HMRC
Making Tax Digital
Simplifying tax for unincorporated businesses

3 November 2016

About ICAS

1. The following submission has been prepared by the ICAS Tax Committee. The ICAS Tax Committee, with its five technical sub-Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

2. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members in the many complex issues and decisions involved in tax and financial system design, and to point out operational practicalities.

General comments

3. ICAS welcomes the opportunity to contribute to the consultation 'Making Tax Digital: Simplifying tax for unincorporated businesses', issued by HMRC on 15 August 2016.

4. ICAS supports the overall objectives of 'Making Tax Digital' (MTD), as set out by HMRC in December 2015. The four 'foundations' are laudable goals, but we have significant reservations about the timescale and the mandatory approach and particularly so for small and medium enterprises. To describe MTD as a reform of tax compliance obscures the reality that it is a colossal IT and change management project affecting some 5.4 million businesses and many more taxpayers. A project on this scale needs careful risk management to maximise both its success and acceptance by users. For instance, RTI was introduced with the largest employers that had dedicated payroll staff who could identify and assist in ironing out any difficulties with the system, before it was cascaded down to smaller businesses. A similar approach is recommended here.

5. Making Tax Digital is something of a misnomer. The key business impact is making accounting digital, within narrowly defined parameters. For businesses currently using accounting software and preparing quarterly management figures, the transition to quarterly digital tax submission may be relatively straightforward. The businesses primarily falling within this category would be those with a turnover of around £1.5 million or more. For small businesses, particularly those with a single owner manager, the challenge in terms of available time, and the costs of maintaining real-time digital records and making quarterly tax submissions is immense. Many of these small businesses use spreadsheets and HMRC should make sure that MTD can accommodate these.

6. Use of MTD should be voluntary or, at the very least voluntary for an initial period whilst the system beds in.

7. ICAS is concerned that MTD proposes that full accounts may be dispensed with for many unincorporated businesses. However, accounts are not simply about tax. They are about profitability, the need for accurate information for decision making, and lending and creditor decisions. We believe it is a mistake to view the proposed changes in tax-only terms and that whilst cash accounting should be a useful simplification for micro businesses, it is not appropriate for more substantial businesses. Without full accounts, there is a danger that far too many businesses will have a lack of understanding, and hence control, over their affairs.

8. We also question how a revised set of tax reporting standards would bring simplification. There would be the options of:

    - cash accounting
    - HMRC GAAP light, and
    - GAAP accounts

    For businesses that needed full accounts there would be the accounting options of FRS 102 UK GAAP accounts or for the micro business FRS 105 accounts. The addition of

HMRC GAAP light is likely to be confusing. We also question how consistency will be maintained and how GAAP light will interact with true GAAP. Has HMRC discussed this proposal with the Department for Business, Energy and Industrial Strategy or with the accounting standard setting bodies?

9. We also remain very concerned about the negative messages about tax agents which are being suggested by publicity around MTD, and the exclusion of agents from viewing their clients' online accounts. Development of agent services consistently runs behind the development of the business and personal tax accounts. This is causing major problems for agents which need to be addressed urgently. We believe agents are vital to implementation and every effort should be made to work with agents and ensure that they can assist their clients in dealing with the huge challenge of MTD.

Specific questions

Question 1a: What level do you consider to be an appropriate turnover entry threshold?

10. Cash accounting should be a natural fit with making quarterly submissions to HMRC. However, the suggestion to increase the turnover limit for cash accounting – both at entry and exit levels - could potentially mean some businesses would remain in cash accounting until turnover reached £332,000 (four times the VAT registration threshold, and double the proposed entry limit).

11. This raises a fundamental question: who needs accounts? Accounts are not simply about tax. They are about profitability and managing a business effectively. There is a danger in viewing the proposed changes in tax-only terms. Certainly, there is simplification in cash accounting and cash basis submissions to HMRC. But looking to the wider picture, how high should cash basis turnover limits be set before accruals basis accounts are needed in order, for example, to access losses in the early years of a business, support loan applications, enable effective business decisions and determine profit allocation between partners? We believe that the suggestions in the consultation set the threshold too high and ignore important reasons for preparing proper accounts.

12. Paragraph 2.10 of the consultation points out that the original cash basis entry threshold was set by reference to the VAT registration threshold to ensure consistency across taxes and to reduce complexity. The VAT threshold is also reviewed annually. These reasons remain compelling. As noted above there are also other reasons for keeping larger businesses outside the cash basis. ICAS therefore considers that the entry threshold for the cash basis should remain at the VAT threshold.

Question 1b: For a threshold not linked to the VAT threshold, should it be reviewed annually in the light of inflation or less frequently (please state recommended interval)?

13. We do not think the threshold should be de-coupled from the VAT threshold, but if should it be, it would need to be revised annually in line with inflation to prevent it losing its value.

Question 2a: If the entry threshold were to be increased, do you agree that the exit threshold should continue to be set at twice the entry threshold?

14. See our comments under question 1a above.

Question 2b: If the entry threshold were to be increased, do you agree that the UC threshold should continue to be set at twice the entry threshold?

15. No: this would become too high. If the entry threshold were to be increased, we would not see a need to have a different, higher threshold for universal credit.

Question 3: Do you agree with the proposed approach of following accounting periods? If not, what alternative approach would you support?

16. We are sympathetic to the aims of paragraph 3.13, to simplify the rules around basis periods, to eliminate the overlap period, and to bring trading profits onto a current basis of assessment. In broad terms, the proposals for periods of account are welcome.

17. Small businesses might find it useful to have a series of shorter accounting periods but it only makes sense if they are using the cash basis, probably using Pay as you go, and probably if they are unrepresented. However, given the End of Year procedure outlined elsewhere this may cause confusion.

18. For those outwith the cash basis, using accruals and adjustments, capital allowance claims and so on, there needs to be end of year adjustments. In effect, therefore the quarterly submissions are just an admin inconvenience and the real calculations will only happen at the year-end on the basis of the year's results.

19. However, there is a lack of clarity about how the approach to trading profits, which are only one part of the overall tax liability, would align with the personal allowance, other sources of income and reliefs, and also with tax administration. There is scope for confusion if accounting periods are not aligned with the tax year. Also, one would not expect the end result of this to be an end of year return after 9 months and a 31 January filing deadline for other income.

20. It is currently not at all clear whether the DWP and HMRC will accept one report for both tax and UC and this needs to be addressed if the aim of government digital processes is to minimise input of information by the citizen.

Question 4a: Are there any other events or situations which would require additional rules?

21. See our comments immediately above.

Question 4b: Would it be helpful to make any changes to tax accounting periods for any other types of income?

22. We do not believe it would be helpful to change the tax accounting periods for other types of income (except possibly property income, although this would only really be helpful if someone had a property portfolio effectively run as a business ie not just letting out a home that the owner used to occupy and might return to or does not want to sell). Savings income, dividends etc should remain on a fiscal, tax year and 31 January deadline.

Question 5: Are there other end of year adjustments not listed in paragraph 4.13 which could be simplified within a reduced reporting framework?

23. No; we do not consider that businesses which are too large to use the cash basis should be encouraged to give up GAAP accounting. This is likely to be detrimental to business development and profitability. Businesses and their advisers are familiar with GAAP so it is hard to see that this approach would be a worthwhile simplification. We discuss this further in our response to question 6 below.

Question 6: Would you welcome the four relaxations proposed?

24. Removing elements of generally accepted accountancy practice may simplify the preparation of accounts for submission to HMRC but, as an institute of chartered accountants, we have serious concerns about any such move for the reasons discussed in our general comments and our response to Question 1a above.

25. The consultation proposes that businesses too large for even a revised cash basis, could use non GAAP compliant accounts. This would be achieved by accepting, for tax purposes, accounts prepared on modified rules with no requirement for a year-end stock take and simplified models for long term contracts, bad debts and accruals. Bad debts

could be written off once recovery action had failed (though leaving open the question of what happens if recovery action is not taken). Accruals and work in progress adjustments would not be required where the 'timing adjustment' is under a year. This would clearly be a fundamental change.

26. Reporting true and fair profits to the tax authorities is an important use made of accounts: but it is not the only, or the main, purpose of producing accounts. Accounts are not simply about tax. They are about profitability, the need for accurate information for decision making, and lending and creditor decisions. We believe it is a mistake to view the proposed changes in tax-only terms and to encourage fairly large businesses to dispense with GAAP accounting; without GAAP accounts there is a danger that far too many businesses will have a lack of understanding, and hence control, over their affairs.

Question 7: Do you think that the restrictions proposed are appropriate? If not, what restrictions would you suggest?

27. See our response to question 6. We do not support the proposal for GAAP light. The need to include restrictions in the proposals illustrates some of the problems with deviating from GAAP and will add complexity (undermining the stated reasons for taking this approach in the first place). Businesses and their advisers are familiar with GAAP so, as noted above, it is hard to see that this approach would be a worthwhile simplification.

Question 8: Do you believe that simplifying the capital/revenue distinction as suggested in paragraphs 5.7 to 5.13 would simplify reporting for businesses within the cash basis?

28. The proposed levelling rule here would be to move toward a 'use up in the business' definition. Cars, as always, would not be included. Property too would be excluded, including any fixtures included in the price. Intangible assets with a life expectancy of over 20 years would be disallowable, as would financial instruments, purchase of a business and any non-depreciating asset. So, in practical terms, as long as there is an annual investment allowance at around its current level this proposal is likely to have little effect for most SMEs. At the same time it may introduce some confusion around the capital/revenue divide which has long been contentious.

29. Removing the capital/revenue divide may be also be problematic if the threshold for cash basis is increased to the levels suggested in the consultation document, to £332,000, the amounts involved in giving tax relief at the time of capital expenditure will be significant (taken across all businesses which could then adopt cash basis) and likely to have a detrimental impact on the exchequer.

30. Removing the distinction between capital and revenue also distorts the business accounts – even more than the existing cash basis which is undesirable for business development and business management purposes.

Question 9: Can you identify any specific caveats which might be needed to ensure that the new rule operates as intended? Are there any potential tax planning opportunities which the current draft rules would not prevent?

31. As outlined in our response to Question 8 we do not support this proposal. The fact that HMRC believes caveats would be required illustrates another problem with the proposed approach. Including anti-avoidance measures in the proposed legislation would add complexity and undermine the simplification which is supposed to be the aim of the proposal – and a key part of the Making Tax Digital.

Question 10a: If the cash basis entry threshold is raised would you consider using the cash basis, or advising your clients or members to use it? If so please provide details of anticipated impacts, including both one-off and ongoing benefits and costs.

32. We tend to find that cash accounting is a tool for those who are have a turnover threshold below that at which accountants are engaged. As discussed above accounts are not just

about tax and accountants provide a valuable service to successful businesses by helping them to understand and manage their affairs effectively.

33. In general, accountants do not recommend the cash basis for their clients because for the larger businesses they are dealing with cash accounting fails to provide relevant and meaningful information.

    Question 10b: If the proposed basis period reform is taken forward, how do you think this would impact on business admin burdens? If possible, please provide details of anticipated impacts, including both one-off and ongoing benefits and costs.

34. Starting with a clean slate in a digital age, one might not have opted for a system which results in complex opening and closing year rules, where the same profits are potentially assessed more than once. Therefore, ICAS has sympathy with a move towards a model more like that for companies and based on accounting periods with a final end of year "return" due nine months after the chosen accounting date. It is not clear though, how this will align with other elements of personal taxation such as 'Simple Assessment'.

35. The consultation has little, if anything, to say about how the transition to a new model might impact existing businesses, beyond "the government believes that it would be beneficial to businesses for changes to be made in time for the introduction of Making Tax Digital in 2018". It would be useful to have detailed transitional proposals – without them it is impossible to assess how far these would impose a burden on business. Almost certainly there would be an administrative burden and additional costs.

    Question 10c: If the reduced reporting framework is introduced, please provide details of how this will affect your business or your clients or members, including details of both the expected one-off and ongoing benefits and costs for:

    - Familiarisation with the new scheme and updating software or systems
    - Having to make fewer adjustments than would be required under UK GAAP

36. A reduced reporting framework is likely to increase work and therefore costs because it simply introduces a different set of reporting requirements for tax purposes. It is not simplification.

    Question 10d: If the revenue / capital divide is simplified as suggested do you believe that this would simplify reporting for businesses within the cash basis? If so please provide details of anticipated impacts, including both one off and ongoing benefits and costs.

37. See our responses to questions 8 and 9.

    Question 10e: Please tell us if you think there are any other impacts, benefits or costs not covered above.

38. The reporting of business income will not be simplified as long as there are separate tax adjustments to be made. We also consider that there are likely to be adverse consequences from significantly raising the threshold for the cash basis and from the proposals to encourage larger businesses to dispense with true GAAP accounting. Without GAAP accounting businesses are likely to lack vital information to enable them to develop and expand – and will find it harder to become and remain profitable.