

## Making Tax Digital consultations

### Response by the Office of Tax Simplification to the six consultative documents

#### 1. Introduction and overall comments

- 1.1 The OTS has taken a close interest in MTD since its announcement. There are obvious synergies with simplification; we are linking to ABAB<sup>1</sup> (and hence the Digital Advisory Group) and would generally endorse their comments but will make our own points from a simplification standpoint.
- 1.2 Our comments are based on a combination of:
- our own analysis of the proposals, informed by our previous work and relevant recommendations
  - the knowledge and experience of our team
  - comments made to us during meetings and seminars, though we would stress that these have been collected whilst discussing other OTS projects (primarily our current Corporation Tax project or the Small Company Taxation work); we have not undertaken a formal evidence gathering exercise on MTD
- 1.3 The consultation foreword states that “Businesses want a simpler tax system” and “We want to create something that is more effective, more efficient and easier for taxpayers”. These are laudable aims but the crux will be whether once the system is up and running businesses are prepared to say that the system is more effective, more efficient and easier, with the corollary that it is simpler and cheaper for them to deal with. We would also note that the comment from business refers to a desire for a simpler tax system both technically and administratively – aims that are of course key to the OTS’s work. But MTD is primarily about reporting and although there are related simplification of system proposals (for example with the changes to the opening year rules for the self-employed) it is disappointing that there isn’t a greater commitment to simplify the tax system. That would facilitate MTD.
- 1.4 One of the main reasons for mandation is that HMRC consider this will help close the tax gap, and will enable yield to be scored as part of the Budget arithmetic. This in turn justifies the necessary investment in HMRC’s systems. Although that has become known to some within the stakeholder community, it is not something that is generally understood.

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<sup>1</sup> The Chair of ABAB (Administrative Burdens Advisory Board) is a member of the Board of the OTS and our Tax Director sits on ABAB and the Digital Advisory Group.

1.5 We think that HMRC should be open about this as it will help many understand the drivers. At the same time, it would have been productive to have invited contributions as to how to close the tax gap without mandation.<sup>2</sup>

### MTD challenges

1.6 The key points/challenges in delivering MTD have been from the outset, and remain:

- will HMRC deliver? There is huge reliance on IT (apps and general software) and a track record of HMRC systems being late. We appreciate HMRC are working with and relying on software providers but that does not alter the general perception. People also wonder whether HMRC will be able to do anything more with the additional information being delivered to them
- will this produce an overall admin saving to businesses? There is much cynicism over how doing four (or five) updates a year can ever be cheaper than one return. Again, the feelings are hugely influenced by experiences with RTI and iXBRL and particularly over whether HMRC will recognise transitional costs as well as long term savings
- mandation – we know this is driven by HMRC’s view that the change will help close the tax gap, and thus the ability to ‘score’ yield, but the fear from taxpayers/business (again with RTI & iXBRL scars and the reliance on IT deliveries) is that at the end of the day the law will simply say ‘you have to do MTD quarterly reporting’ whether or not things are ready

1.7 Overall, it is difficult to see the benefits to business owners. They are merely delivering the same (or possibly more) information digitally. The incentive appears to be the oft-repeated benefit of accuracy and clarity in their affairs but this isn’t proven. Although an earlier indication of tax liabilities will be helpful to some, it is unlikely to be seen as a major benefit.

1.8 We have always argued that systems should be developed on a carrot rather than stick basis, i.e. that the pressure should be on HMRC to design a system that people want to use rather than (in effect) using sticks to force taxpayers to make the best of it. Compulsion is fine if the software, tools and so on are in place, tested and working and people are showing they are engaging with the system and finding it is indeed easier.

1.9 In many ways the biggest concern is: is the MTD timescale really realistic? The project looks more like a 3-5 year plan rather than 18 months-2 years.

### Which businesses should be brought in?

1.10 We are concerned that mandating all businesses – except those below a £10,000 turnover (not profit), itself below the personal allowance – will add much complexity to many of those

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<sup>2</sup> In the OTS small business review on HMRC administration

([https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/199179/01\\_ots\\_small\\_business\\_tax\\_review\\_hmrc\\_administration\\_280212.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/199179/01_ots_small_business_tax_review_hmrc_administration_280212.pdf)) we said at para 3.4:

*“Focusing on individual business owners highlights the considerable role that emotion can play in HMRC’s relationship with small businesses. Fear and anxiety are particularly important: the perception that tax requirements are constantly changing and that innocent errors will be punished severely are recurring themes..... Businesses and advisers have highlighted the perceived asymmetry in the standards that HMRC expects and those HMRC maintains in its own conduct....The resulting lack of confidence and trust can generate difficulties with a wide range of administration issues and can deter business owners from engaging with tax issues. Most worryingly, this lack of confidence can persist over the lifetime of the business. **The OTS believes that HMRC can take action to help to overcome the negative presumption about HMRC initiatives by demonstrating a desire to act in the taxpayer’s interest**”.* At the time HMRC accepted the point: it is worth reflecting on what can be done to ensure MTD reflects this principle.

affected. It will potentially create a large burden for HMRC in terms of helping those affected with a new and unproven system.

- 1.11 The consultation promises a one year delay for businesses above the £10,000 threshold but below a certain level. We endorse this as a way of excluding the very smallest businesses, but would raise two points:
- the £10,000 figure, although a simple round number, does not link to anything; would it be more logical to frame the exclusion in terms of the personal allowance figure? (Although we acknowledge that is a figure that will change most years.)
  - we question whether the 1-year delay should be definitive at this stage: it should await the success of the first stage of MTD
- 1.12 As for the level, it would surely be better to introduce the requirement in stages: bringing in those businesses that are already involved with VAT – and so used to quarterly electronic reporting – would surely be the best way to start. That means all those registered for VAT, not just those above the registration threshold.
- 1.13 There is an argument for landlords being treated differently from general traders and allowed a higher threshold than the £10,000. Simplicity, though, suggests that there should be a single limit. If the ‘VAT registered’ level is used initially, that would mean that landlords generally would not be in MTD initially. This is probably appropriate as we suspect landlords generally will not have digital records (of the sort HMRC desire) at present.

#### **Administrative savings**

- 1.14 A key issue is convincing businesses that there will be an admin saving for them with MTD. We do not doubt HMRC’s commitment to trying to secure and demonstrate this but there is a long way to go before people are convinced. It is naturally difficult to show admin savings at this stage in the project but it would be possible to commit to something that would resonate and show HMRC is serious in this regard.
- 1.15 Our lead suggestion is that a commitment is made to integrating iXBRL reporting with MTD for affected businesses. We are regularly told by businesses we meet that iXBRL reporting remains an additional burden for them: it is not, as at one stage envisaged by HMRC, proving to be a one-off change but one that requires time, effort and cost each year. Surely it should be possible to commit to working towards a single reporting framework, effectively replacing iXBRL with MTD?
- 1.16 For small businesses in general, one of the key issues will be whether existing spreadsheet-based systems that many use can be easily adapted to the needs of MTD. If Excel and similar systems have to be ditched and replaced with new systems, when the existing systems are satisfactory for running the business and reporting to HMRC, that will be a major complexity (and cost) for those affected.
- 1.17 On penalties, the “soft landing” should be “none will apply” until such time as MTD is established as running properly. The Administration condoc suggests the new penalty regime will not apply until 12 months after the new update obligations come into effect: we are unconvinced this is sufficient and fair.

#### **Simplification first**

- 1.18 The OTS focuses on simplification and much of our past, current and future work has looked at aspects of business taxation. We are currently looking at streamlining the corporation tax

computation and are optimistic that we will be able to develop useful simplifications that will facilitate MTD for companies. Naturally we will be liaising with the MTD project team.

- 1.19 It would surely have been better to simplify income tax for business before requiring such businesses to embark on MTD. We do though welcome the proposals to simplify the opening year rules for businesses (something that stems from earlier OTS recommendations though arguably does not go far enough<sup>3</sup>) and the cash basis for landlords (which we envisaged would be covered by the cash basis when we recommended it).

### General points

- 1.20 As a general observation the main document in particular is so long as to obscure its message. The various case studies should be in a separate document or at least in an appendix. To have as many as 44 questions in one document does not feel like a manageable consultation; it is swamping.
- 1.21 The case studies in the condocs focus attention on small businesses, usually very small ones. MTD will apply to medium and large businesses as well so we wonder if they have had the equivalent level of attention to date. The assumption may be that these organisations are sophisticated enough to adapt more easily; although they are probably keeping digital records already, we are not sure this is always the case and they are likely to have more complex systems to adapt. There is reference to another consultation for larger and more complex businesses; this should be published as quickly as possible.

## 2. The Office of Tax Simplification

- 2.1 The OTS is an independent office of HM Treasury, established in 2010 to provide independent advice to Ministers on ways of simplifying the UK tax system. In developing our recommendations we carry out extensive evidence gathering from all those involved with the tax system – businesses large and small, individuals, representative bodies, advisers and HMRC. Our recommendations cover both technical and administrative aspects of the tax system.
- 2.2 The OTS is now established on a statutory basis by FA 2016 with an expanded remit. As well as researching specific areas of the tax system as requested by Ministers, our new remit now puts greater onus on the OTS to actively seek areas of complication and responding accordingly. And it is in that context that we comment on this consultation.

## 3. Bringing business tax into the digital age

- 3.1 As a preliminary point, we note that at 1.4 the document states: ‘...businesses want more certainty over their tax bills and don’t want to wait until the end of the year...’. We would in principle endorse this and indeed we have often argued that certainty is an important component of simplification. However, there are two aspects to the statement we have highlighted:
1. *businesses don’t want to wait to the end of the year to find out how much they have to pay*: yes, MTD may help in this aspiration
  2. *desire for more certainty over their actual and final tax bill*: MTD does not address that at such

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<sup>3</sup> Not least because it does not at the moment seem to extend to partnerships – which was the foundation of the OTS response. Why cannot partnerships benefit?

- 3.2 There is still much to be done to increase certainty, as the OTS has recommended in various areas. One of the biggest risks with MTD is that businesses simply end up asking for more help from their agents to ensure they comply with their new responsibilities.

## Chapter 2

- 3.3 Q1: As we have highlighted in our general comments, MTD depends on the availability of software tools. As para 2.10 says: 'We expect digital tools to be produced...'. We appreciate HMRC are working hard with the software industry to ensure the delivery of such tools but we wonder what happens if the tools are not available or, at least as important, available in good time? That issue has been raised with us by stakeholders who ask why MTD's introduction is not phrased in terms of: 'MTD will only be introduced when digital tools are ready'.
- 3.4 A key challenge is the question of whether Excel (or similar spreadsheet products) will work in some way under MTD. Many small businesses keep records in Excel (either directly or their advisers do). To them that is digital but it does not go far enough for what is wanted here – so it seems Excel users will have to migrate. We note that para 2.12 acknowledges the point and states that the issue is being explored but if the result is that excel users do have to start using something else, that will potentially be a significant burden.<sup>4</sup> It would be a major source of requests for financial assistance (or free HMRC replacement software) for the costs of moving to MTD.
- 3.5 A key challenge with software is simply convincing businesses and landlords that appropriate digital tools will be available and won't require wholesale reengineering of their business processes.
- 3.6 Q2: The issue around information and guidance on software is in many ways a simplification issue. Many people will say 'don't give me information/guidance, tell me what I should use'. HMRC clearly envisage that many small businesses will choose their own software. In such cases we think many of these businesses will expect HMRC to provide recommendations, as they are laying down the requirement. HMRC needs to grasp this nettle and be prepared to signpost ways to appropriate software, if only in setting out clear criteria for what the business should look for, possibly with others then kite-marking products. Choice takes time and adds complexity.
- 3.7 For some specific sectors, such as pubs and contractors in the building trade there may be trade-specific software available, and information about this would be most helpful to businesses. We recommend HMRC approach as many trade associations/bodies as possible to discuss this with them. At a minimum, the trade body will want to be in a position to provide its members with routes to choosing appropriate software.
- 3.8 Qs4 & 5: The questions around the type of support that would be appropriate for those gearing up for MTD is not easy to answer. It must be borne in mind that this is not simply buying new hardware: costs extend to developing necessary expertise and what many will see as wasting time on requirements that have no relevance to how they run their activities.
- 3.9 Accordingly there are costs to consider in terms of:
- cost of acquiring hardware
  - cost of acquiring software

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<sup>4</sup> This also raises vistas of complaints around 'how can HMRC tell me/my clients what records they have to keep and how to keep them' with overtones of the business records checks debate.

- training and development
  - fees to agents for support and education (or simply dealing with MTD)
- 3.10 Whatever support is offered, there may be difficulties in identifying the costs that should be supported with a risk of there being complex rules to navigate. There will also be a timing issue: some who have already invested in the necessary equipment and training will be irritated if latecomers get additional support that is denied to them.
- 3.11 We would naturally opt for a simple, pragmatic rule around support. That would suggest an enhanced tax relief<sup>5</sup> for software, digital tools and training spend directly related to MTD preparation. That needs to be introduced before the MTD deadline to encourage proper preparation. However, we recognise such a system may be difficult to police or be open to abuse and risk needing additional rules which then mean it is not simple. It may be that a compromise could be allowing such a deduction for businesses with a turnover under £X, reducing the exposure for HMRC but risking some deserving causes not qualifying.
- 3.12 If free software is made available as HMRC envisage, that should not obviate support for buying software that does more for a business than the free version.

### Chapter 3

- 3.13 In para 3.6 it states that legal requirements for keeping records will remain ‘broadly unchanged’: if the change will involve anything more than strictly necessary adaptations to a digital environment that needs to be spelt out quickly.
- 3.14 There should be an opportunity to more align the profits based taxes and VAT in terms of processes and record keeping requirements. Paras 3.6/3.7 suggest this will not be looked at – which must be an opportunity missed.
- 3.15 Q7: This is much about the capabilities of the software. Will the software available actually record automatically the amounts on the invoice/receipt? We assume that in many cases there will still be a need to manually enter the amounts and other details. That work should reduce future input time and adjustments but the need to categorise the expenditure for tax purposes remains the same.
- 3.16 Much comes down to HMRC’s requirements: no doubt many businesses will say that their existing systems and records work for what they need so any additional requirements will be down to HMRC.
- 3.17 The example in Fig 3.1 (Eve) envisages that the taxpayer will be able ‘...to capture her receipts closer to real time...’. There is a cost benefit here for the taxpayer: making sure that taxpayers don’t lose expenses with potentially lower tax bills. We find it odd that more prominence has not been given to this feature.
- 3.18 The comments in paras 3.21 ff about the level of categorisation envisaged seems quite granular but is probably similar to what would be recorded normally, for example tracking property expenses by property (para 3.18) and forming an up-front view about own use percentages (para 3.23). However, it cannot be assumed that payments to a particular supplier will, for example, always be on revenue rather than capital account, so some need for manual checking seems inevitable.

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<sup>5</sup> Probably 150% or 200% for a set period

## Chapter 4

- 3.19 We note that para 4.2 says that no changes in VAT calculations are contemplated. We can understand that to a degree but surely there is an opportunity to align filing, data collection and payments, and facilitate calculating VAT & IT/CT together? This may be difficult but having MTD cover everything would deliver a simpler system. Perhaps a commitment could be given to exploring this<sup>6</sup>?
- 3.20 Qs14 & 15: Offering businesses choices over when to record annual adjustments is logical but that means choice and that can mean added complexity. Provided this is simply allowing the business to make the adjustments when it suits them it is probably the right way to go. However, this doesn't align with the aim of providing more certainty and clarity on tax liabilities on an ongoing basis. It does provide choice but implies an annual "true up" and review. In itself it doesn't pass the test of creating a simpler system as it appears that exactly the same adjustments will be required though this can be done four times a year or once.
- 3.21 The big simplification would of course be that the accounting and taxable profits should be more closely aligned. The OTS is looking at how this might be achieved for corporation tax, which may feed into MTD for companies. It is unfortunate that there will not be an opportunity to undertake a similar exercise for unincorporated businesses before MTD mandation.
- 3.22 Q16: It is logical to allocate personal allowances and rate bands on a pro rata basis to submissions, with the second and subsequent periods being calculated on a cumulative basis, as is done with PAYE. However, if this is to give a sensible estimate of the tax bill for the year there has to be the clear caveat 'this assumes you continue to trade at the same level and profit for the rest of the year'. Plus of course if there are year-end adjustments, that will affect the figures substantially.
- 3.23 For loss relief, para 4.35 suggests that the software will suggest options for loss relief utilisation. That could be quite difficult for the free software (or indeed basic paid-for software) to deliver.
- 3.24 Q17: we support the aim of bringing partnerships into MTD and '...sweep away a whole tier of the current process...' as this is very much in line with recommendations in our partnerships reports. We agree with focussing on the partnership for reporting and allow information to feed through to partners' digital accounts.<sup>7</sup>

## Chapter 5

- 3.25 Exactly what is required for updating is the crux of MTD in many ways. Para 5.7 talks about 'simple data upload' but that is the big question. Will it be automatic and require no manual intervention?
- 3.26 Q23: para 5.19 discusses flexibility around update cycles. We are not convinced about the 'maximum period of three months' (partly as it's not yet clear why this is critical for HMRC or what they will do with the information each quarter). Could a few days over be allowed?

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<sup>6</sup> Once MTD is bedded in it may facilitate consolidated returns for groups of companies – something the OTS have suggested be looked at in the past.

<sup>7</sup> The OTS partnership reports suggested that the partnership return could be abolished but the nub of our proposal was to eliminate the duplication inherent in partnership and partners' returns. With the development of pre-population, the route in the condoc seems appropriate.

- 3.27 Q24: The one month period for updating seems sensible. But if the updating is automatic it would be tempting to suggest a shorter period, though the problem is that would not allow for sickness/holidays. Harmonising with VAT is logical and although this means that VAT registered businesses will experience a 7 day acceleration in producing quarter end data, we do not believe that the standardisation of the period to one month represents a significant disadvantage, particularly as traders will not be penalised for late returns for the first 12 months of the new regime.
- 3.28 Q25: The discussion of transitioning to MTD (para 5.27 onwards) risks bringing in complexity. The simplest solution would be Option 1, based on accounting periods.
- 3.29 In passing we have to note that aligning the tax year to 31 March to avoid the complications of 5 April would simplify matters. We accept this is well outside the scope of MTD but it is something we have raised before and the difficulties caused by the UK's odd year end will only increase as the tax system modernises.
- 3.30 Q26: The comments in para 5.44 onwards about notifying amendments does raise concerns about the nature of amendments. The initial question is whether amendments would be needed to the update, or whether they'd be subsumed into the next update? Why does it matter if it's all going to be trued up at the end of the year anyway?
- 3.31 If amendments to previously-reported data need highlighting, will this be more detailed than VAT corrections? (Which is another argument for integrating VAT and IT/CT reporting as far as possible.) HMRC suggest that it is important that software records and displays amendments but we are not sure that taxpayers will feel that is necessary, especially if they are simply correcting an error.

## Chapter 6

- 3.32 Q27: Finalising the regular updates should be separate from the regular updates; that permits the taxpayer or his agent to carry out any additional reconciliation work and perform year-end adjustments without interfering with the normal quarterly submissions. However, this does mean that the trader is inevitably going to be making five updates for the year: this needs to be borne in mind when assessing the administrative burden impact.
- 3.33 Q28: The document talks of bringing end of year activity into line with CT, but then proposes a period of 9 months from the end of the AP, some 3 months shorter. It should be remembered that for an AP ended 30 April, this will advance the end of year activity by 12 months (from 21 months after end of AP to 9 months). That apart, 9 months to complete adjustments seems appropriate but we wonder if an aim should be to simplify the system such that the finalisation can be done considerably more quickly.

## Chapter 7

- 3.34 Q 29: excluded businesses – apart from size the main criteria should be in terms of inability to engage digitally.
- 3.35 Q30: The general exclusion of charities seems odd, especially now there is a £10k de minimis limit. If MTD is so easy and useful why shouldn't charities be in? There would surely be an opportunity to integrate MTD with Gift aid reclaims as an incentive for smaller charities; as for larger ones, they are often substantial businesses and as able to cope with MTD as small non-charity businesses.



- 3.36 In addition, a main objective of MTD is to help HMRC close the tax gap; do not charities contribute at all to this?
- 3.37 If MTD is brought in for VAT-registered businesses initially, that would itself exclude many charities.
- 3.38 Certainly trading subsidiaries of charities should be within MTD; otherwise such businesses have an advantage over non-charity competitors.
- 3.39 Q32: we think the exclusion of CASCs is more sensible – though again a VAT-threshold limit might be appropriate.
- 3.40 Q34: digital exclusion will need to be carefully assessed in terms of proper broadband coverage as well as individual capabilities.
- 3.41 Q35: We endorse the £10,000 threshold for exempting businesses from MTD and digital record keeping. As many have pointed out, this is below the personal allowance and is also in terms of turnover rather than profit. But, certainly for the introduction of MTD, it needs to be a much higher threshold as we have discussed.
- 3.42 Q36: We would certainly go along with giving the smallest businesses an extra year to prepare. The easiest criteria remains turnover – up to the VAT limit (or VAT-unregistered businesses).

## Chapter 8

- 3.43 Paras 8.28-8.33 refer to the Standard Cost Model and different scenarios considered around 42 obligations<sup>8</sup>. During our work on our current CT review, we have begun to look at whether considered the SCM model for CT does capture all costs that it should. We think there is scope for a review of the effectiveness and appropriateness of the SCM.
- 3.44 Q39: There seems to be an implication in this section that all businesses have an agent. We agree most do but we have had suggestions that the introduction of MTD will mean more businesses turn to agents for support rather than fewer as HMRC seems to expect. At a minimum many will want agents to confirm they are properly prepared for MTD. If the business has an agent engaged, it seems likely that many, if not most, will want their agent to confirm that the quarterly update figures are appropriate. Some will be happy if the agent simply makes sure their systems are properly set up to supply MTD figures; for some it may well mean the agent needs to do more work to safeguard against HMRC enquiring into the figures in subsequent years.
- 3.45 This means that HMRC need to be clear on the standard of accuracy expected of the quarterly updates and appreciate that the more accurate the figures are expected to be, the more businesses will want assurances from agents that they are not at risk of penalties. All of this needs to be taken into account in preparing the impact assessment.

## 4. Simplifying tax for unincorporated businesses

- 4.1 In general the proposals are welcome and sensible; our concerns are twofold:

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<sup>8</sup> It would be useful to publish these 42 obligations and to critically review them.

- we question whether they go far enough, particularly in relation to capital allowances
  - it would be far better to complete the simplifications and let them bed down before requiring the different reporting inherent in MTD
- 4.2 We recommend that HMRC stresses that it is open to making further simplifications, especially in the light of experience with MTD. That will go some way to answering our second main point.
- 4.3 Q1a/b & 2a/b: In many ways we think there is a good argument for there to be no threshold for cash accounting: that businesses should be free to choose the method that works best for them. Larger businesses would normally have advisers to point to the value of full accounts; not having a limit would also obviate the need to have an exit figure. It would be easy to provide general guidance to the merits of cash basis vs full accounts (e.g. 'if you hold trading stock, full accounts would probably be preferable'). However, we suspect that no limit would not be acceptable to the Exchequer and our comments assume that there will be a limit. Twice the VAT threshold make a lot of sense but given the annual changes to the VAT threshold we wonder if it would be simpler to set a figure for (say) five years and commit to uprating it after that period.
- 4.4 In striking a balance, we also are of the view that there is no reason for the exit threshold to be twice the entry threshold, so might suggest that given the likely increase in qualifying threshold, a 50% excess would be sufficient to prevent businesses having to move from one basis to the other too often.
- 4.5 We note that at para 2.4 the effect on Government revenues is highlighted as a concern. This is understandable, but it amounts to a timing difference. The benefit of greater simplification should outweigh this negative effect.
- 4.6 Reforming Basis periods – We regard the proposals as very welcome, long overdue and a real simplification for businesses, which will allow businesses to use their accounting information to manage their business in a way that suits them.
- 4.7 The reforms suggested are limited to sole-traders. Extending to partnerships would result in greater simplification and we do not understand why this is not the case. Not doing so also adds to complexity: what if a sole trader takes on a partner, would the old basis period rules reapply?
- 4.8 Paras 3.15, 3.23: Abolition of basis periods and following the CT example would greatly simplify the system and make it much more understandable for the business owners.
- 4.9 Example 4 at 3.20 shows annual accounting periods, and short accounting periods falling within the tax year, but what about a short accounting period straddling the tax year? The notes don't appear to cover a business making up accounts from commencement on say 1 February to 31 January following year, then to 31 December following year, then to 30 November – would the assessments for the first years each be based on 11 months profits only?

## Chapter 4

- 4.10 Para 4.13: Will the areas highlighted – stock, long-term contracts, bad debt provisions, accruals and prepayments – have a significant effect for the businesses in question? If the businesses are “digital” and using the type of software and tools envisaged in the first paper

are the adjustments really that difficult or will they be automated (by imputing period covered by bills, for example).

- 4.11 Para 4.17: The annual stocktake also ensures stock is not being carried that has no value, giving a more accurate net worth position for the owner, banks and so on. So this is not just a tax adjustment. In this regard, it seems odd to suggest businesses only undertake stocktakes only every other year...surely any sort of business practice is to say these need to be annual?
- 4.12 Para 4.28: Bad debt provisions are similar to stocktake. Flexibility is sensible and certainly there should be no requirement to do quarterly provisions but surely businesses with debtors need to assess them annually at least?
- 4.13 Para 4.30 etc.: Simplification would come from not having to do sundry accruals for utility bills and similar things but many businesses will still want to so as to be able to reduce tax bills. Again flexibility is sensible so this relaxation makes some sense but there seems to be concern about manipulation coming in at para 4.33. Is there some way of writing this so that it is an easy rule but with a general anti-abuse proviso?
- 4.14 Would it be easier to accept the accounting treatment for smaller entities (FRS 102 and 105) – this would ensure consistency across all SMEs and software could be focused on compliance with these standards? There is arguably simplicity driven by consistency across tax and accounting using one set of figures. If tax followed accounts with the “usual” add-backs for depreciation, entertaining would this deliver what is required? The bad debt provision example (4.27) highlights the need for accounting and tax alignment – there is no benefit in removing the need to analyse the provision for tax reasons if there is still a requirement for accounts purposes

## Chapter 5

- 4.15 This section seems to offer little more in practice to the current cash basis rules. The ideas fail to solve the admin burden of deciding whether something is plant or setting; there are so many exclusions that an analysis exercise will still be needed.
- 4.16 The capital and revenue expenditure proposals appear to be replacing one set of complex rules (capital or revenue) with a new set of complex rules (is the asset of longer term value). The fact that the draft legislation at Annex C runs to 13 clauses tells its own story.

## 5. Cash basis for unincorporated property businesses

- 5.1 Overall we think this is a sensible reform and one we contemplated in our recommendation that led to the current cash basis.
- 5.2 Para 1.6 tees up the differences in rules between different sorts of property. We would encourage HMRC to consider the scope for reducing the extent of those differences, to help make the most of the advantages noted in para 1.11. See paras 2.19 and 3.29 as to these differences.
- 5.3 As we have noted earlier, although it is beyond the remit of this consultation, we are reminded of a previous OTS recommendation: to move from 5 April as the year end to 31 March which would make things easier.

- 5.4 Q1/Q2: We reiterate the need to appreciate that giving taxpayers a choice adds complexity, because of the amount of effort (or fees) needed to be able to make the choice. Hence we often prefer a default basis – i.e. ‘This is what you do because it’s the best route for someone in your position but if you need to opt out you can do.’ That was our recommendation for the cash basis, on the basis that only businesses who knew they were going to grow, or had lots of stock, really needed to think about not using the cash basis.
- 5.5 So why shouldn’t the small landlord be in the cash basis automatically? The answer may be that it’s best left to people to decide but HMRC should at least indicate to landlords that the cash basis is simpler in principle – but may not work if you are above income of £X or something similar.
- 5.6 On maximum limit – why put one in? Why not any unincorporated property business? Let them decide (and have cash as the default basis!) We accept that would create a new boundary between trading and property business but what pressures might that cause in practice?
- 5.7 We also note that the rules need to cater for people with multiple businesses, including a mix of trading/services and property rentals.
- 5.8 Q3: Simplicity dictates that it should be one or the other for all businesses. We could see the point in having a very limited split for different categories – residential, non-UK and business probably – and allow separate options for each. But not separate options within e.g. UK residential holdings.
- 5.9 Q4: The changes to the deduction for interest incurred in relation to residential letting is likely to be a confusing area for most landlords, and lead to potential errors, understating the profits of their property business. Moving to a cash basis is likely to exacerbate this issue as the landlord will potentially assume that all (cash) interest is deductible.<sup>9</sup>
- 5.10 Q5 If HMRC are going to want to put the whole picture together, for compliance purposes, then there could be problems with allowing different approaches. On the other hand if HMRC are willing to forgo that, then it’s simpler to allow different approaches, subject to our idea of a default cash basis.
- 5.11 Q7 Simplicity says that the cash basis should rule and so deposits are taxable when received. But they can be significant amounts and therefore would be a cash flow hit when they cannot be used. There has to be some scope in marrying up with good practice and wider requirements – so if, for example, the deposits are put in a separate account so that landlord cannot access them, then they do not count as cash unless and until released/taken.

## 6. Voluntary pay as you go

- 6.1 The key here is to move towards a system that allows taxpayers to make monthly payments with periodic top-ups/adjustments – like so many utility companies do. The proposals here go a long way to meeting this aim, but there is more to do. This also needs to be a system that allows the taxpayer, their agent and HMRC to all see exactly the same data.

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<sup>9</sup> We would note in passing that the wear and tear allowance (repealed from April) would have been more straightforward for quarterly updates that renewals/repairs adjustments

- 6.2 There is an assumption that all businesses will be able to make electronic payments. It is not clear that is the case.
- 6.3 Para 2.6: Mention is made of restricting the number of payments due to “systems capacity”. This seems odd: surely maximum flexibility should be just that?
- 6.4 Q1: The main aim has to be to give taxpayers flexibility; an element of paying what they want when they want (and with access to repayments) but in full knowledge of the implications.
- 6.5 Q2: The aim has to be that taxpayers’ accounts show clearly what is happening in a format that taxpayers readily follow and understand. Reference needs to make back to what taxpayers said in the early years of self-assessment which shows what not to do!
- 6.6 Q3: The period of grace before a voluntary payment is used (para 2.16) to enable a non-voluntary payment against due date liability appears complex. Taxpayer accounts must show what is happening and offer a facility for correction of misallocation. Plus the simple requirement of prompt credits of payments.
- 6.7 Q4/5: The general rule should be a FIFO basis (as with credit cards) subject to specific taxpayer allocation. The taxpayer must be able to reallocate payments if the system does an automatic allocation not in accordance with the taxpayer’s wishes/instructions.
- 6.8 Q6 & 7: We would expect a ‘If you need to seek a repayment’ option in the system (which only appears if you’re in credit?) which first takes the taxpayer to a screen explaining consequences and ending with a ‘do you want to proceed’ box before you get at the actual mechanics of so doing. Putting a restriction on repayment ‘...shortly before a liability becomes due’ could be difficult to manage?
- 6.9 Q8: The Payment on Account section (3.1 onwards) is confusing. If basis periods are being reviewed (see above on Simplifying Tax for Unincorporated Businesses) it would seem sensible to tie the payment system to this, and tailor the new payment regime to the new basis periods. It doesn’t seem sensible to separate the reviews.
- 6.10 The classic gas/electricity bill approach has merits (even if they don’t always get it right!). In other words, HMRC contacting the taxpayer (by e mail or flag on the account) saying ‘your payment seems to be too high/low – have you considered revising’. But then rather than doing the gas/electricity approach of ‘we have therefore changed your payment to £x’ perhaps saying ‘if you need assistance in revising your payment contact us/your adviser’.
- 6.11 Para 3.10 – could we have a simpler system for interest credits and debits i.e. the same applying across all taxes? This would be a real simplification (which is why such a system is suggested in the Administration paper at 4.10 onwards?).
- 6.12 Q10: For the system to be as flexible as possible, there should be an option for the firm to deal with the tax payments on profits if that is the choice of the firm, or for individual partners to make their own tax payments if that is preferable to them. We realise that this would add some complexity for the systems constructed, but for voluntary payment take up to be maximised it needs to replicate what firms are doing under the current system, The system has to provide for the PwCs of this world, or the City asset finance partnerships, to make payments as a firm, rather than expecting all the partners to do it. The system should allow for

PwC to send in a payment together with an allocation statement – or of course to be able to access partners’ accounts and make payments there (so there is a link to Q11).

- 6.13 Q11: We agree that the system needs to facilitate third parties making payments: husband & wife, parent & child, partnerships etc. We don’t see any need to put any special restrictions on third party payments – if a payment is made and the taxpayer asks HMRC for it back, that’s up to her: she will still have the liability.
- 6.14 Q12: OTS has certainly had calls for a flexible payment facility such as HMRC are heading towards. It keeps coming back to the carrot or stick approach. HMRC tend to design/introduce things with sticks (e.g. MTD) whereas OTS prefers carrots (i.e. make it good so people want to use it). Per HMRC, people do want to manage their payments and not keep getting annual or bi-annual huge bills (OTS endorse this, particularly the latter) – so offer a sensible facility that works how they want to work and sit back and wait. Then take feedback and improve it.
- 6.15 Q13/Chapter 5 – the QIPS regime for CT allows flexibility if amounts have been overpaid so it should be possible to give the same flexibility here.

## 7. Tax Administration

- 7.1 We recognise the need to adapt compliance and enquiry powers to fit with MTD. Our main observation here is to encourage HMRC to keep in mind the potential for there to be situations where it could be simpler to have a single enquiry embracing multiple issues (e.g. across income tax and VAT).
- 7.2 In general, we welcome the proposals to modernise penalties for late submission and late payment, as per our penalties report<sup>10</sup>. The proposals set out appear to be logical and therefore easier for customers to understand. The key is that taxpayers understand what is going on, are able to access information and have time to remedy things. Penalties must aim to penalise bad behaviour and encourage compliance through prompts, and not impose significant, escalating penalties for simple mistakes or business misfortune.
- 7.3 The aim must be to develop a fairer system of penalties than the current one.
- 7.4 Q3.1: 12 months is the minimum length of time needed. We think that the MTD system needs to be fully up and running, tested and proved before penalties are set in motion. Only then should penalties start fully.
- 7.5 Q3.2: The digital tax account needs to show the customer a clear ‘audit trail’ of how penalty points have accumulated and when they will expire. This will encourage customers to focus on compliance in search of a “clean slate”. This may require a separate box or analysis note on the DTA.
- 7.6 Q3.4: We agree with the penalty points system but are troubled that a business that has multiple obligations (for instance someone with more than one trade or a trade and a property business) could get into difficulties and so start to accumulate penalties very quickly, even under the outlined new system. Partly for these reasons, we think that more frequent submission obligations need more leeway for example monthly items should only attract

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<sup>10</sup> <https://www.gov.uk/government/publications/tax-penalties>

penalties after three late submissions whereas quarterly obligations should perhaps attract penalties on the second late submission.

- 7.7 Q4.4: We agree with penalty interest (para 4.19 – but having two tiers of interest pre and post a 14 day period risks complexity. Would it be better to have one rate (above commercial loan/overdraft rates – say base rate plus 5%) which is charged from the due date if the 14 day period is exceeded?
- 7.8 Section 5 on interest: The present interest position on VAT (which is not spelt out) is especially odd; especially as regards the treatment of error notifications (aka voluntary declarations).

## **8. Transforming the tax system through the better use of information**

- 8.1 We support the aspiration in paras 1.5 and 1.6. It is all heading in the right direction of trying to make the tax system less burdensome for taxpayers by making better use of data that HMRC already has & not asking taxpayers to fill in forms with data that HMRC already hold (for example NIC reconciliations).
- 8.2 The key is to design processes so that the reporting of data to HMRC fits in with the information providers' own systems and processes. This will ensure that additional burdens are not imposed unnecessarily.
- 8.3 Information being requested should be clearly needed for relevant purposes. It should be possible – indeed it should be a requirement – to demonstrate to taxpayers who provide information how their input will facilitate theirs or others' compliance. This should not be HMRC just gathering further information which might be useful.
- 8.4 There are obvious links to the issues raised in the Gig/sharing economy; collecting data from platforms, for example. This would require platforms or similar organisations to collate this data and provide it to HMRC (Chapter 5 deals with this). New processes will have to be developed which will bring complexity to the information suppliers, if not to taxpayers
- 8.5 Q4: Joint assets (para 3.9) simplicity would be enhanced if HMRC and the third parties worked out how to allocate joint income (or operated on a default 50:50 basis) rather than leaving this to the taxpayers to revise their tax accounts.
- 8.6 Q5 & 13: Not all information providers will be large businesses with sophisticated systems. For example, there will be cases where the information will have to be supplied by a small organisation – potentially a small company making returns of dividend payments. It is important that they can use an approach that is simply for them and with minimal burden. But in principle HMRC getting and using full non-ISA dividend income information is desirable, especially from listed companies or funds.
- 8.7 Careful consideration will need to be given to the time allowed to provide the information. Continuing with the dividend example, if the small company were allowed to make the information return as part of its general tax compliance there would be little extra burden. But we appreciate that may not be in sufficient time for pre-population.
- 8.8 Also need to make sure that HMRC get and use information from other governments departments – mainly DWP.

8.9 Q8: Section 3.12ff sounds reasonable but may prove time-consuming. The crux is that there needs to be a simple procedure for the ordinary taxpayer to deal with HMRC saying “the bank told us this” then convincing the bank they have it wrong or HMRC that they have allocated it to the wrong John Smith. Alternatively, they need to be able to correct the prepopulated information, and provide an explanation on-line, which may or may not then lead to an enquiry.

The Office of Tax Simplification  
31 October 2016