



HMRC
Making Tax Digital
Overview

7 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.

Our overall view of the Making Tax Digital proposals

Introduction

3. ICAS is pleased to contribute to the six consultations on Making Tax Digital (MTD), issued by HMRC on 15 August 2016.

HMRC consultation documents:

- [Bringing business tax into the digital age](#)
- [Simplifying tax for unincorporated businesses](#)
- [Simplified cash basis for unincorporated property businesses](#)
- [Voluntary pay as you go](#)
- [Tax Administration](#)
- [Transforming the tax system through the better use of information](#)

We have made detailed responses to each of the six consultation documents, which are available at:

ICAS responses:

- [Bringing business tax into the digital age](#)
- [Simplifying tax for unincorporated businesses](#)
- [Simplified cash basis for unincorporated property businesses](#)
- [Voluntary pay as you go](#)
- [Tax administration](#)
- [Transforming the tax system through the better use of information](#)

General comments

4. This paper gives our overview of the MTD project and how professional accountants can support and facilitate the project.
5. 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 planned rollout, timescale and the mandatory approach, particularly for small and medium enterprises.
6. ICAS calls for:
 - stronger risk management of this vast project by introducing Making Tax Digital on a phased basis starting with larger businesses
 - a non-mandatory start and phased introduction of Making Tax Digital
 - the cash accounting threshold to remain constant with other tax thresholds, ie at the VAT threshold
 - to abandon the proposal to have 'HMRC GAAP lite' accounts
 - the role of tax agents in bringing positive change to be fully recognised

Customers at the heart of all we do

7. HMRC has experienced dramatic change. There have been challenging reductions in staffing. Now a digital revolution is promised. How might this impact HMRC's target of 'putting customers at the heart of all we do'¹?
8. The vision of MTD is attractive. It can potentially empower taxpayers, reduce data handling costs, and provide a new range of services for both taxpayers and their agents. It is a goal worth achieving. Yet with change, comes risk.
9. The National Audit Office review of a previous HMRC service delivery change estimated that 'for every £1 reduction in HMRC's annual telephone transaction costs there has been approximately a £4 increase in the time and money cost to customers'².
10. Savings to HMRC may not equate to savings for taxpayers. 'HMRC believes it was over-optimistic about the scale of change its staff could take.'
11. MTD impacts a very diverse range of people and businesses. The proposed changes to the tax system are complex and hard to quantify. We are moving in uncharted waters and the behavioural impact of digital transformation is at best uncertain. As a default, 'monopoly supplier', it behoves HMRC to move with caution if benefit to the taxpayer is really to be 'at the heart of all we do.'

One size fits all

12. Making Tax Digital is something of a misnomer. The key business impact of MTD is making accounting digital. Specifically, it attempts to harness the power of cloud accounting to tax administration.
13. This is a very laudable aim, but the distance to be travelled by the average business to achieve it should not be underestimated.
14. Beyond digital record keeping, MTD mandates quarterly updates for all businesses with gross income of £10,000 or over. The scope of this 'one size fits all' approach is breathtaking. It would cover businesses with turnover of many millions of pounds and businesses with profits well below the tax threshold.³
15. It must be asked if this is appropriate, proportionate or realistic.
16. Businesses with turnover of under £1.5 million would not routinely be expected to need quarterly accounting. The smallest businesses are more regularly run from a knowledge of the bank balance and a full order book.
17. Phased introduction of MTD, starting with larger businesses, would more effectively achieve the desired goal of an efficient digital administration.

Better business records

18. We support the goal of better business records. The possibilities offered by digitalisation of records are welcomed and encouraged.
19. But for small business, 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.
20. Add to this, imperfections in software and broadband coverage, differing skillsets and costs, and it soon becomes apparent that mandatory imposition of quarterly digital

¹ <https://www.gov.uk/government/publications/hmrcs-business-plan-2014-to-2016/hmrc-business-plan-2014-to-2016>

² National Audit Office report: The quality of service for personal taxpayers <https://www.nao.org.uk/wp-content/uploads/2016/05/The-quality-of-service-for-personal-taxpayers.pdf>

³ The net profit percentage of SMEs varies widely depending on business sector. With the tax-free personal allowance at £11,000 (2016-17), gross income could be well over £20,000 in some sectors without any tax liability.

updates direct from accounting software on all businesses is likely to be counterproductive.

21. Rather than tackling the tax gap, there is a grave danger of currently compliant businesses moving into the shadow economy.
22. It takes time for business owners to change accounting systems. Training and support is needed to ensure accuracy. It is not an overnight transition, and the journey is longer for existing businesses. To minimise disruption, businesses may opt for transition at their accounting year-end. This means a significant lead time.
23. Effective stage transition to MTD compliant digital records would be best spread over 3 -5 years.

More haste, less speed

24. The backbone of accurate digital business records is the bank data feed. This is the spine onto which the other appendages fit. Scanned invoices, while attractive are an add-on: unless the invoices are matched to a payment method and cash and bank balances reconciled, the data has no integrity from an accounting point of view.
25. Technology here is still in its infancy. The MTD consultation 'Bringing business into the digital age' appears to assume that scanning invoices will mean more reliable business records. Without matching invoices to accurate bank data feeds this is not so.
26. It will take time for the technology to bed in and for businesses and their advisers to come to workable arrangements that take account of the skill sets of the business owner, costs, business needs and available technology.
27. There are significant data security issues to be resolved, including that of liability for losses arising from data security breaches where accounting software is linked to both HMRC and bank data.
28. Rushing this process risks self-submission of high volumes of low quality data.

Accounting – cash versus accruals

29. ICAS is concerned that MTD proposes that full accounts may be dispensed with for many unincorporated businesses. Accounts are not simply about tax. They are about profitability.
30. There is a need for accurate information for business decision making, lending and creditor decisions, as well as for business sale and succession planning.
31. We believe it is a mistake to view the proposed changes in tax-only terms and that whilst cash accounting could 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.

Exemptions and thresholds

32. For some business sectors quarterly digital updates do not line up well with the overall objectives of cost saving and certainty around tax liabilities. The examples given here are illustrative rather than exhaustive.
33. **Farming:** The nature of farming means that quarterly updates are unlikely to provide either meaningful business management information or figures from which tax liability can be accurately estimated.
34. **Rural business and low income self-employment:** Looking more widely at rural businesses, many individuals are self-employed as rural employment opportunities can be limited. Businesses may be carried out on a small scale, with significant turnover, but low profits. For many businesses here the aim is to break even and cover essential

private living expenses. Cloud accounting, if feasible, would be akin to using a Rolls-Royce for a journey which could be done by bicycle.

Software costs

35. The consultations are predicated on the availability of free software for the smallest businesses. It is difficult to see how HMRC can ensure that this becomes a reality. Commercial software providers are unlikely to be able to supply free products with adequate functionality to enable all small businesses to meet the filing requirements.
36. The reality is that businesses will incur additional costs to comply with their tax obligations. There may be a basic free product, but most businesses will need add-ons to deliver the functionality they need.

Voluntary compliance

37. The UK tax system depends on the goodwill and active co-operation of the majority of taxpayers. Fair systems encourage compliance. Use of MTD should be voluntary.
38. A secure, user-friendly digital solution addressing what many regard as a tedious chore, should attract willing users among businesses and individuals alike.
39. MTD should be phased in. It should not begin with mandation for the smallest business. Those creating the new system need to face the invigorating challenge of making it attractive and easy for users. To achieve this, they are likely to set realistic goals, aiming initially at those most likely to become enthusiastic early adopters.
40. By trailblazing the system in this way, they should create a natural following among others eager to experience the advantages they might otherwise miss. This would also focus attention on addressing HMRC service standards for taxpayers and businesses.
41. By contrast, starting with a mandatory system for the smallest business carries the risk of burdening the system with unwilling and reluctant users. Any initial problems with the digital systems risks these users giving up: for some small businesses and individuals non-compliance may become increasingly attractive.

Mixed messages

42. The 2016 Budget announced the introduction of a £1,000 allowance for property income and a £1,000 allowance for trading income from the 2017 to 2018 tax year. The new allowances will mean that individuals with property income below £1000 or trading income below £1,000 will no longer need to declare or pay tax on that income.
43. This is clearly an administrative simplification for those who will never make more than these amounts but those who go on to establish more significant businesses will not have been encouraged into compliance from the start.
44. At the point they realise they have exceeded the £1,000 allowances they will be confronted with a mandatory digital reporting regime, backed by penalties. This will impose significant costs and some may well be tempted to opt out.

Risk Management

45. 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.
46. The National Audit Office report highlights the risk of change⁴. Service standards can fall and costs to taxpayers far exceed savings to HMRC.

⁴ <https://www.nao.org.uk/report/hm-revenue-customs-customer-service-performance/>

The role of tax agents in bringing positive change

47. 70% of small and medium enterprises (SMEs) have a tax agent⁵. 40% of taxpayers do not want direct contact with HMRC. The influence of professionally qualified agents on taxpayers is immense. They are uniquely placed to facilitate change.
48. MTD is a revolution the magnitude of which is hard to overstate. It is a colossal IT and change management project affecting 5.4 million businesses; and many more taxpayers.
49. The way taxpayers interact with HMRC is being completely redesigned. Everyday business life is set to change. From the way businesses maintain records to the prominence they give to their tax affairs, it is a new world.
50. Professional accountants are a powerful asset to have on board when considering change on such a scale. They are involved in the daily life of business. They help businesses to be efficient and profitable. They advise on book keeping and major business decisions. They help businesses calculate and pay the right amount of tax at the right time and encourage compliance.
51. We 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.
52. 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.

Conclusion

53. SME business is the life blood of the UK economy. It needs to be encouraged, supported and freed from administrative burden. Currently it is facing the challenge of Pensions Auto-enrolment. It has recently adapted to RTI.
54. MTD has an even longer reach. For some businesses the transition may be straightforward. For others the scope and nature of the proposed changes will bring significant additional costs, both one off and ongoing.
55. The potentially negative impacts of MTD can be best managed by phased introduction on a realistic timeframe. This may take five years and should start with tranches of large business. This will best allow businesses, and the system, to adapt and accommodate the diversity involved.

⁵ HMRC Agent Strategy Team, Talking Points; 23 October 2015