SA 100% online since 1998 and adopted online filing of VAT, PAYE and CT at the earliest opportunity. We participated in the RTI pilot. However our attempts to convert clients on digital have failed. We find we need to support a typical client for about 50 hours before they are reasonably competent to avoid fundamental errors such as posting personal expenditure as business expenditure. Ongoing, we need to support these clients for about 30 hours a year eg how to deal with unusual transactions, problems balancing the bank etc. Because of the cost and time commitment, only 2% of our clients have successfully switched to digital accounts.

4. The primary problem will be time: taxpayers do not have time to learn and use digital accounting software. No amount of support is going to create the time that is needed. Taxpayers who do attempt to maintain their own records will be doing this late evening. HMRC will need helplines in place well beyond the existing 8 pm service. Banks have been encouraging their customers to use online banking and have found it necessary to have 24/7 helplines. HMRC will need to also offer extended hours. Based on when I know my clients do their books HMRC will need to be open until at least midnight. If HMRC is going to force this massive time burden on taxpayers, HMRC is going to have to put in time itself.

5. Staff awareness and initial training – once the final requirements and timescales of MTD are known it will be necessary to brief all staff involved in taxation and accounts production. Average staff cost is £27/hour. I have spent 50 hours working through the consultation documents. Extracting the practical points and taking into account other areas that would need addressing I would say we would have to spend one day per member of staff. Across the whole organisation that would cost us £11,137 (55 partners and employees x 7.5 hours working day).

6. During a recent HMRC face-to-face meeting HMRC told us that there are 25 software companies developing MTD products. Staff would need to be competent in all because

clients will be phoning us, not HMRC or the software company, for support. We recently ran a “Product A” [the firm’s main in-house system] refresher course for staff. The course was run on-site by a qualified “Product A” trainer. The course consisted of 3 sessions of 3 hours. The cost in staff time was therefore £243. That was just one software product. Multiply by 25 different products = £334,125 across the organisation.

7. We will need agent licences for the software. We have no idea how much the software companies will charge and can only use “Product A” as an example. Currently we pay £500 a year to “Product A”. It is run on a small number of PCs that staff can remote into when doing “Product A” jobs. This avoids the need for licences on all PCs. The local “Product A” rep has told me that “Product A” is changing to monthly and it will cost £20 per client per month. Across our client base of 5500 SA clients that would cost £1.3 million! Clearly that is out of the question and I can’t imagine the final cost will be anywhere near that. But without doubt there will be a cost. Currently we only purchase “Product A” and “Product B”. We will need to purchase licences for 25 different products. If we wish to avoid buying a licence for each PC we will have to use our existing dedicated PC and remote desktop model. We would then need at least 2 PCs available for each product at any one point, so a minimum of 50 PCs. Alternatively we could buy additional terminal server licences. Cost would be £50 per licence, so £2500 in total. That is the cost of terminal server licences: the cost of the MTD software would be in addition.

8. The above costs are just to get us into a MTD ready position. Ongoing we have calculated it will cost an extra £2000 a year to support clients in MTD. This doesn’t take into account the extra costs that we will be facing as listed above. Clients have already told us that they cannot afford fee increases of that magnitude yet we cannot absorb those costs. As a result I fear that some businesses will simply move to the hidden economy.”

9. The above analysis illustrates a “hidden cost” of MTD: the provision of advice and support to taxpayers to move to entirely new systems. The cost estimates above may need to be revised in the light of the fact that HMRC have indicated that taxpayers will in fact be able to use spreadsheets as a basis for their MTD filings. However, since that was confirmed only on 31 January and there is no indication yet of what such packages would look like it is impossible to assess what the costs might be. It is not clear from HMRC’s Impact Assessment whether their estimate of transition costs (and subsequent annual benefits) is based on the use by some taxpayers of the more familiar spreadsheet format.

10. Equally, it is clear from HMRC’s summary of responses to the *Bringing Business Tax into the Digital Age*[1] that the final shape of VAT reporting for MTD is far from settled, and in particular the question of how, or whether, VAT reporting will be integrated with

[1] *Bringing business tax into the digital age Summary of Responses 31 January 2017* at Para 21 via https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/587433/Making_Tax_Digital_-_Bringing_business_tax_into_the_digital_age_-_Summary_of_responses.pdf

reporting for business profits for income or corporation tax. In the face of such uncertainty it is difficult to make any accurate prediction of what costs or benefits might arise further into the implementation of MTD.

Topic 2: the evidence base for mandatory digital reporting. In particular the potential impact on the 'tax gap' and for HMRC resources;

11. The latest tax gap figures from HMRC[2] put the overall SME tax gap at £18.3bn, and it is this substantial figure (equating to an average of over £3,400 of lost tax per SME) that HMRC aim to tackle through MTD. We note that for the smallest businesses, which pay tax at a marginal rate of 20%, that would equate to £17,000 of income in respect of which the tax is not collected. The size of this average sum suggests that the bulk of that tax gap must arise from a few larger MEs, as comparatively few micro businesses will have failed to pay the tax arising on £17,000 of income. The higher tax rates on larger businesses would reduce the level of income under-declared in both real and proportional terms.

12. Not all behaviours contributing to the tax gap will be susceptible to improvement directly as a result of MTD. The 15% of HMRC's estimate attributable to legal interpretation is unlikely to be significantly affected, although HMRC may contend that the "prompts and nudges" feature of the new software may enable them to reduce the level of disagreement. The 6% caused by avoidance is unlikely to change as such behaviour is conscious and deliberate. It also tends to be the case that avoidance behaviour is uncommon in the smallest businesses, as they have neither the incentive nor the means to undertake such strategies.

13. The 13% arising from criminal attacks is likely to change as attack vectors evolve; whether the net impact is an increase or decrease will be dependent on HMRC's success in addressing its own cybersecurity issues, and in facilitating effective cybersecurity strategies on the part of taxpayers and their agents.

14. MTD is unlikely to have any significant impact on the 10% of the tax gap attributable to non-payment. Although HMRC do intend to go ahead with the voluntary pay as you go elements of MTD, it seems unlikely that those whose behaviour contributes to the non-payment aspect of the tax gap (primarily amounts written off on insolvency) will avail themselves of that facility.

15. The one area of non-compliance which HMRC do expect to see improved by MTD is the annual loss to Error (9%) and Failure to take reasonable care (15%). These figures go towards the estimated SA ta gap of £7.0bn (19% of the theoretical take), and are accounted for by the falling proportion of taxpayers who under-declare liabilities (22% for

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[2] *Measuring Tax gaps 2016 edition: Tax gap estimates for 2014-15* Accessible via https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/561312/HMRC-measuring-tax-gaps-2016.pdf

2012-13, the most recent year for which HMRC give a figure). We would welcome greater clarity from HMRC on how these figures are arrived at and split out, as the logical conclusion must be that the distribution of losses is disproportionately skewed towards individuals and businesses with well above average theoretical liabilities.

16. We would also welcome greater clarity from HMRC on how they arrive at their estimates of the net impact of error and failure to take reasonable care on tax receipts. The tax gap methodology understandably concentrates on underpayments, dealing as it does primarily with deliberate behaviours, which will be aimed at reducing the taxpayer's exposure to tax liability. However, there is no reason to assume that pure error results only in losses of tax. Over a sample size of the magnitude of the UK taxpayer population, it is reasonable to assume that the impact of genuine errors in data entry etc would initially result in an equal proportion of over as under payments.

17. While taxpayers might investigate an unexpectedly high tax bill with more enthusiasm than an unexpectedly low one, the distinction between "Error" and "Failure to take reasonable care" would equally suggest that such cases would fall into the latter, rather than the former category. We understand that HMRC have been collecting data on over-declarations of tax since at least 2010[3] and would welcome clarification of how those figures are reflected in the MTD impact assessment.

18. From 2011 to 2015, HMRC operated a series of pilot operations, the Business Record Checks, which were designed to proactively reduce the estimated £6.5bn SME tax gap attributed to errors in basic record keeping. HMRC's contention was that by intervening to improve the standard of record keeping in business the tax gap would fall sharply.

19. The programme was controversial from its inception, with agent representatives concerned that the model overestimated the level of inaccuracy in small traders' initial record keeping, and underestimated the role played by advisers in "tidying" records at year end. There were also legal issues to overcome around the level of HMRC's authority to inspect records prior to completion of the related assessments, and worries about the perception of businesses selected for checking.

20. An interim research report published in 2014[4] indicated that (despite the checks being "targeted" at businesses HMRC considered to be at higher risk) 73% of businesses reviewed under BRC in the year to April 2014 were found to have no significant errors or anomalies in their paperwork. At a high level, this broadly reflects the Tax Gap report conclusion that 78% of business tax returns do not represent an underpayment of tax. HMRC has yet to publish any final conclusions or analysis from the BRC programme,

[3] *Engaging with Tax Agents* Report by the Comptroller and Auditor General HC486 Session 2010-2011 13 October 2010, at para 2.5 via https://www.nao.org.uk/wp-content/uploads/2010/10/1011486.pdf

[4] *Qualitative research into Business Records Checks and attitudes towards record keeping HM Revenue and Customs Research Report 334* via https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/350657/Report334.pdf

but we would expect the conclusions to be relevant to the assessment of the likely effectiveness of MTD in reducing the related tax gap.

21. HMRC's efforts to tackle the tax gap do not exist in a vacuum. Alongside the expected benefits from MTD, HMRC is undergoing a significant transformation of resource, with an ambitious five year programme under way to rationalise the HMRC estate and re-profile staff capacity accordingly. That aspect of HMRC's activities has recently been the subject of inquiry by the Committee for Public Accounts, and ACCA submitted written evidence to that inquiry[5].

22. The NAO report[6] which prompted the PAC inquiry highlighted concerns about HMRC's long term strategic resource, and the potential impact on the levels of service provided to taxpayers. One specific aspect which will be of relevance in the MTD context is assessment of digital exclusion.

23. Although the precise criteria for exemption from MTD on grounds of digital exclusion have not yet been clarified, HMRC have undertaken to legislate based on the existing VAT exemption, which will cover "persons for whom MTDfB is not reasonably practicable for reasons of disability, age, remoteness of location, or any other reason". The government has also committed to ensuring that non-digital means of applying for exemption are available, as will be clear information about the choices available to taxpayers.

24. The existing exemption for VAT is not widely used, and arose as a consequence of litigation brought following the introduction of "mandatory" online filing for VAT. Less than half the businesses affected by MTD are registered for VAT, and it will by definition be the smallest businesses which are not registered, and have therefore not yet had to consider whether they are digitally excluded.

25. HMRC has undertaken some limited research into the prevalence of digital exclusion, and the "digital assist" population, in the SME population, but this predated the current proposal. It is not currently therefore clear how many additional businesses may consider themselves within the scope of HMRC's discretion to be considered "digitally excluded".

26. We note also that the financial threshold for MTD exemption has not yet been finalised, and if this were to be set at the VAT registration threshold (as many respondents proposed) then the number of businesses which might qualify for MTD exemption who are not already exempted from VAT is likely to be small, given that the indications are

[5]The HMRC Estate inquiry, *Written evidence from the Association of Chartered Certified Accountants* available via http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/public-accounts-committee/the-hmrc-estate/written/45337.html

[6]*Managing the HMRC Estate* Report by the Comptroller and Auditor General HC726 Session 2016-17 10 January 2017 via https://www.nao.org.uk/report/hmrc-estate/

that HMRC intend to make MTDfB compliance no more burdensome than VAT compliance on a quarterly basis.

27. However, in the event that the threshold for MTDfB is set significantly below the current VAT threshold then HMRC will be faced with a number of claims to qualify as digitally excluded. Dealing with these requests is likely to be labour intensive, since the applicants will be communicating by non-digital channels and may well require face to face contact.

28. The additional resource to deal with these specific claims will be in addition to that required to deal with those businesses which fall into the "digital assist" category. Subject to the financial exemption threshold, applying the findings of the HMRC research[7] to ONS statistics[8] indicates up to 1.95m businesses would fall into "digital assist", while up to 790,000 could be digitally excluded ,of which 62% (490,000) indicated that they would not engage digitally with HMRC even if all other methods of engagement were removed.

29. While the precise levels of additional resource requirement on HMRC from these taxpayers will be dependent upon the final threshold level and the reliance of taxpayers on other sources of support (family and friends, voluntary organisations or paid professional advisers) it seems inevitable that HMRC will face an increased burden of taxpayer support, at the very time at which it in in the throes of its own reorganisation and relocation programme.

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[7] *Digital Exclusion & Assisted Digital Research To understand digital access, use and skills among the UK population* HMRC Research Report, Luc Altmann 17 August 2015 via https://www.gov.uk/government/publications/digital-exclusion-and-assisted-digital-research

[8] Business population estimates 2015, via https://www.gov.uk/government/statistics/business-population-estimates-2015