

ADMINISTRATIVE BURDENS ADVISORY BOARD

David Gauke MP
Exchequer Secretary to the Treasury
HM Treasury

12 March 2014

Dear David

ABAB ANNUAL REPORT 2014

1. I write as Chair of ABAB to submit the Board's Annual Report. You invited us to produce such a report when, in December 2012, you strengthened the remit of the Board; and restated that invitation in your Foreword to HMRC's Autumn Statement publication *Supporting Small Business*. This being our first such report, it will reach back over rather more than the immediate last 12 months. Going forward, we propose to submit a report each year in advance of the Budget, though we may submit an interim report on urgent matters in advance of the Autumn Statement if that seems appropriate.
2. Since ABAB was established (in 2006), our **primary goal has always been to 'make a noticeable difference'** for small business by working constructively with HMRC to support the delivery of material improvements in tax administration. We pursue this agenda by maintaining a critical overview of HMRC's performance, particularly against the commitments the Department made in *Making tax easier, quicker and simpler for small business*, and by engaging in more depth with selected key issues where we feel we can add most value. Our approach is to operate as an **independent 'critical friend' offering constructive challenge and support** to HMRC. We are passionately committed to the goal - a simpler and easier tax system for small business. As you know, ABAB members, who act on the Board in a pro-bono capacity, are all directly involved with small businesses – as business operators or advisers to small businesses – and we believe we are well placed to 'tell it like it is'.
3. **Our headline assessment is that HMRC has made, and continues to make progress, with some welcome and significant improvements delivered or in train.** That said, it remains a challenging agenda for HMRC, demanding sustained commitment, focus and energy, and there is still much to be done to arrive at a simpler and easier system for small business. In this report we offer some pointers as to how HMRC can learn from the experience of recent and current initiatives and so strengthen its capacity to drive and deliver positive change.
4. We are pleased that Lin Homer, HMRC's Chief Executive, and her Executive Committee colleagues have engaged directly with ABAB and demonstrated both an awareness of the issues and challenges facing small business and a commitment to addressing them. We similarly welcome your

own engagement with the Board, both when you have been able to join our meetings and when you have responded positively to issues we have raised with you.

5. In arguing for simpler procedures for small business, we are well aware that HMRC ascribes around half the tax gap to the SME sector. Understandably, perhaps, this means that the Department can be risk averse when contemplating changes impacting that sector (given the scale of revenue risk already being managed). But we think that simpler procedures can help close the tax gap – easier for businesses to manage, easier for HMRC to police, and potentially encouraging greater voluntary compliance.

1) Priority issues

6. Over the past 12-24 months we have focussed a good deal of our time and effort on a **number of key issues impacting small business**, including implementation of Real Time Information, introduction of the new cash basis rules for business income tax, and introduction of Business Record Checks. We will comment further on these three major issues.

7. In all instances - as is our working model more generally - our engagement has involved debate with the relevant HMRC teams at our Board meetings (we meet quarterly), and close and active participation of Board members in relevant working groups between meetings. In this way we seek to bring our influence to bear on both the overall direction of key measures and on the working level detail, not least because the latter is, in many instances, just as important as the former. **Our experience is that we are able to offer the most, and make more of a positive contribution, when we are brought in early in the process and listened to.**

Real Time Information (RTI)

8. We recognise that RTI represents an important and worthwhile modernisation of the PAYE system, and have worked very closely with HMRC on several aspects of its implementation. However, it took some time to achieve a proper debate with HMRC about the issues that ABAB members could see in practice with RTI. This was disappointing: surely that is what we are here for? Essentially, we were not involved at an early enough stage and, when we were brought in, some entrenched views (not solely in HMRC) proved difficult to shift. We feel that some of the problems encountered during implementation could have been designed out had external stakeholders (including ABAB) been listened to at a much earlier stage.

9. We do welcome the pragmatic and sensible changes that have been adopted - informed, in part, by ABAB's representations - on both the introduction and extension of the easement for 'on or before' and, most recently, the phased introduction of penalties. In both cases this showed HMRC was prepared to listen and respond to concerns registered by ABAB and others. We particularly welcomed the willingness of very senior people at

HMRC to visit agents and employers last year to gain a clear personal understanding of the difficulties RTI posed.

10. We remain concerned about the representation of the benefits of RTI to business (in terms of how these are expressed as a reduction in administrative costs). In simple terms, whilst we can see some long term gains, the costs to businesses in the interim seem to us to be significant. We are working this through with HMRC with a view to arriving at a clearer picture of the real impacts on business¹. None of this is intended to detract from the overall judgement that RTI is the right step to have taken; rather it is to help us all arrive at a better shared understanding of the costs and benefits to business of the change, in both the short and medium term. We also want to try and help assess whether businesses are really complying with RTI or simply putting in returns to ensure obligations appear to be met: we have continuing concerns about how some businesses are able to deal with 'on or before'. We therefore recommend that HMRC monitors this and conducts a survey this summer and in summer 2015 of small businesses to test how the 'on or before' rules work for them.

Cash basis for business income tax

11. In pursuing our remit we are very alive to the complementary role and contribution of the Office of Tax Simplification - and we have the benefit of John Whiting (Director of the OTS) serving as a member of ABAB. We have been very keen to support the OTS's valuable work on small business tax administration (as reflected in its 2012 report *Small business tax review: HMRC administration*). Looking across the span of the OTS recommendations to improve the workings of tax administration for small business, we are satisfied that HMRC's comprehensive programme (eg to improve education, support and guidance, and access to it; to make the basics - registering, filing, paying - easier; to deliver much improved online/digital services) should substantially address those recommendations (and other improvement needs). We will continue to monitor HMRC's programme and maintain pressure on the Department to deliver.

12. We welcomed the OTS's recommendations in 'Simpler income tax for the smallest business' and 'Disincorporation' and are pleased that these have been taken forward. We have worked with HMRC on various aspects of these measures. Our concern has been to help ensure that the practical implementation - for example of cash basis - is as clear and simple as possible. While respecting the policy and other considerations that led to the design of that measure, our overall view is that, as implemented, it is more complex than OTS's original proposals (which were focused on the smallest businesses). We also feel that the rates at which the simplified expenses have been introduced make them unattractive to most businesses.

¹ This entails us better understanding the assumptions that underpin HMRC's calculations of the benefits (i.e. how the Department's Standard Cost Model arrives at the estimated benefits) and how those assumptions relate to practice (past and current) on the ground. We also want to see a clearer quantification and analysis of the various transitional costs that businesses have undoubtedly incurred as part of RTI implementation.

13. All this puts a particular premium on the efforts HMRC is making to guide small businesses through the choices they face (with, for example, online tools). It also shows how the new rules in many ways miss the key point of the OTS's recommendations – to introduce simple, default bases that would be virtually automatic for the relevant businesses. (It is noticeable how advisers are concerning themselves with these systems and generally advising against them.) We continue to believe that there remains a credible case for a radically simpler tax regime for the smallest businesses, and that that option merits further examination. At a minimum there will be a need for a proper evaluation of the success of these new options in a couple of years' time.

Business Record Checks

14. We feel bound to cite this issue as it was one that, at one stage, occupied a significant amount of ABAB's time. Very briefly, a logical enough initiative was, in our view, launched with insufficient dialogue with business and the tax profession and without sufficient clarity as to its goals and the measurement of its impact. There were confused signals as to its primary driver (support to small business to 'get things right' or compliance driven). ABAB, and others across the tax profession, engaged very powerfully to help get the initiative back on an even keel, which HMRC did, eventually, providing a revised methodology which we believe is both more customer-friendly and reduces both the cost impact on businesses and HMRC whilst better targeting the tax gap.

15. The powerful lesson we draw, and wish to share, from that experience is that HMRC should be consistently open to dialogue and engagement with the business and professional community from the earliest opportunity, and not misconstrue constructive challenge from those such as ABAB who genuinely want to help. We can offer insights into what will be the real impact on and perception of businesses. We would, though, stress that the result is a better system – something we think all those involved would endorse.

16. More recently, experience of our dealings with HMRC is much more positive (for example the approach to the design and delivery of new digital services, with robust and consistent user input and testing) but the learning from Business Record Checks should not be lost. Indeed, it should be actively applied to support greater openness, including to constructive challenge or criticism and greater candour, in accepting that better outcomes are invariably achieved by genuinely working with the business community and tax profession.

Other issues

17. We applaud the steps that HMRC is taking to **modernise the education and support offering to small business**, and the creative use of new technologies as part of that. Record-keeping apps (developed in partnership with the software industry) are a powerful illustration of this. We

strongly encourage HMRC to continue to pursue the opportunities that digital (in various guises) offers, and see exciting possibilities to deliver radical improvements.

18. We also welcome the various initiatives that HMRC is pursuing to **modernise its compliance activities** (with improved targeting of compliance interventions, with better use of data to inform assessment of risks; the adoption of less adversarial methods; and the introduction of innovative approaches such as Alternative Dispute Resolution). We are particularly impressed with HMRC's application of behavioural insight techniques, for example to debt management, and here too see huge potential for the wider use of such approaches. Combined with digital initiatives, such changes to HMRC's compliance work have the potential to bring big improvements to the experience of small business in dealing with tax. They demonstrate too that HMRC is moving actively away from 'one size fits all' compliance actions to a much more considered and targeted approach – although that message is not yet well understood and recognised (given perceptions that persist of heavy-handedness).

19. We recognise that HMRC has improved and looks to improve further its relationship with the SMEs community whilst continuing to reduce the tax gap. It is important therefore that the attitudes set out in the last paragraph and the awareness of the disproportionate effect that compliance burdens can have on the smallest business are inculcated through the whole of the organisation and do not simply reside at the top levels. Much effort is being made to ensure that HMRC staff involved in all processes (from the design of forms and help-sheets through to compliance activities on the ground) understand how small businesses work, and **training** in these areas must continue to go hand-in-hand with other initiatives.

20. On **external communication**, we have consistently argued that HMRC can and should do more to get the message across (to the small business community, the tax profession, and the media and other opinion formers) about the progress that is being made to improve tax administration for small business, including the shift in the approach to compliance. HMRC's publications at Budget 2012 and Autumn Statement 2013 are steps in the right direction, focusing on the practical improvements that are being delivered; and we understand that HMRC has a more concerted communication initiative in hand. We feel that HMRC could be bolder and more active in taking what is often a very positive story out there. Clearly HMRC will always face criticism (sometimes legitimately, often not), but the progress being made is real and should be given more exposure. We have always felt there is a need for proper communications of SMEs concerns to HMRC: we hope that the 'Tell ABAB' option will contribute to meeting that need.

II) Scrutiny and challenge function

21. In addition to our work on the 'big ticket' items identified above we have also adopted a more systematic approach to testing HMRC's overall

performance. We receive (on a rolling cycle over each quarter) and critically examine reports from HMRC on performance against:

- i) the target to reduce costs to business by £250m by March 2015;
- ii) its customer survey results; and
- iii) delivery against its commitments in *Making tax easier, quicker and simpler*.

This approach certainly gives us a better sense of the overall picture and a greater ability to test and challenge, although sometimes it can be difficult to 'get behind the numbers' amidst a great deal of data/information.

We continue to work with the (HMRC) Secretariat to the Board to help us navigate these reports so as to prioritise our focus and the support we can offer.

22. We are also directly engaged with **HMRC's own programme of internal Challenge Panels** (scrutinising performance against customer experience objectives in different directorates of HMRC) through ABAB representation on such panels. We welcome this involvement as it helps the Board to make stronger connections to our own work programme and to gain a better perspective on some of the challenges and choices that HMRC faces and how those impact on small business experience. Such panels are important too in helping to reinforce within HMRC the need for sustained and concerted action (in the short *and* medium term) to address small business issues. We see evidence of a welcome positive shift in thinking and attitude, but this needs to be reinforced and embedded across the organisation (ie must become the norm rather than a matter of localised good practice as is still sometimes the case today).

22. The debate about the quantification of RTI benefits exposes some interesting wider questions about how best HMRC should estimate and state **benefits and costs to business**. We strongly support an approach which is not confined to the literal application of any one model, but strives to take a more rounded view, informed by actual experience and practice and seeks to gather all relevant costs. We recognise that HMRC is committed to this course, in respect of RTI and more generally. We are pleased that HMRC has work in hand exploring how its methodologies can be enhanced, and are keen to continue to support that work. We would expect this approach to extend to looking at actual outcomes: assessing whether cost projections have actually been delivered and learning lessons accordingly. In doing this work, we will always have regard to the total costs involved: an area of concern that many raise with us is that costs reductions for HMRC can sometimes simply move costs to business rather than deliver overall reductions.

III) Priorities for 2014-15

23. Our priorities for the coming year (in all instances working with HMRC) are:

- supporting the clarification of the impacts on business of the implementation of RTI, including looking for changes which will make it possible for micro-businesses to comply with RTI without increasing their administrative cost burden and reducing generally the cost impact of RTI;
- developing a means of better distinguishing cost and other impacts on small business from those on all business;
- more generally, supporting work to devise more rounded methods of evaluation and measurement of the costs/benefits of change;
- addressing the implications for the self-employed of the introduction of Universal Credit (and transition out of Tax Credits), given the apparent monthly reporting requirement. We do recognise that DWP holds the policy lead on Universal Credit but we do need to find a way to address our concerns;
- using the new 'Tell ABAB' online facility (through which we are able to capture ideas for improvements direct from small business) to bring small business experience more directly to bear on what HMRC is doing now and is planning for the future;
- supporting initiatives to improve the communication (to small business, and more generally) of improvements that are being delivered, given the stronger story here that deserves to be told;
- identifying options and ideas for the next phase of simplification (2015 onwards). Here, we see a case for continued examination of options for more radical simplification of the treatment of micro businesses, for a 'single financial account' for small businesses with government (allowing the taxpayer to manage their interactions more actively), and for further rationalisation and alignment of basic features of the tax system such as penalty regimes. In much of this we see real scope for advances through digitisation;
- continuing to work with HMRC to ensure that the right culture is embedded at all levels within the organisation; and
- encouraging HMRC to involve ABAB and other external stakeholders at the earliest stages of design of new systems to ensure that what happens in the real world of small business is fully and genuinely understood.

24. As I hope this report demonstrates ABAB is doing much to fulfil the scrutiny and challenge function assigned to us, and to support HMRC in its delivery of a simpler and easier tax system for small business. I hope too that you are content with our proposed programme for the coming year. My Board colleagues and I look forward to continuing to work with you as we pursue this important agenda.

25. As a final point, we accept that there are always going to be constraints on what HMRC can deliver because of Government policy and revenue and compliance risk issues. Ideally we feel ABAB could usefully be involved in policy development in areas that will affect the administrative burdens of small businesses. We appreciate that there will sometimes be issues of Budget confidentiality, but these should not be a material constraint in most instances. Applying our favoured principle of earliest possible engagement we feel we could make a positive contribution in selected policy areas too.

26. We hope that this report will be of interest to a wider community, so I am sharing a copy of this letter with the principle business and tax professional bodies, and with Lord Curry at the Better Regulation Executive. A copy will also be posted to ABAB's webpage.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Teresa', with a large, stylized flourish extending from the end of the signature.

Teresa Graham CBE