



House of Lords Economic Affairs Sub-Committee

**Call for Evidence: Draft Finance Bill 2018 HMRC Powers and
Making Tax Digital**

By 1 October 2018

About ICAS

1. The following submission has been prepared by the ICAS Tax Board. The Board, with its five technical 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.
2. 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.

General comments

3. ICAS welcomes the opportunity to contribute evidence to the House of Lords Economic Affairs Finance Bill Sub-Committee, in response to the call for evidence for its inquiry into the draft Finance Bill 2018 issued on 12 September 2018.

Specific questions

HMRC Powers

What principles should underlie the design of HMRC powers, and where should the balance be struck between taxpayer and tax authority?

4. ICAS believes that HMRC should have appropriate powers to enable it to administer the UK tax system efficiently and to enforce compliance; this means a degree of access to taxpayer information and the power to impose penalties.
5. However, there should be a balance between these HMRC powers and taxpayers' rights to certainty and privacy. HMRC should also provide adequate support and guidance to taxpayers who want to comply, particularly those who are vulnerable and may find dealing with their tax affairs challenging.
6. Taxpayers need to have confidence that HMRC is exercising its powers proportionately and that appropriate safeguards are in place. A degree of external scrutiny is required, so the right of appeal to an independent Tribunal against HMRC decisions is important.
7. The last significant examination of HMRC's powers was the review of HMRC Powers, Deterrents and Safeguards which ran from 2005 to 2012. This was a programme of consultation and legislative change intended to provide a modern framework of law and practice for tax administration. Following the merger of HM Customs and Excise and the Inland Revenue it also aimed to align powers, deterrents and safeguards across taxes, where this made sense. ICAS contributed to this project.
8. As a result of the review significant changes were made to legislation in Finance Acts for every year from 2007 to 2012. Legislation dealing with HMRC powers, deterrents and safeguards is now scattered across different Finance Acts and the Taxes Management Act 1970, making it very hard for taxpayers to access. Developments in digital processes and handling of information also mean that some parts of the legislation are no longer fit for purpose – as evidenced by numerous Tribunal cases considering issues arising from computer generated communications and decisions.
9. ICAS believes that the time has come for another review of the framework within which HMRC operates. This should include the consolidation in one act (a new TMA) of the legislation governing HMRC powers, deterrents and safeguards.

What principles should govern the development of HMRC powers in a globalised digital information age?

10. We do not consider that the basic principles underlying HMRC powers have changed. These are:
 - A presumption that taxpayers are honest and telling the truth, unless HMRC has good reason to think otherwise;
 - Where taxpayers have complied with their filing obligations they should have certainty and closure within a reasonable timeframe (this was an explicit guarantee when self assessment was introduced but is now being eroded);

- Respect for the taxpayer's right to appoint an agent to deal with HMRC on their behalf (and HMRC should work with authorised agents);
 - A helpful, efficient service for taxpayers (which requires HMRC to have adequate resources) and taxpayer-friendly filing and administrative systems;
 - A robust regulatory and oversight framework to ensure that the right balance is maintained between HMRC powers and taxpayers' rights.
11. As noted above the legislation has not kept up with digital processes. Digitalisation also raises other issues which need to be addressed.
 12. In recent years HMRC has moved major parts of the tax system to a mandatory online approach (including CT returns, RTI returns for employers and VAT returns for all businesses). This trend will continue with MTD which will also require more information to be submitted more frequently.
 13. A review of HMRC powers should consider how much information HMRC needs to have routinely submitted by taxpayers – just because more information can be submitted by digital means, does that mean that it should be submitted? It is not clear what HMRC plans to do with the increasing amounts of information it will receive digitally.
 14. HMRC staffing levels have been significantly reduced since 2010 as a result of the move to online, but this has had some adverse effects on customer service, particularly for smaller businesses and individuals. This is likely to be exacerbated by the diversion of HMRC staff to deal with Brexit. The UK tax system depends on a degree of trust and voluntary compliance – coercion alone is not enough. Poor service from HMRC undermines the trust vital to the operation of the tax system.
 15. In several recent consultations (and resulting legislation) HMRC has sought extended assessment time limits to give it extra time to deal with data being received under the Common Reporting Standard regime – we understand that this is because its resources do not apparently allow it to process this data in the existing time limits. This is a cause for concern because time limits are meant to ensure that taxpayers who must self-assess their tax can have certainty that their affairs are settled within a reasonable timeframe.
 16. Another worrying digital development is HMRC's refusal to provide any software for taxpayers to use for MTD for business income tax (currently voluntary) or MTD for VAT (mandatory for businesses above the threshold from April 2019). ICAS believes it is fundamentally wrong to force businesses to use third party software to meet their basic tax obligations.
 17. Last, but not least, ICAS does not support mandatory 'online everything' in the tax system. ICAS believes that digital facilities should be accessible to all on the terms that they want and that digital services should be so good that everyone wants to use them. However, there must be proper alternatives for the digitally excluded and adequate support for the digitally challenged.

To what extent, or in what areas, is the existing balance of powers between HMRC and the taxpayer inappropriate or unfair? The Sub-Committee would be interested in examples of perceived unfairness, either in areas of policy or instances of enforcement.

How should HMRC powers be differentiated to reflect the different problems being tackled e.g. careless error, sophisticated tax avoidance, and deliberate tax evasion?

18. The last review of powers, deterrents and safeguards recognised that there should be a different approach to tackling different types of behaviour. For example, the level of penalties for incorrect returns will be different, depending on whether the taxpayer's behaviour is deliberate, arises from lack of reasonable care or from a simple mistake. Penalties can also be reduced to recognise the level of cooperation given by the taxpayer and there will be no penalties in cases where the taxpayer has a reasonable excuse. HMRC also has stronger powers to tackle serious non-compliance.
19. Over the last few years there has been an increased focus on avoidance and HMRC has been given a constant succession of extra powers and the ability to impose new penalties – mainly for anti-avoidance purposes. Examples include: GAAR (General Anti-abuse rule); POTAS (Promoters of Tax Avoidance); STAR (Serial Tax Avoiders Regime); Requirement to Correct and the Failure to Correct Penalties; and Penalties for enablers.

20. Whilst we support government and HMRC efforts to tackle tax avoidance, the new regimes are not given time to settle down or for their effectiveness to be assessed – before the next new regime is introduced. The main purpose of penalties should be to act as a deterrent, but an effective deterrent relies on taxpayers being aware of (and understanding) the increasingly large numbers of different penalties.
21. In March 2015 the government challenged the tax profession ‘... it is asking the regulatory bodies who police professional standards to take on a greater lead and responsibility in setting and enforcing clear professional standards around the facilitation and promotion of avoidance.’ The Professional Bodies have met this challenge and have issued revised guidance, making clear that there is a distinction between tax planning that is acceptable and that which is not.
22. This has been reflected in the revised Professional Conduct in Relation to Taxation (PCRT) guidance, issued by the main tax professional bodies including ICAS. A new standard has been inserted ‘Members must not create, encourage or promote tax planning arrangements or structures that i) set out to achieve results that are contrary to the clear intention of Parliament in enacting relevant legislation and/or ii) are highly artificial or highly contrived and seek to exploit shortcomings within the relevant legislation.’ This is directed at changing behaviours and is in the same territory as the General Anti-Abuse Rule (GAAR) and the Scottish GAAR in relation to devolved taxes.
23. We have actively promoted the revised PCRT at our roadshows, tax updates, and in our member communications. PCRT is discussed widely, we believe our members are aware of its contents, and are mindful of its requirements.
24. Tax evasion is illegal: we do not believe that our members have any role in relation to tax evasion other than assisting wrongdoers to rectify their affairs. The focus on tax avoidance has perhaps meant that tax evasion has not received the same level of attention although the new Corporate Criminal offence of facilitating tax evasion was introduced recently.
25. The latest [estimates of the tax gap](#) indicate that avoidance now only accounts for £1.7 billion whereas far more is accounted for by criminal attacks (£5.4 billion), evasion (£5.3 billion) and the hidden economy (£3.2 billion). There are a few measures in the pipeline, but it would be useful to understand the overarching government strategy for tackling these.

How are HMRC’s powers operating in practice? Are they being used in line with their original policy intent?

26. We have had some feedback from our members that HMRC are adopting a very rigid approach to compliance and penalties and are reluctant to exercise discretion (using their ‘care and management powers’) in cases where this may be merited. This is doubtless in part due to the reaction against the perception that HMRC had previously made favourable settlement arrangements with some taxpayers. However, the current approach can lead to a perception of rigidity and to questions about whether ‘fairness’ is being considered.
27. Some HMRC officers are also reluctant to accept that taxpayers have made a mistake or have a reasonable excuse – instead seeking to argue that there has been a lack of reasonable care which carries increased penalties.

Is there sufficient oversight of HMRC powers, and safeguards against their abuse or misuse?

28. Broadly speaking we believe that there is sufficient oversight of HMRC powers and safeguards against their misuse. However, it is very important that safeguards and oversight are not eroded. For example, we have concerns about the proposal in the recent consultation ‘Amending HMRC’s Civil Information Powers’ to remove the main safeguard in the third party notice process.

Does the oversight and governance of the powers need to be improved? If so, how?

What is the right balance of powers and safeguards in the security deposit regime and the assessment of offshore matters, for which amendments are proposed in clauses 33–35 of the draft Finance Bill?

Extension of the security deposit regime (clause 35)

29. HMRC already has the power to require high-risk businesses to provide an upfront security deposit, where it believes that there is a serious risk to the revenues – but only for certain taxes and duties (including VAT and PAYE).
30. As set out in the consultation on these proposals for an extension of the regime to CT and CIS, HMRC only considers using the existing powers in a relatively small number of cases a year and only around 1,100 of these lead to the issue of a formal notice of requirement to provide a security.
31. The current regime also includes procedural and legislative safeguards (which are intended to apply also to CT and CIS), including the right to an independent review of the decision to require a security or the amount, and a right of appeal (to an independent tribunal) against the issue of a notice requiring a security deposit. We are unaware of any problems arising in practice with the existing regime and it seems reasonable in principle to extend it to CT and CIS with the same safeguards in place. In the case of CT our view (as set out in our response to the consultation on these proposals) is that the CT securities provision should primarily be used against abusive phoenixism – and should not be used against those experiencing genuine difficulties.

Extension of offshore assessment time limits (clauses 33 and 34)

32. ICAS supports government efforts to tackle offshore tax evasion. However, it is important to note that the extension of offshore time limits proposed by clauses 33 and 34 does not apply to cases of deliberate evasion.
33. Where deliberate behaviour is involved HMRC already has 20 years to make assessments/issue determinations. The clauses in the draft Finance Bill will introduce 12 year extended assessment time limits (in offshore cases) for non-deliberate behaviour. We do not consider that this is proportionate where taxpayers have taken reasonable care but have nevertheless made a mistake.
34. The only effective safeguard would be to remove taxpayers who have taken reasonable care from the scope of the clauses – ie the 12 year extended time limits would only apply to those who had not taken reasonable care (but whose behaviour was careless rather than deliberate so that they were not within the scope of the 20 year time limit).
35. As noted above, the existing assessment time limits are meant to ensure that taxpayers who must self-assess their tax liabilities can have certainty that their affairs are settled, within a reasonable timeframe. The main driver behind this proposal (and others) to extend time limits appears to be inadequate HMRC resources.

Making Tax Digital for VAT

36. ICAS supports and promotes the long term vision for Making Tax Digital (MTD) which is attractive to our members and their clients. MTD can potentially empower taxpayers and reduce data handling costs. Chartered Accountants are trusted business advisers who advise businesses on how to streamline their processes, administration and controls; this includes advice on tax compliance and the use of a digital approach, where this is beneficial.
37. However, it is essential that the digital approach adopted is suitable and effective for each business so that it frees up time for the business owner and enables the agent to give more real time proactive advice, including help with managing tax compliance. Adopting the wrong digital approach is likely to impose additional burdens and undermine compliance.
38. ICAS welcomes the delay to the introduction of Making Tax Digital for business income tax until at least 2020. However, we remain concerned that the timetable for mandatory MTD for VAT will lead to poor digital choices and the loss of many of the benefits which properly implemented MTD should have provided for businesses.

What key improvements have occurred, or new concerns have arisen, since the Sub-Committee's report on Making Tax Digital for Business was published in March 2017?

39. The Sub-Committee's report of March 2017 made four recommendations, which primarily related to the implementation of Making Tax Digital for business income tax. Due to the deferral of this aspect of MTD, the focus has shifted to MTD for VAT.

40. The MTD for business income tax pilot has continued but on a very small scale – there are still (at 20 September 2018) only four software providers listed on the [Finding software suppliers](#) GOV.UK page.
41. No attempt has been made to deal with the interaction between MTD for VAT and MTD for business income tax – early consultations suggested there would be some alignment, but this was not taken forward. As a result, if MTD for business income tax is mandated in 2020 some businesses may find that they will be forced to use different software packages for income tax and VAT, potentially increasing costs.
42. We are also concerned that the overall objective of MTD is being lost. What started as the ‘death of the tax return’ and all tax in one financial account has now become three separate strands of work, MTD for VAT, MTD for business income tax and MTD for individuals (placed on hold indefinitely earlier this year) which show no signs of being joined up.
43. It is good practice for major IT projects to allow for proper testing before mandatory implementation. When the government [announced](#) that MTD for VAT would go ahead from April 2019 it stated that HMRC would start to pilot MTD for VAT by the end of 2017, starting with small-scale, private testing, followed by a wider, live pilot starting in Spring 2018. The same [announcement](#) also promised that there would be “well over a year of testing before any businesses are mandated to use the system”.
44. These commitments have not been met and we have serious concerns that the rushed timescale for the implementation of MTD for VAT will cause problems for businesses and HMRC. The pilot (with a very small number of simple, straightforward businesses) only started in April 2018. The public phase (when more businesses will be able to join) was due to begin in summer 2018 but was delayed.
45. It was announced on 21 September that the pilot will finally be expanded in October 2018. Businesses allowed to join in October will have no more than 6 months testing. Additionally, many businesses will still be excluded from taking part including: trusts, charities, members of VAT groups or VAT Divisions, businesses trading with the EU, businesses based overseas and businesses which submit annually, or make payments on account.
46. Businesses should be choosing business record keeping software which meets their commercial needs and will enhance their business management – but will also meet MTD requirements. Choice should not be driven purely by what is available in time to meet a government imposed tax deadline, that may be unrealistic for many.

How prepared are HMRC, businesses (small and large) and software providers for the implementation of Making Tax Digital for VAT in April 2019, and what are the challenges of concurrent preparations for Brexit?

47. Recent [research by the ICAEW](#) indicates that over 40% of business affected by MTD for VAT are unaware of it. Feedback from our members supports this.
48. We understand that HMRC will be issuing communications direct to businesses, with test letters to small numbers issued in October – and letters to all other businesses in late November. It is doubtful that this will give businesses time to identify, test and implement software.
49. Our members are doing their best to prepare their clients, but they are hampered by lack of access to the pilot and the absence of a range of compliant software to meet differing business needs. As yet, there is no HMRC list of software which will meet the MTD requirements. [The list](#) published in July falls well short of this and only lists software suppliers in the pilot who have: “tested their products in HMRC’s test environment” and “demonstrated a prototype of their software to HMRC”. The tax return filing season is imminent, so advisers now have very little time left to advise clients on MTD for VAT.
50. We understand that an interactive ‘software choices viewer’ listing products which will successfully file MTD VAT returns will not be available until December. We also understand that this software will not have been checked by HMRC to ensure it also meets the MTD digital record-keeping requirements. This is a serious flaw because many businesses will be unable to check for themselves and will expect that software on the list will meet all the MTD requirements.
51. ICAS also believes it is wrong to force all businesses to use third party software to meet their basic tax obligations; no HMRC MTD system will be available. We have raised numerous concerns, which remain unresolved, about whether HMRC will be able to enforce:

- minimum standards for functionality;
 - the ongoing availability of software, once adopted;
 - provision of assistive or other non-standard software;
 - adequate security; or
 - other features important to users.
52. It is unclear what enforcement action HMRC can or will take, if developers do not meet the limited requirements set out in the terms of collaboration or it emerges that products do not meet MTD record keeping requirements. The only sanction appears to be withdrawing access to HMRC APIs, which would have a detrimental impact on all businesses using that software.
53. The VAT Notice, setting out the MTD for VAT requirements, was only published in July 2018 – less than a year before implementation. Unanswered questions remain, for example around issues relating to public sector bodies and charities. HMRC have agreed that there is a need for supplementary guidance on some aspects of VAT and for charities. However, it is not clear when any of this will be available – we understand that the charity guidance is at an early stage.
54. ICAS continues to believe that it is unreasonable to expect businesses to deal with MTD for VAT at the same time as Brexit. We have been told by members that businesses affected by Brexit are currently prioritising time and resources for contingency planning and preparation for a no-deal outcome. Inevitably, MTD is taking second place. Even if there is a Brexit deal changes to VAT and Customs Duties are still likely to be needed.
55. We have been told that businesses (including some large and complex ones) are nowhere near ready and are struggling to understand the guidance around mandatory digital links and which records are outside the scope of MTD. Even with the 'soft landing' businesses will find it difficult to implement digital links and some will be forced to change their systems and processes to comply. Combined with Brexit changes there are serious concerns that widespread compliance issues will arise.
56. We understand that the 'old' penalty regime will still be in force for 2019/20 so problems with MTD compliance could lead to default surcharges, record keeping penalties or penalties for filing through the portal rather than via software. We understand that HMRC do not intend to adopt a harsh approach to businesses which are trying to comply; such an approach from HMRC is essential to avoid perceptions of unfairness which could bring the system into disrepute.
57. The timing is also presenting problems for HMRC. The Public Accounts Committee, in its [January 2018 report](#) on HMRC, identified that HMRC was under considerable pressure. It was undertaking 15 major transformation programmes including the reorganisation of its office network and relocation to 13 large regional centres, making tax digital for individuals and businesses and developing the Customs Declaration Service system. The UK's exit from the EU would lead to about 40 additional projects, equivalent to a 15% extra workload.
58. HMRC told PAC that it would, therefore, need to re-prioritise and consider its capacity to deliver the 250 projects that underpin the 15 transformation programmes. It subsequently announced that it was delaying plans to introduce further digital services for individuals, to release project capability to EU Exit work. This re-prioritisation made sense, although it has left some projects for individuals in an undesirable partially-implemented limbo. However, it may not have been enough to allow HMRC to deal effectively with both Brexit and MTD for VAT.

What are the potential costs of Making Tax Digital for VAT for businesses? Businesses involved in the pilot programmes are encouraged to contribute their experiences.

59. The government and HMRC have failed to guarantee that there will be any free software for Making Tax Digital for VAT. Pricing is being left entirely to the software developers. Apart from one bridging product for charities we are not aware that any software providers intend to offer a free product.
60. This raises serious concerns because commercial software developers are likely to target market sectors where they believe demand will be highest. This could leave charities, individuals requiring assistive software and others with non-mainstream requirements, without software – or paying a very high price for a product which may or may not meet their requirements. Those with non-standard needs are also less likely to be able to take part in the pilot – or may only be able to join too late for problems to be resolved in time.

61. One of the recommendations of the Committee's 2017 report was that the government must revise its assessment of benefits and costs of the new scheme. A revised impact statement was issued in December 2017, reflecting the changed scale and scope of the mandatory elements of MTD. However, this did not adequately address the issues raised by the Committee.
62. Costs for businesses in general arising from MTD for VAT will vary considerably and will depend in part on how far businesses are already using software – and whether their provider intends to produce an MTD compliant version. However, overall the message we are getting from members is that software providers are increasing prices.
63. Comments we have received from members working with the OMB sector and charities include:
- Charity: basic MTD accounting packages do not cover everything required and software provider is not planning to upgrade current software. They will be forced to change their accounting software, at considerable expense; also, time and further costs changing processes and implementing new software.
 - Some software providers are not planning to offer bridging products for spreadsheet users – customers are being pushed towards more expensive software packages.
 - Switch in pricing structure from one-off licensing payment to monthly charges for software. Monthly costs are high for small businesses: £40 / £50 a month. Many run older versions of software and are being pressed to upgrade.
 - Nobody wants mid-accounting period system changes, but it is now so close to April 2019 that many businesses will face this unless they opt for spreadsheet bridging software.
 - People want to 'try before they buy'. But as the pilot has been inaccessible (and they would need to buy new software before they joined) this is impossible.
 - Smaller businesses feel that they are being overwhelmed with new compliance requirements: GDPR, pensions auto-enrolment, RTI, National Minimum Wage compliance and AML etc. Whilst properly implemented MTD for VAT should provide advantages, these businesses cannot currently see them – it is just another onerous administrative burden.

How could the penalty regime and the new VAT interest regime proposed in the draft Finance Bill be improved or simplified?

64. There have been three consultations on the proposed penalty regime. ICAS has contributed to these and, broadly, we support a points system and the overall aims of the draft legislation (as detailed in the explanatory notes to the draft Finance Bill).
65. The legislation in schedule 11 is difficult to access. Although the design concept is simple, trying to accommodate a single regime for fundamentally different types of taxes introduces complexity. By different types of taxes we mean:
- Those taxes where the business acts as collector – primarily VAT and PAYE where collection problems arise when there are cash flow difficulties; and
 - Those taxes that are regular, but profit based, such as income tax or corporation tax.

Taxes covered by the proposed new regime also operate on different collection cycles - monthly, quarterly or annual - with the possibility of moving from one to another. The result is difficult, detailed legislation.

66. We strongly recommend the involvement of the Office of Tax Simplification in reviewing the legislation to make it more accessible – it should not be so complex that separate explanatory guidance is needed. This is all the more the case because in any legislation that imposes penalties, the provisions need to be precise and clear for all taxpayers, many of whom may be unrepresented. The legislation does not yet have a commencement date, so we suggest that further efforts are made to fine tune it and make it more accessible.
67. In our view there is also a lack of clarity as to whether this will be a fully automated system or whether there will be scope for HMRC discretion (for example, 'HMRC may assess...' sch 11 para 17) but if it is the latter, this needs to be more explicit about when HMRC may, or may not, assess.

What are the implications of having different penalty regimes for different taxes?

68. ICAS agrees with HMRC's five principles for penalties set out in paragraph 5.3 of HMRC's 2015 [discussion document](#) on penalties.
69. Whilst it is desirable to have a degree of consistency between penalty regimes we do not believe it is possible to have one single penalty regime to cover every possible breach of the requirements for every different tax. There should be different penalty regimes for the three main tax return cycles: continuous' or on-going returns, such as those for VAT, PAYE and CIS; transactional, or 'one-off' returns, such as Inheritance tax, SDLT / LBTT and Non-resident Capital Gains Tax (NRCGT); and annual returns, such as those for corporation tax (CTSA) and income tax self assessment (ITSA).
70. As an example of the problems arising from an inappropriate penalty regime, recent experience of the penalties being applied to late submission of NRCGT returns demonstrates that a penalty structure largely designed for annual returns does not work when applied to returns due 30 days after a transaction takes place.
71. Numerous appeals against late filing penalties for NRCGT returns have now been heard by the First Tier Tribunal. Most concerned taxpayers with no tax to pay, who did not realise that their normal SA returns could not cover NRCGT and corrected their omission as soon as they became aware of the new NRCGT regime. FTT decisions are not binding so the result has been that in very similar circumstances, some taxpayers have had the penalties removed and others have not – depending entirely on which Tribunal judge dealt with the case. This is unlikely to be perceived as fair, brings the system into disrepute and could probably have been avoided by a penalty regime more tailored to this type of one-off return.
72. The NRCGT cases also illustrate the importance of HMRC running a comprehensive communications campaign to alert taxpayers affected by new requirements. Penalties will not encourage compliance or prevent non-compliance if taxpayers are not aware that the requirements exist.