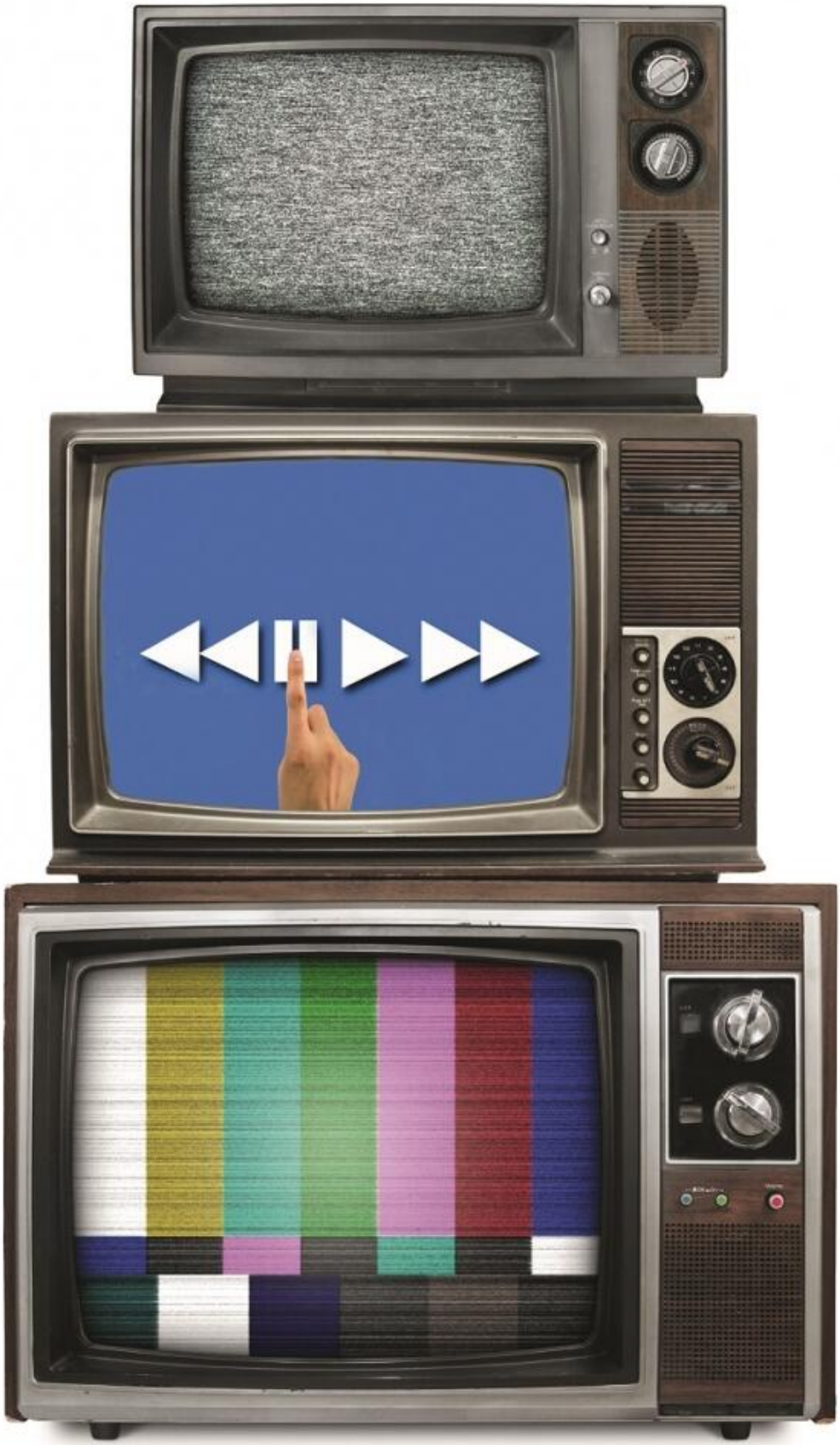
Pausing to reflect

General Features | Management of taxes



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Anthony Thomas suggests that the Making Tax Digital agenda needs further consideration before successful implementation

Key Points

What is the issue?

Critics suggest HMRC risks damaging further the already fragile relationship and trust between taxpayer and state if quarterly reporting is made compulsory for all. It will be crucial for the tax agent to have access to HMRC systems in advance of MTD being rolled out if it is to work properly.

What does it mean to me?

Taxpayers will have to engage with HMRC at least quarterly. Despite HMRC's assurances that it is going to be simple and straightforward, the process may prove time-consuming, costly, worrying for many and turn out to be a burden on some taxpayers for little, if any, value.

What can I take away?

It is a big call for small and micro business to keep their records digitally within two years when taxpayers are unaware of their new reporting requirements. Legal challenges may follow in relation to people with disabilities or taxpayers who live in remote areas with limited internet access.

Big Bang' announcements provide wonderful soundbites for the press. Yet many fail on implementation.

In the March 2015 budget the chancellor announced 'the end of the tax return'. Headline measures and narrow implementation timescales were publicised with little in the way of prior public consultation. But consultation on an 'implementation only' basis puts at risk the success of trying to create one of the most digitally advanced tax administrations in the world. The chancellor's announcement surprised those involved in tax administration and whose main focus is on tax compliance.

Anything the government can do to improve tax collection is welcome and digital options will help. Nevertheless, it seems likely that businesses and landlords will now be required to have digital records, with only minor exemptions. This will require a radical and substantial change in the behaviour of many taxpayers and business owners.

The slogan issued at the time of the budget, Making Tax Easier, promised to reduce the administrative burden. But, before long, HMRC realised that this objective was not achievable so the principle became known as Making Tax Digital (MTD). The proposals to achieve this represent a significant and unprecedented change in the way taxpayers maintain their records and engage with HMRC. Further, there are major challenges for its eventual rollout within what many see as unrealistic timeframes. For MTD to work well it is crucial for its implementation to be managed carefully with a proper and open consultation with taxpayers, tax professionals and software developers to minimise risk of failure.

Mandation

Serious concerns have been raised against the elements of compulsion in MTD – and not only from tax professionals. HMRC's own research published last August showed that there are many taxpayers who, for a variety of reasons, will be unable to cope with quarterly reporting.

It is becoming clearer that the main plank of mandatory reporting will be compulsory record-keeping in digital formats. A major stumbling block to this working easily will be the difficulties small and micro businesses may encounter in converting to digital records within two years.

There are features of MTD relating to mandatory quarterly reporting that seem to be predicated on the belief that a significant part of the tax gap relates to errors in bookkeeping and accounting records. But this is open to challenge. Only recently HMRC scrapped the Business Records Checks on the basis that they failed to identify the level of errors expected. The closing of the tax gap is the likely driving force for the initial rollout on mandatory reporting by smaller businesses, but where is the independent, robust evidence for the need to do this?

Every pronouncement made by HMRC focuses on how quarterly reporting will help taxpayers. But it is likely that the record information will be subjected to computer analysis and used as a further tax compliance tool in HMRC's relentless – some would say misguided and unachievable – quest to eradicate incomplete records. There will no doubt be penalties for those who make mistakes. Many needless enquiries will result should HMRC fail to appreciate the numerous innocent reasons why records, accounts and returns do not seem to match. This risks placing a disproportionate burden on the tax compliant.

It is misleading for HMRC to state repeatedly that 'quarterly updates will largely be a matter of checking data generated from record-keeping software or app and clicking send'. There is no clearer indication of the department's failure to understand how businesses operate, especially smaller ones. Nor does it seem to recognise or give any appreciation to the huge burden and costs that would be placed on ordinary taxpayers and enterprises in trying to comply while at the same time attempting to run their businesses. Indeed, the whole thrust of government policy seems to be towards increasing compliance burdens on businesses that are reporting quarterly for VAT, will soon be reporting monthly to the Department for Work and Pensions for universal credit, and are now required to report to HMRC—each periodical report using different figures.

HMRC also believe that MTD will contribute towards the £400m cost savings to businesses. My fear is that on the contrary, the costs of compliance in training, software and time are almost certainly going to be significantly increased.

HMRC says it will assist the digitally excluded, but may have underestimated the number of taxpayers and businesses that will find it difficult to comply without considerable support. It is harsh that the smallest businesses with the lowest profit margins will have to invest significantly in training in computer technology in order to comply with HMRC's reporting requirement.

Alternative reporting methods must be realistic. Requiring pensioners and business owners of pensionable age to use smartphones if they cannot use a computer would not be sensible. People must have a choice and software must be developed that is convenient and easy to operate. Rather like the filing of tax returns after the introduction of self-assessment, given a sensible timescale the digital option will become the preferred choice.

HMRC asserts that some 3.7 million businesses are already using their digital account. The Department for Business, Innovation & Skills statistical release dated 14 October 2015 stated that there were 5.4 million private sector businesses at the start of the year. If 3.7 million (68.5%) are using digital to access their account, it follows that 31.5% are not – which is a significant proportion. HMRC also seems to believe that all businesses are already using digital tools. It is true that many do use a form of technology but this is a far cry from assuming that all businesses, especially the smaller ones, use even basic accounting software. They do not.

Although HMRC says it will phone those who cannot use digital tools and help them, based on past experience, these conversations will not be easy. Many taxpayers are fearful of HMRC and even those using tax agents will want a reassurance review before submitting anything. This will drive many taxpayers and businesses into the hands of tax professionals and increase their costs. It also means that agent access to HMRC systems will be an essential prerequisite to MTD being rolled out.

Rule of law

Every public authority in a democracy must respect the rule of law, and HMRC is no exception. The courts have found that enforcing mandatory use of digital technology can infringe the human rights of older or disabled people, or those who cannot access broadband easily because of where they live.

In *L H Bishop Electrical Co Limited and others V HMRC Commissioners* [2013] UKFTT 522 [TC] the judge held that regulations that required online filing of VAT returns without providing exemptions for older people, those with disabilities that make it difficult or impossible for them to use computers, or who live in a remote area where broadband access is unreliable or unobtainable, were in breach of the appellants' human rights and were unlawful under EU law. This is still good law and HMRC may be challenged in the courts if it is perceived to be exceeding its powers.

It is worrying that there is little apparent thought given to the immense communication programme necessary if these MTD changes are not to harm the already fragile relationship between taxpayers and HMRC. Millions of taxpayers and businesses are unaware of the imminent major changes to the tax system and their mandatory digital obligations. It is no exaggeration to say that MTD will not work easily despite assurances by HMRC that in many cases a click of the 'send' button will suffice. It is naïve to think it will be that easy.

In HMRC’s haste to operate the most digitally advanced tax system in the world, the MTD project has features that sometimes cause basically good ideas to go spectacularly wrong. Already Administrative Burdens Advisory Board and the Federation of Small Business have voiced legitimate concerns, as have some MPs. Perhaps some pause and reflection on quarterly reporting and the mandatory aspects would be wise. It would be a pity if it all went wrong with the consequent reputational damage to HMRC and cost to taxpayers.