Office of
Tax Simplification

Tax reporting and payment:
Simplifying tax for self-employed people and residential landlords

October 2019

Contents

Foreword

In this report the Office of Tax Simplification (OTS) explores some possible ways of making it simpler for people who are self-employed, or who receive private residential property income, to meet their tax obligations in a practical and streamlined way.

This has been a fast-paced initial exploration, following the publication of the scoping document on 10 July 2019 (see Annex A), building on the OTS's previous work in this area including:

- a report published in July 2018 on the impacts of the platform economy[1]
- a Technology discussion paper, published in January 2019, which explored a range of wider questions about the impacts of technology, including the role of HMRC's Personal Tax Account[2]

This report considers existing and potential new developments or approaches to simplifying the experience of self-employed people and landlords in dealing with tax, including options that would enable information to be reported, and potentially tax to be paid, in or closer to real time.

As envisaged in the scoping document, the recommendations focus on potentially fruitful areas for further, more detailed, work.

The OTS would like to thank Bethan Kay, who led the review, supported by Simon Jackson, Zoe Judd, Nigel Mellor, Mark Pickard and Andy Richens, guided by OTS Head of Office David Halsey. We are also grateful to our HM Treasury and HM Revenue & Customs colleagues and all those who have willingly given time, ideas, challenge and support.

Kathryn Cearns – OTS Chair

Bill Dodwell – OTS Tax Director

[1] https://www.gov.uk/government/publications/ots-suggests-paye-equivalent-for-online-platform-workers

[2] https://www.gov.uk/government/publications/will-tax-simplification-still-be-needed-as-technology-advances

Overview and recommendations

Introduction

The Office of Tax Simplification (OTS) is the independent adviser to government on simplifying the UK tax system. The work of the OTS is rooted in improving the experience of all who interact with tax. The OTS aims to improve the administrative process – which is what people actually encounter in practice – as well as simplifying the rules. These are often of equal importance to taxpayers and HM Revenue & Customs (HMRC).

This report explores the role that a more developed version of HMRC's Personal Tax Account could play in simplifying the experience of the tax system for both self-employed people and landlords and enable fruitful changes to reporting and payment arrangements. Such developments could make it easier for people to see and keep track of their taxable income, to know what tax may be due, and to make regular contributions towards their tax liability. While the role of the OTS is to simplify the tax system for individuals and businesses, the OTS is mindful that the secondary effect of any potential new developments could be to reduce the tax gap through fewer mistakes and errors being made.

This report also explores whether it might help self-employed people and landlords of residential property if some third parties made direct reports to HMRC, with that information then being visible in an individual's tax account. The report also considers how to help self-employed people and landlords pay their tax.

The OTS recognises that given the range and diversity of the situations and activities undertaken by those who are self-employed or residential landlords that there is no one change in this area that would be capable of simplifying matters for everyone.

The OTS is also mindful of the wider context of how an individual's employment status determines which statutory employment rights apply and how much tax is due. These issues are explored through the Taylor Review[1] and the government's response in the Good Work Plan.[2] However, this report does not explore such issues or the boundary between employment and self-employment for tax purposes; they are complex, but beyond the scope of this report.

1 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf

2 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/766187/good-work-plan-printready.pdf

Background

One of the areas that has been raised in several previous reports[3] from the OTS is the complexity many self-employed people experience in understanding and complying with their tax obligations.

This issue is increasing in importance as the number of self-employed people is growing, rising from 3.3 million in the year 2000 to 4.96 million this year.[4]

Although many self-employed people receive help with their reporting from tax agents, HMRC figures show that 46% of them do not have an agent[5]. Similarly, around one third[6] of residential landlords who report their income through the self-assessment property income page[7] do not use an agent.

In addition, agents have often told the OTS that they are instructed some time after the self-employed person has started work, so the agent's first task is often to help with compliance failures.[8]

The OTS has heard that some of those that are unrepresented struggle with their tax reporting and payment obligations. This can become especially difficult for those setting up their business or with more complex affairs, for example if a person has more than one self-employment, or an employment and self-employment.

Some self-employed people are unaware of their current tax position during the year and can then find themselves unable to pay the tax they owe when it is due. The OTS has heard that it would be useful for them to be able to gain an up to date picture of their tax affairs throughout the year from HMRC, and to be able to make payments toward this.

However, this is not the case for all, and the OTS has also heard from others who keep their own up to date records that allow them to budget appropriately, or who do not wish to engage with the tax system more than once a year.

One aim of the options discussed in this report is to help people to be more easily able to report to HMRC or to pay the tax they owe on time.

Part of the overall approach to reporting and paying tax by self-employed individuals and landlords explored in this report could be met through Making Tax Digital (MTD). For example, the MTD quarterly upload of data could be the means by which some businesses reported their expenses to HMRC, enabling HMRC to calculate their tax liability in the enhanced Individual Tax Account discussed in this report.

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3 See https://www.gov.uk/government/publications/simplifying-everyday-tax-for-smaller-businesses and https://www.gov.uk/government/publications/ots-suggests-paye-equivalent-for-online-platform-workers

4 https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/employmentintheuk/august2019

5 HMRC data from 2016-17 tax year

6 HMRC data from SA returns

7 SA105 supplementary page

8 https://www.gov.uk/government/publications/simplifying-everyday-tax-for-smaller-businesses

Making Tax Digital

HMRC's Making Tax Digital project[9] was first announced in March 2015. The project has two elements: the introduction of the Personal Tax Account for all individual taxpayers and the introduction of new record-keeping and filing requirements for those in business.

The initial requirement for Making Tax Digital related to Income Tax. Self-employed individuals (and landlords) would be required to keep their business records digitally and upload high-level summary data to HMRC every quarter (by using software, rather than manually entering the figures into the HMRC online portal), followed by their Self-Assessment tax return.

After receiving evidence that many taxpayers would not be ready for such an important change (and that necessary accounting software would not be ready), ministers decided to postpone its introduction. The current commitment is not to introduce Making Tax Digital for Income Tax (or for any other tax) before 2021. Instead, the government decided to introduce Making Tax Digital for VAT from April 2019.

The Making Tax Digital project thus has two core requirements:

- that business records must be held digitally
- that filing of information/returns with HMRC must be made digitally.

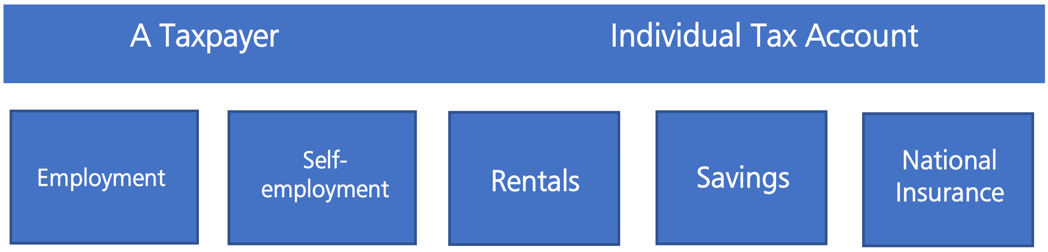
Reporting and payment using the Individual Tax Account

Over 19 million taxpayers have accessed their Personal Tax Account.[10] It's a modern way for a taxpayer to report income and expenses to HMRC and receive information about their tax affairs for the tax authority. For self-employed people and landlords, it is linked to the Business Tax Account, which adds self-assessment data. The Personal Tax Account continues to be developed by HMRC, which is important as there are a range of gaps and inaccuracies in the current version.

Imagine that in three years' time, HMRC have merged the Personal Tax Account and the Business Tax Account, so that self-employment and rental income are simply new tiles in the Individual Tax Account, alongside other tiles for Employment income, Savings income and National Insurance.

9 https://www.gov.uk/government/publications/making-tax-digital/overview-of-making-tax-digital
10 https://www.gov.uk/government/publications/hmrc-annual-report-and-accounts-2018-to-2019

Chart A: Illustration of the Individual Tax Account structure



Source: OTS

The taxpayer logs on to the Individual Tax Account, clicks the self-employment tile and notes that gross income from several intermediaries has been reported to HMRC. The taxpayer has the option of uploading unreported income and expense data, possibly from an app or software package.

The Individual Tax Account then calculates the net income, takes account of the personal allowance and other income sources, before presenting the taxpayer with a calculation for the year to date, perhaps by month. The taxpayer is presented with an optional button to click to pay on a monthly or less frequent basis the tax calculated – or indeed another amount. When the taxpayer next logs on, the account shows the estimated tax liability to date, together with the tax already paid on account.

The OTS considers this would ease the administration burden for some taxpayers, and help those who struggle to pay their tax, by making it easier to be aware of what tax they may have to pay, and to make regular contributions towards their tax liability.

Introducing this type of system is key to simplifying the reporting and payment arrangements of self-employed people and landlords, and any further changes to reporting and payment arrangements should be built on this. Further work should be done to explore the potential for HMRC to offer such a fully integrated Individual Tax Account, providing an end-to-end tax reporting and payment service.

Options for reporting

The OTS has explored whether self-employed people or landlords would benefit from being able to report information more regularly to HMRC and gain an up to date figure for the amount of tax likely to be owed to date within the fully integrated Individual Tax Account.

There has been enthusiasm for such an idea from some of those the OTS has consulted with, especially if this is linked to a facility to pay tax more regularly. Further investigations should be done to explore who would most benefit, and the types of data that would be needed for this to work effectively.

This report also looks at whether third party reporting might be a helpful addition for taxpayers. Third party reporting remains the cornerstone of the UK personal tax compliance approach, since PAYE was introduced in 1944. Employers, pension payers, banks and building societies all report data to HMRC which ends up in an individual taxpayer's Personal Tax Account.

There are not always third parties available who could report income for self-employed people, but the growth in the number of people who work freelance suggests that there are more engagers or intermediaries who could play a useful role in supporting many self-employed people. In particular, this could benefit those on lower incomes or starting in business, and others from among the 1.1 million[11] people who use the cash basis of accounting for tax purposes.

The OTS recognises that there will be different considerations for those self-employed people who sell goods through an intermediary to those that provide a service, and this would need to be considered further. In this report the OTS has focused on those that provide a service through a third party.

The introduction of third-party reporting should be considered on a sector by sector basis, in order to mitigate any economic distortions or competitive disadvantages that could arise if reporting was introduced only in relation to certain types of third parties or intermediaries.

There are fewer obvious third parties or intermediaries who could help residential landlords with reporting. However, one category where there is a range of intermediaries which typically have access to information about income is holiday property and short-term letting.

The OTS recognises that asking third parties to report taxpayer data would represent an additional burden for them. New burdens must be proportionate, introduced in the least burdensome manner and offer clear benefit to the wider group of taxpayers. Where relevant, they should support internationally agreed standards.

The OTS considers that any changes to reporting arrangements should be made only if these can be reflected in an individual's fully integrated Individual Tax Account. Further investigation should examine which sectors would be best suited for such developments and offer self-employed people the most benefit from the introduction of third-party reporting.

Options for paying tax

In the course of this scoping review, the OTS has considered several different options for paying tax, including more regular payments and third parties withholding tax and paying it to HMRC on behalf of the self-employed person or landlord.

The current system requires that a self-employed taxpayer or landlord pays Income Tax and National Insurance contributions (if relevant) twice a year, on 31 January and 31 July. Instalment payments are made on these dates, with a final payment due on the following 31 January.

HMRC also offers a 'budget payment plan' to make regular payments in advance. The payments are taken by direct debit and allows the taxpayer to decide how much to pay each week or month, including stopping for up to six months. The plan does not suggest how much a taxpayer might pay.

Many people have told the OTS that they would welcome being able to pay tax more regularly. This isn't a universal view, though; the OTS has also heard from others who would not wish to pay tax before it is due. This latter view is more often expressed by higher-income taxpayers, those with more complex businesses and by some tax agents.

[11] HMRC data from 2017-18 tax year

The OTS has heard a variety of opinions on the idea of introducing a withholding tax system, where a third party deducts an amount from the payment due to the self-employed person and sent to HMRC on their behalf. The OTS recognises that the government may want to consider such a system further for other reasons, for example to increase compliance, however this is not considered further in this report.

The OTS considers that the focus at this point in relation to third parties should be on investigating further the scope for introducing reporting requirements in relation to self-employed people and landlords operating in particular sectors. This should be reflected in an individual's tax account alongside the facility to voluntarily make more regular payments.

The introduction of such a system could ease their administrative burdens, allow them to gain a complete picture of their tax affairs and be able to make more regular payments. If this were to be successfully implemented, the OTS considers that further investigations could be made into the potential for a system of withholding of tax by third parties.

Recommendations

Recommendation 1

The government should invite the OTS to, or HMRC should, explore the potential for HMRC to offer a fully integrated Individual Tax Account, providing an end-to-end tax reporting and payment service, and the key steps and timescales that would be involved.

This Individual Tax Account, would:

- merge the present personal and business tax accounts, so that taxpayers could see information about all their different types of income separately in one place
- be able to receive and display data from taxpayers about their self-employment or rental income
- offer a running calculation of the additional tax that the individual may need to pay in relation to the year to date, looking across all the information held in the individual's tax account
- offer the facility for the taxpayer to make payments (whether of the calculated amount, or other amounts chosen by the taxpayer) to HMRC towards their overall liability, and to display information about amounts paid
- be able, in time, to receive and display data from third parties in selected sectors who have a significant role in relation to the individual's self-employment or rental business

Recommendation 2

The government should invite the OTS to, or HMRC should, explore and identify in more detail:

- the sub-sectors of the economy where third parties play a significant role in relation to a group of taxpayers, in particular where the majority of a taxpayer's activity can involve third parties who would have sufficient information to support effective reporting; sub-sectors to consider further could include the taxi/private hire market and holiday lettings market
- the information it would be natural for such third parties to hold and any additional information (such as the National Insurance number) that might need to be gathered to support effective and helpful reporting
- the extent to which it is usual for such intermediaries to handle money relating to the business
- the key steps and timescales that would be involved in requiring them to report such information

Recommendation 3

The government should invite the OTS to, or HMRC should, explore in more detail

- which types of self-employment business or rental business would most benefit from being able to report data periodically and pay tax through an integrated Individual Tax Account
- what data individual taxpayers would need to be able to send to HMRC for this to work effectively (whether through MTD or in other ways)
- the key steps and timescales that would be involved

Chapter 1
Background

1.1 Throughout this report the position of self-employed people is considered separately from that of those who receive rental income, who are referred to as landlords.

Self-employed people – key facts and figures

1.2 The UK has a large and growing number of self-employed people, representing a diverse cross section of the UK economy, from gig workers to engineers, hair stylists to designers.

1.3 The total number of people who are self-employed in the UK has risen steadily in the recent past, in fact since 2000 the number of self-employed workers in the UK has risen by around 50%, from 3.275 million to 4.96 million this year.[1]

1.4 As a proportion of total employment, the UK self-employed population is comparable with the average of EU member states,[2] with around 15% of the workforce undertaking some self-employment. The composition by occupation in the UK is quite different, though, with the largest groups across the EU being in professional occupations, while in the UK construction is the largest sector.

1.5 Although construction work remains the most common occupation for self-employed people, professional, scientific and technical occupations make up the second most common type of self-employment. The latest statistics on the sectoral split of self-employment in the UK is shown in Chart 1.A:

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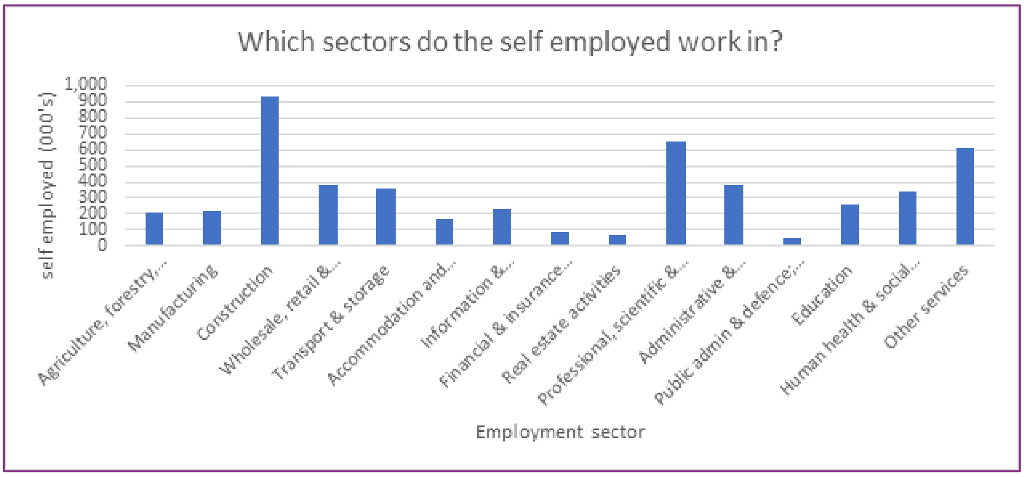
[1] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/employmentintheuk/august2019

[2] https://ec.europa.eu/eurostat/web/products-eurostat-news/-/EDN-20190430-1

Chart 1.A: Self-employed people by industry, April-June 2019



Source: https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/datasets/employeesandselfemployedbyindustryemp14

1.6 It is fairly common for self-employed people to have multiple sources of income. In their 2016 report 'Double take: workers with multiple jobs and reforms to National Insurance'[3] the Resolution Foundation set out that in the UK around 1.1 million people work in multiple jobs, making up 3.6% of the workforce. Of this 1.1 million, nearly half undertake self- employment, whether in addition to working as an employee (420,000) or through multiple self-employments (120,000). So, of the total self-employed population of around 4.5 million in 2016, over 10% had multiple sources of income.

1.7 The significant numbers of self-employed people having multiple sources of income may partly be because self-employment is not always successful or highly profitable. Around 20% of sole trading operations do not last longer than a year, and in fact only 20% continue as businesses for more than 12 years.[4]

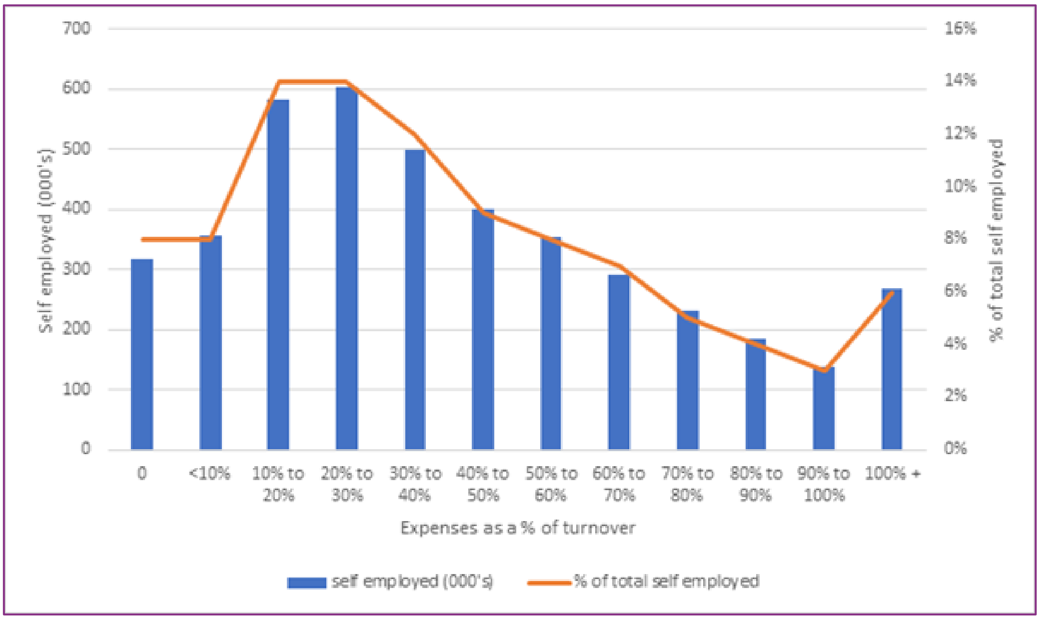
1.8 The great majority of sole traders have low levels of turnover, with most having a turnover of £20,000 or less.[5] A key issue for self-employed people in managing their tax affairs is the need to account for expenses that can be netted off for tax purposes. As set out in Chart 1.B, expenses play a significant role in the day to day management of self-employed businesses.

[3] https://www.resolutionfoundation.org/publications/double-take-workers-with-multiple-jobs-and-reforms-to-national-insurance

[4] https://www.ifs.org.uk/uploads/R158_Who_are_business_owners_and_what_are_they_doing.pdf

[5] https://www.ifs.org.uk/uploads/R158_Who_are_business_owners_and_what_are_they_doing.pdf

Chart 1.B: Expenses incurred as a percentage of total business turnover



Source: HMRC 2017/2018 SA data

1.9 Chart 1.B shows the expense ratio for the entire self-employed population, however, the trend is very similar even when it is split into those on the cash basis and those on the accruals basis.

1.10 More widely, self-employment is statistically likely to be less financially rewarding than employment. In their report 'Who are business owners and what are they doing' the Institute for Fiscal Studies states:

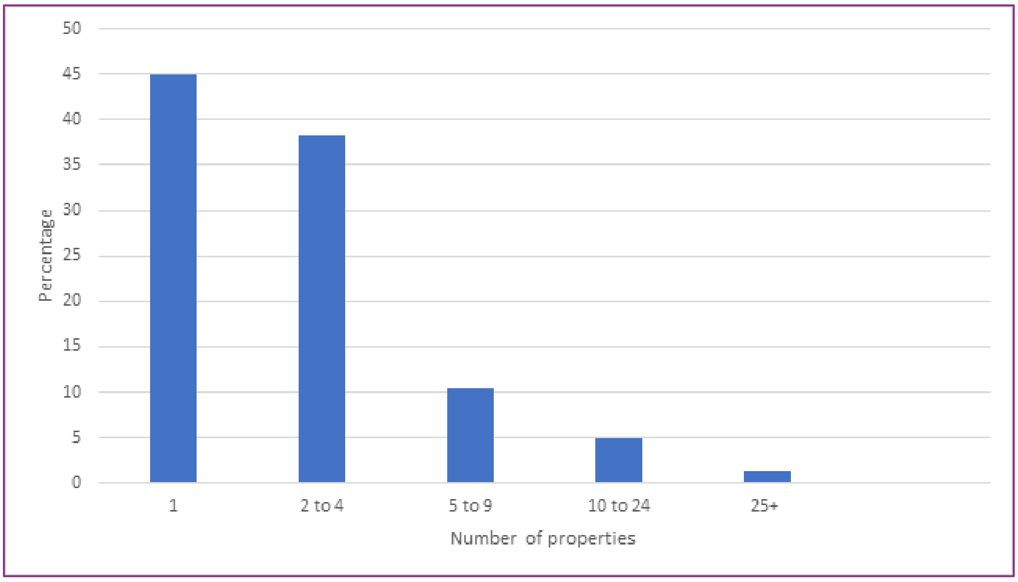
'On average, sole traders have particularly low average incomes: median income from all sources (including employment) in 2015–16 was just £13,000, with 36% (1.5 million people) earning below £10,000 and therefore below the personal allowance (such that no Income Tax would be due) – compared with only 15% of employees who had income below £10,000. There are very few sole traders in the top 1% of income taxpayers'.

Landlords – key facts and figures

1.11 The UK has a large and growing landlord population with 1.5 million landlords involved in the long term letting of property other than their home in England alone.[6] This report does not consider landlords letting property through companies (5% of the landlord population according to the English Private landlord Survey, where corporation tax is involved) or letting non-residential property.

[6] MHCLG, English Private Landlord Survey 2018

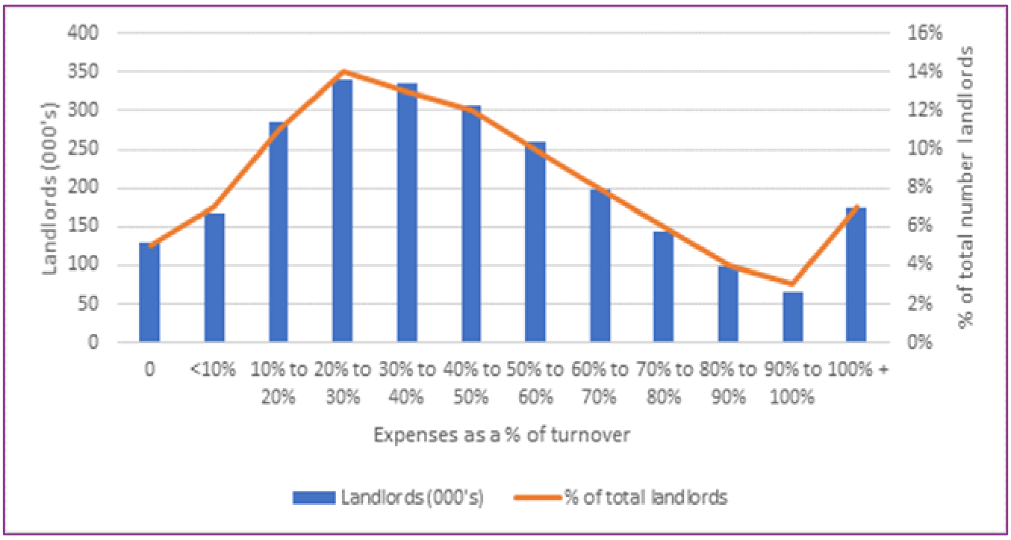
Chart 1.C: Landlords by portfolio size (2018)



Source: MHCLG, English Private Landlord Survey 2018

1.12 As with self-employed people, landlords need to calculate their expenses when finalising their tax returns. Chart 1.D illustrates landlords' expenses as a percentage of turnover for the 2017 -2018 tax year – notably only 5% of landlords report no expenses while 24% of landlords incur expenses equivalent to between 50-80% of turnover.[7]

Chart 1.D: Landlord expenses



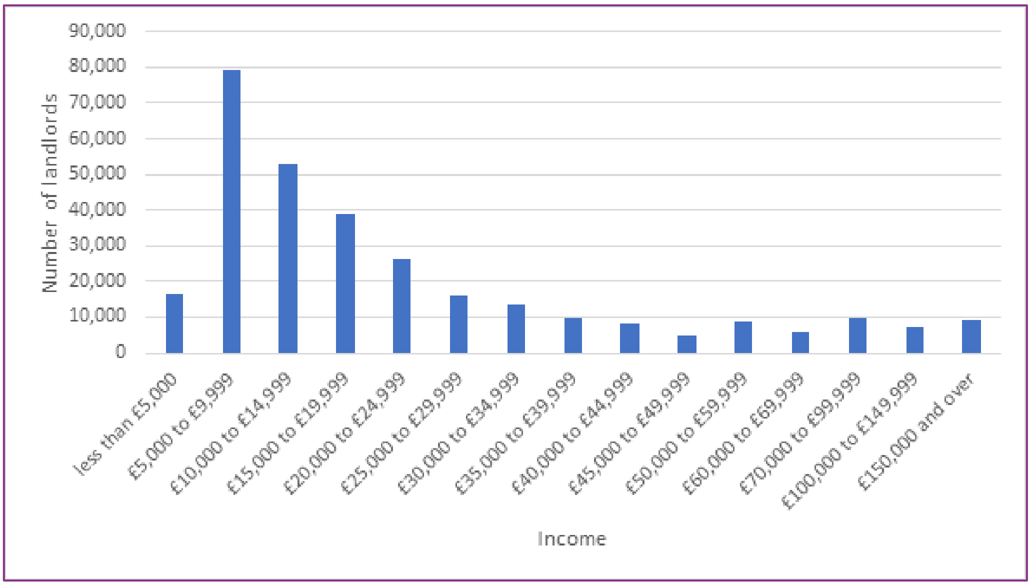
Source: HMRC 2017/2018 SA data

1.13 Landlords, on average, report a gross rental income of £15,000 per year (before tax and other deductions). For most landlords, income from rent makes up two fifths (42%) of their total gross income.[8] Chart 1.E illustrates the spread of income earned by English landlords, which is clearly clustered to the lower end of the scale.

[7] HMRC 2017 – 2018 SA data

[8] MHCLG, English Private Landlord Survey 2018

Chart 1.E: Landlord income



Source: MHCLG, English Private Landlord Survey 2018

1.14 Other key facts are that:

- between 60% (among landlords who rent one property) and 82% (among landlords who rent 11+ properties) of UK landlords who reported their income on the self-assessment property income page[9] used tax agents[10]
- among English landlords a third (34%) used an agent for letting services, with one in ten (9%) using an agent for both letting and management services. The remaining 5% only used an agent for management services[11]
- HMRC received 2.8m Self-Assessment tax returns which included property income in 2016/2017. However, this data does not distinguish between residential and non-residential property[12]
- of these, 107,000 report income from furnished holiday lets which collectively generate over £1bn a year or around £12,000 per person[13]
- it is not easy to get an accurate figure of the number of people who submit a return purely for property income, HMRC estimated that 500,000 people only complete the self-assessment property income page.[14] There may be other reasons they would need to submit a return such as to declare income from abroad, having an annual income over £100,000 or having received certain benefits amongst others. But it is likely that many would not need to be in self-assessment if they didn't have to report property income in this way

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[9] SA105 supplementary page

[10] HMRC 2016-17 SA data

[11] MHCLG, English Private Landlord Survey 2018

[12] HMRC 2016-17 SA data. Individuals may submit more than one Self-Assessment tax return with property income.

[13] HMRC 2016-17 SA data

[14] HMRC 2016-17 SA data

Chapter 2

Current tax reporting and payment arrangements

Self-employed people

2.1 Self-employed people pay Income Tax and National Insurance contributions using self-assessment. A clear majority submit tax returns digitally, whether by using HMRC's own portal or through their agents using software.[1] Some self-employed people may operate through a company or partnership, but the scope of this report does not extend to those that operate in this way.

2.2 A sole trader or partnership must register with HMRC as self-employed by the 5 October following the end of the tax year in which they started their business if their gross annual income exceeds £1,000. HMRC will then send them a notice, either in paper form or electronically, to complete a Self-Assessment tax return showing their business income and expenses.

2.3 A self-employed person must submit a return by a deadline which depends on whether they file on paper or electronically, and when during the year they received the notice to file from HMRC.

2.4 The return will determine how much Income Tax and Class 4 National Insurance contributions they must pay. Tax will only be due on their profit, after deducting business expenses from their turnover or receipts, and after setting off any other trading losses. This process is further complicated by some self-employed people having multiple sources of income, whether through a mix of employment and self-employment, or different self-employment roles.

2.5 Self-employed people have the same £12,500 personal allowance and Income Tax rates and bands as employees, whose Income Tax is primarily collected under the PAYE system.

2.6 Self-employed accounts can be prepared using cash basis or accruals basis accounting. The cash basis of reporting income from self-employment was introduced in 2013, following a report from the OTS.[2] The cash basis allows small businesses to account for their income and expenses when they actually receive payment or when they actually pay for an expense. The accruals basis uses accountancy principles to ensure that only income and expense which accrue over the accounting year are recorded in that year, rather than when cash is received or paid.

1 https://www.gov.uk/government/news/over-93-of-taxpayers-file-tax-returns-by-the-deadline

2 https://www.gov.uk/government/publications/small-business-tax-review

2.7 The cash basis currently may be used by taxpayers with gross income up to £150,000. HMRC data shows that approximately 1.1 million self-employed taxpayers reported their income using the cash basis in 2017-18,[3] and the numbers using the cash basis have been fairly static in recent years.

2.8 Self-employed people may choose their own accounting period, or period for which accounts are made up. If they elect not to deduct their expenses self-employed people are entitled to benefit from the 'trading allowance', which exempts the first £1,000 a year from tax.

2.9 Self-employed people pay Income Tax and both Class 2 National Insurance contributions (£3 per week if profits are above £6,365 a year) and Class 4 National Insurance contributions (if profits are above £8,632 a year). Class 2 contributions secure their entitlement to contributory benefits such as the state retirement pension. If a self-employed person's profits are lower than £6,365 a year, they can opt to pay Class 2 contributions voluntarily.

Payments on Account

2.10 After a self-employed person's first year of self-assessment, they may be asked to pay some tax in advance of the total tax bill. These are called Payments on Account (POA). POAs are based on the previous year's tax calculation and are paid twice a year, in January and July.

2.11 POAs do not include student loan repayments or Class 2 National Insurance contributions. Those taxpayers whose tax bill totals less than £1,000 or who have paid at least four fifths of it through PAYE or Construction Industry Scheme deductions (see Chapter 3) are not required to pay POAs.

Table 2.A: How Payments on Account work

Payment dates	What is paid
31 January 2020	**Any balance payment for 2018-19 + 1st POA for 2019-20** Any remaining liabilities for 2018-19 tax year Plus, POA of 50% of 2018-19 Income Tax + Class 4 NIC (the taxpayer may reduce this if profits are expected to be lower)
31 July 2020	**2nd POA for 2019-20** Based on 50% of 2018-19 Income Tax and Class 4 NIC (the taxpayer may reduce this if profits are expected to be lower)
31 January 2021	**Balancing payment for 2019-20 tax year** Plus, POA of 50% 2019-20 Income Tax + Class 4 NIC (the taxpayer may reduce this if profits are expected to be lower)

If a Self-Assessment return is submitted online, the POAs are automatically calculated by HMRC.

[3] HMRC 2017/2018 SA data

Landlords

2.12 The tax rules for landlords broadly mirror those for self-employed people, but there are some important differences:

- while most expenses are allowable, from 2020 interest on financing will be restricted to the basic tax rate (in practice by way of a reduction in the amount of tax payable). This change has been phased in from 2017. The restriction does not apply where the landlord owns a 'furnished holiday let', a tightly defined but more advantageous tax category[4]
- Capital allowances do not apply in relation to residential property (except for furnished holiday lets) but there is a similar relief available for replacement of domestic items
- The cash basis is the default position for landlords unless their annual turnover is greater than £150,000
- While landlords cannot benefit from the 'trading allowance' they can from the 'property allowance' which is also set at £1000 and achieves a similar effect
- Unlike trading losses, property losses cannot normally be set against other income sources
- Landlords renting out a room in their own home, whether on a residential or commercial basis are likely to be eligible for a £7,500 tax free rent a room allowance

Other schemes

2.13 There are several schemes and programmes already being operated by HMRC that include more regular reporting or payment for some self-employed people and landlords.

Construction Industry Scheme

2.14 The construction industry scheme (CIS) in its current form was introduced to try to tackle high levels of non-compliance in the construction sector. In outline it requires contractors to deduct tax and National Insurance contributions from payments to sub-contractors and to report and pay these monthly to HMRC.

How does it work

2.15 Under the scheme contractors are required to deduct money from a subcontractor's payment and pay this across to HMRC. Where this exceeds the subcontractor's Income Tax and National Insurance contributions liability, repayment may be claimed after the tax year.

2.16 Contractors are required to register with HMRC. Subcontractors are encouraged to register by being subject to a lower rate of deductions (20%) compared to those who do not register (30%). Those who register may also apply for 'gross payment status', where no deductions are made from the

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4 https://www.gov.uk/government/publications/furnished-holiday-lettings-hs253-self-assessment-helpsheet/hs253-furnished-holiday-lettings-2019

payments they receive, and tax and National Insurance contributions must then be paid in full at the end of the year in the normal way.

2.17 Contractors must use the online service to verify whether a subcontractor is registered to determine what rate of tax to deduct. They must also file monthly returns online to HMRC detailing payments, material costs and deductions per subcontractor and pay the money over to HMRC.

2.18 Contractors are also required to provide monthly statements to subcontractors of payments and deductions which can be used to help calculate whether Income Tax and National Insurance contributions are still owed at the end of the year or whether a refund is due. Self-Assessment forms must be completed by both the contractor and the sub-contractor and any overpayment of tax can be refunded.

What are the positives

- The CIS scheme is well established and has proven to be a fairly straightforward way for many to pay significant amounts of Income Tax and National Insurance contributions
- It is effective in ensuring regular payments on account are made
- Subcontractors receive a written record from contractors each time they are paid showing how much has been deducted from their payment
- Subcontractors are not left with a large tax bill at the end of the year and may receive a refund
- Costs of materials are taken account of as they occur

What are the limitations

- Sub-contractors are not able to easily see or check with HMRC what money has been paid over on their behalf
- Contractors may fail to pay money across to HMRC
- Self-Assessment returns still need to be completed at the end of the year to cater for expenses other than materials
- Any refunds due are not automatic and must be claimed
- Some CIS subcontractors feel the need to use high volume repayment agents to make refund claims

The Budget Payment Plan

2.19 The budget payment plan is HMRC's more regular payment option, available to those who need to submit a Self-Assessment return.[5]

How does it work

2.20 The budget payment plan was introduced in 2009. It enables an individual to set up a direct debit that lets them decide how much to pay, earlier than it is legally due, on either a weekly or monthly basis. It also has the facility to enable the individual to stop making payments for a period of up to 6

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

months or to cancel it altogether. The full amount due must, however, be paid by the relevant deadline, unless the individual seeks a 'time to pay' agreement with HMRC.

2.21 In the two years to 31 March 2018, around 81,000 budget payment plans were created, relating to around 58,000 individuals.[6] HMRC has recently published a research report which included looking at customer responses to the budget payment plan.[7] This showed that there was limited customer awareness of the plan, alongside a desire for a facility of this kind, particularly so that tax would not have to be paid all in one go.

What are the positives

- Allows for more frequent payments to be made up front towards final tax bill
- Allows for some flexibility for those who have irregular income
- Can be stopped at any time or payments put on hold for up to 6 months

What are the limitations

- Not that widely known about and little promotion
- Difficult to find guidance on how to set it up
- Clunky system requires a number of steps online to be gone through to set up plan
- Only available to those whose current tax liabilities are up to date
- It does not give any indication of how much it might make sense to pay
- Interest does not arise on any payments made, so there is no incentive of that kind

Making Tax Digital

2.22 Making Tax Digital (MTD) for Income Tax was originally announced in outline in 2015. It is intended to facilitate a move towards a more real time reporting system for self-employed people and landlords, based on digitally kept business records being submitted to HMRC on at least a quarterly basis, followed by year-end adjustments (and a Self-Assessment tax return).

2.23 The government announced a delay to its introduction and has now announced that MTD will not be extended to Income Tax or to any new taxes before 2021.

2.24 MTD for VAT has been compulsory for most VAT-registered businesses since April 2019. There are some exemptions: businesses with turnover below the VAT threshold; certain digitally excluded businesses; insolvent businesses; or businesses that are run entirely by members of a religious body whose beliefs are incompatible with the use of electronic communications.

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[6] HMRC data

[7] https://www.gov.uk/government/publications/supporting-customers-to-pay-their-tax-on-time

How does it work

2.25 MTD for Income Tax is being piloted for a very small number of sole traders with income from one business and/or landlords who rent out UK property, providing they are resident in the UK for tax purposes and their Self-Assessment returns and payments are up to date.

2.26 Individuals are required to use HMRC-approved software to keep records of their business income and expenses and every 3 months submit high level details to HMRC. Such software may then enable individuals to see an estimate of the tax they might owe, based on the details they have submitted, but this is not currently available through the HMRC online tax accounts. Agents can also send in the updates on behalf of their clients.

What are the positives

- Promotes more organised record keeping which helps reduce error helping taxpayers get their tax right and manage their tax affairs more efficiently and effectively
- The potential for a more up to date picture of tax liability relating to the business subject to purchasing the appropriate third-party software

What are the limitations

- Currently, transferring data through HMRC compatible software is not free (although HMRC have said they expect there will be some free options)
- MTD for Income Tax is in Beta stage, with 4 software suppliers, compared to 378 software suppliers for VAT.[8] It is not known whether the VAT software suppliers would support the necessary record-keeping and data uploads for Income Tax, or whether bridging software might be developed. Take up is currently very low due to it being voluntary and only in the pilot phase, with very few software providers
- Currently only those with simple tax affairs are able to submit data to HMRC this way, because MTD for Income Tax self-assessment remains in the Beta testing phase
- There is no built-in option to pay more flexibly

Non-resident landlord scheme

2.27 The non-resident landlord scheme is for landlords of UK property who live abroad for 6 or more months of the year. The basic rate of tax is deducted from rent by letting agents or tenants or, if agreed by HMRC, tax on rent can be paid annually through self-assessment.

How does it work

2.28 The default position is for tax to be deducted from rent by a letting agent or the tenant (providing they pay more than £100 per week) after allowing for any expenses they may have paid. Letting agents or tenants must pay the

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8 https://www.tax.service.gov.uk/making-tax-digital-software?_ga=2.52076521.1179902704.1569233628-932395791.1553774459

deducted tax quarterly to HMRC, complete an annual information return and at the end of the year provide a certificate to the landlord detailing the amount of tax deducted. They must also keep records of all payments and expenses for four years.

2.29 If a non-resident landlord wants to receive their rent in full and pay tax at the end of the year through self-assessment, then they need to apply to HMRC. They must be up to date with their taxes and filing of tax returns to apply. If agreed, HMRC will then write to the letting agent or tenant and tell them not to deduct tax from the rent.

What are the positives

- Payments of tax are made quarterly, which may aid budgeting for tax due

What are the limitations

- Relies on letting agents/tenants registering with HMRC
- Little public knowledge about the scheme
- Non-resident landlords cannot use HMRC's online services to declare their rental income (so the process is paper based)
- Relies on letting agents/tenants knowing that the landlord is non resident

Chapter 3
Options for change

Introduction

3.1 The OTS has heard a variety of different opinions on how the tax reporting and payment arrangements could be improved for self-employed people and landlords.

3.2 As well as meeting with interested parties the OTS also ran two online surveys, one for self-employed people which received 487 responses and one for landlords which received 623 responses. Some of the results are included below but it is important to highlight that the survey was open to all those who wished to take part, and does not form a representative sample of society, so they should be viewed as illustrative snapshots only.

3.3 For changes to the reporting or payment arrangements to be successful, the timing and sequencing of these changes would be crucial, for two main reasons.

3.4 Firstly, it would be important to ensure that whatever information was reported, or payments made, to HMRC can be matched to the individual or business it relates to and is accessible and visible to the self-employed person through an online individual tax account. This means HMRC would need to have the right systems in place to make this happen. This is not currently the case and will require additional funding to be secured.

3.5 Secondly, those affected would need to be given time to adapt to any changes, so that any information sent to HMRC is accurate and useable. There would need to be a sufficient notice period between any change being announced and it being implemented.

3.6 For these reasons, the OTS considers that in any further work it would be important to identify the key steps and timelines that would be involved.

3.7 Another consideration is digital capability. The options for change in this area are digitally focused, and it must be recognised that there are digitally excluded people, who wouldn’t be able take advantage of some of these changes. Alternatives would need to be available so that they can continue to engage with the tax system.

3.8 As outlined in Chapter 1 different people are in different situations, and the OTS does not believe that there is a single option for change that would improve things for everyone, and for some the simplest option may be to leave the reporting and payment arrangements as they currently are.

3.9 Additionally, the options considered would likely have different levels of impact on HMRCs compliance efforts, and on the tax gap that exists in this area. The OTS considers that any changes that would ease the process of reporting and paying tax would additionally have the benefit of helping taxpayers to remain compliant. While the OTS has not gone into detail in analysing these impacts, it is noted that this is something that would be considered if the government were to implement any changes in this area.

3.10 This chapter outlines different options for change, those who could benefit from any changes and further issues that need to be considered.

Tax reporting

3.11 The current system, as outlined earlier, means that an individual who is self-employed will report tax information to HMRC once a year for Income Tax and National Insurance contributions purposes. However, there may be a benefit in more regular reporting, especially for some self-employed people and landlords. More regular reporting could be done in several ways, which are explored further in this chapter.

Reporting by the individual

Self-employed people

3.12 The OTS heard from many stakeholders that the idea of a more regular reporting mechanism would be welcomed by some self-employed people, if it gave them a more accurate picture of their tax affairs throughout the year. However, this view was not universal, and there are also many who are content with the current arrangements.

OTS survey results

74% of the respondents to the self-employed survey did not believe that more regular reporting would make budgeting for their tax bill easier. The main reasons given included concerns about:

1. increased admin burdens or adviser cost
2. how it would cater for seasonal fluctuations and irregular work patterns
3. duplicating existing monitoring they were doing themselves

However, 26% of total respondents said that they would welcome more regular reporting and gave the following reasons for doing so:

1. it would help with budgeting
2. it would be simpler and help with record keeping
3. it would give increased certainty about their tax liability

3.13 Additionally, the OTS heard from many of those consulted that a facility to more regularly pay tax would be welcomed by some self-employed people.

How could this work?

3.14 As outlined in Chapter 2, HMRC do offer a 'budget payment plan' which allows more regular payment of tax, either on a weekly or monthly basis. However, the OTS found there to be little knowledge about this among those it consulted with; this is also a finding of recently published HMRC research.[1] While the current system allows for more regular payments, it doesn't give the person setting it up any indication of the amount they should be paying, or a clear and easily accessible picture in the Personal Tax Account of the amounts that have been paid.

3.15 The OTS suggests that HMRC should offer a more visible, flexible and accessible system for those who are self-employed and wish to report and pay more regularly, through a fully integrated online Individual Tax Account.

3.16 The OTS considers that the introduction of such a voluntary system, available through the Individual Tax Account, would be welcomed, especially if it allowed self-employed people to more regularly report income and expenses to HMRC (whether through MTD or otherwise), gain an up to date picture of their tax affairs and make flexible payments.

OTS survey results

42% of total respondents to the self-employed survey said that they would find it helpful to be able to make payments throughout the year towards their final tax bill.

3.17 Such a system should allow flexibility about the amounts and frequency of payment to help to cater to those with less regular and stable cash flow. It should also allow for the withdrawal of funds that have been paid to HMRC: this would help to safeguard against cash flow issues and cater for those whose income is seasonal or not consistent throughout the year for other reasons. It would also be of benefit to provide an up to date figure of the tax due, in order to show whether the payments being made will cover the amount owed.

3.18 The OTS considers that this system should also have the facility to receive and display data from third parties, should they be required to do so in the future. This could allow the system to provide a 'real time' update of a person's tax affairs in the future. Any further changes to the reporting and payment arrangements, such as this, should therefore build upon this system rather than be introduced in isolation in order to be of benefit to self-employed people.

3.19 Offering this facility at the point at which people register to become self-employed may help people to budget appropriately for their tax liability and prevent them from getting into a position where they were unprepared and unable to pay the tax due.

3.20 It is not anticipated that the introduction of such a system would remove the need for self-employed people to submit a return for each tax year, as is the

[1] https://www.gov.uk/government/publications/supporting-customers-to-pay-their-tax-on-time

case now. This would be required to reconcile their overall tax position against any payments made and to report any further income and expenses that may have arisen.

Who could benefit?

3.21 The OTS has heard that a voluntary flexible reporting and payment system as described above would largely be welcomed by those self-employed with lower incomes, are unrepresented, who struggle with cash flow and would like the security of knowing that they have contributed throughout the year towards the tax they owe. Additionally, the OTS has heard that it would be welcomed by self-employed people on a wide range of incomes, if their business is essentially 'labour only' or with few expenses.

3.22 This would particularly suit those who use the cash basis of reporting to HMRC rather than the accruals basis. For those on the cash basis, more regular reporting will provide a more accurate picture of the tax due throughout the year and is unlikely to require significant end of year adjustments.

3.23 However, the OTS has also heard from other self-employed people who would not want to change the way they report and pay tax. Those that fall into this category are usually those with more complex businesses, those who have a higher proportion of expenses, those earning higher incomes and those who have tax agents.

3.24 The OTS therefore considers that a single option for change wouldn't improve the reporting and payment arrangements for all self-employed people. However, a system, available to all, that allows for more regular reporting and payment would be of benefit, as long as this was flexible in order to take into account different circumstances.

Other considerations

Making Tax Digital

3.25 As outlined in Chapter 3, the government is thought likely in the future to introduce mandated regular reporting through HMRC's Making Tax Digital (MTD) for Income Tax programme.

3.26 The OTS understand that the long-term vision is to introduce a voluntary system to allow people to be able to make payments more regularly,[2] however the OTS consider that there is merit in prioritising this facility, and that further exploration should be done into making the necessary investment to provide such a facility.

One Online Tax Account

3.27 Almost everyone with whom the OTS has engaged have pointed out that there are difficulties that arise from having a separate Personal Tax Account and Business Tax Account for self-employed people.

3.28 Logically, there should be one online account that contains all the relevant tax information for an individual, whether self-employed or not. The OTS

[2] https://www.gov.uk/government/consultations/making-tax-digital-voluntary-pay-as-you-go

considers this would in itself be a simplification and make information about their tax affairs more accessible for self-employed people and landlords.

Reporting for Universal Credit

3.29 One of the points raised with the OTS is that those on low incomes who claim Universal Credit already have to report details about their income on a monthly basis. While the OTS acknowledges that different things are taken into consideration in working out Universal Credit than in relation to tax, and that they are administered by different government departments, it seems there could be an opportunity to link these processes, so that a person would only need to report details about their income once. The OTS has not considered this idea in any detail, and it is beyond the scope of this report.

Basis Periods

3.30 A basis period is the period in relation to which someone's taxable income for a tax year is calculated. For self-employed people this depends on the date to which they make up their accounts, though it can be the year ending 5th April (the end of the tax year) if they so choose.

3.31 One reason basis periods can be complicated is that if an alternative date is chosen, the basis periods for the first year or two of trading will overlap. If a self-employed person could voluntarily report their income and expenses and pay tax on a more regular basis, it was suggested to the OTS that this could enable basis periods to be aligned to the tax year, removing the need for these specific rules. However, this is a complex issue that would need to be considered further.

Landlords

3.32 In discussions with landlords, there was some support for an improved budget or advanced payment plan. However, some landlords were resistant to the idea of reporting or paying more regularly.

3.33 The OTS was told on a number of occasions that any such plan must have in built flexibility so that payments can be varied. The reasons for this are numerous and cover situations such as when properties are being renovated (and as a consequence no income is generated) or periods when landlords are unable to find tenants, or tenants leave early and default on their rental obligations.

OTS survey results

16% of total respondents to the landlord survey said that they would find it helpful to be able to make payments throughout the year towards their final tax bill.

Of these respondents some said that their preference was to pay fixed amounts at regular intervals (37%), whereas others wanted to make payments based on an estimated tax liability to date (26%) or to make variable payments when they chose (25%).

3.34 This indicates that while it may not be a useful tool for some landlords, for others the option to pay tax through an integrated individual tax account could help to prevent them from struggling and falling behind with their tax payments. So the OTS would envisage including landlords alongside self-employed people in further exploration of the benefits of a fully integrated online account.

Reporting by an intermediary or third party

Self-employed people

3.35 Self-employed people work in a variety of different ways. Some work through an intermediary such as a platform, business or agency, others work directly for either their customers or a larger business, and some will work in both ways. For example, a self-employed taxi driver may obtain work through an online platform, through a local firm, or directly from the public. There may, therefore, be a variety of different sources of income that need to be reported to HMRC.

3.36 For those who do work through some type of intermediary or third party, one way to simplify the reporting of their income could be for the intermediary or third party to report to HMRC on their behalf. Such a requirement is already in place for specified employment intermediaries who do not operate PAYE.[3] Extending this kind of approach to others could provide simplification benefits and making the information visible to the taxpayer in their online Individual Tax Account would improve transparency.

3.37 Further work will be required to fully explore which intermediaries and third parties should be in scope given the range of business models and approaches. As a starting point, the OTS take intermediary to mean any kind of business, agency or platform through which someone who is self-employed gains work.

3.38 The OTS recognises that many self-employed people are contracted directly by larger companies without acting as an intermediary. For reporting by either group to be possible, they would need to know details of the income earned by those who obtain work or work through them. This is not necessarily the case for all intermediaries, as some may only link together a self-employed person with work, and not be aware of the money earned.

How could this work?

3.39 An intermediary could report directly to HMRC any income paid through them to someone who is self-employed. This would then be available to view in the self-employed person’s fully integrated individual tax account, so they would not need to report this income themselves.

3.40 Further investigation is needed into the type of information third parties already hold, and what additional information would be needed in order to make reporting in this way effective.

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[3] See regulations 84E-H of the Income Tax (Pay As You Earn) Regulations 2003

3.41 Third party intermediary reporting could help some self-employed people, by easing their administrative burden surrounding their tax reporting, especially where the majority of their income is received through third parties.

Illustrative Case Study – Taxi Drivers

Mandy is self employed as a taxi driver and earns all of her income in this way. She gains jobs through both a local company and two online platforms. Mandy earns approximately £18,000 a year.

When it is time to submit her tax return, Mandy often puts this off to the last minute as she finds it complicated. She is often unsure of the amount of tax she will owe, as she keeps her records of income in different ways, some in paper format and some digitally and doesn't keep track of these throughout the year as they come from different sources at, different times and are presented in different ways, which she finds confusing. She does keep up to date records of her expenses on a spreadsheet on her computer.

Mandy always files her Self-Assessment return online and on time but has struggled to pay her tax bill on time for the past couple of years and has had to arrange with HMRC to be able pay this over several months.

If Mandy instead had access to an integrated individual tax account, providing an end-to-end tax reporting and payment service, the online platforms and the local company could provide details of Mandy's income directly. Mandy would be able to keep track of her income received and update her account with any additional income and her expenses to gain an up to date figure of the amount of tax she owes. She would also be able to make more regular payments throughout the year, allowing her to stay up to date with her tax.

3.42 However, there are further things to be considered. In particular, it is unlikely that an intermediary or third party would have full details of the self-employed person's business expenses. Where an intermediary or third party does know some expense details, these could be reported to HMRC, but the self-employed person would still need to report other expenses directly to HMRC.

3.43 It is also likely that many of those who gain work via intermediaries or third parties will also have other sources of income that couldn't be reported in this way. These would still need to be reported to HMRC by the self-employed person.

3.44 Another option that has been suggested to the OTS is that the reporting could instead be carried out by a bank. This would only be possible if there were a specific business bank account that was used for all business income and expenditure.

3.45 The OTS is aware that there are certain accounts and products that exist that already allow categorisation of income and payments, and that accounts can be linked to accounting software. However, further data and information may have to be provided to HMRC to ensure, for example, that any non-taxable outgoings are properly accounted for.

3.46 In all cases, the OTS has heard that to be of benefit to self-employed people, the details that are reported to HMRC should be easily visible in their Individual Tax Account. A key concern that was raised was over the accuracy of the information, and it was stressed that there should be a clear means of disputing any information that had been reported to HMRC if the person believed it to be inaccurate.

Who could benefit?

3.47 The OTS suggests that third party reporting should be considered on a sector by sector basis, and further work needs to be done to identify those sectors that would most benefit. The types of characteristics that the OTS believes will highlight the sectors that would benefit most are as follows:

- Self-employed people receiving the majority of their income through one or more intermediaries or third parties working in sectors where a significant proportion of the self-employed people working in them operate through a third party or intermediary
- As with reporting by the individual, it would likely suit those on the cash basis more than the accruals basis
- It is also likely to suit those who have fewer expenses, or other sources of income, as this would reduce the need for them to report further information themselves

3.48 The OTS understands that this will not apply to the entirety of the self-employed population and that any approach should be flexible enough to accommodate this.

3.49 Further investigation is needed into the sectors in which a reporting arrangement by third parties would be best suited.

Other considerations

Cash Basis

3.50 Third party reporting would most likely cover cash payments, rather than payments owed. So if HMRC could reflect reported income of cash basis taxpayers in their Individual Tax Accounts on a real-time basis, this would fit naturally with what they would otherwise need to report. By the same token, third party reporting may be less of a help to those operating on an accruals basis.

Burden on intermediaries or third parties

3.51 The OTS recognises that asking third parties to report taxpayer data could represent an additional burden for them. New burdens must be proportionate, introduced in the least burdensome manner and offer clear benefit to the wider group of taxpayers.

3.52 For some types of intermediary or third party, it would not be a significant change to their systems to report information to HMRC, and of course some businesses already regularly report information to HMRC. The OTS spoke to some businesses who already provided regular income statements to those self-employed people who gained work through them, and such statements or similar information could therefore be shared with HMRC on their behalf, without introducing a significant new burden. However, for others it may require significant changes to their systems.

3.53 Additionally, Intermediaries may need to collect further information from those who gain work through them, including their National Insurance number (or less obviously their unique taxpayer reference), so that any information reported to HMRC could be matched correctly.

3.54 The level of further information would depend on the type of intermediary or third party, some will already require more personal information from the self-employed person in order to obtain work through them than others. For example, in sectors that are regulated (such as taxi drivers, education or healthcare) it is likely that the intermediary is already required to obtain more details from those that obtain work from them.

3.55 Further work would be needed to consider the type of information that different intermediaries or third parties would already hold that could be passed onto HMRC, along with the type of further information it would be necessary for them to acquire to ensure that reporting in this way is effective and helpful.

3.56 Any further work would need to carefully balance any potential benefits for the self-employed against any potential additional compliance burdens for intermediaries or third parties.

Voluntary or mandatory

3.57 One key issue that arose when the OTS discussed this idea was whether reporting should be something that was voluntarily offered by intermediaries, or whether it should be mandated.

3.58 Many who the OTS spoke to initially resisted the idea of mandatory reporting. However, it was recognised that if reporting was not mandated across all types of intermediary or third party in a sector, it could cause economic distortions. This issue would need to be closely considered, as introducing mandatory reporting for only one type of intermediary or third party could lead to commercial disadvantages. There is also a concern that if such a system were voluntary, there could be low take up by intermediaries, reducing the benefit to self-employed people. For these reasons, the OTS considers that reporting requirements should be considered on a sector by sector basis.

3.59 The OTS therefore considers that for reporting by intermediaries to be of benefit to self-employed people, it would need to be introduced on a mandatory basis within any given sector.

International considerations

3.60 Some of the businesses which could potentially be in the scope of a new reporting system operate internationally. They would benefit from common standards for reporting, so they can operate a single system capable of delivering reporting to multiple countries. Global standards for reporting would keep the burden of new systems manageable.

3.61 This work would need to be coordinated by one of the global or regional bodies such as the OECD, the Global Forum on Transparency and Exchange of Information for Tax Purposes[4], the BEPS Inclusive Framework[5] or the European Union.

3.62 A further question for governments to consider is how to enforce reporting obligations where the relevant business has no physical presence in the country under consideration. This issue is acknowledged but is beyond the scope of the OTS's work.

Making Tax Digital

3.63 Making Tax Digital for Income Tax is part of a government initiative[6] announced in 2015.

3.64 Making Tax Digital for Income Tax remains in pilot, with 4 software suppliers, as compared to 378 suppliers for VAT record keeping and submission, as at 23 September 2019.[7]

3.65 HMRC originally consulted about the level of profit at which adoption of the Income Tax version should be mandatory, having accepted that those with sales/turnover below £10,000 should not be required to join the system. No new minimum level of profit or turnover has been announced. Making Tax Digital for Income Tax could support the wider vision outlined in this report.

Landlords

3.66 The range of landlords is, like that of self-employed people, diverse. It contains those who use a property managing agent who provides a full service including finding tenants and managing the property, or a managing agent who just identifies tenants with the landlord then managing the property themselves, and those landlords who do all of the work themselves. Consequently, the issues concerning reporting of income for landlords are broadly similar to those for self-employed people outlined above.

OTS survey results

While 91% of respondents to the landlord survey rejected additional reporting requirements, 32% thought it would be helpful to use third party data to prepopulate their tax return.

3.67 Although respondents to the OTS survey were clearly not in favour of additional reporting requirements, in discussions with landlords and their representative bodies, there appeared to be some support for reporting to be via banks, alongside limited support for reporting by property management agents. Nonetheless, while property agents do have access to

4 http://www.oecd.org/tax/transparency/

5 http://www.oecd.org/tax/beps/

6 https://www.gov.uk/government/publications/making-tax-digital/overview-of-making-tax-digital

7 https://www.tax.service.gov.uk/making-tax-digital-software?_ga=2.52076521.1179902704.1569233628-932395791.1553774459

extensive amounts of data, not all landlords use such agents. As such the OTS do not consider this broader group would benefit from additional reporting requirements.

Illustrative Case Study – Short Term Holiday Lets

John rents out his furnished cottage in Devon for most of the year to tourists briefly visiting the area. As such it qualifies as a 'Furnished Holiday Let.' Although he used to let the cottage directly, he now relies on an online intermediary for most of his bookings.

John works full time in London and the lettings income only represents a small share of his overall income. It is the only reason he has been brought into self-assessment. He keeps a record of his mortgage interest and furniture purchases which he uses to offset against his gross rental income.

John is one of the many people who find the process of paying tax difficult and time-consuming, so he only engages with his tax liability once a year, towards the end of January. This means that his tax liability sometimes comes as a bit of a surprise and he often struggles to pay HMRC several thousand pounds in one go.

With an integrated individual tax account, providing an end-to-end tax reporting and payment service, which is directly fed by information from John's online intermediary, John's experience of and visibility around paying tax could be greatly improved, allowing him to make regular payments throughout the year.

3.68 In relation to intermediaries, such as those used for shorter term holiday lets, there is in some cases a ready-made mechanism for reporting which is being actively rolled out in some countries. As such the OTS suggests exploring further whether regular reporting from this specific group could play a role in easing administrative burdens and allowing landlords to gain a complete picture of their tax affairs.

3.69 In discussions with stakeholders, there was broad support for the idea that any requirements be consistent with any future international reporting obligations so that a supplier does not have different reporting requirements in each taxing jurisdiction.

3.70 The OTS heard from one of those it consulted with that it operates in many different countries which indicates the benefit of a high degree of commonality. Similarly, the OTS was told that if reporting requirements for intermediaries were to be introduced, it should be mandatory so as not to cause competitive or commercial distortions.

3.71 Further investigation is needed into how reporting arrangement by third parties would work for landlords working through intermediaries or third parties in specific sub sectors.

Paying tax

3.72 The OTS has heard that there are people who struggle to budget throughout the year in order to pay any tax they owe, and who can then be surprised by the amount due.

OTS survey results

23% of total respondents to the self-employed survey said that they had received an unexpectedly large tax bill at the end of the year that they were not prepared for.

3.73 The OTS has therefore explored different ways in which tax could be paid more regularly to HMRC, which could help to prevent people struggling and falling behind with their tax payments. In the previous section, the idea of more regular payment by individuals was discussed alongside more regular reporting; this section explores the idea of more regular payment of tax by intermediaries or third parties.

Tax payments by an intermediary or third party

Self-employed people

3.74 The construction industry accounts for more self-employed people than any other sector and is the only one that uses a system of withholding tax from payments to self-employed people by intermediaries.

3.75 The OTS has considered whether a withholding or other payment system of some kind by third parties could benefit other self-employed people. As with reporting by intermediaries or third parties, this would only help those self-employed people who gain work through an intermediary or third party.

How could this work?

3.76 There are various ways in which such a payment system could work.

3.77 An intermediary or third party could for example withhold an amount from any amount they pay to a self-employed person. This could be done either as a set rate (for example 20% as in CIS) or at a rate set by HMRC that more accurately reflects the person’s final liability, taking their other income and expenses into account.

3.78 If it were to operate more accurately in this way, this would appear to require the self-employed person to report other income and expenses so the rate could be determined. Alternatively, the rate could be based on the data received by HMRC in the previous year.

3.79 The OTS has heard that the idea of a set rate would probably be generally preferred as it is simpler and easier to understand. However, this would need to be considered in more depth, as there are other concerns, including the effect on those on lower incomes, seasonal work, or with cash flow problems, as a set rate can lead to overpayment during the year.

3.80 The self-employed person would still need to complete a tax return (as is the case with those within the CIS scheme) to report any other income and report their expenses. They may also need to pay further tax if the amount withheld doesn't cover the tax due or claim a refund if they have overpaid during the year.

3.81 It has been suggested that payments could be operated in other ways, for example by accounting software linked to a bank account through open banking or directly through a business bank account. Much like the suggestion that business bank accounts could report details of income and expenses, the suggestion is that they could pay part of the net profit directly to HMRC. This could be calculated by categorisation of any income received or expenses paid through the account.

3.82 This is not an option the OTS has explored in any detail and has received mixed responses from those with which it has been discussed to date.

Who could benefit?

3.83 Overall the idea of a third-party payment system was not welcomed by the majority of those with which the OTS has consulted.

3.84 However, the OTS has heard from some that introducing a voluntary payment, or withholding, system more widely would benefit those on lower incomes and those who struggle to engage with the tax system. Additionally, it heard from some who operate within the construction industry who were very enthusiastic about the construction industry scheme and the potential to extend this further.

3.85 For those that do struggle with tax reporting and payment, having the responsibility of paying tax to HMRC removed may relieve a burden and stress. However concern has also been raised that introducing a withholding system could lead to them overpaying, as they would still need to report to HMRC any expenses and they may then struggle with this process and the claiming of a refund.

3.86 It is not clear to the OTS that there is one sector of the self-employed population that would most benefit from a withholding type system at this stage, however further work would need to be done on this area to examine the workability and suitability for different sectors.

3.87 The OTS self-employed survey has indicated that there is a wariness around the introduction of such a system and there are a number of concerns which would need to be addressed.

OTS survey results

86% of the respondents to the survey for self-employed people stated that they would prefer to make their own tax payments rather than them being processed by a third-party engager and 93% would prefer to make their own payments rather than they being processed by a bank.

Key concerns identified include:

- a lack of trust of third parties and banks to get it right
- impact on cash flow
- issues around how expenses would be accounted for
- the removal of control over personal tax affairs

3.88 The OTS considers that the payment of tax by third parties is a much more complex area and has received less favourable feedback from those with which the OTS has consulted, mainly due to a lack of trust in those third parties to get it right. The OTS do not suggest investigating this further at this stage. However, were the introduction of third party reporting successful and helped to improve public perceptions and increase trust of third parties, then further work could be done into the potential of such payment options.

Other considerations

Voluntary or mandatory

3.89 Whether or not a payment or withholding system should be introduced on a voluntary or mandatory basis raises some of the same considerations as reporting by intermediaries.

3.90 For example, the OTS has heard there is a concern that introducing mandated withholding for only one type of intermediary or third party could distort behaviour, in that it may encourage self-employed people to work differently, avoiding those intermediaries that operate withholding.

3.91 Offering it on a voluntary basis to self-employed people who work through intermediaries could be one way of combatting this, but there is a concern that few intermediaries would want to offer this unless they were mandated to. Alternatively, withholding could be mandated for all intermediaries, or for all intermediaries in a certain sector, reducing the risk of competitive disadvantage.

Burden on intermediaries or third parties

3.92 Operating a withholding system is likely to be more burdensome for the intermediaries than introducing a reporting mechanism. However, there are some types of intermediary or third party for whom it could be easier, as they may already withhold for purposes other than tax.

3.93 The OTS has spoken to some companies who already do this; however, it acknowledges that for the majority of third parties, this would be introducing a new burden, and it is unclear whether this would be proportionate to any simplification gain on behalf of the individual at this point. However, the OTS recognises that there may be other benefits, including to HMRCs compliance efforts, but this is not considered further in this report. Further work would be needed to establish those third parties for which it would be reasonable to introduce a requirement to withhold.

Intermediaries do not all handle payments directly

3.94 While it is likely that many intermediaries are aware of the amounts paid to self-employed people, there are likely to be fewer that handle the payments directly. Some may offer only an introductory service with payments being made directly to the self-employed person. Others will have an external payment system through which the money is paid, and so will not have direct access to it. This adds to the complexity of this type of arrangement and would need further consideration.

Landlords

3.95 The OTS has found very little evidence that landlords would welcome payments made through intermediaries or that this would be a proportionate response to prevent them from struggling and falling behind with their tax payments.

OTS survey results

Most respondents did not think it would be helpful for their letting agent (95%) or bank (96%) to pay tax directly to HMRC. Reasons given included:

- low levels of trust in banks and lettings agents
- a preference to be in control of their own tax affairs
- a concern that this could result in more admin if they needed to check the third party had made the correct payment
- any increased cost that may be passed onto them
- the impact on their cashflow

3.96 Several other stakeholders also raised privacy concerns and queried how a taxpayer would be able to contest potentially inaccurate data.

3.97 Accordingly, the OTS do not envisage investigating further at this stage how payments by the generality of property intermediaries would work. However, if third-party reporting was successfully introduced, for example in relation to short-term holiday lettings, further work could be done into the potential of such arrangements.

Annex A
Scoping document

A.1 This scoping document was published on 10th July 2019.

Simplification of tax reporting and payment arrangements for self-employed people and landlords of private residential property

Summary

In the UK, self-employment has grown in popularity over recent years. For most, dealing with Income Tax involves submitting a tax return each year. Although this well-established process suits many, the OTS has heard that some, including those working freelance or in the gig economy, would welcome the option to report information and pay tax to HMRC periodically or on the completion of work assignments, rather than only through self-assessment.

This note sets out the scope of further work by the OTS to explore existing and potential new developments or approaches, including options concerning information reporting and paying tax in or closer to real time (or through some form of withholding) which could make it simpler for people who are self-employed or receive private residential property income to meet their tax obligations in a practical and streamlined way.

The OTS will be carrying out this work over the Summer of 2019 with a view to publishing an initial paper in the Autumn. It is possible this could then be followed by a more extensive review.

Background

Two previous reports from the Office of Tax Simplification (OTS) are particularly relevant as part of the background to this work.

The first is a report the OTS published in July 2018 on the impacts of the platform economy on the management of tax affairs: The OTS heard from those who work through digital platforms, the digital platforms themselves and others, about the concerns that arise through the management of tax affairs. There was an appetite for a system which would feel more like PAYE for self-employed platform workers (without affecting their employment status). The report also explored the possibility of an app for self-employed people to help them manage their tax affairs.

The second was a Technology discussion paper, published in January 2019, which explored a range of wider questions about the impacts of technology and stated that the government should, in particular, consider:

- the potential for applying new technology in engaging with the public to deliver efficiency and cost savings;

- enhancing HMRC's current Personal Tax Account to deliver better targeted guidance and information.

The paper also said the OTS would consider in more detail the idea of introducing withholding tax regimes, which will be one of the possibilities considered in this work.

Scope of work

This work will explore the merits and drawbacks both of existing approaches to tax reporting and payment for self-employed people, such as the construction industry scheme, and of new potential developments or planned approaches to this, including options for information reporting or payment of tax to take place closer to real time.

The objective of this work will be to consider how such processes could be made simpler, or developed in a way that is straightforward to use, so that people can meet their tax obligations in a practical, convenient and streamlined way.

While what follows is expressed in terms of self-employed people, this work will also consider the position of those receiving rent from letting residential property, whether on a short or a long-term basis.

At this initial stage, the work will be open to considering a relatively wide range of factors and possibilities, but only in limited depth. Considering the likely benefits or drawbacks of these will help identify the most promising or necessary areas for further, more detailed work, in the light of the findings made, and in the context of wider developments and discussions with HMRC.

Self-employed people work in diverse ways and contexts, so it is quite possible there will not be one single approach to making things simpler. Also, any changes aimed at simplifying self-employed people's experience of the tax system will need to reflect broader issues, such as the technology available, minimising the burden of any administrative changes involved and ensuring that the right amount of tax is paid.

More specifically, the work will:

- aim to secure the maximum level of direct input from a wide range of taxpayers, agents, businesses, platforms and others such as software providers, through meetings, an on-line survey and potentially wider media engagement, as well as in-depth discussion with HMRC/HMT

- explore the potential segments or populations of self-employed people where their circumstances or business models may point to different approaches or options, and the likely level of interest or appetite for these

- give initial consideration to the merits or otherwise of having different approaches for different groups or creating one overall system with sub-options, and wider trade-offs (such as those between simplicity and accuracy or comprehensiveness, and the costs, benefits and burdens involved), and take account of the significant number of self-employed people using the cash basis rather than accrual accounts

- consider the issues arising with different potential approaches or opportunities for information about self-employed people's income and expenses to be reported to tax agents and to HMRC, whether by platforms, engagers more generally or self-employed people themselves, recognising that some of the parties handle both information and money while others do not

- consider the scope, including opportunities and risks, for self-employed people's tax affairs to be managed in real time or closer to real time, taking expenses into account,
- consider the issues involved where the self-employed person has other income, whether from employment or other sources, and links with personal or business tax accounts
- look at the extent to which such approaches would be best pursued on an optional, incentivised or potentially on a mandatory basis, either from the perspective of the self-employed person, or any other party involved, such as a platform - for whom a level-playing field with others in the marketplace may be important
- the wider practical, behavioural or competitive factors which would need to be considered, both in relation to self-employed people and others including HMRC

In carrying out this work, the OTS will be mindful of:

- the likely implications of recommendations on the Exchequer, the tax gap and compliance with the tax system generally
- the role and contribution of taxation agents
- the government's response to the Taylor review of Modern Working Practices
- HMRC's existing plans for improving the experience of tax for self-employed people
- relevant international experience

Annex B
Organisations consulted

B.1 The OTS has listed below the organisations who gave their time to provide evidence to this review, either though meetings or by providing a written response to the published scoping document. The OTS is grateful to all of them for giving their time to provide evidence and insight.

Airbnb

Association of Local Landlords

Chartered Institute of Taxation

Confederation of British Industry

Employment Lawyers Association

Equity

Grafter

Low Incomes Tax Reform Group

National Farmers Union

Residential Landlords Association

Saffrey Champness

Sage

South West Landlords Association

Taxaid

The Association of Independent Professionals and the Self Employed

The Association of Taxation Technicians

The Association of Accounting Technicians

The Department for Work and Pensions

The Freelancer and Contract Services Association

The Institute of Chartered Accountants of Scotland

The Institute of Chartered Accountants in England and Wales

Tolley

Uber

Validis

Annex C
International systems

Reporting by digital platforms

C.1 Reporting requirements are being focused on globally, so it is not surprising to see that various countries are using technological advances to encourage greater tax reporting. This is especially the case with digital platforms who potentially have access to large amounts of transactional data on those who operate through them and so by reporting centrally to the tax authorities can save the individual from having to report this data themselves.

Spain

C.2 One example is in Spain where recent legislative changes have targeted the holiday rental sector resulting in platforms such as Airbnb having to share hosts' booking information including earnings with the Spanish tax authorities.[1]

C.3 The specific personal information that is required to be shared with the Spanish Tax Authorities includes:

- Identification of the owner of the property
- Identification of the assignor(s) (host(s)) if they are not the owner of the property
- Identification of guests (assignees)
- Property identification: complete address, including the cadastral reference, if assigned
- Number of days of enjoyment of the dwelling for tourist purposes
- Amount received by the host
- Start date of the reservation

C.4 While these changes are unlikely to have been motivated by tax simplification it does result in a richer data set for the Spanish tax authorities. It has been suggested, however, that that not all businesses have complied with the new legislation and that this has created an unfair advantage towards those who do not comply; with hosts who are reluctant to have their income data shared switching platforms. It is also worth noting

[1] https://www.airbnb.ie/help/article/2470/tax-data-sharing-in-spain-frequently-asked-questions?locale=en

that large platforms often operate across many countries and that it can be quite costly for them to comply with many different reporting jurisdictions.

France

C.5 The French enable self-employed people and landlords to consolidate their Income Tax and VAT liabilities into one payment through the micro enterprise scheme.

C.6 This scheme simplifies tax by allowing a fixed percentage of revenues as business expenses and the remainder is then taxed as profit, removing the need to account for accurate expenses, and entitles the owner to pay a lower social security charge. Accordingly, the system removes the need for microbusinesses to produce a complete set of accounts or carry out complicated corporate tax computations.

C.7 This aims to alleviate paperwork, simplify tax calculations, and offer greater certainty to business on their level of tax payments. While the scheme reduces tax administration burdens, it does not necessarily offer a lower tax regime to micro businesses - it is possible they would pay more tax through this scheme than if they were subject to the normal French tax regime. The rates applied and eligibility criteria depend on the business sector but range from a maximum threshold of €170,000 for commercial businesses to €70,000 for professionals. Businesses can exceed these for two years running before being required to move into the standard tax regime.

Australia

C.8 The Australian Tax Office (ATO) operates a scheme known as Pay As You Go or PAYG, which has two components, PAYG withholding and PAYG instalments.

C.9 PAYG withholding is operated by employers when paying employees, similarly to PAYE in the UK, but it is also used for other purposes such as withholding tax from payments to

- businesses or investors that do not quote certain identification numbers
- interest, dividend and royalty payments to non-residents
- any payments to foreign residents
- certain payments to temporary residents departing Australia

C.10 Annual reports must be lodged with the ATO summarising payments subject to PAYG withholding and the amounts withheld from them, unless the payments have already been reported electronically when made.

C.11 PAYG instalments are regular payments that self-employed people or investors can make to the ATO towards their eventual tax liability for the year. The object is to enable taxpayers to spread their liability over the year and avoid having to pay a large tax bill when lodging their return. In certain circumstances the ATO will enter people into the system, but it is also possible to enter voluntarily and the ATO provides a calculator which helps people decide whether it is in their interests to do so.

C.12 Taxpayers can either ask the ATO to calculate their instalment payment for them based on their latest tax return, or, if eligible, they can apply a rate provided by ATO to their instalment income. The latter method may be preferable if the taxpayer's income fluctuates from one instalment period to the next. If too much tax is paid, any overpayment will be refunded at the end of the year; and if too little, the taxpayer must make up the difference on receiving their assessment. Taxpayers can vary their instalment payments if they think they will pay too much or too little, but if the variation results in their paying less than 85% of the total due, they may incur an interest charge and penalties.

Russia

C.13 From 1 January 2019, the Russia tax authorities have introduced a new tax regime in four regions of Russia: Moscow, Moscow region, Kaluga region, and Republic of Tatarstan.

C.14 The system changes the way in which professional income is taxed – where services are rendered for individuals, the tax rate is 4%. If services are rendered for legal entities or individual entrepreneurs, the tax rate is 6%. Tax is payable on a monthly basis. Individuals paying tax on professional income are not required to pay personal Income Tax or social insurance contributions.

C.15 This new system is not compulsory, with individuals and individual entrepreneurs having an option to switch to this special tax regime via a special app from the Russian tax authorities.

Estonia

C.16 Estonia has since the early 2000s, focused on ways to digitalise interactions with government departments.

C.17 Their tax system is ranked the most competitive in the world (UK is 14th) and a recent development has seen the introduction of an Entrepreneurs account. This is a bank account aimed at individuals who provide services to other private individuals where there is limited expenditure in advance such as child minders, gardeners and those carrying repair type jobs where the person engaging them supplies all the tools and materials. It is also suggested that it might be useful for individuals who provide their services through ride sharing platforms such as Uber or Taxify.

C.18 As well as the provision of services the Entrepreneur's account is also aimed at those who sell goods that they have made or prepared themselves such as handicrafts and artwork or homemade food products. The main benefit of the account is that it is designed to operate relatively free of bureaucracy and allows for financial statements, monthly tax deductions and the payment of taxes to be made to the tax authority automatically.

C.19 Any income entering the account up to €25,000 in a calendar year is taxed at a flat rate of 20% and at 40% on anything over this amount.

C.20 The account does not have the option to be able to deduct expenses so is not suitable for anyone who has large amounts of expenditure. It is also not suitable for anyone who is registered for VAT.